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Report to the Chairman, Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

December 2004

RURAL HOUSING

Changing the Definition of Rural Could Improve Eligibility Determinations

GAO

Accountability ★ Integrity ★ Reliability

GAO-05-110

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Highlights

Highlights of GAO-05-110, a report to the Chairman, Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

Why GAO Did This Study

Rural America has become more diverse: technology and the spread of suburbia have linked rural areas to urban areas, resulting in diminished distinctions between the two. The Rural Housing Service (RHS) applies statutory requirements for eligibility that may not reflect changes in rural areas or best determine which areas qualify for its housing programs. GAO's objectives included assessments of how eligibility is defined for RHS programs and how changes in the current eligibility requirements might impact the RHS mission of meeting rural housing needs.

What GAO Recommends

GAO is not recommending executive action. However, to better ensure that RHS more consistently makes eligibility determinations for rural housing programs Congress may wish to consider (1) including density measures, rather than the currently used MSA criterion, in the statute to better reflect where people live; (2) phasing out the "grandfathering" of communities that experienced changes in eligibility because of inclusion in an MSA; and (3) eliminating the "lack of credit" requirement. The Department of Agriculture generally agreed with GAO's matters for congressional consideration.

www.gao.gov/cgi-bin/getrpt?GAO-05-110.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William B. Shear at (202) 512-4325 or shearw@gao.gov.

What GAO Found

RHS determines which areas will be eligible (that is, defined as rural) for its programs by applying requirements in the Housing Act of 1949, as amended. While the definition largely focuses on population—generally up to 20,000—certain communities must also be "rural in character," not part of metropolitan statistical areas (MSA—which is defined as a county or counties associated with a city or urbanized area that has a population of at least 50,000), or demonstrate a serious lack of mortgage credit for lower- and moderate-income families. Also, a "grandfather" clause allows communities with populations over 10,000 to retain eligibility if they become part of an MSA—and still meet the "rural in character" criterion and not exceed 25,000 in population.

These eligibility requirements resulted in dissimilar determinations for what appeared to be similar areas. For example, in visits to five states GAO found that applying the grandfather clause enabled certain communities within MSAs to retain eligibility while other communities within the same MSAs remained ineligible even though they met current "rural" and population criteria. In addition, GAO analysis of nationwide data found that RHS made more than 1,300 communities with populations of 10,000 or below eligible that were within or contiguous to areas that had populations of 50,000 or more.

GAO identified alternatives to retaining the MSA, grandfather, and credit requirements in the Housing Act of 1949. Because MSAs contain both urban and rural areas and have increased substantially in both size and number in recent decades, they may not be good determinants of urban–rural distinctions. According to the 2000 census, about half the nation's rural population lives in MSAs. An alternative measure would be to use the Census Bureau's urbanized areas and urban clusters, which are density-based measures that provide finer-scale information and could help RHS better and more consistently make eligibility determinations for areas with similar population and characteristics. By dropping the MSA requirement, "grandfathering" also could be phased out, allowing RHS to make determinations that focused on current conditions rather than prior eligibility. In addition, a 1997 USDA report found that lack of credit in rural areas was no longer a serious problem; rather, a lack of income and ability to pay the mortgage were greater issues. Therefore, the requirement to demonstrate a lack of credit no longer appears to be relevant to meeting housing needs in rural America.

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United States Government Accountability Office
Washington, D.C. 20548

December 3, 2004

The Honorable Robert W. Ney
Chairman
Subcommittee on Housing and Community Opportunity
Committee on Financial Services
House of Representatives

Dear Mr. Chairman:

The federal government has provided housing assistance to eligible residents of rural America since the 1930s. Housing assistance is still available for such residents; however, the rural America of 2004 is different from the rural America of the 1930s, and the population levels and other criteria used to determine whether a community is rural and which areas are eligible for housing assistance have evolved.[1] As a result of changing economic and demographic conditions, and greater proximity to urban centers, many of the distinctions between rural and urban life have blurred. Advances in transportation, computer technology, and telecommunications, along with the spread of suburbia, have linked many rural areas to urban areas. Farming is no longer the primary economic activity of rural areas. However, as in urban areas, the need for decent, safe, and affordable low-income housing remains strong in rural areas.

The Housing Act of 1949 authorized new rural lending programs to farmers, which were administered by the Rural Housing Service's (RHS) predecessor, the Farmers Home Administration, within the U.S. Department of Agriculture (USDA). Over the decades, Congress changed the requirements for rural housing program eligibility—for example, by changing population limits—and rural housing programs have evolved to serve low- and moderate-income people of all occupations. RHS now facilitates homeownership, develops rental housing, and promotes community development through loan and grant programs in rural communities. Also, the eligibility requirements in the Housing Act of 1949 have been amended. The current definition of rural considers factors such as whether an area is contained in a standard metropolitan statistical area (MSA), is "rural in character," and "has a serious lack of mortgage credit for

[1]For the purpose of this report, we use area and community interchangeably to refer to any open country, place, town, village, or city.

lower and moderate-income families."[2] Concerned about whether the current definition of "rural" used for RHS housing programs is still appropriate, you requested that we evaluate RHS's eligible service areas. The objectives of this report are to assess (1) how rural is defined and implemented for RHS housing programs; (2) how RHS targets areas for program delivery; (3) the populations of the rural areas served by RHS housing programs; and (4) how a change in the current definition of rural would likely impact the RHS mission of meeting rural housing needs.

To meet these objectives, we interviewed officials from USDA, the Department of Housing and Urban Development (HUD), the Census Bureau (Census), and the Office of Management and Budget (OMB) for information about housing and other community programs for rural areas and to understand how rural is defined for these programs and how populations are counted and classified. We also reviewed the legislative history of the statutory definition of rural for the purposes of rural housing programs. We analyzed population data from Census and RHS program data from USDA to determine what areas receive RHS loans and grants, and the effects on those areas if the eligibility boundaries were to change. To obtain a better understanding of how rural areas vary across the country, we conducted case study visits in Arizona, California, Maryland, Massachusetts, and Ohio. We did not attempt to derive our own definition of "rural," but relied on USDA, Census, and OMB criteria for determining rural areas. Appendix I contains a full description of our scope and methodology.

We conducted our review from January 2004 through October 2004 in accordance with generally accepted government auditing standards.

Results in Brief

Section 520 of the Housing Act of 1949, as amended, defines rural for most RHS housing programs and, based on instructions promulgated by the national office, state and local (together, field) offices, determines the boundaries to delineate eligible areas from ineligible areas—a task field office officials acknowledged is time-consuming, based on judgment, and

[2] Section 520 of the Housing Act of 1949, as amended (42 U.S.C. 1490). An MSA is a statistical entity consisting of a county or counties associated with a core city that has a population of at least 50,000. Since the 1990 Census, OMB has not used the term "standard MSA."

can be problematic.[3] The statutory definition generally identifies eligible rural areas as those with populations up to 20,000 and defines "rural" and "rural areas" as any open country or any place, town, village, or city that is not part of or associated with an urban area. Specifically, there are several population levels at which communities may be determined eligible, but as a community's population increases, the statute imposes additional requirements that include being "rural in character" (a concept that is not defined in the statute), having a serious lack of mortgage credit, or not being located within an MSA. Certain communities with populations up to 25,000 may be "grandfathered in" based on prior eligibility if they still met the "rural in character" and lack of credit criteria. Additionally, specific communities are automatically eligible for RHS funding, irrespective of their population, because they are so identified in the statute or in annual appropriations legislation. In implementing the statute, USDA's instructions give its field offices flexibility in determining which communities are eligible but require a re-evaluation of eligibility determinations every 3 to 5 years, depending on whether or not the communities are within an MSA. USDA's instructions also provide descriptions of "open country," which is defined in the statute, and instructs field offices on how to consider contiguous areas for eligibility purposes.[4] Additionally, while the field offices may use population as the primary factor in determining eligibility, field office officials said that drawing the eligibility boundaries required an element of judgment because "rural in character" is open to interpretation—even with the overall national guidance on the statute and review of census populations, MSA standards, maps, aerial photographs, and visits to communities.

While Section 520 determines how communities become eligible, RHS relies on other processes to target areas of greatest need for program delivery: funding set asides, funding allocations, application reviews, and

[3]The definition of rural applies to most RHS housing programs. Two programs—farm labor housing loans and grants—are not restricted by any rural eligibility definition. Housing built for farm workers through these programs can be located anywhere in the country, including cities. The definition also can be waived in situations where an RHS loan was made on a house that currently is no longer in an eligible area but needs a repair loan to remove major health and safety hazards. While RHS also administers community facilities programs for rural areas, Congress imposed a different definition of rural to determine eligibility. This report focuses on RHS' housing programs.

[4]According to the RHS handbook, "contiguous areas" can be two or more towns, villages, cities, or places. Field offices can consider them separately for eligibility determinations "if they are not otherwise associated with each other, and their densely settled areas are not contiguous."

state-level strategic plans. RHS has regulations, guidance, and procedures in place to cover the programmatic requirements to target housing resources to specific places or special needs groups. However, in the states we visited, economic and demographic factors limited the agency's ability to make loans, and sometimes grants, in the specified areas or to the groups targeted. For example, Arizona state officials told us that the lack of qualified applicants, insufficient infrastructure, and the poor quality of the housing stock have kept RHS from meeting its goals for the colonias (rural communities located within 150 miles of the Mexican border that often lack basic infrastructure) and tribal lands.

Analysis of USDA's eligibility areas and program funding data from the five states we visited found that, from October 1998 through April 2004, RHS's housing loans and grants generally went to residents of communities with populations at or below 10,000. About 60 percent of the 29,000 housing loans and grants approved for these five states during that period went to communities with populations at or below 10,000. Another 25 percent went to communities with populations of 10,001 to 20,000, and almost 15 percent went to communities with populations over 20,000, which included higher-populated communities that received exemptions to the eligibility requirements. Our analysis of RHS eligible areas nationwide compared to Census data found approximately 1,300 examples where communities with populations at or below 10,000 were within or contiguous with urban areas that had populations of 50,000 or more. The statute states that eligible communities cannot be part of or associated with an urban area. Some field staff determinations of eligibility in these cases might be questionable as some of these communities, despite their low populations, might not be considered rural, and thus, eligible. We also found rural communities with populations exceeding 10,000 that were directly impacted by the MSA restriction and the grandfather clause. Because MSAs are county-based and may contain both urban and rural areas, the MSA restriction and the grandfathering of certain communities resulted in some communities being eligible while others with similar demographic profiles were ineligible.

Changes to the way rural is defined might allow RHS to treat communities with similar characteristics more consistently. The methods vary from changing population limits to dropping the "lack of credit" requirement. Decreasing population limits would reduce the number of areas eligible for the programs, potentially allowing RHS to concentrate services in fewer areas. In contrast, increasing population limits would increase the number of eligible areas, but potentially dilute RHS's ability to serve many of the rural areas that it targets. Another alternative, which might help RHS better serve its clients, is to eliminate the MSA requirement. As OMB pointed out, many counties included in MSAs contain both urban and rural areas. Using an alternative measure, such as Census's urbanized areas and urban cluster classifications as a guide, could help RHS better draw boundaries around rural areas because density-based measures provide finer-scale information. Furthermore, if MSAs were removed from the eligibility criteria, RHS officials could make determinations for more communities based on population data and "rural" character. Additionally, eligible communities within MSAs would not need to be "grandfathered" based on previous eligibility, which essentially gives these communities an advantage over similar though ineligible towns located in MSAs. Finally, eliminating the "lack of credit" requirement would have little or no effect on targeting of priority areas or impact RHS eligibility determinations because eligibility for RHS programs are based on income levels.

To improve eligibility determinations in rural housing programs, this report contains three matters for congressional consideration. Congress may wish to consider (1) eliminating the MSA criterion and recommending that RHS use density measures as a basis for its eligibility decisions, (2) phasing out the practice of "grandfathering" communities that experienced changes in eligibility because of inclusion in an MSA, and (3) eliminating the "lack of credit" requirement.

In commenting on a draft of this report, USDA generally agreed with our matters for congressional consideration. USDA stated that our report articulates how the use of MSAs has resulted in disparate treatment of some communities. USDA stated that applying a density-based measure may have merit but that further study is needed to properly define such a measure for nationwide application. We concur with this position. In addition, the agency anticipates that the "lack of credit requirement" could be removed with no detriment to RHS housing programs.

Background

Federal housing assistance in rural America dates back to the 1930s when most residents of rural areas worked on farms, and rural areas were generally poorer than urban areas. Subsequently, Congress authorized separate housing assistance for rural areas and gave USDA responsibility for administering it. Rural housing programs are now part of USDA's rural development mission area and RHS is responsible for rural housing and community facilities programs.[5]

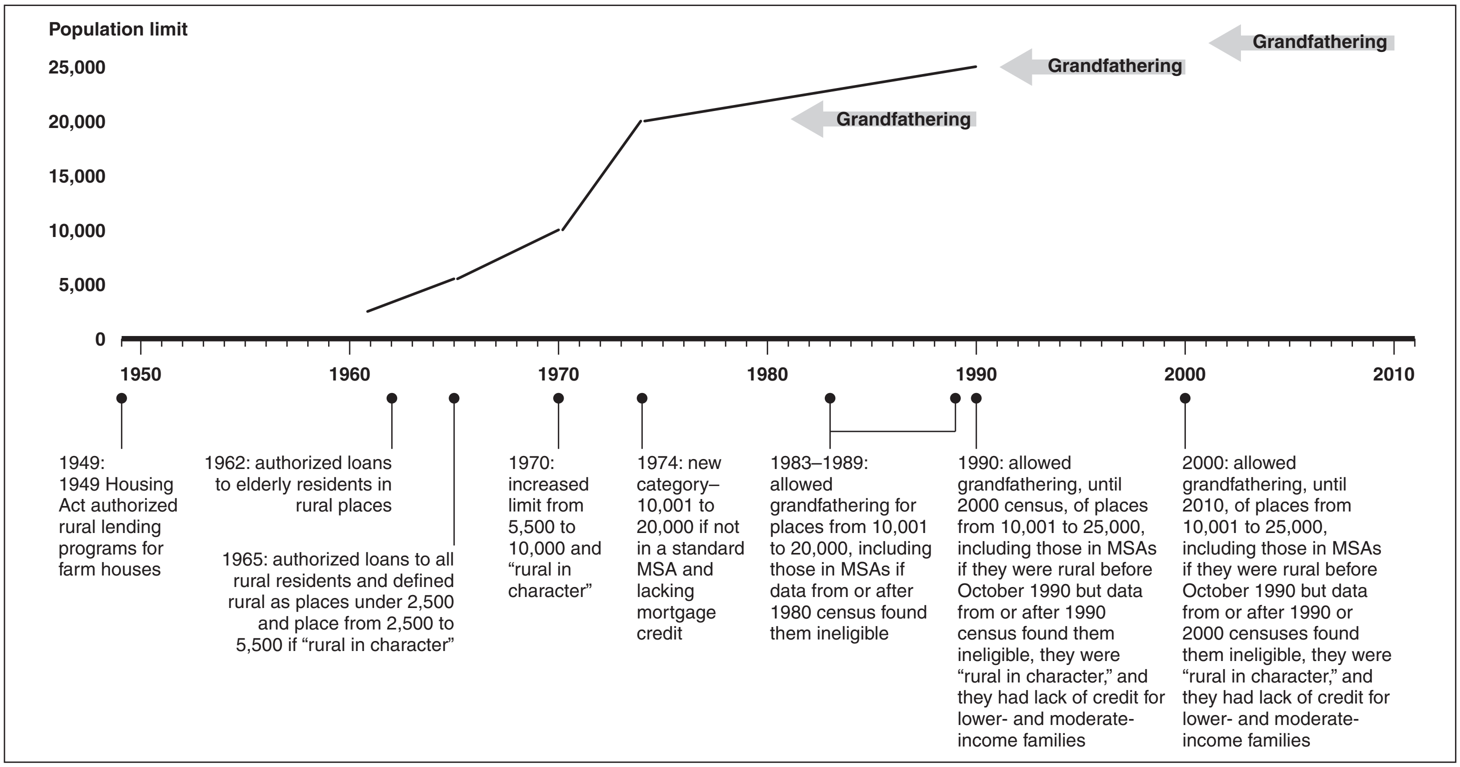
Congress Has Changed the Definition of Rural to Reflect Population Changes

When the Housing Act of 1949 authorized rural lending programs in USDA, eligibility was limited to persons who lived in dwellings on land capable of producing at least $400 worth of agricultural products annually. In 1962, Congress expanded eligibility to include low-income elderly people living in rural areas. In 1965, Congress first defined "rural" and "rural areas" for the purpose of rural housing program eligibility as communities with populations below 2,500 or from 2,500 but not over 5,500 and "rural in character." Congress expanded the eligibility categories and population limits for rural housing programs several more times and imposed additional requirements.[6] In 1970, Congress increased the population threshold to 10,000 as long as the community was "rural in character." Then, in 1974, Congress increased the population limit to 20,000 but stipulated that communities with populations from 10,001 to 20,000 could not be within an MSA and had to have a serious lack of mortgage credit for their lower- and moderate-income families. In 1983, Congress modified the statute by permitting communities to retain eligibility even though they had become part of an MSA. Congress has updated this "grandfather" clause several times to take into account updated census data. Figure 1 provides a timeline of changes to population limits and other eligibility requirements.

[5]RHS administers most federal rural housing programs. While HUD's programs are generally for urban residents and communities, HUD administers several housing programs targeted specifically to assist Native Americans and residents of colonias, which are rural, mostly unincorporated, communities within 150 miles of the U.S.-Mexican border that often lack basic infrastructure. Residents may also apply for other HUD programs, ranging from public housing to Federal Housing Administration (FHA) loans. However, RHS loans, which have lower interest rates and low or no down payment requirements, are generally more affordable than FHA loans. Rural residents who are veterans can also apply for loans guaranteed by the Department of Veterans Affairs.

[6]Eligibility for RHS's community facilities loans and grants programs is based on a different statutory definition. For the community facilities programs, "rural" means a city, town, or unincorporated area that has a population of not more than 20,000.

Figure 1: Congress Increased Population Limits



Source: GAO.

RHS Offers a Wide Array of Housing Services

RHS helps low- to moderate-income residents (including the elderly and farm laborers) of rural communities by providing loans and grants for single-family homes and apartments. Eligible rural residents may obtain direct or guaranteed loans to purchase single-family homes.[7] Additionally, RHS offers a housing preservation grant program, which provides grants to sponsoring organizations for the repair or rehabilitation of low- and very

[7]Direct housing loans enable low- or very low-income rural households (less than 80 percent of area median income and less than 50 percent of area median income, respectively) to purchase, build, repair, renovate, or relocate houses. There is no required down payment and loan terms can be for up to 38 years. Guaranteed loans are made by a bank or another private lender rather than RHS; RHS guarantees repayment if the borrower defaults. Applicants for guaranteed loans must have incomes below 115 percent of area median incomes.

low-income housing. Very low- and low-income rural residents can also participate in a program in which they help in the construction of their homes in order to reduce their cost of ownership. While many RHS programs promote homeownership in eligible rural areas, RHS rental assistance programs also are available to a variety of populations. Direct or guaranteed loans also are available for the purchase or development of affordable rural rental housing for low-income people, the elderly, persons with disabilities, and farm laborers. Finally, RHS also offers rental assistance for eligible households with incomes too low to pay the RHS subsidized rent from their own resources.

From October 1, 1998, through September 30, 2004, RHS issued more than 434,000 direct and guaranteed housing loans and grants valued at $28.7 billion.[8] All of these housing programs, with the exception of the farm labor housing programs, are required to follow the statutory definition of rural—as stated in Section 520 of the Housing Act of 1949, as amended—to determine which communities are eligible. Housing funded by the farm labor programs can be built anywhere in the country as long as it is intended for farm laborers.

Definition of Eligible Area for RHS Housing Programs Differs from Other USDA Rural Development Programs

USDA's rural development mission area administers a number of related community and business development programs that have eligibility requirements that differ from RHS's. Most of the other definitions, also statutorily imposed, cover areas with population limits ranging from less than 2,500 to 50,000. Table 1 summarizes key rural development programs and lists population and other requirements used for determining eligibility.

[8]Actual federal outlays are much lower because guaranteed housing loans are based on subsidy costs and projected losses that are less than loan levels.

Table 1: USDA's Rural Development Programs Have Different Eligibility Requirements

Rural Development Agency	Rural Development Program	Area Eligibility Requirements
Rural Housing Service (RHS)	RHS Single-family Direct and Guaranteed Loans, Single-family Home Repair Grants, Multifamily Housing, Self Help Housing Technical Assistance, Housing Preservation Grants, and Rural Rental Housing	Area with a population of 10,000 or below and rural in character. If not contained in a metropolitan statistical area (MSA) and has a serious lack of mortgage credit with a population in excess of 10,000 but not in excess of 20,000. If classified as rural prior to Oct. 1, 1990, even if in an MSA, and (1) has a population in excess of 10,000 but not in excess of 25,000 and (2) is rural in character. This designation to remain in effect until receipt of 2010 census data.
RHS	Farm Labor Housing Loans and Grants	There are no geographical or population limitations.
RHS	Rental Assistance Payments and Rural Housing Site Loans	With the exception of farm labor units and developing sites for farm labor housing, rural areas are as defined in the first box above.
RHS	Community Facilities Direct and Guaranteed Loans and Grants	Towns with populations up to 20,000 people.
Rural Business-Cooperative Services (RBS)	Business and Industry Direct and Guaranteed Loans, Rural Business Enterprise Grants, Rural Business Opportunity Grants, and Section 9006 Renewable Energy Systems and Energy Efficiency Program	Any areas other than (1) a city or town with a population greater than 50,000, and (2) the urbanized area contiguous and adjacent to such a city or town.
RBS	Rural Cooperative Development Grants	Any areas other than (1) a city or town with a population greater than 50,000, and (2) the urbanized area contiguous and adjacent to such a city or town.
RBS	Rural Economic Development Loans and Grants	Area with a population of 2,500 or below.
RBS	Intermediary Relending Program	All areas of a state not within the outer boundary of any city with a population of 25,000 or more, according to the last census.
Rural Utilities Services (RUS)	Electric Loans	Any area with a population up to 2,500. Once an area or town has a loan, that area will always be eligible for subsequent loans.
RUS	Telecommunications Infrastructure Loans	Area with a population of 5,000 or below.
RUS	Distance Learning and Telemedicine Loans and Grants	Area with a population of 20,000 or below.
RUS	Rural Broadband Loans and Guarantees	Area with a population of 20,000 or below and not located in a standard MSA.

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Rural Development Agency	Rural Development Program	Area Eligibility Requirements
Water and Environmental Programs (WEP)	Water and Waste Disposal Loans, Grants, and Guarantees, Emergency Community Water Assistance Grants, Empowerment Zones/Enterprise Communities, Rural Economic Area Partnership, Colonias Grants, Native American Grants, Alaskan Villages Grants, Solid Waste Management Grants, and Technical Assistance and Training Grants	Area with a population of 10,000 or below.

Source: USDA.

OMB and Census Provide Geographic Area Classifications

For the past 50 years, OMB, in consultation with Census and other experts inside and outside government, has defined MSAs to provide consistency in collecting, tabulating, and publishing federal statistics for geographic areas in the United States.[9] An MSA is a statistical entity consisting of a county or counties associated with a core urbanized area of 50,000 or more people. MSAs are not intended to be urban-rural classifications, and MSAs can contain both urban and rural areas. OMB states that MSAs may not be suitable for use in program funding formulas and cautions against using them for nonstatistical purposes.

OMB uses Census's "urbanized areas" and "urban clusters" to help define MSAs and micropolitan statistical areas.[10] Urbanized areas and urban clusters are statistical areas that do not necessarily follow political boundaries. An urbanized area is a continuously built-up area with a population of at least 50,000, comprising one or more places and adjacent

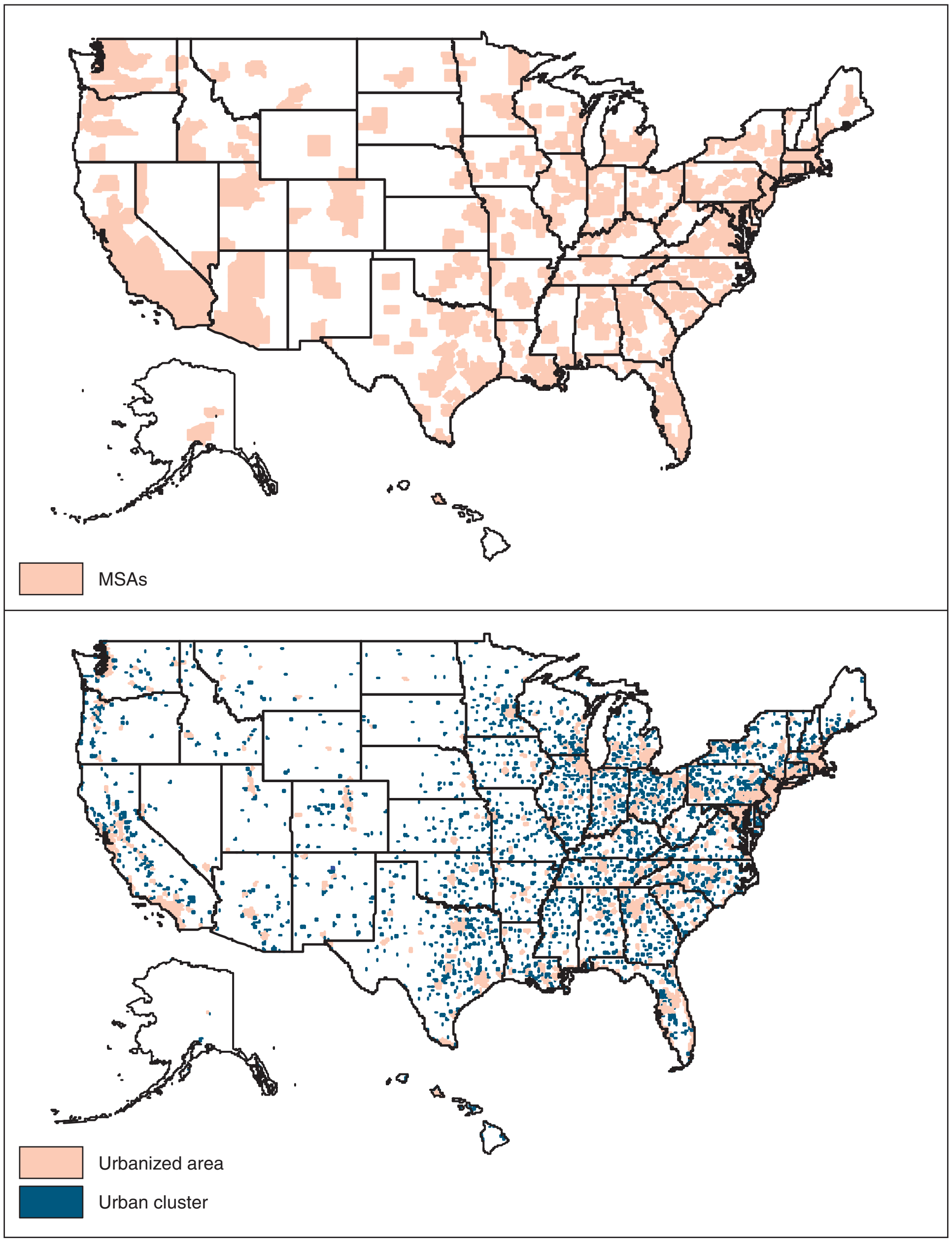
[9]After each decennial census, OMB uses census data to define new MSAs. OMB issued the most recent MSA list in 2003, based on the 2000 census. For details on the new standards, see U.S. Government Accountability Office, *Metropolitan Statistical Areas: New Standards and Their Impact on Selected Federal Programs*, GAO-04-758, (Washington, D.C.: June 14, 2004).

[10]The micropolitan statistical area, was created for the 2000 census; it too is county-based and includes densely settled area with a population of 10,000-50,000. The micropolitan statistical area is built around urban clusters. Census defines a densely settled area as an area with a population density of 1,000 people per square mile and includes surrounding areas with a density of at least 500 people per square mile.

densely settled areas. An urban cluster consists of densely settled territory that has at least 2,500 people but fewer than 50,000 people, a definition which encompasses a variety of communities, some of which are eligible for rural housing and development programs. Collectively, urbanized areas and urban clusters are referred to as urban areas.

Census defines “rural area” by exclusion; that is, it views all areas that it did not already identify as urbanized areas or urban clusters as “rural.” Using this Census definition, based on the 2000 census, 59 million Americans (or 20 percent of the population) reside in rural areas, with slightly more than half of them residing within MSAs. Figure 2 shows MSAs and urbanized areas/urban clusters, using data derived from the 2000 census.

Figure 2: MSAs and Urbanized Areas/Urban Clusters Have Different Boundaries



Source: GAO's mapping of 2003 MSAs, urbanized areas, and urban clusters.

While Eligibility for Rural Housing Programs Focuses on Population, "Rural in Character" Requirement Is Open to Interpretation

The Housing Act of 1949, as amended, defines rural for most RHS housing programs largely based on population limits but also includes other criteria such as being "rural in character," not being part of an MSA, and having a serious lack of mortgage credit for lower- and moderate-income families. Additionally, Congress has exempted certain communities from complying with the eligibility requirements and, in its annual appropriations, designated the communities that are eligible for rural housing programs without having to meet the usual eligibility requirements. A USDA handbook provides guidance to state field office staff on implementing the definition. However, because "rural in character" is open to interpretation, RHS field officials acknowledged that determinations are based on judgment and can be problematic.

The Housing Act of 1949, as Amended, Defines Eligibility along Population Thresholds

While the Housing Act of 1949, as amended, generally identifies eligible rural communities as areas not part of or associated with urban areas and having populations of 20,000 or below, it appends other requirements to areas with populations above 2,500. Communities with populations from 2,501 to 10,000 also must be "rural in character." Communities with populations from 10,001 to 20,000 are not required to show that they are "rural in character" but they cannot be within MSAs and must have a serious lack of mortgage credit for lower- and moderate-income families.

Additionally, the statute's "grandfather" clause allows communities that have experienced population growth or inclusion within an expanding MSA to remain eligible for RHS programs (see table 2). The clause enables communities to remain eligible if they meet the following criteria:

- Were classified as "rural" before October 1, 1990, but determined not to be "rural" as a result of data received from or after the 1990 or 2000 censuses,[11]
- Can demonstrate that they are still "rural in character,"

[11]When the "grandfather" clause was first added to the Housing Act of 1949 in 1983, it allowed communities to retain eligibility if they were "rural" prior to the receipt of data from (or after) the 1980 census. However, grandfathered communities must still meet the "rural in character" and lack of credit requirements, and have a population not in excess of 25,000 to retain eligibility.

- Have a serious lack of mortgage credit for lower- and moderate-income residents,[12] and
- Have a current population in excess of 10,000 but not in excess of 25,000.

Table 2: Communities Must Meet Different Requirements for Eligibility Based on Their Populations

Eligibility by population	"Rural" or "rural area" equates to open country or any place, town, village, or city which is not part of or associated with an urban area	"Rural in character"	Not within a standard MSA	Has serious lack of mortgage credit for lower- and moderate-income families
2,500 or fewer residents	X			
2,501 to 10,000	X	X		
10,001 to 20,000	X		X	X
Current grandfather clause: community with population from 10,001 to 25,000, was classified as "rural" or "rural area" before Oct. 1, 1990, but determined not "rural" or "rural area" from or after the 1990 or 2000 censuses; eligible until 2010 census.		X		X

Source: GAO analysis of Section 520 of the Housing Act of 1949.

Note: Since the 1990 census, OMB has not used the term "standard MSA."

Exemptions to the Eligibility Requirements Found in Statute and Annual Appropriations Legislation

A number of communities are exempt from meeting the population requirements of the Housing Act of 1949, as amended. The act made Pajaro, California, Guadalupe, Arizona, and Plainview, Texas, permanently eligible. Altus, Oklahoma, is eligible until receipt of data from the 2010 census. In addition, in annual appropriations legislation over the past several years, Congress has designated other communities as meeting the eligibility requirements. These congressional designations typically are valid for one

[12] Section 5.3 of a USDA Handbook (HB-1-3550) states "there is a serious of lack of mortgage credit readily available to families throughout rural America at rates and terms comparable to those offered by the agency. Therefore, Agency officials do not need to determine if there is a serious lack of mortgage credit available when determining whether an area is rural or in reviewing rural area designations."

fiscal year. However, some communities, such as Casa Grande, Arizona, have been congressionally designated for several years (see table 3).

Table 3: Fourteen Communities Designated Exempt by the Congress in the 2004 Appropriations Legislation (P.L. 108-199), with Population Levels

Community Designated in the FY 2004 Appropriations Legislation (P.L. 108-199)	Population, Based on 2000 Census
Lawrence County, Ohio	62,319
Havelock, North Carolina	22,442
Portsmouth, Ohio	20,909
Binghamton, New York	47,380
Vestal, New York	26,535
Ithaca, New York	29,287
Casa Grande, Arizona	25,224
Clarksdale, Mississippi	20,645
Coachella, California	22,724
Salinas, California	151,060
Watsonville, California	44,265
Hollister, California	34,413
Carolina, Puerto Rico	168,164
Kinston, North Carolina	23,688

Source: P.L. 108-199 and 2000 census data.

Handbook Provides Guidance to Field Staff on Implementing Definition

USDA's handbook, HB-1-3550, contains implementing guidance to help RHS field staff designate eligible areas, and defines the flexibility field offices have in implementing RHS housing programs. The handbook provides information on assessing open country, population, and contiguous areas, but is silent on what "rural in character" means. For instance, open country includes areas that are "not part of or associated with an urban area" and "separated by open space from any adjacent densely populated urban area." Open space could include undeveloped land or agricultural land, but not rivers, parks, or commercial developments. The handbook also specifies that population figures used by field staff must come from Census. Additionally, it instructs that two or more communities "that are contiguous may be considered separately for a rural designation if they are not otherwise associated with each other, and their densely settled areas are not contiguous." As previously noted, the handbook also states that there is a serious lack of mortgage credit throughout rural America and thus agency officials do not need to make this statutorily required determination for areas they have already defined as rural.

The national office leaves it up to the field offices to determine which areas are eligible in the states for which they are responsible. In addition to applying the national guidance on open country, population, and contiguous areas, field staff must ensure that any site eligible for a rural housing loan or grant must

- be "modest,"
- meet minimum standards regarding water and wastewater systems, and
- meet street and access requirements, such as having direct access to a maintained hard-surfaced road.

Field offices are required to review all areas under their jurisdiction every 3-5 years to identify areas that no longer qualify as rural. More specifically, for eligible communities within MSAs and in areas of rapid growth, field offices are required to make the review every 3 years. Field staff may review current maps and aerial photographs, tap local staff knowledge of the area, and drive through the communities to determine where to draw the eligibility boundaries. Eligibility maps are supposed to be updated after every review.

Determining What Is "Rural in Character" and Drawing Eligibility Boundaries Require Element of Judgment

According to RHS headquarters officials, rural America is diverse and the concept of "rural in character" is broad and will vary by state and circumstance. Senior headquarters officials told us that, given diverse geography and settlement patterns in rural areas across the country and the intent to implement RHS programs at the state and local level, they depend on the knowledge of field staff in making eligibility determinations. In fact, they expect rural to be interpreted differently across the states. The national office also defers to the field offices in determining what densely settled areas are and the extent to which areas are contiguous with each other.

While the handbook does not specifically address what "rural in character" means, field staff use the other components of the handbook to help determine "rural in character" for their jurisdictions. Field staff told us that drawing the eligibility boundaries required an element of judgment because “rural in character” was open to interpretation—even with the national explanations of “open country” and “contiguous areas” and review of census populations, MSA standards, maps, aerial photographs, and visits to the boundaries. In December 2002, the national office provided guidance on features that could be used as boundaries, including streets, highways, streams, lakes, railroads, and political boundaries, and requested that the field offices redraw all boundaries in order to allow headquarters to create an automated mapping system for the public to determine whether a property was within an eligible area. Even with this guidance, delineating eligible areas from ineligible areas is a task field staff acknowledged is time-consuming, requires judgment, and can be problematic. For example, one local office official told us that he believes that “drive-through” visits to boundary areas largely are subjective. Another senior field office official told us that making adjustments to eligible areas is not an exact science. The official believed that local supervisors have the best knowledge of local conditions and the rural character of the areas and he trusted the local supervisor’s judgments in recommending boundary line changes.

However, even when local supervisors fully understand the local conditions and rural character of an area, finding a way to equitably decide on a boundary line sometimes becomes problematic. For instance, field staff in Maryland told us that in response to the December 2002 national guidance, they chose to no longer use natural boundaries such as rivers or mountains as eligibility boundaries for Maryland communities. Maryland now only uses roads as boundaries. Figure 3 shows a new boundary, a road outside Hagerstown, Maryland, that divides the eligible area on the left from the ineligible area on the right. RHS local office officials told us that the “road only” criteria forced them to find the nearest public road to a populated section of Hagerstown, which happens to go through farmland. The result is that apparently similar rural areas received different designations.

Figure 3: Road Serving As Eligible Area Boundary outside Hagerstown, Maryland

Source: GAO.

Figure 4 shows an area near the city line in Brookside, Ohio, where the city line divides the eligible from the ineligible area. While the Maryland example shows that two parts of a road through farmland received different designations, the Brookside example shows that using a political boundary also does not necessarily equate to a readily discernible urban-rural difference.

Figure 4: City Line of Brookside, Ohio, Divides Eligible from Ineligible Area

Source: GAO.

RHS Targets Areas for Its Programs through Funding, Application, and Strategic Planning Processes

RHS determines eligible areas by following requirements of the Housing Act of 1949, as amended, but relies on other processes to target areas for program delivery: funding set asides and reserves, funding allocations, application reviews, and state-level strategic plans. RHS has regulations, guidance, and procedures in place to ensure that it meets programmatic requirements to target housing resources to specific places or groups, and low- and moderate-income residents of rural areas in general. However, in the states we visited, economic and demographic factors limited RHS's ability to make loans in the specific areas or to the groups targeted.

RHS Targets Low- and Moderate-Income Areas with the Greatest Housing Needs

Although RHS must respond to statutory, regulatory, and other procedural requirements to make its loans and grants in certain areas, it also uses planning procedures to further direct funds to areas of greatest need—rural areas with low- and moderate-income populations that lack decent, safe, and affordable housing. Funds are targeted through set asides, allocations, application reviews, and state-level strategic plans.

- RHS national and state offices are required to set aside funds to ensure that single-family and multifamily programs serve specific populations or rural areas. Areas targeted by set-asides are generally underserved, and have low- and moderate-income residents who lack decent, safe, and affordable housing. For instance, Section 509(f) of the Housing Act of 1949, as amended, requires set asides in RHS's single-family direct (Section 502) as well as single-family housing repair loans and grants (Section 504) and multifamily rural rental housing (Section 515) programs for the top 100 underserved counties and colonias. Funds are also reserved and earmarked in RHS's single- and multifamily housing programs at both national and state levels for many targeted groups such as homeless applicants, or for specific areas such as empowerment zones, or purposes such as self-help housing.[13]

- The RHS national office annually targets remaining funds that have not been set aside or reserved to states. Using a formula, RHS weights the allocations toward states with areas that have higher percentages of substandard housing and lower-income populations. States may be directed or given the option to suballocate funds to district or county offices. When performing a suballocation, states must use the same allocation formula used by the national office.

- Once states receive funding, they approve applications annually for single-family and multifamily housing loans and grants in the state. While requirements differ slightly depending on the program, applicants must meet very low- to moderate-income requirements. Further, properties purchased by all applicants must be in eligible rural areas as determined by the statutory definition.

- States also are required to develop strategic plans under the Federal Agricultural Improvement and Reform Act of 1996 (P.L. 104-127). Unlike other targeting methods, which occur annually, state strategic planning is done on a 5-year cycle. These plans target program resources towards areas with greatest housing needs. The act stipulates that USDA must give priority to communities with the smallest populations and lowest per capita income. State plans that we reviewed generally used census or other economic data to assess and identify counties with poor housing conditions, high vacancy rates, and high concentrations of low- and moderate-income populations. Critical housing needs are identified through surveys, forums, or interviews with interest groups.

[13]The self-help housing program enables low-income people to work together to build each other's homes. It combines the single-family direct (502) loan program with a grant program for nonprofits to oversee the construction.

Economic and Demographic Factors Often Limit Ability to Deliver Products to Areas with Greatest Housing Need

Although many funding directives are built into the system and RHS prioritizes program activity, other factors may determine whether RHS can actually make loans or grants in desired areas. In the five states we visited, we found that the states had difficulty making loans in areas targeted in their strategic plans as having the greatest housing needs. For instance,

- Ohio targets its Appalachian region because it is home to some of the lowest-income and highest-poverty areas in the state. However, state officials explained that they have difficulty closing loans in this region because of issues related to road systems, sparse populations, high unemployment, unusable housing stock, and geography. For example, industry officials told us that they would not consider building in many of the communities along the Ohio River floodplain due to higher insurance costs.

- Arizona's strategic plan targets colonias, tribal lands, La Paz County on the California border, and Pinal County between Phoenix and Tucson. However, RHS local officials said that they have difficulty meeting their targets in these areas, and that foreclosure rates in these areas are often higher because they are dealing with low-income populations that have poor credit and other money management challenges. For example, Arizona field office officials told us that they have had problems serving the less-populated areas in the colonias and Indian tribal lands due to the lack of qualified applicants, insufficient infrastructure such as roads, and the poor quality of the existing housing stock that could potentially be purchased.

- California's strategic plan prioritizes and ranks counties based on a number of factors including most severe housing condition, incomes, and housing vacancy rates. Loan and grant delivery to tribal lands and the colonias is a priority. However, according to field office officials, outreach efforts on tribal lands and the colonias have not been as successful as desired.

- Massachusetts officials described a different scenario. The average sales price of homes in the state often precludes many applicants from finding an affordable house. Massachusetts officials said that the problem exists even though applicants in the Section 502 single-family guaranteed housing program can qualify at 115 percent of an area's median income. As a result, in 1999-2003, Massachusetts did not use its total allocation for both single-family direct program loans in 3 of the 5 years and its guaranteed program in 4 of the 5 years.

A Majority of RHS Loans and Grants in Five States Went to Smaller Communities, but Our Review Found Varying Interpretations of Eligibility

Our analysis of USDA's eligibility areas and program funding data in the five states we visited shows that a majority of RHS loans and grants went to residents of communities with populations of 10,000 or below, while communities with higher populations received correspondingly fewer loans and grants. Additionally, we found variations in how RHS interpreted and applied the eligibility requirements, which can be partly explained by demographic differences in the rural areas of the states we visited and partly by differing interpretations or judgments as to what is "rural in character" by field offices. As a result, the application of the "rural in character" finding in some eligible areas was open to question. We also found that, as the population of a community increased, the application of the "rural" criterion became less clear. Finally, we found that the application of the statute's grandfather clause resulted in similar communities receiving different determinations for eligibility.

More Than Half of RHS Loans and Grants Went to Communities with Populations of 10,000 or Below

For the five states we visited, 16,930, or about 58 percent, of the almost 29,000 RHS housing loans and grants funded between fiscal years 1998 and 2004 were made in communities with populations of 10,000 or below. The 29,000 loans and grants were made under RHS's major programs, including single-family and multifamily direct and guaranteed housing programs. As shown in Table 4, the majority of loans and grants issued in the different housing programs went to communities with populations at or below 10,000 and successively smaller percentages of loans and grants for each program were made to communities in the higher population tiers. RHS also provided 7,277 loans and grants, or about 25 percent, to communities with populations ranging from 10,001 to 20,000. RHS funded an additional 15 percent of the loans and grants to communities with populations over 20,000, including some with populations over 25,000 that had received exemptions.

Table 4: Communities by Population Range in Five States That Received RHS Housing Loans and Grants in Fiscal Years 1998-2004

Population	Single- family Direct Loans and Grants	Percent of Total	Single- family Guaranteed Loan	Percent of Total	Multifamily Direct and Guaranteed Loans	Percent of Total	Total of All Programs	Percent of All Programs
10,000 and below	10,222	57.2	6,524	60.4	184	55.3	**16,930**	58.4
10,001 to 20,000	4,751	26.6	2,450	22.7	76	22.8	**7,277**	25.1
20,001 to 25,000	1,337	7.5	931	8.6	26	7.8	**2,294**	7.9
Greater than 25,000	1,195	6.7	843	7.8	35	10.5	**2,073**	7.2
Not available	358	2.0	49	0.5	12	3.6	**419**	1.4
Totals	**17,863**	**62%**	**10,797**	**37%**	**333**	**1%**	**28,993**	**100%**

Source: GAO Analysis of RHS Data.

Note: Data as of April 30, 2004.

Some Eligibility Determinations in Communities with Populations at or below 10,000 Are Open to Question

During our site visits and through our analysis of RHS eligibility areas nationwide, we identified communities with populations at or below 10,000 that were contiguous to ineligible, higher-population communities, but that field offices determined to be eligible for RHS housing programs. The statute says that communities considered for eligibility cannot be part of or associated with an urban area and that those with populations from 2,501 to 10,000 residents must be "rural in character." As a result, it is not clear why all of these communities were considered eligible by the field staff.

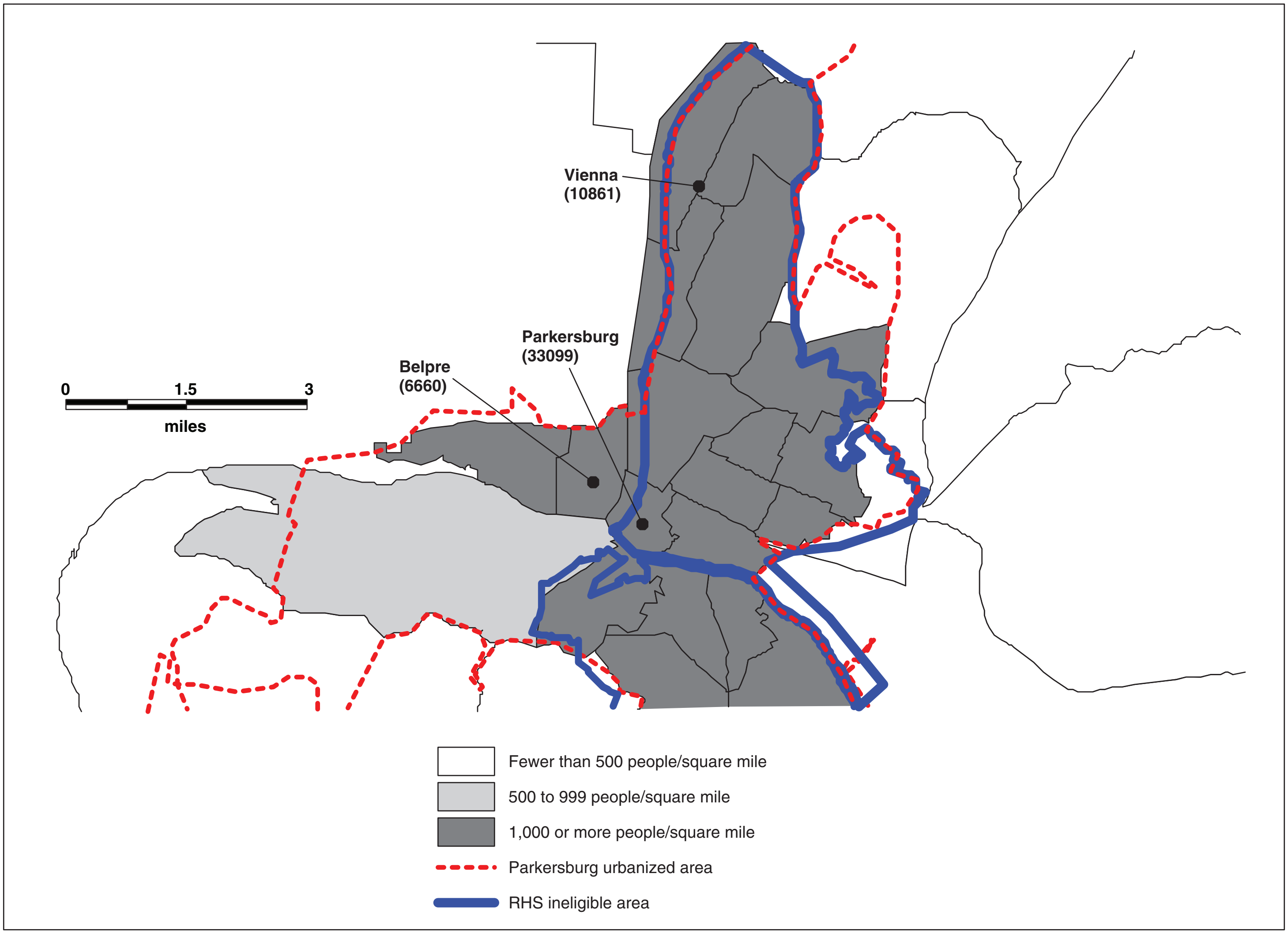
For example, field staff told us that Belpre, Ohio, an economically depressed Appalachian community, is eligible for RHS programs because it meets both the population and "rural in character" requirements. However, Belpre is contiguous to Parkersburg, West Virginia, which has a population of more than 33,000.[14] In addition, the 2000 census considers Belpre, Ohio, along with Parkersburg and Vienna, West Virginia, as part of an urbanized area because its total population is over 50,000. Although it is across the Ohio River from Parkersburg, bridges have connected Belpre and Parkersburg for decades. According to a Belpre city employee, many people from Belpre work in Parkersburg because there are more jobs there. Furthermore, most of Belpre has a population density of 1,000

[14]Parkersburg, West Virginia, is not an eligible area.

people or more per square mile, which Census uses to determine urban areas. For these reasons, it is unclear whether Belpre meets the eligibility requirements. Figure 5 shows Belpre, Ohio, in relation to Parkersburg and Vienna, West Virginia, as well as area density levels by census tract.[15]

[15]Census tracts are small, relatively permanent statistical subdivisions of a county or statistically equivalent entity used to provide a stable set of geographical units for presenting decennial census data. The 2000 census is the first census to divide the entire country into census tracts.

Figure 5: Belpre, Ohio, Is Part of the Parkersburg, West Virginia-Ohio, Urbanized Area



Sources: RHS and Census data.

In addition to the case noted above, our analysis of RHS eligibility areas nationwide found about 1,300 eligible communities with a population of 10,000 or below that are either within an urban area or contiguous with an urban area of 50,000 or more residents. Almost half these communities have populations of 2,501 to 10,000, even though Section 520 states that eligible communities at this population tier should “not be part of or associated with an urban area” and must be “rural in character.” The remaining communities that are at or below 2,500 in population are not required to be “rural in character,” but are required to “not to be part of or associated with an urban area.” The approximately 1,300 communities represent 6 percent of the communities with population of 10,000 or fewer nationwide.

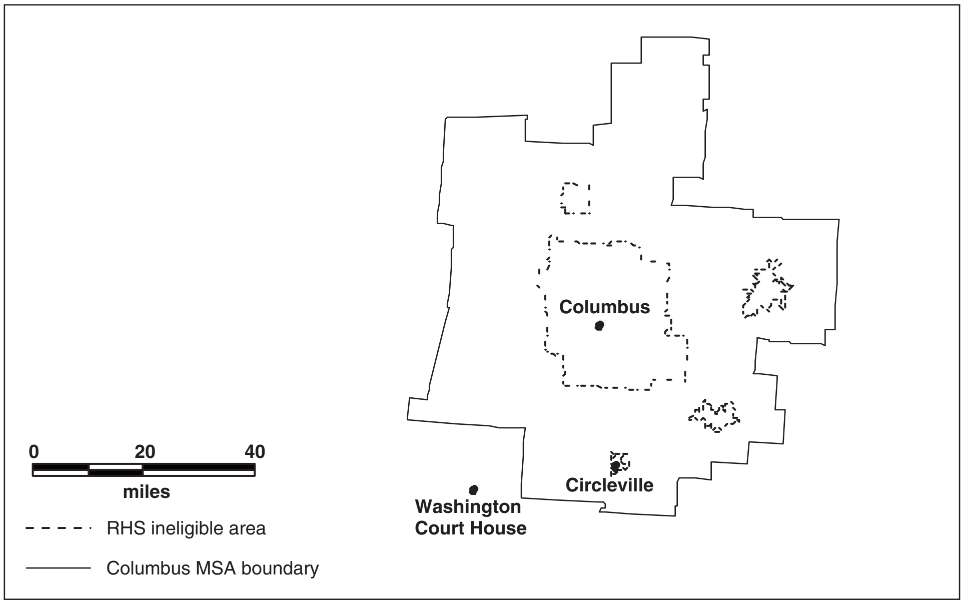
MSA and Grandfathering Provisions Affect Eligibility of Rural Communities

During our visits, we also identified communities made eligible through the grandfather clause and other communities that were ineligible because of the MSA restriction in Section 520, even though these communities had similar demographic profiles. As discussed previously, the statute governing eligibility for RHS housing programs states that communities with populations from 10,001 to 20,000 are not eligible if they are within an MSA. In contrast, other communities with populations from 10,001 to 25,000 could still be eligible even if they are within an MSA because the statute allowed some communities to be “grandfathered in” if they were eligible prior to October 1, 1990, and still met the “rural in character” and lack of mortgage credit requirements. The following four examples illustrate these effects:

Circleville and Washington Court House, Ohio

Both Circleville and Washington Court House, Ohio, are located in the general vicinity of Columbus, the state capital. Based on the 2000 census, both communities had populations of about 13,500 and were about the same size—about 6.5 square miles. However, Circleville, which is part of the Columbus MSA, is not eligible while Washington Court House, which is just outside the Columbus MSA, is eligible. Because Circleville is in an MSA and was not eligible prior to October 1990, it remains ineligible regardless of its current population and whether or not it is “rural in character” (see fig. 6).

Figure 6: Circleville and Washington Court House Relative to Columbus, Ohio MSA



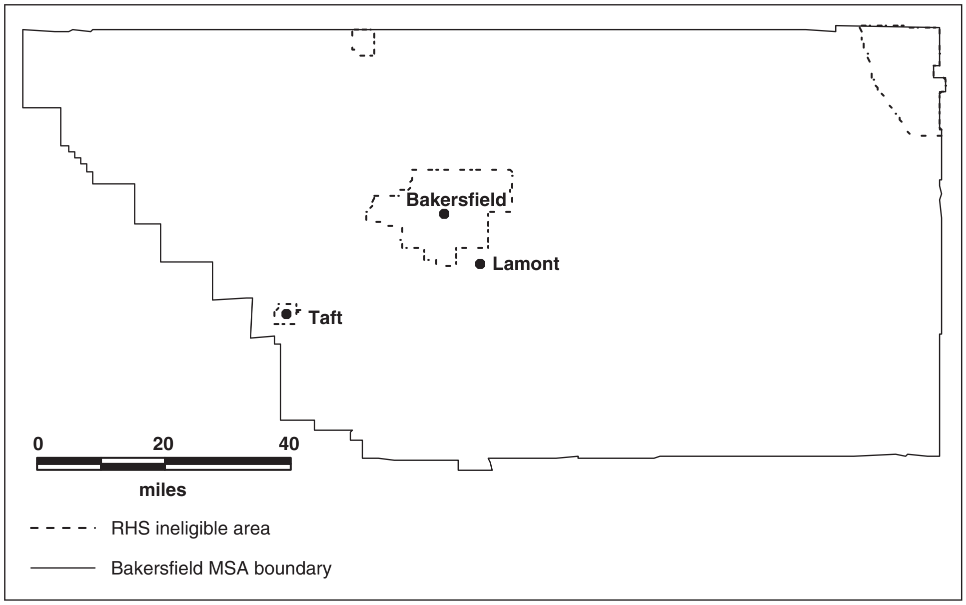
Source: GAO analysis of Census data.

Lamont and Taft, California

We identified two communities in the Bakersfield, California, area that, according to field office officials, had similar demographics. Both of these communities are in Kern County and the county's borders have defined the Bakersfield MSA since 1960. However, Lamont is eligible and Taft is not. Lamont has just over 13,000 residents and is about 14 miles from downtown Bakersfield. According to a state office official, Lamont was grandfathered because it was eligible prior to 1980 while the Taft area was not. But the Taft area, which now has a population of about 13,700 residents in four contiguous areas, is more isolated and is located about 37 miles from downtown Bakersfield (see fig. 7).[16] Field office officials believe that their housing programs would benefit Taft, an economically depressed area as evidenced by its slow growth since 1980. They asked the national office to allow Taft to receive RHS funding. However, a field office official told us that the national office denied the petition stating that they had to follow the statute regarding eligibility determinations and could not make exceptions.

[16]The Taft area includes Taft, Taft Heights, South Taft, and Ford City.

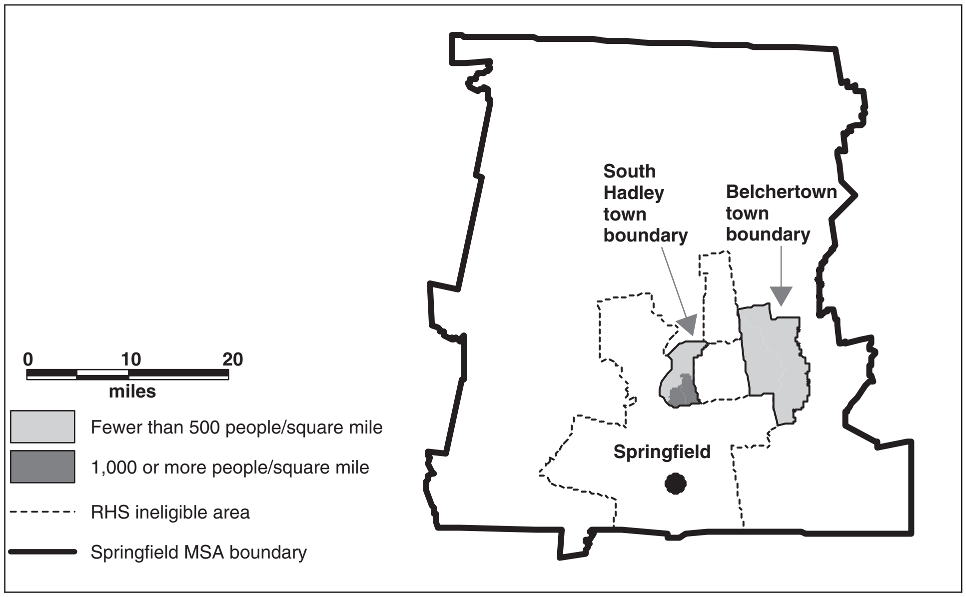
Figure 7: Lamont and Taft Relative to Bakersfield, California, within the Bakersfield MSA



Source: GAO analvsis of Census data.

The grandfather clause also directly affected the eligibility status of two communities in Massachusetts that are adjacent to each other. Both Belchertown and South Hadley are in the Springfield MSA. While both towns have areas that could be considered "rural" and current populations are in excess of 10,000 but not over 20,000, Belchertown was grandfathered based on previous eligibility. In contrast, South Hadley was never eligible because its population was over 10,000 and it was already part of the Springfield MSA when grandfathering first began. (see fig. 8).

Figure 8: Both South Hadley and Belchertown Have Less Densely Settled Areas within the Springfield MSA



Sources: GAO analysis of Census and RHS data.

Note: Population density is shown only for South Hadley and Belchertown.

Figure 9: South Hadley and Belchertown Rural Areas

South Hadley, Massachusetts

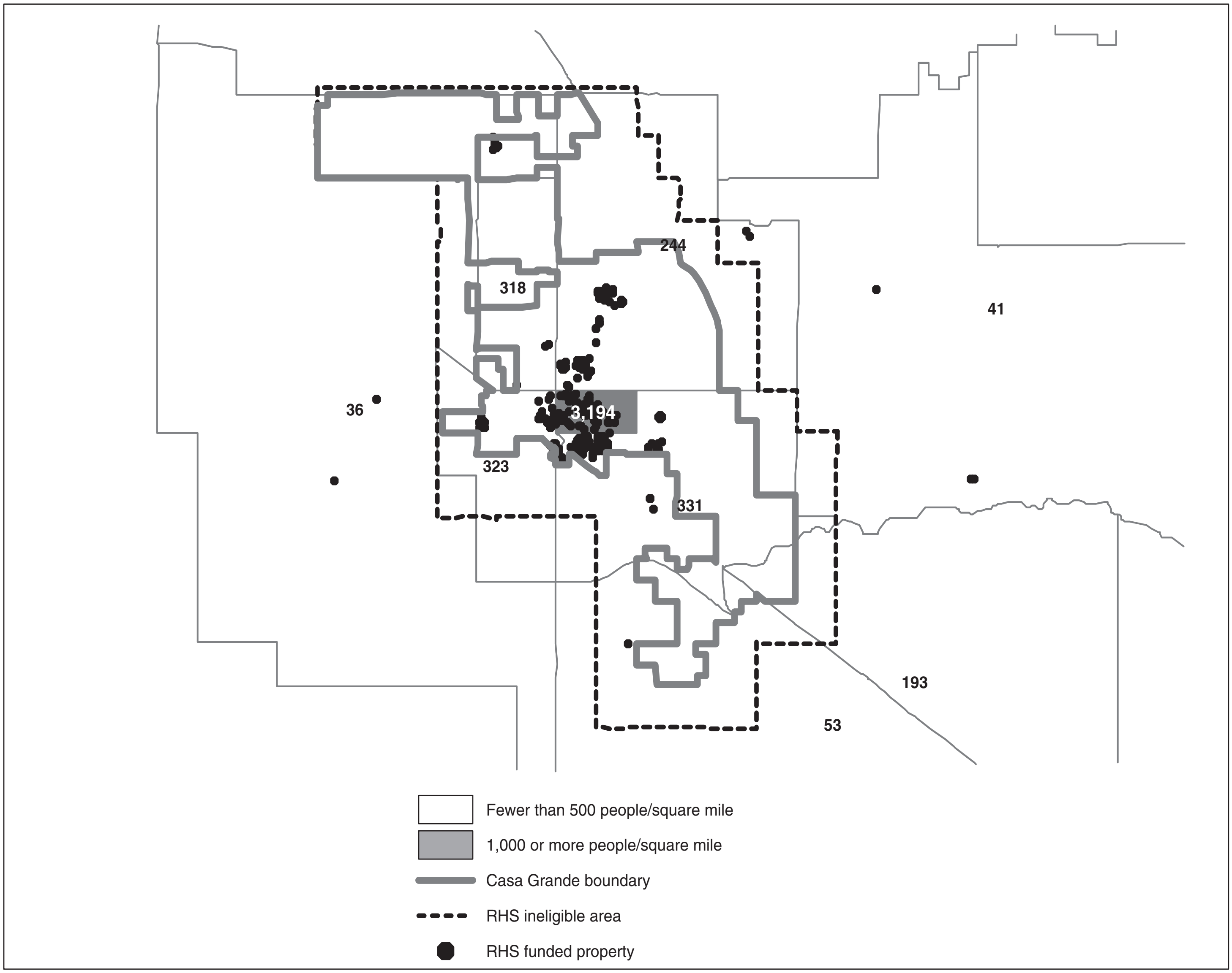
Belchertown, Massachusetts

Sources: GAO (left photo); Leslie Campbell (right photo).

Casa Grande, Arizona

Casa Grande, Arizona, is located between Phoenix and Tucson and became part of the Phoenix-Mesa MSA in 1993. Its eligibility for RHS housing programs was grandfathered after its population increased above 20,000 (the grandfather clause allowed eligibility to already eligible towns with populations up to 25,000). However, the 2000 census found that Casa Grande's population had increased slightly over the 25,000 limit. As a result, Casa Grande received a congressional exemption for each of the last 3 fiscal years (2002-2004) to allow it to remain eligible for RHS programs. A Casa Grande housing official told us that the population increase was, in part, attributable to the success they have had in adding over 300 homes and 1,500 residents to the area through the self-help housing program. Additionally, Casa Grande covers about 48 square miles, and only one of its nine census tracts has a density of more than 500 people per square mile (see fig. 10). As noted previously, Census uses density as a measure of urbanization.

Figure 10: Only a Small Portion of Casa Grande Is Densely Populated



Sources: RHS and Census data.

Changes to Components of the Definition of Rural Could Address Inconsistent Treatment of Similar Communities

Changes to eligibility requirements in the definition of rural—whether focused on population, the grandfather clause, or lack of credit requirements—could affect whom and where RHS serves. An option that would involve only changing the population limits in the definition of rural would impact the number of eligible communities, but without additional resources, the major change would be a shift in where resources are spent. However, population limits alone do not determine whether communities in currently eligible areas are "rural in character" and "not part of or associated with urban areas." Consequently, we explore three options that could allow RHS to better determine eligibility: (1) using density measures that better reflect where people live rather than county-based MSA criteria, (2) discontinuing the "grandfathering" of communities, and (3) eliminating the lack of credit requirement.

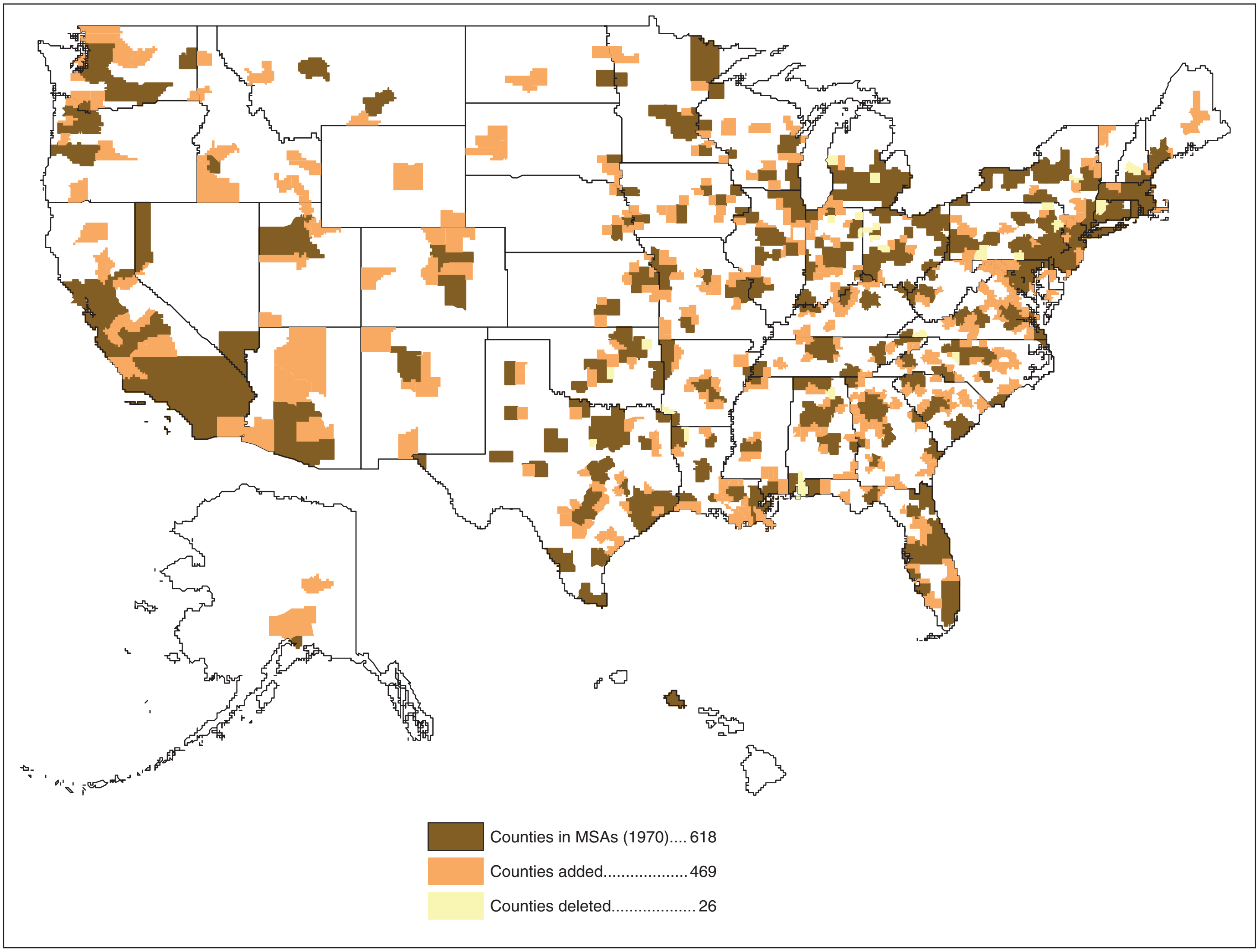
Eliminating MSAs and Using Density-based Measures Could Better Reflect Population Patterns

Changing the population limits in the definition of rural would impact the number of eligible communities. For instance, if eligibility were kept to communities with populations at or below 10,000, RHS might be able to concentrate services in fewer eligible areas, potentially making loans or grants to more applicants in low-population communities. In contrast, increasing the population limit to 50,000, the upper limit for some of the other USDA rural development programs, could potentially affect RHS's ability to serve both existing and newly added eligible areas by increasing the size of the potential applicant pool. Without additional resources, RHS would have to shift available resources to provide some service in all the added areas. However, population limits alone do not address whether communities in currently eligible areas are "rural in character" and "not part of or associated with urban areas." As a result, we explored options that focused on arriving at a better analysis of population patterns and eliminating requirements that are not key to a determination of rural.

If the definition were changed to delete the MSA requirement and allow the use of a density-based measure such as urbanized areas and urban clusters to help make eligibility determinations, RHS would have better information on which to base its decisions. We believe that the MSA requirement is not a key element in identifying a rural community. According to OMB, MSAs do not equate to an urban-rural classification and counties included in MSAs may contain both urban and rural territory. In addition, 2000 Census data show that 13 percent of the population of counties currently in MSAs lived in rural areas and that these rural residents living within MSAs included more than half the population that the Census defined as rural.

Also, updates and changes that OMB makes to MSAs can result in changes to eligible rural areas that are outside of RHS's control and may or may not support RHS's mission of serving rural areas and residents. In addition, the number of MSAs has increased since 1974 (when Congress increased the rural housing programs' population eligibility limit from 10,000 to 20,000 for communities outside of MSAs that lacked mortgage credit). Figure 11 shows that since the 1970 census, OMB added 443 counties (net) to MSAs.

Figure 11: MSAs Encompassed More Territory in 2000 Than in 1970

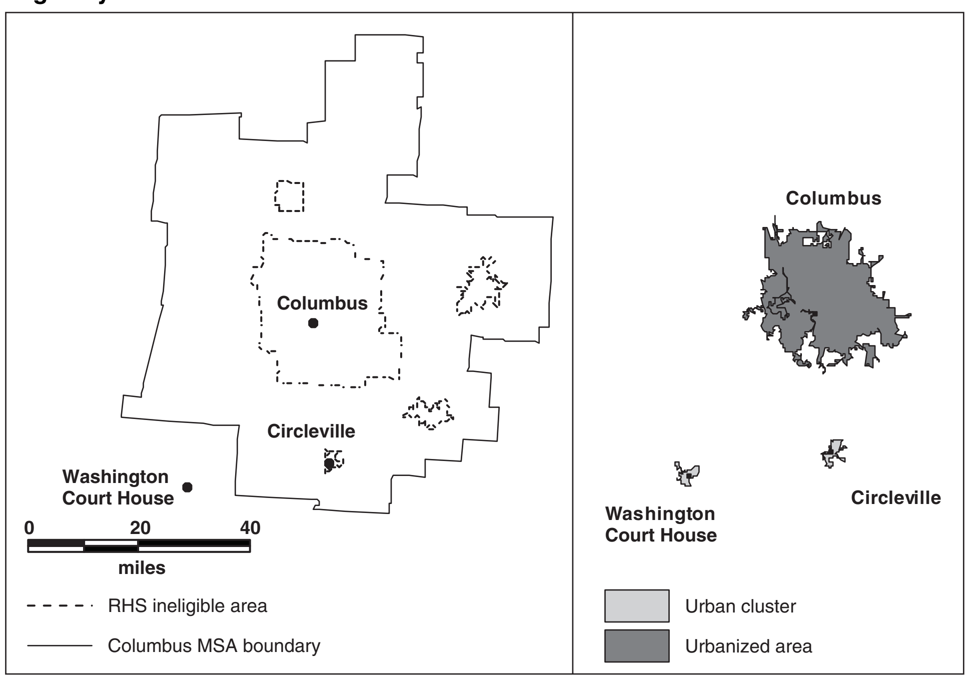


Source: GAO analysis of Census data.

An MSA comprises one or more entire counties, with the result that MSA boundaries follow county boundaries, which typically have little relationship to an urban-rural divide. In contrast, urbanized areas and urban clusters may be used to better identify rural areas, because they are built from Census-defined block groups that show changes in population at a relatively fine scale.[17] We note that density alone cannot measure differences between urban and rural.

However, mapping changes in density might help RHS officials better pinpoint the areas in which the boundaries dividing eligible from ineligible areas might be drawn. For example, by eliminating the MSA criterion, RHS could review the eligibility of Washington Court House and Circleville, Ohio, based on population and rural character criteria. Additionally, using density-based mapping could help RHS draw boundaries around these communities, which although Census-designated as "urban clusters," still meet rural housing program population requirements (see fig. 12).

Figure 12: Eliminating MSA Criterion Could Allow Circleville To Be Considered for Eligibility



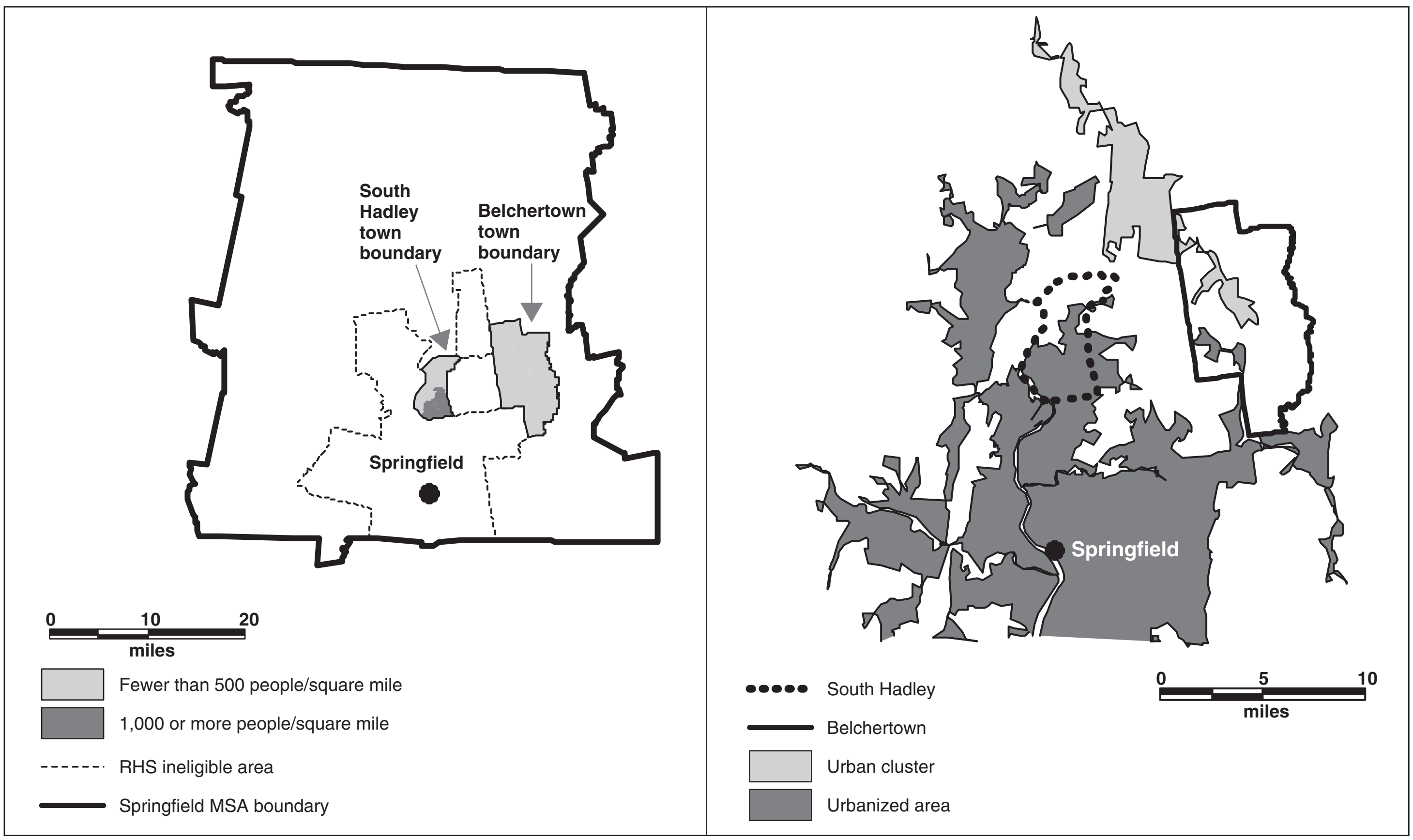
Source: GAO analysis of Census data.

Similarly, replacing MSA criteria with density-based classifications such as urbanized areas and urban clusters could help resolve issues illustrated by

[17]Block groups generally contain 600-3,000 people, with an optimum size of 1,500 people.

the two communities in Massachusetts that we discussed earlier. Currently, all of Belchertown is eligible for RHS housing programs, but all of South Hadley, which is near Belchertown, is not. The limits of each town encompass both more- and less-densely settled areas—that is, areas that could be judged as urban or "rural in character" (see fig. 13). Using density as a guide for determining eligibility, RHS could better judge where to draw a boundary that would differentiate the rural from the urban areas in both jurisdictions.

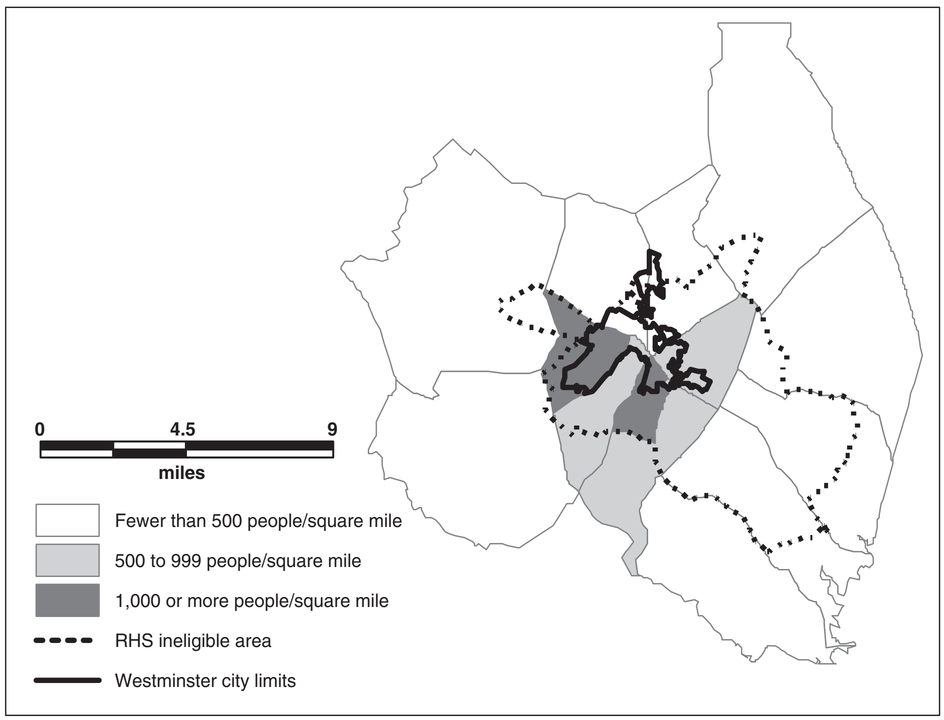
Figure 13: Using Urban Clusters, Rural Portions of Both Belchertown and South Hadley Could Be Eligible



Sources: GAO analysis of Census and RHS data.

In another example, in April 1990, an RHS field office made Westminster, Maryland, ineligible because the town was "fast becoming urban." Westminster's population increased from about 9,000 residents in 1980 to about 13,000 in 1990 and 17,000 in 2000. Westminster is included in the Baltimore MSA. As shown in figure 14, portions of the ineligible area are densely populated. However, although Westminster is in a growing area, it is not contiguous to highly-populated communities and is about 36 miles from downtown Baltimore, a situation that could be more clearly represented using density-based measures.

Figure 14: Population Density in and around Westminster, Maryland, Varies



Sources: GAO analysis of Census and RHS data.

Although urbanized areas and urban clusters better reflect the urban-rural continuum than county-based MSAs, the boundaries often appear jagged or random. Because the boundaries can appear convoluted, it would not be prudent to use the exact urbanized area/urban cluster lines for eligibility boundaries. It would make more sense to use the density information provided by the clusters as input for eligibility determinations. For example, an RHS sister agency, the Rural Business Cooperative Service, interprets language from the 2002 farm bill to apply exact urbanized area boundaries in eligibility determinations for its business and industry loan program (which helps develop rural businesses).[18] However, officials in one state we visited told us that they believe that using exact urbanized area boundaries prohibits them from making loans in rural town business districts. These and RHS officials in other states we visited agreed that using the density information would be helpful in their eligibility determinations, but that they would not want to be held to using density as the sole eligibility factor.

USDA's Economic Research Service (ERS) has developed a number of density-based approaches that can be used to measure "rurality," such as commuting zones and labor market area classifications. ERS developed these approaches to go beyond the county level to better capture the economic and social diversity of rural areas. For example, ERS reports that its rural-urban settlement continuum model can more precisely reflect the diversity of rural settlement patterns because it is based on about 62,000 census tracts, rather than about 3,000 counties, and also considers commuting flows to and from metropolitan core (urbanized) areas, population density, and population growth during the previous decade. ERS believes that the "census-tract continuum" provides a more precise territorial delineation than do the county-level data, particularly in the large western counties where MSA boundaries stretch far beyond the actual urban core.[19]

Grandfathering Attempts to Address Eligibility Issues Arising from MSA Requirement

Congress first wrote "grandfathering" language into the statute in 1983, 9 years after the MSA restriction became part of the statutory definition. The provision enabled a number of communities located in MSAs to retain their eligibility. Because census data show that 13 percent of MSA residents reside in rural areas, it is likely that RHS will continue to grandfather certain areas as long as exclusion from an MSA remains an eligibility criterion. If the MSA requirement were eliminated and density-based measures such as urbanized areas and urban clusters were used as a basis for eligibility determinations, the need to "grandfather" communities would lessen since eligible communities would then better reflect the rural character of the areas. Eligibility decisions also would be made based on

[18] Farm Security and Rural Investment Act of 2002 (P.L. 107-171).

[19] Cromartie, John B. and Swanson, Linda L., *Census Tracts More Precisely Define Rural Populations and Areas*, *Rural Development Perspectives*, vol. 11, no. 3, Economic Research Service (Washington, D.C.: June 1996).

the most recent census data rather than data dating as far back as 1980. Moreover, eliminating the MSA requirement would allow more consistent treatment of communities with similar demographics, some of which meet population requirements and are rural in character, but are ineligible solely because of their inclusion in MSAs.

The most illustrative example we found during our visits of the potential effect of using urbanized areas and urban clusters and discontinuing grandfathering is the Bakersfield/Lamont/Taft, California situation. The left side of figure 15 shows the Bakersfield MSA, which encompasses a county that is more than 100 miles wide in parts, and is basically rural outside the environs of Bakersfield. Lamont was grandfathered because it lost eligibility when its population went above 10,000 at the 1980 census. Taft's population was already over 10,000 prior to the 1980 census, so Taft was not eligible for grandfathering. The right side of the figure shows what would happen if MSAs and the grandfather clause were removed from the equation. Taft would be in its own urban cluster outside of the Bakersfield urbanized area, which happens to include Lamont. Based on our visit, we believe this scenario, where the more rural community would be the one eligible, is more in line with the overall purpose of the legislation than the current situation.

Figure 15: Taft, California, Could Be Eligible under Density-based Criteria

Source: GAO analysis of Census data.

Eliminating Lack of Credit Requirement Would Have Little Effect on Eligibility Determinations

The statute imposes a requirement to demonstrate a serious lack of mortgage credit for lower- and moderate-income families in communities with populations from 10,001 to 25,000. RHS has developed a policy stating that a serious lack of mortgage credit at comparable rates and terms to that offered by RHS exists in all rural areas. In effect, RHS's blanket policy frees field staff to focus on the other requirements in making eligibility determinations for communities with populations from 10,001 to 25,000. However, a 1997 study by USDA's Economic Research Service concluded that credit problems in rural areas are primarily limited to sparsely populated or remote rural areas.[20] Such communities generally do not fall into the 10,001-25,000 range cited in the act.

Lack of income, rather than lack of credit availability, appears to be the primary credit problem in much of rural America. Many of the RHS officials and industry experts with whom we spoke said that they see the problem more as lack of income than lack of credit. Moreover, eligibility requirements for RHS programs are based on income levels. For example, the single-family direct program is limited to low-income households defined as those making 80 percent or less of area median income. The single-family guaranteed program is limited to moderate-income families, defined as those making 115 percent or less of area median income. If income rather than credit were considered the major issue, then the lack of credit requirement would not be central to determining eligibility as RHS program requirements already incorporate income levels. Also, RHS uses targeting to further prioritize loan and grant making to areas based on income and other factors that determine the need for affordable housing.

Conclusions

Changing some of the requirements that define eligibility for RHS housing programs would allow the agency to better serve rural areas. Specifically, certain elements of the definition of rural in Section 520 of the Housing Act of 1949, as amended, are not key to making determinations of what areas are "rural," and in some cases may cause similar communities to receive dissimilar treatment. One such option would be to eliminate the MSA requirement. As OMB acknowledged, many counties included in MSAs contain both urban and rural areas. In addition, according to the Census Bureau, over 50 percent of the nation's rural population resides in rural

[20]U.S. Department of Agriculture, Economic Research Service, Rural Economic Division, *Credit in Rural America*, Agricultural Economic Report No. 749 (Washington, D.C: 1997).

areas within MSAs. Using alternative measures, such as the urbanized area and urban cluster classifications, as a guide could help RHS better draw boundaries around rural areas because density based measures provide finer-scale information. Furthermore, if MSAs were removed from the eligibility criteria, the grandfather clause could also be phased out to allow more eligibility considerations to be based on a community's current characteristics. Our visits to five states have shown instances where the combination of the MSA requirement and grandfathering granted eligibility to communities that appear more closely linked with urban areas than similar, but ineligible, communities. Finally, according to USDA and mortgage industry experts, most of rural America does not appear to lack credit. If credit availability issues are not prevalent in rural areas, particularly those areas at the population tier specified in the statute, then the requirement appears to have little or no relevance to eligibility for rural housing programs.

Matters for Congressional Consideration

To better ensure that the definition of rural results in more consistent application of eligibility for RHS housing programs, Congress may wish to consider

- eliminating the MSA criterion and recommending that RHS use density-based measures as a basis for its eligibility decisions,
- phasing out the practice of "grandfathering" communities that experienced changes in eligibility because of inclusion in an MSA, and
- eliminating the "lack of credit" requirement.

Agency Comments and Our Evaluation

We provided drafts of this report to USDA, OMB, and the Census Bureau for review and comments.

USDA provided written comments that are discussed below and presented in Appendix II, and the Census Bureau provided technical comments that were incorporated where appropriate. The Census Bureau's technical comments included the observation that ERS has developed a set of commuting areas that reflect both population density and commuting data criteria. We added discussion of ERS's efforts to develop alternative measurement approaches that add information beyond that captured at the county level, such as commuting zones, labor market areas, and the rural-urban settlement continuum and how these approaches could be used as a basis to judge the “rural character” of individual communities.

USDA stated that our report articulates how the use of MSAs has resulted in disparate treatment of some communities. The department also noted that applying a density-based measure might have merit but that further study is needed to properly define such a measure for nationwide application. USDA cautioned that since rural areas were diverse, unintended impacts could possibly result because density-based measures might not always identify areas that were “rural in character.” We agree that further study is needed to develop a density-based approach to identify areas that are “rural in character.” However, USDA’s ERS has developed measurement approaches that reflect both population density and commuting data criteria, and these density-based approaches provide a basis to better identify and describe rural areas.

USDA also added that Rural Development would implement any modifications to the statutorily based “grandfathering” provisions that Congress directs. Finally, USDA stated that Rural Development anticipates that the “lack of credit requirement” could be removed with no detriment to RHS housing programs.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from its issuance date. At that time, we will send copies of this report to the Ranking Minority Member for the House Subcommittee on Housing and Community Opportunity and the Chairmen and Ranking Minority Members for the House Committee on Financial Services, Senate Committee on Banking, Housing, and Urban Affairs, House Committee on Agriculture, Senate Committee on Agriculture, Nutrition and Forestry, and other interested congressional committees. We will send copies to the Secretary of the Department of Agriculture, the Director of the Office of Management and Budget, and the Director of the Bureau of the Census. We will also provide copies to others upon request. In addition, this report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions concerning this report, please contact me at (202) 512-4325 or at shearw@gao.gov, or Andy Finkel at (202) 512-6765 or at finkela@gao.gov. Key contributors to this report are listed in Appendix III.

Sincerely yours,

William B. Shear
Director, Financial Markets and
Community Investment

Scope and Methodology

To determine how the Rural Housing Service (RHS) defines rural and implements its programs, we interviewed officials from the U.S. Department of Agriculture (USDA), Department of Housing and Urban Development (HUD), the Census Bureau (Census), and the Office of Management and Budget (OMB) to obtain their views on the federal government's role in providing housing and other community programs to rural areas. In addition, we also met with representatives of private nonprofit housing organizations, including trade and advocacy organizations, to ascertain their views on the target populations and locations for RHS housing programs. To obtain an understanding of how rural areas vary across the country and how RHS defines rural in different parts of the country, we visited five states—Arizona, California, Maryland, Massachusetts, and Ohio—and in each state met with officials from RHS Rural Development field offices, and representatives of state agencies and local organizations. We chose these states because they face different challenges serving rural residents. Collectively, they administer all the available rural housing programs; depict a variety of urban, suburban, and rural populations; contain both affluent and underserved areas, including tribal lands and the colonias; and represent geographically and demographically dispersed areas of the country. Furthermore, including Massachusetts allowed us to evaluate some of the unique issues involved with town-based rather than county-based local governing bodies. Finally, we researched the legislative history of the statutory definition (Section 520 of the Housing Act of 1949 and its amendments) for all rural housing programs and analyzed Census and OMB classifications of geographic areas, based on population levels and density—particularly MSAs—to obtain an understanding of the applicability of these classifications to the current definition.

To determine how RHS targets areas for program delivery, we reviewed regulations and handbooks as well as state funding allocations and obligations. We also reviewed state strategic plans and discussed targeting goals and the ability to deliver resources to high-needs areas with appropriate RHS headquarters staff and officials in the five states we visited. We analyzed state loan and utilization data where available and compared the data with the targeting goals for the five states we visited. In addition, we spoke with representatives of several national housing organizations to obtain their views on whether RHS was targeting resources efficiently.

To evaluate the populations of the rural areas served by RHS housing programs, we used information obtained from databases maintained by

Information Resources Management in St. Louis and focused our analysis on the five states we visited. We used information extracted from the Guaranteed Loan System (GLS), Dedicated Loan Origination and Servicing System (DLOS), and Multi-Family Housing Information System (MFIS) databases. Each extract from a database contained overall funding information for USDA loans and grants in the department's single-family direct, single-family guaranteed, and multifamily housing loan programs, from October 1998 through April 2004.

To determine the characteristics of locations and populations within the five states that receive RHS loans and grants, we used the most recent funding information from the three databases in conjunction with 2000 census data. We analyzed the extent to which different population ranges received RHS housing assistance under the aforementioned programs for the 5-½ -year period. For our analysis, we divided each location's population into one of five numerical ranges, and for each range, computed the total number of loans and grants and the total dollar amount of such assistance. This analysis enabled us to compare and contrast the extent to which different locations within the states received RHS housing assistance.

Although we found the St. Louis data to be generally adequate to perform our analysis, the vast majority of these files did not contain population data for the communities that received RHS assistance. We used the 2000 census to identify population data for the 3,014 unique communities in the five states that received 28,993 loans and grants.[1] In assessing the reliability of relevant 2000 decennial U.S. Census Bureau data, we reviewed information available online from the U.S. Census Bureau Web site on its data quality assurance processes. On the basis of the results of our document review, we concluded that the relevant census data we used were reliable for our purposes for this analysis. Because the census data did not contain population information for 403 (13.4 percent) of the unique communities, we used other sources to obtain this information, ranging from checking a community's Web site (if one was available) to calling a community's administrative offices. USDA state officials also helped by supplying population data in some cases and confirming population data we received from others sources in other cases. These actions enabled us to document

[1]Unique communities are places, towns, villages, or city names that we identified in one or more of the 3 databases.

populations for all but 8 of the 3,014 unique communities identified in the RHS databases. We could not identify population data for 419 of the 28,993 loans and grants because the databases did not include adequate information (street address, name of town, and ZIP Codes) to identify a corresponding community. To determine the extent of loan and grant activity for the previous 6 years on a nationwide basis, we contacted officials at the St. Louis Finance Office and obtained financial reports for this period.

To ensure that RHS databases were reliable, we met with USDA officials in St. Louis to discuss the accuracy and reliability of this information. We also performed internal electronic and manual checks to determine (1) the extent to which the data were complete and accurate, (2) the reasonableness of the values and information in the data fields, and (3) the existence of data limitations such as missing information, incorrect data types, and the existence of other unusable data that would undermine the accuracy and usability of the data. Based upon this reliability assessment, we concluded that the data were reliable for purposes of this report. The data obtained from RHS are as of April 30, 2004.

To understand how a potential change in the definition of rural might impact RHS' mission, we reviewed alternative definitions of and classifications used to define rural, such as those used by Census and OMB, and several classification schemes developed by USDA's Economic Research Service. We also developed case studies in the five states we visited. We interviewed officials at state and local RHS offices, and spoke with representatives of local community development organizations to obtain their views on the current definition of rural and the challenges of implementing programs. We also visited numerous eligible and ineligible rural communities in the various states to assess the impact of the definition on seemingly similar communities (based on demographic profiles).

We conducted our review from January 2004 through October 2004 in accordance with generally accepted government auditing standards.

USDA Comment Letter

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

NOV 15 2004

William B. Shear
Director, Financial Markets and Community Investment
United States Government Accountability Office
441 G Street, NW
Room 2A10
Washington, DC 20548

Dear Mr. Shear:

Thank you for providing the United States Department of Agriculture (USDA), Rural Development with your draft report entitled Rural Housing: Changing the Definition of Rural Could Improve Eligibility Determinations, Audit Number GAO-05-110. For your consideration, Rural Development offers the following comments on your draft report and requests that a copy of these comments be included in your final version.

Rural Development provides affordable housing opportunities for very low- to moderate-income borrowers in rural areas through its Single-Family and Multi-Family housing programs. Rural Development takes its stewardship of these programs seriously and evaluates ways to improve their effectiveness on an on-going basis.

Based on the current statutory standard contained in the Housing Act of 1949, Rural Development has effectively implemented the requirements for ensuring that its housing programs are delivered in areas and communities that are rural. Over the years, dissatisfaction conveyed to Rural Development about eligible lending areas for its housing programs, and how they are derived, has been negligible. When inquiries from the public do occur, they primarily center on the exclusion of an area that was once considered eligible for Rural Development housing programs. These exclusions occur on occasion, and are based on new census data, in order to comply with statutory and regulatory requirements.

In 2004, an interactive public web-site was deployed that contains nationwide maps and street-level data for areas eligible for housing-related programs. Feedback from partners and the public on this web-site has been overwhelmingly positive. Users can now get clear and quick references for eligible areas, including a specific property's eligibility, based on street address information. The system's eligible area information can be updated as required.

The Government Accountability Office (GAO) report articulates how the use of Metropolitan Statistical Areas (MSAs), currently required by statute, to define what is "rural" for Rural Development housing programs, has resulted in disparate treatment of some communities. GAO's report proposes to use density-based measures as an alternative, and suggests that the MSA criteria should be eliminated.

While GAO's proposal to apply a density-based measure may appear to have merit, further analysis would be needed to properly assess how best to define such a measure for nationwide application and what the impacts would be, including any unintended impacts. Due to the diversity of rural areas, a density-based measure may not always identify areas that are "rural in character." Rural Development believes that a comprehensive analysis, preferably for alternative, specific definitions of a density-based measure, would be needed to potentially support a change in the statutory requirements.

AN EQUAL OPPORTUNITY EMPLOYER

GAO also recommends a phasing out of the "grandfathering" of communities that experienced changes in their rural area designation due to inclusion in an MSA. The "grandfathering" provisions for communities have been provided for statutorily over time. Rural Development will implement any modifications to this policy that Congress directs.

GAO's report also recommends that the statutory "lack of credit requirement" as it is applied to rural area determinations, be eliminated. Rural Development anticipates that this standard could be removed with no detriment to the housing programs. As stated in the report, Rural Development's interpretation of this provision is applied to the customers we serve, rather than the areas we serve. Individual applicants for housing loans would still have to meet a credit-standard test. Rural Development's housing programs are directed towards very low- to moderate-income borrowers. While mortgage credit to the general public is more readily available than in the past, credit that is truly affordable for lower income families is not always widely available to rural residents.

As Congress considers the recommendations of the GAO report, Rural Development is interested in participating in a dialogue on any contemplated changes to the statutory requirements to rural area designations. Congress may wish to facilitate further study of this issue to ensure that any proposed changes take into full account the consequences of reliance on density measures as a rural area determinant.

Our comments on this study pertain only to its relevance to Rural Development's Single-Family and Multi-Family housing programs.

USDA is committed to the future of rural communities and intends to continue improving the opportunities for decent, safe, affordable housing in Rural America.

Thank you for this opportunity to comment on the report. If you have any questions, please contact John M. Purcell, Director, Financial Management Division, at (202) 692-0080.

GILBERT G. GONZALEZ
Acting Under Secretary
Rural Development

GAO Contacts and Staff Acknowledgements

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Staff Acknowledgements

In addition to those named above, Diane Brooks, Martha Chow, Mark Egger, Diana Gilman, Christine Kuduk, Richard LaMore, John McGrail, John Mingus, Barbara Roesmann, and Thomas Taydus made key contributions to this report.

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