

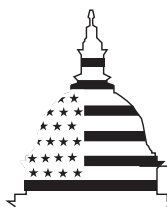
GAO

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

September 2000

RURAL HOUSING

Options for Optimizing the Federal Role in Rural Housing Development



G A O

Accountability * Integrity * Reliability

Contents

Letter		3
Appendixes		
	Appendix I: Opportunities to Improve the Effectiveness of Current Rural Housing Programs	44
	Appendix II: Estimated 1999 Census by Metro and Nonmetro Categories	55
	Appendix III: Comments From the Department of Agriculture	56
	Appendix IV: Comments From the Department of Housing and Urban Development	72
Tables		
	Table 1: Data on RHS' Housing Programs	15
	Table 2: Key Features of the Principal Single-Family Programs Offered in Rural Areas	21
	Table 3: Key Features of the Principal Multifamily Programs Offered in Rural Areas	26
	Table 4: Key Features of Specialized Programs Offered in Rural Areas	31
Figures		
	Figure 1: Distressed Home With Outhouse in Northwest Mississippi	12
	Figure 2: New Home Financed With RHS Single-Family Loan and Additional Funding Sources	13
	Figure 3: Counties Where RHS Guaranteed More Loans Than FHA Insured in 1999	25
	Figure 4: Locations of Units Subsidized by HUD and RHS in Nonmetro Areas	28
	Figure 5: Counties Where RHS Subsidizes More Units Than HUD	29
	Figure 6: RHS Elderly Repair Grant Home	51
	Figure 7: RHS Repair Loan Home	52

Abbreviations

CDBG	Community Development Block Grant
CRA	Community Reinvestment Act
FHA	Federal Housing Administration
FHLBank	Federal Home Loan Bank
HFA	housing finance agency
HOME	Home Investment Partnerships Program
HUD	Department of Housing and Urban Development
MSA	metropolitan statistical area
OMB	Office of Management and Budget
RHS	Rural Housing Service
VA	Department of Veterans Affairs
USDA	U.S. Department of Agriculture



United States General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-284435

September 15, 2000

The Honorable Rick Lazio
Chairman, Subcommittee on Housing
and Community Opportunity
Committee on Banking and Financial Services
House of Representatives

Dear Mr. Chairman:

In the 1930s, the distinctions between rural and urban life were far sharper than they are today. At that time, there were few suburbs—little in the way of urban sprawl extending the city into the country—and most rural residents were farmers. Without electricity, telephone service, or good roads connecting rural residents to population centers, most rural residents were comparatively isolated and their access to credit was generally poor. Today, conditions are very different. More people live in suburbs than in central cities, and the proportion of the nation's population that lives on farms has dropped dramatically, from 25 percent in 1930 to less than 2 percent today. Advances in transportation, computer technology, and telecommunications have—or have the potential to—put rural residents in touch with the rest of the nation, and credit has become more readily available in rural areas. With these demographic and economic changes, the federal role in rural housing has also evolved. Most notably, the federal government has scaled back its involvement in rural housing assistance programs, often reducing its financial commitment to direct lending and shifting responsibilities to state and local governments and the private sector.

As the distinctions between rural and urban life have blurred and federal budgets have tightened, some policymakers have questioned the need for the separate rural housing programs that were first created in the mid-1930s to stimulate the rural economy and assist needy rural families. Accordingly, you asked us to describe (1) the physical condition of today's rural housing and rural households' access to affordable housing credit; (2) the rural housing programs offered by the U.S. Department of Agriculture's (USDA) Rural Housing Service (RHS) and the ways in which RHS' programs have adapted to changes in the level of federal housing assistance; (3) any overlap between RHS' programs and the programs of the Department of Housing and Urban Development (HUD) and other

federal, state, and private organizations; and (4) options for maximizing the efficiency and effectiveness of the federal role in rural housing.

Our work is based on reviews of agency and published data; analyses of market data provided by RHS, HUD, and the National Council of State Housing Agencies; and discussions with RHS, HUD, and industry experts. We also conducted case studies in six states where we observed the condition of rural housing and RHS operations and met with local agency, housing, banking, and community development officials. We judgmentally selected these states to obtain a cross section of rural housing conditions, delivery structures, and states with different concentrations of rural counties. We relied on published studies, primarily by USDA's Economic Research Service, to evaluate the condition of rural housing, the cost and availability of rural credit, and changes in rural housing markets. Our analysis of the overlap between RHS' and other agencies' programs is based on a comparison of program features, including eligibility requirements, subsidy levels, product terms and conditions, and the location and income levels of the households served.

Results in Brief

Nationwide, the physical condition of rural housing has greatly improved since the inception of rural housing programs in the 1930s, but it still lags somewhat behind that of urban housing. Particularly in some remote rural areas, the quality of housing is poorer for some groups, especially minorities. Affordable housing is also difficult to find in some rural areas, and rural homeowners sometimes pay slightly higher mortgage interest rates than their urban counterparts.

RHS is the largest component of a comparatively new USDA mission area, Rural Development, created when the Department was reorganized in 1994. RHS targets a wide array of housing services to rural residents, often offers more favorable terms and conditions than other federal housing programs, and delivers services through an extensive field network. RHS' single-family and multifamily programs are available to households that live in rural areas and have incomes ranging from very low to moderate. Specifically, RHS' single-family programs provide highly subsidized direct loans to households with very low and low incomes, guaranteed loans to households with low and moderate incomes, and grants and direct loans for housing repairs to households with very low incomes.¹ RHS' multifamily programs provide direct and guaranteed loans to commercial developers or nonprofit organizations to produce new rental housing; grants and loans to public or nonprofit agencies or individual farmers to build affordable rental housing for farm workers; housing preservation grants to local governments, nonprofit organizations, and Native American tribes; and rental assistance subsidies. As the federal government has scaled back its involvement in rural housing assistance, it has greatly reduced its funding for RHS' direct loan programs, expanded RHS' guaranteed loan programs, and increased its reliance on state, local, and private partners to leverage funds for rural communities. RHS has also streamlined and centralized its operations in many states, reducing its field office staffing. Nevertheless, rural households still have greater access to RHS than to other federal or state agencies because RHS continues to operate offices in and assign staff to cover rural areas.

Overlap in the products offered and in the households served by RHS and the other organizations offering housing assistance varies by rural housing program and program mission. Some RHS products are similar to products offered by others. For example, although RHS' guaranteed loan program offers borrowers better terms than HUD's Federal Housing Administration's (FHA) insurance program, both programs allow borrowers to obtain mortgages with little or no cash and protect lenders against losses when loans go into default. In addition, RHS' rural housing programs often serve many of the same markets as programs offered by others. In particular, HUD and the Department of Veterans Affairs (VA)

¹Very-low-income households have incomes at or below 50 percent of their area's median income; low-income households have incomes above 50 percent and at or below 80 percent of their area's median income; and moderate-income households have incomes above 80 percent and at or below 115 percent of their area's median income.

provide housing assistance nationwide, including assistance to eligible households in rural areas. For example, RHS' single-family loan guarantee program serves a moderate-income market segment, as does FHA's much larger single-family mortgage insurance program. But RHS guarantees more loans than FHA insures in the more remote rural areas, in part because lenders in some rural areas do not always offer FHA loans and because RHS loans are less expensive to the consumer. Some RHS products and terms have no counterparts elsewhere. For example, RHS offers the only farm worker housing construction program. In addition, RHS' single-family direct loan program offers a greater interest subsidy than other programs and is available only to households that are unable to qualify for credit elsewhere. Although most state housing finance agencies also offer single-family direct loan programs, these programs typically complement rather than duplicate RHS' program because they provide smaller subsidies and their products are therefore available to households with higher incomes. The state agencies further complement RHS' efforts by participating in RHS' single-family loan guarantee program. In the multifamily area, despite overlap in the eligibility requirements for households benefiting from RHS' and HUD's multifamily guaranteed loan and/or rental assistance programs, RHS typically delivers program services through district or local offices, whereas HUD relies on regional offices. On the one hand, RHS' program management structure can make it easier for rural households to gain access to housing credit; on the other hand, the differences in RHS' and HUD's program management structure have led to inconsistencies in program rules, sometimes causing frustration and extra paperwork for property owners and managers. In addition, the two agencies have established separate, uncoordinated systems for monitoring the physical and financial condition of their properties.

Given the diminished distinctions between rural and urban areas today, improvements in rural housing quality and access to credit, and RHS' increasing reliance on guaranteed lending and public/private partnerships, the federal role in rural housing is at a crossroads. Options for optimizing the federal role include fundamentally changing the programs' targeting, subsidy levels, and delivery systems, as well as merging RHS' programs with HUD's or other agencies' comparable programs. Without some prodding, the agencies are not likely to examine the benefits and costs of merging as an option. Nonetheless, as a first step toward achieving greater efficiency, the Congress may wish to require RHS and HUD to explore the potential benefits of merging similar programs. Depending on the results, the Congress may then choose to merge similar programs, such as the single-family insured lending programs and the multifamily portfolio

management programs, taking advantage of the best practices of each and ensuring that targeted populations are not adversely affected. In addition, RHS and others have identified a number of actions that could be taken to increase the efficiency of existing rural housing programs, whether or not they are merged (see app. I).

Background

Federal housing assistance in rural areas dates back to the 1930s. At that time, most rural residents worked on farms, and rural areas were generally poorer than urban areas. Accordingly, the Congress authorized separate housing assistance for rural areas and made USDA responsible for administering it. Specifically, the Bankhead-Jones Farm Tenant Act of 1937 authorized USDA to provide long-term, low-interest loans to farm tenants and sharecroppers so that they could purchase and repair farms, including homes on farms. The Housing Act of 1949 authorized new rural lending programs, which were administered by RHS' predecessor, the Farmers Home Administration, within USDA. Persons were eligible for this assistance if they lived in dwellings on land capable of producing at least \$400 worth of agricultural commodities annually. Legislation authorizing the Farmers Home Administration to make loans to rural residents other than farmers was enacted in 1961.

Nationwide housing assistance programs also originated during the 1930s. FHA began providing mortgage insurance in 1934, and the first public housing program was authorized in 1937. The Veterans Administration (now the Department of Veterans Affairs) started offering housing assistance to all eligible veterans in 1944. Later, other federal housing programs were placed under HUD, created in 1965. Currently, federal tax policies, especially the Low-Income Housing Tax Credit program, help make housing affordable nationwide. In addition, various programs, some of which are administered by federal departments other than HUD or USDA and by state housing finance agencies (HFA), offer low-interest financing for affordable rural housing. Community development corporations, regional commissions, and other nonprofit organizations also promote affordable homeownership and rental assistance at local levels. Finally, the federal government helps make homeownership affordable by requiring certain lenders to meet special housing finance needs.²

Historically, the term “rural” has described an area that is sparsely settled with wide open spaces, a population engaged in resource-based occupations, and a lifestyle and culture distinct from those of urban places. But the definition has evolved over time, responding to population increases and changes in land use. Today, vast areas are still clearly rural, but suburban sprawl in other areas has created a mosaic of regions that are alternately rural and urban in character. For example, rural pockets persist between new suburbs that have grown up near urban centers. And within rural areas are urban pockets—small towns that have grown into cities as urban “expatriates” have moved beyond established suburbs. Conversely, some areas have lost population and are more rural today than they were 20 or 30 years ago.³

²Specifically, the Community Reinvestment Act (CRA) encourages depository institutions and other lenders to meet the housing credit needs of the communities they serve, and the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 places upon Fannie Mae and Freddie Mac numerical goals for the loans they purchase that are made to low- and moderate-income persons and are made in underserved areas. In addition, the Federal Home Loan Bank (FHLBank) system operates the Community Support Program that, among other things, requires FHLBank members to meet standards of community investment or service in order to maintain continued access to long-term FHLBank system advances. For example, a member is required to provide federal oversight agencies with the public disclosure portion of its most recent CRA evaluation and a description of how the member assists first-time homebuyers.

³Joseph N. Belden and Robert J. Wiener, *Housing in Rural America* (SAGE Publications, 1999).

To keep up with such demographic changes, USDA identifies areas on maps in local and state offices that are eligible for its rural housing programs. The following criteria determine eligibility:

A rural area is open country that is not part of or associated with an urban area. A rural area may include any town, village, city, or place, including a place that is not part of or associated with an urban area but is immediately adjacent to a densely settled area, has a population of no more than 10,000, and is rural in character. Such a place may be in either a metropolitan statistical area (MSA) or a nonmetropolitan area. In addition, a nonmetropolitan area with a population of 10,001 to 20,000 may be considered a rural area if USDA or HUD determines that it has a serious lack of mortgage credit.⁴

For this report, where the data allowed us to do so, we broke down rural or nonmetropolitan (nonmetro) areas into three subcategories—urbanized nonmetro, rural nonmetro, and completely rural nonmetro areas. We defined (1) urbanized nonmetro areas as counties that are not in MSAs and have at least one town with a population of 20,000 or more; (2) rural nonmetro areas as counties that are not in MSAs and have one or more towns with a population of 2,500 to 19,999; and (3) completely rural nonmetro areas as counties that are not in MSAs and do not have a town with a population of over 2,499. This breakdown corresponds with the requirement for most of RHS' programs that eligible households be located in rural communities with fewer than 20,000 residents and shows the extent to which RHS' and other agencies' programs serve the most rural areas.

Today's Rural Housing Quality and Rural Households' Access to Affordable Housing Credit

Since the inception of rural housing programs in the 1930s, the quality of rural housing has improved. For example, in the 1930s, very few rural homes had electricity or indoor plumbing, but by the 1970s, virtually all rural homes had both. Today, despite improvements, the quality of rural housing still lags somewhat behind that of urban housing. According to HUD's American Housing Survey, 22 percent of the nation's population lived in rural areas in 1991. Yet 29 percent of the nation's occupied housing units with severe or moderate physical problems related to plumbing, heating, electricity, kitchen facilities, or maintenance were in rural areas. In some rural locations, housing quality continues to lag because there is little incentive to invest in housing. Overall, housing credit is almost as readily

⁴Specifically, MSAs consist of counties with central cities of at least 50,000 residents and surrounding contiguous counties that are metropolitan in character and economically tied to the core counties.

available in rural as in urban areas, but rural borrowers often pay slightly higher rates.

Housing Quality Lags in Some Rural Areas

While distinctions between rural and urban areas are no longer as pronounced as in the past, a higher proportion of rural units are substandard, and minorities and persons living in remote areas are affected the most. According to HUD's 1997 American Housing Survey, rural households lived in moderately or severely inadequate housing more often than urban households. The 1990 Census found that 6 percent of rural African-American homes and 12 percent of rural Native American homes lacked complete plumbing. In comparison, 2.4 percent or less of all the remaining homes—regardless of location—lacked complete plumbing. In addition, the Housing Assistance Council reported that 9 percent of owner-occupied rural units in 1991 were substandard, compared with 6 percent in central cities. For renters, the incidence of substandard units was similar in rural areas and central cities—about 13 percent. This difference in housing quality for owners and renters is particularly noteworthy, given that a significantly higher proportion of rural residents own their homes. HUD's 1999 American Housing Survey found that 75 percent of rural households owned their own homes, compared with 67 percent of households nationwide and 50 percent of households in central cities. Rural ownership rates are higher even among very-low-income households, reflecting the basic tenet that owning a home on a parcel of land has become part of the culture of rural America. But a higher incidence of housing quality problems in rural areas nullifies many of the advantages of homeownership, including the ability to use homes as investments or as collateral for credit. A 1999 HUD report concludes that the most severe rural housing problems are found farthest from the nation's major cities, especially in such places as the Mississippi Delta, Appalachia, the Colonias on the Mexican border, and Indian trust land. Furthermore, for some rural residents, such as migrant farm workers, a shortage of affordable rural housing persists.

Although the overall quality of housing in rural areas has improved, some rural counties continue to lose population and suffer from stagnant property values. In such economically depressed locations, there is little incentive to invest in housing. Some state Rural Development officials we spoke with noted that low population levels and low household incomes affect both the availability and attractiveness of affordable housing as an investment for builders. Because housing development costs are not significantly lower in rural areas, it is difficult to build even highly

subsidized housing in rural areas that is affordable to low- and very-low-income families.

We found such difficulties in the following areas:

- The Mississippi Delta, which contains some of the poorest counties in the nation, is having problems attracting new housing investment. Casino gambling and catfish-processing operations have brought some new jobs to the area, but the jobs are not always near the older rural Delta towns. As a result, there is a need for affordable housing closer to the new jobs. Meanwhile, a number of older distressed towns, with little economic development and no significant housing construction in the past 40 years, continue to decline.
- In northern Missouri, employment has declined with farm production. Moreover, according to Missouri RHS and local community development officials, vacancies in multifamily housing have increased with the poor agricultural economy. Some new jobs have recently appeared in the farm-processing sector. However, these jobs are not located in the areas with the multifamily housing vacancies, creating an imbalance in the supply and demand for houses.
- The Colonias consist of hundreds of quasi-rural communities located along the Mexican border in Texas, Arizona, New Mexico, and California. These communities are characterized by severely substandard living conditions, lacking water and sewage systems and decent housing. The Colonias of the Rio Grande Valley in Texas serve as the principal “home base” for many migrant farm laborers. Housing is often constructed of “found materials,” such as cardboard, wood palettes, and corrugated metal sheets. The Colonias often fall outside the jurisdiction of cities; counties may not have the legal power to incur debt for financing infrastructure improvements; and the Colonias’ low-income, minority residents have little political power to compete for scarce resources.

In contrast, there is a greater willingness to invest in neighborhoods closer to growing urban areas. For example, we visited a home that was 1 of 10 recently built with funds from RHS, the Federal Home Loan Bank (FHLBank), the state of Mississippi, and the local government. According to the Mississippi state director, the willingness of the other partners to contribute to maintaining an historically significant African-American neighborhood in an economically growing area was the key to the

development's moving forward. Figure 1 shows the house and privy where the homeowner lived for 46 years until his new home, shown in figure 2, was finished in February 2000.

Figure 1: Distressed Home With Outhouse in Northwest Mississippi



Outhouse is located in the rear of the yard.

Figure 2: New Home Financed With RHS Single-Family Loan and Additional Funding Sources



USDA Has Determined That Credit Is Available in Most Rural Areas

In its 1997 analysis of the demand for and availability of credit in rural areas, USDA found no evidence of widespread or economically important market failures or imperfections. USDA concluded that financial markets are serving the credit needs of rural America reasonably well. The report cited increased competition in rural housing markets and the increased secondary market activity of Fannie Mae, Freddie Mac, and other secondary market institutions in rural areas as key factors in reducing the rural financial market inefficiencies that plagued the sector in the past. Nonetheless, the study noted that interest rates were slightly higher in rural areas for most types of home mortgages. The report found that, with the exception of some smaller and remote rural areas, the banking system and other lenders active in rural America generally have sufficient deposits and access to money markets and other sources of funds to respond quickly to changes in the demand for credit. The report also found that the interest rates on home mortgages eligible for purchase by Fannie Mae, Freddie

Mac, or other secondary market institutions are comparable in rural and urban areas. However, rural borrowers often pay slightly higher rates because the cost of doing business is greater in sparsely populated areas and loans to rural borrowers often have unconventional terms that make them ineligible for purchase by secondary market institutions. For example, housing factors, such as unacceptable water and sewer facilities and dated utility systems, and employment factors, such as a higher incidence of seasonal or self-employment, make rural loans less likely to meet the underwriting standards of Fannie Mae, Freddie Mac, and other secondary market institutions.

Major RHS Rural Housing Programs and How They Have Changed Over Time

RHS offers a wide array of services to rural residents. An increased emphasis in recent years on leveraging limited funds with public- and private-sector partners and a general move away from direct lending programs has led RHS to streamline and centralize its operations in some states. This increased centralization reflects RHS' overall shift in emphasis from being primarily an on-site lender of last resort to being primarily a facilitator delivering a variety of low-income housing and other community development services as a part of USDA's restructured Rural Development mission area.

RHS Offers a Wide Array of Housing and Community Development Services

USDA's Farmers Home Administration managed rural housing programs along with farm credit programs until the Department's 1994 reorganization legislation split these functions. Farm credit programs were then shifted to the new Farm Service Agency, and housing programs were moved to the newly created RHS in the new Rural Development mission area that was tasked with helping improve the economies of rural communities.

RHS' homeownership programs provide highly subsidized direct loans to households with very low and low incomes, guaranteed loans to households with low and moderate incomes, and grants and direct loans to rural residents for housing repairs. Multifamily programs provide direct and guaranteed loans to developers or nonprofit organizations for new rental housing; grants and loans to public or nonprofit agencies or to individual farmers to build affordable rental housing for farm workers; housing preservation grants to local governments, nonprofit organizations, and Native American tribes; and rental assistance subsidies that are attached to about half of RHS' rental units. In addition, RHS administers community facilities programs that provide direct and guaranteed loans

and grants to help finance rural community centers, health care centers, child care facilities, and other public structures and services.

For fiscal year 2000, RHS received an appropriation of \$1.3 billion and loan authorizations of about \$4.6 billion, primarily for its guaranteed loan programs. RHS employs about 6,500 staff and oversees an outstanding single-family and multifamily direct loan portfolio of about \$28 billion. RHS' major housing programs were funded at higher levels both 20 years ago and in 1994, when the Congress set up the current organizational structure. Table 1 lists RHS' programs, briefly describes them, and compares the spending for them in fiscal year 1999 with the spending for them in fiscal years 1979 and 1994.

Table 1: Data on RHS' Housing Programs

Dollars in millions

RHS housing program	Total dollars spent, fiscal year 1979	Total dollars spent, fiscal year 1994	Total dollars spent, fiscal year 1999	Number of households helped, fiscal year 1999	Type of assistance
Single-Family Housing Direct Loans (sec. 502)	\$2,870.0	\$1,656.8	\$966.9	15,600	Loans subsidized as low as 1 percent interest
Single-Family Housing Guaranteed Loans (sec. 502)		\$725.9 ^a	\$2,980.0 ^a	38,600	No money down, no monthly mortgage insurance loans
Single-Family Home Repair Grants and Loans (sec. 504)	\$33.7	\$52.7	\$46.8	9,021	Grants for elderly and loans subsidized as low as 1 percent interest
Single Family Housing Mutual Self-Help Grants (sec. 523)	\$5.6	\$12.8	\$25.4	1,350	Grants to nonprofit and public entities to provide technical assistance
Multifamily Direct Rural Rental Housing (sec. 515)	\$869.5	\$512.4	\$114.3	2,181	Loans to developers subsidized as low as 1 percent interest
Multifamily Housing Guaranteed Loans (sec. 538)			\$74.8 ^a	2,540	Guaranteed loans for developing moderate-income apartments

Dollars in millions

RHS housing program	Total dollars spent, fiscal year 1979	Total dollars spent, fiscal year 1994	Total dollars spent, fiscal year 1999	Number of households helped, fiscal year 1999	Type of assistance
Multifamily Housing Farm Labor Grants and Loans (secs. 516/514)	\$68.8	\$56.3	\$33.2	622	Grants and loans subsidized at 1 percent interest
Multifamily Housing Preservation Grants (sec. 533)		\$23.0	\$7.2	1,800	Grants to nonprofit organizations, local governments, and Native American tribes, usually leveraged with outside funding
Multifamily Housing Rental Assistance (sec. 521)	\$423.0	\$446.7	\$583.4	42,000	Rental assistance to about one-half the residents in RHS rental and farm labor units

^aDollar amount represents private-sector loan levels guaranteed by RHS. Actual federal outlays are much lower because they are based on subsidy costs and projected losses that are less than loan levels.

Declining Budgets Have Increased the Use of Guaranteed Loans, Led to Streamlined Delivery Systems, and Increased Reliance on Partners

In recent years, RHS has changed how it delivers its major programs in response to declining budgets. RHS has increased its use of guaranteed lending, streamlined its delivery systems, and relied more on public and private partners to deliver its programs.

Increased Use of Loan Guarantees

Competing demands for limited budgetary resources have increased RHS' reliance on loan guarantees, which, because of their lower subsidy rates, require less budget authority than does the highly subsidized direct loan program. For example, RHS' single-family direct loan program, with a subsidy rate of 8.53 percent for fiscal year 2000, is very costly compared with the single-family guaranteed program, with a subsidy rate of 0.61 percent. That is, for every \$100 that RHS lends directly, it costs the U.S. Treasury \$8.53, whereas, for every \$100 in single-family loans that RHS guarantees, it costs the Treasury only \$0.61. RHS' multifamily direct loan program is also more expensive than its multifamily guaranteed loan program (39.68 percent versus 0.48 percent). While the guaranteed programs cost the government less than the direct programs, they generally

help fewer households with very low incomes. As table 1 indicated, RHS guaranteed more multifamily loans than it made directly (2,540 versus 2,181), and it guaranteed two and one-half times more single-family loans than it made directly (38,600 versus 15,600) in fiscal year 1999.

The increased emphasis on guaranteed loans has also affected RHS' traditional mission of serving as a temporary lender of last resort. For example, although single-family direct loans are available only to borrowers who cannot obtain private credit, lenders that offer guaranteed single-family loans must only certify that a borrower could not obtain financing without the benefit of an insured or guaranteed loan, be it from RHS, FHA, VA or a private insurer.

More Streamlined Delivery Systems

The 1990s also saw significant streamlining of USDA's locally based program delivery structure, including the creation of a new in-house center to centrally service its single-family direct loans.

From the 1930s through the early 1990s, USDA had field staff in almost every rural county, usually with separate offices for credit, conservation, and farm programs. Consistent with the 1994 reorganization, over 1,500 county offices were closed or consolidated into "USDA service centers" that include staff representing the Department's Farm Services, Conservation, and Rural Development mission areas.⁵

Since the 1994 reorganization, about 600 Rural Development field positions were transferred to the St. Louis Centralized Servicing Center, further cutting the need for Rural Development field staff. Previously, RHS staff in hundreds of local field offices manually serviced RHS' portfolio of 765,000

⁵State Rural Development offices were given the authority to develop their own program delivery systems for three sister agencies. RHS is the largest of the three, with 89 percent of Rural Development's fixed funding and 86 percent of its estimated staff years. In addition to rural housing, RHS addresses the need for health facilities, fire stations, and other community facilities in rural areas. The Rural Utilities Service addresses rural needs for basic services such as clean running water, sewers and waste disposal, electricity, and telecommunications. The Rural-Business Cooperative Service helps rural areas develop new job opportunities. The Rural Community Advancement Program gives USDA the flexibility to reallocate up to 25 percent of each state's Rural Development funding among the three Rural Development agencies. As of August 2000, about 6,500 USDA employees delivered Rural Development programs through the Department's headquarters in Washington, D.C.; 47 state headquarters, 144 area, and 671 local Rural Development offices; and the St. Louis Centralized Servicing Center.

direct loans. However, cuts in the single-family direct program since 1994 have reduced the number of loans that are serviced out of St. Louis by 28 percent, raising questions as to the Centralized Servicing Center's long-term viability. According to the Centralized Servicing Center's director, without new direct loans or additional servicing work, the center could be underutilized within a few years. The center's director is seeking new work from other federal agencies and the private sector, proposing to service RHS' guaranteed loans, FHA's and VA's assigned loans, and private residential loans, as well as collect nonhousing debt, such as food stamp overpayments and amounts owed to IRS. As of July 2000, USDA was awaiting approval from the Department of the Treasury to begin a pilot project that would involve the Centralized Servicing Center in servicing all severely delinquent debts in Rural Development programs. According to the center's director, this project could add up to 40,000 new accounts to the center's portfolio.

Increased Emphasis on Partnering

Growing budgetary pressures during the 1990s also increased RHS' emphasis on partnering with state and local governments, nonprofit organizations, banks, and other federal agencies. RHS multifamily funds have been used in combination with low-income housing tax credit developments. In addition, RHS has leveraged its single-family direct loan programs with funding from private banks and its single-family guaranteed program with assistance from state HFAs.

Authorized in the Tax Reform Act of 1986, the Low-Income Housing Tax Credit program is currently the largest federal program to fund the development and rehabilitation of multifamily housing for low-income households. Under this program, the states are authorized to allocate federal tax credits to the private sector as an incentive to develop rental housing for low-income households. Our 1997 report on this program reported that 53 percent of the tax credit properties and 28 percent of the tax credit units placed in service from 1992 through 1994 were in rural areas.⁶ RHS' multifamily direct loans were a financing source for many of those rural tax credit properties. With its funding for multifamily direct loans drastically reduced, RHS has made very few new direct loans and is focusing more on managing the portfolio of loans it has already made.

⁶*Tax Credits: Opportunities to Improve Oversight of the Low-Income Housing Program* (GAO/GGD/RCED-97-55, Mar. 28, 1997).

Rural developers have more recently been focusing on using tax-exempt bonds with tax credits and funding from HUD programs to finance new rural low-income housing developments.

Multiple funding sources are also becoming the norm in financing rural single-family homes. For example, RHS has developed a leveraged mortgage program to help make its single-family direct loan program funds go further. Private lenders provide a market-rate first mortgage loan, and RHS provides a second mortgage, typically covering 80 percent of the loan amount, to ensure affordability. Some bank officials we spoke with consider the program to be a loss leader because of the relatively high costs of servicing such small loans. Others said they believe the program is cost-effective and virtually risk free because the banks assume the first position on the mortgage. Bankers we spoke with who participate in the program said they generally support the program for its goodwill and credit reform benefits and because they understand that the more leveraging involved, the more loans RHS can underwrite. A number of RHS state officials added that they were originally hesitant about leveraging direct loans but now believe that the additional bank oversight and homeowner education requirements most banks impose make better borrowers and improve the overall quality of RHS' portfolio.

Five of the six states we visited were using RHS' single-family guaranteed program to leverage state HFA funds. The exception was Mississippi, where, according to the state Rural Development director, the state HFA tentatively agreed in May 2000 to use some of its bond proceeds to help reduce the interest rate on RHS single-family guaranteed loans. Mississippi has lagged behind most states in making single-family guaranteed loans. Mississippi state Rural Development officials told us they believed that a reduction of as little as 1 percent in the guaranteed program's interest rate would encourage realtors to get more involved in the program, which in turn would pressure lenders to get involved.

Overlap Between RHS' and Others' Programs

In addition to RHS, FHA, state HFAs, and others operate housing programs, though these programs are not targeted to rural areas. The extent of overlap between the products offered and the markets served by RHS and others varies, depending on the program. For example, although RHS' single-family loan guarantee is similar to the mortgage insurance offered by FHA, RHS' deeply subsidized single-family direct loans have no counterparts in other agencies. Furthermore, although FHA insures far more single-family loans than RHS guarantees, RHS guarantees more loans

in many remote rural areas than FHA insures. As for multifamily programs, there is more overlap in both the products offered and the markets served by RHS and HUD. Nonetheless, RHS still is a major source of financing for multifamily housing in more remote rural areas. The extent of overlap between RHS' and other entities' specialized programs varies by program and program mission.

National and State Housing Programs

FHA's and the VA's single-family mortgage insurance programs are the largest national programs of their kind, operating in urban and rural areas. HUD also operates multifamily programs that provide mortgage insurance, rental assistance, and public housing nationwide. Furthermore, HUD operates two major grant programs—the Community Development Block Grant (CDBG) program and the Home Investment Partnerships Program (HOME)—that promote affordable rental housing and homeownership nationwide, although, by statute, 30 percent of CDBG funding and 40 percent of HOME funding is allocated to the states for distribution to smaller communities.

State HFAs provide subsidized financing for affordable housing in urban and rural areas. Specifically, states sell tax-exempt mortgage revenue and multifamily bonds and use the proceeds to finance discount mortgages for lower-income first-time homebuyers and to construct apartments affordable to lower-income renters.

Some Overlap in Single-Family Products and Markets Served in Rural Areas

State HFAs' mortgage revenue bond programs and FHA's principal single-family mortgage insurance program are the major programs that are offered in the same markets as RHS' single-family programs. The state HFAs' mortgage revenue bond programs offer below-market-interest-rate loans in markets served by RHS' single-family direct loan program; FHA's and VA's programs offer mortgage insurance and guaranteed loans in markets served by RHS' single-family guaranteed loan program. The extent to which these programs serve rural areas and the similarities and differences in their products are described below. Table 2 shows the key features of the single-family programs offered by RHS and the other nationwide programs that operate in rural areas. A discussion of the overlap between the programs of RHS and the other principal organizations that operate in rural areas follows.

Table 2: Key Features of the Principal Single-Family Programs Offered in Rural Areas

Agency	Direct loans	Loan guarantee/ insurance	Interest subsidy	Income targeting	Location targeting
RHS	X	X	X ^a	X	X
State HFAs	X	^b	X	X	X ^c
HUD/FHA	^d	X			
VA		X			

^aDirect loans only.

^bState HFAs self-insure some of the loans that they make as well as purchase some guaranteed/insured loans made by RHS, FHA, and VA.

^cVaries by state.

^dFHA makes direct single-family loans as part of property disposition.

RHS Direct Loans and State HFA Direct Loans

RHS and state HFAs both subsidize direct loan interest rates for low-income borrowers in rural areas. However, their products differ in the amount of subsidy offered, and although the two programs serve similar income groups, state HFAs have less activity in rural areas than does RHS. Each program has helped about 2 million families become homeowners, but because RHS' direct loan program targets poorer, more rural areas, it has assisted more rural families to date. In addition, RHS offers larger subsidies, so its program complements, rather than duplicates, the direct loan programs offered by state HFAs. In fact, most state HFAs work directly with RHS. For example, according to RHS, as of October 1999, 39 state HFAs were participating in RHS' guaranteed programs, which typically allow borrowers to obtain below-market-interest-rate loans and/or obtain down payment and closing cost assistance. However, the funding for RHS' direct loan program—about \$1 billion per year—is down significantly from its peak of \$2.9 billion in 1976. On the other hand, more state HFAs have developed housing assistance programs in recent years, and bond activity is expected to increase starting in 2003, when a phased-in increase in the bond cap from \$50 to \$75 per capita will begin to take effect. Starting in 2003, each state's cap will increase in equal annual increments until it reaches the greater of \$75 per capita or \$225 million in 2007. Thus, while RHS offers deeper subsidies and targets rural households, state HFA

programs offer greater growth potential for low-income households nationwide. However, state funding for housing must compete with other state priorities and not all states give priority to housing.

According to RHS Centralized Servicing Center officials, new RHS single-family direct loans made to low- and very-low income households are usually subsidized so that the effective interest rate to the borrower is between 1 and 3 percent. In fact, RHS' mortgage loans are subsidized to the point that the portion of a family's income going toward the RHS mortgage is comparable to what the family would pay under federal rental assistance programs, such as RHS' rental housing or HUD's public and assisted housing program. State HFA funds, which are raised through a state's issuance of tax-exempt housing bonds, generally do not offer such deep subsidies. Nebraska, for example, is offering a 3-percent interest rate for low-income borrowers and is targeting rural counties. But most states do not subsidize as deeply; typically, they offer only a point or two below the market rate. According to the National Council of State Housing Agencies, a typical bond-financed mortgage saves a first-time homebuyer up to \$100 a month compared with a conventional mortgage. The executive director of Vermont's HFA told us that her agency does not try to compete with RHS' deeply subsidized direct loans. Vermont's bond-financed mortgage loan program offers a rate that is about 1 percent below the market rate.

Although state HFAs finance properties in rural areas, they do not focus their lending on those areas as RHS does. Of the single-family properties whose location was reported by the 30 state HFAs that financed these properties in 1998, 77 percent were inside and 23 percent were outside metro counties. Available data do not allow for an analysis of how many of the properties outside metro counties are in urbanized, rural, or completely rural nonmetro counties. Of the states we visited, Maine, Vermont, and New Hampshire had active statewide programs, whereas Mississippi, Missouri, and Ohio focused on urban areas. In comparison, RHS made about 15,600 single-family direct loans in 1999, of which about 8,500, or 55 percent, were outside metro areas. Of those nonmetro loans, about 1,900, or 22 percent, were in urbanized nonmetro areas; about 5,600, or 66 percent, were in rural nonmetro areas; and just over 1,000, or 12 percent, were in completely rural nonmetro areas.

RHS Loan Guarantees and FHA Mortgage Insurance

RHS and FHA both operate in rural areas and offer similar insured single-family products. Along with VA, which offers a mortgage insurance program, both RHS and FHA encourage lenders to make loans by insuring them against losses they might incur when borrowers default on their mortgages.⁷ However, only veterans are eligible for VA's program. Although RHS' guaranteed loan program and FHA's mortgage insurance program require that borrowers meet the same debt-to-income ratios, RHS' program offers more generous terms than FHA's program.⁸ Specifically, RHS borrowers are not required to make a down payment, may finance closing costs, pay a lower up-front fee, and do not pay monthly mortgage insurance. FHA borrowers may finance the up-front fee and closing costs, but they are required to make a 3-percent down payment, pay an up-front fee of up to 2.25 percent, and pay monthly mortgage insurance. As a result, a borrower eligible for both programs would be prudent to choose an RHS mortgage.

Despite the differences in the terms of their programs, RHS, FHA, and VA all serve a significant share of low-income households. According to Home Mortgage Disclosure Act data, about 45 percent of all FHA, VA, and RHS loans made in 1998 went to households that had very low or low incomes. RHS reported that about 30 percent of its single-family guaranteed loans in 1999 went to households with very low and low incomes.

RHS differs from FHA and VA in that it is precluded from lending to households with incomes above the moderate level—that is, above 115 percent of the local area's median income.⁹ Hence, the remaining 70 percent of RHS loans went to moderate-income families. In comparison, over 20 percent of all FHA and VA loans in 1998—the majority of which were FHA loans—were made to borrowers with incomes above 120 percent of the local area's median income, according to Home Mortgage Disclosure Act data.

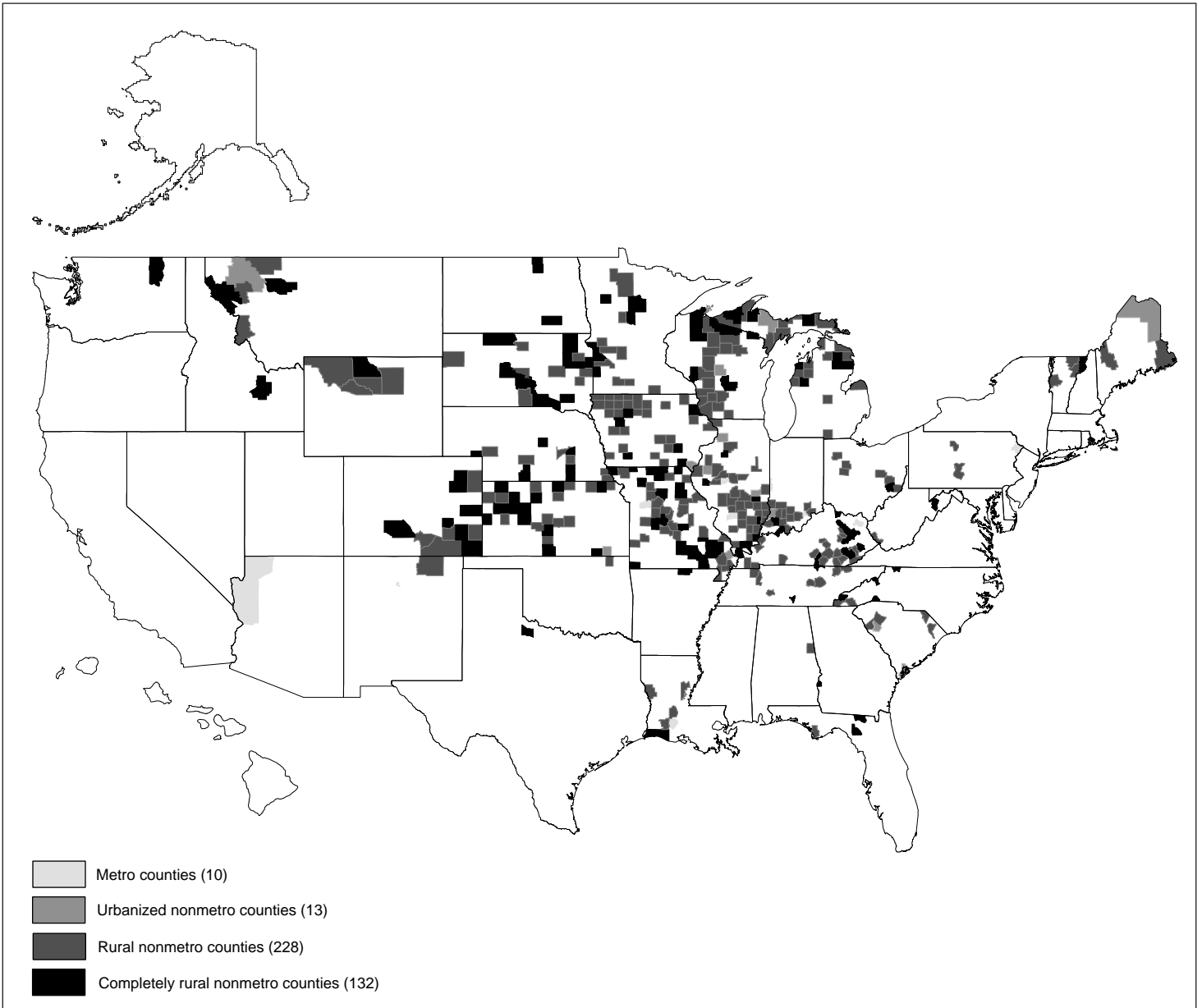
⁷FHA covers essentially 100 percent of the losses on any foreclosed loan. RHS covers up to 90 percent.

⁸Both RHS and FHA require that borrowers not have housing debt payments exceeding 29 percent of their monthly incomes or total debt exceeding 41 percent of their total incomes.

⁹A recent legislative proposal would expand eligibility for the program, particularly in poorer states, by using the greater of statewide or national median income in place of the local area's median income.

RHS also differs from FHA in that its programs are substantially smaller and a higher proportion of its activities are concentrated in rural areas, including remote rural areas. Whereas RHS guaranteed \$3 billion in single-family loans in fiscal year 1999, FHA insured about \$112 billion in single-family loans. Yet even though 20 percent of the U.S. population resides outside metro areas, only 7 percent of FHA's single-family insured loan activity in fiscal year 1999 was outside metro areas. In contrast, 55 percent of the loans RHS guaranteed in fiscal year 1999 were made to households outside metro areas. Nonetheless, because FHA insures 33 housing loans for every loan RHS guarantees, FHA does much more business than RHS in most areas, including rural areas. Yet in 18 percent of the rural and completely rural counties, RHS guaranteed more loans than FHA insured. Specifically, RHS guaranteed more loans than FHA insured in 360 of the 2,053 rural and completely rural nonmetro counties. RHS also guaranteed more loans in 23 additional metro counties and urbanized nonmetro counties. (See fig. 3.) In fact, RHS is a significant source of mortgage insurance in some of the least populated counties. The 383 counties in which RHS guaranteed more single-family loans than FHA insured contain only 3 percent of the nation's population and are primarily located in the Midwest.

Figure 3: Counties Where RHS Guaranteed More Loans Than FHA Insured in 1999



One possible reason for the low number of FHA-insured loans in some counties is low bank participation. Some bank officials indicated that they

do not want to deal with the extra paperwork required for government-insured loans or get involved with 30-year loans. An FHA official said that she believes some small rural banks do not participate in FHA's programs because they do not want to hold FHA loans in their portfolios and are not large enough to benefit from pooling loans to back securities sold to investors. In contrast, rural bank officials cited certain advantages of participating in RHS' programs, including the opportunity to advertise guaranteed loans that require no money down and the assistance provided by local RHS staff.

More Overlap Within Multifamily Products and Markets Served in Rural Areas

Like its single-family programs, RHS' multifamily programs are small relative to HUD's. But there is more overlap in the products offered and the groups served by the two agencies' multifamily programs, even though RHS has a greater presence across nonmetro counties. Similarities and differences in the agencies' products and the extent to which their programs serve rural areas are discussed following table 3, which shows the key features of the multifamily programs offered by RHS and HUD. The two principal ways in which RHS and HUD make multifamily housing affordable—mortgage credit and rental assistance—along with the location of units receiving assistance by RHS and HUD are also described.

Table 3: Key Features of the Principal Multifamily Programs Offered in Rural Areas

Agency	Direct loans	Loan guarantee/insurance	Interest subsidy	Rental assistance	Income targeting	Location targeting
RHS	X	X	X	X	X	X
HUD		X	X	X	X	

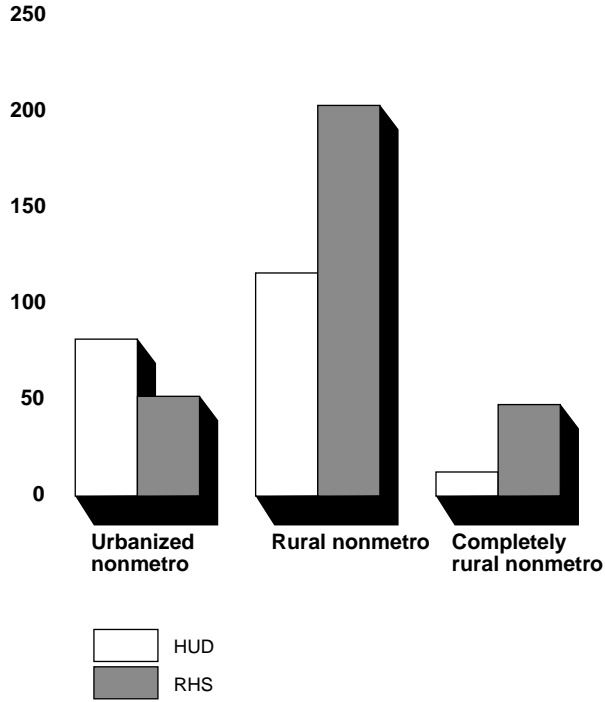
RHS and HUD subsidize multifamily housing through multifamily subsidized loan and rental assistance programs. HUD's portfolio of about 1.4 million subsidized units in about 38,000 properties overshadows RHS' multifamily portfolio of about 466,000 subsidized units in 17,702 properties.¹⁰ But unlike HUD's single-family mortgage insurance programs, which insured only 7 percent of the loans in fiscal year 1999 to families living outside metro counties, HUD provided assistance to over 210,000, or 16 percent of its subsidized multifamily housing units, outside metro counties.¹¹ In comparison, about 65 percent, or about 303,000 of RHS' 466,000 subsidized multifamily units, were outside metro counties. Figure 4, which compares the locations of HUD and RHS multifamily units outside metro counties, shows that RHS has a large number of multifamily units in all but urbanized nonmetro counties.¹²

¹⁰HUD also provides funding to 1.3 million public housing units and 1.4 million privately owned units rented by tenants with certificates and vouchers.

¹¹Because we could not identify county classification code data for about 108,000 HUD units, our analysis is based on about 1.3 million HUD multifamily subsidized units.

¹²About 45,000 of the units that HUD subsidizes are located in developments financed by RHS.

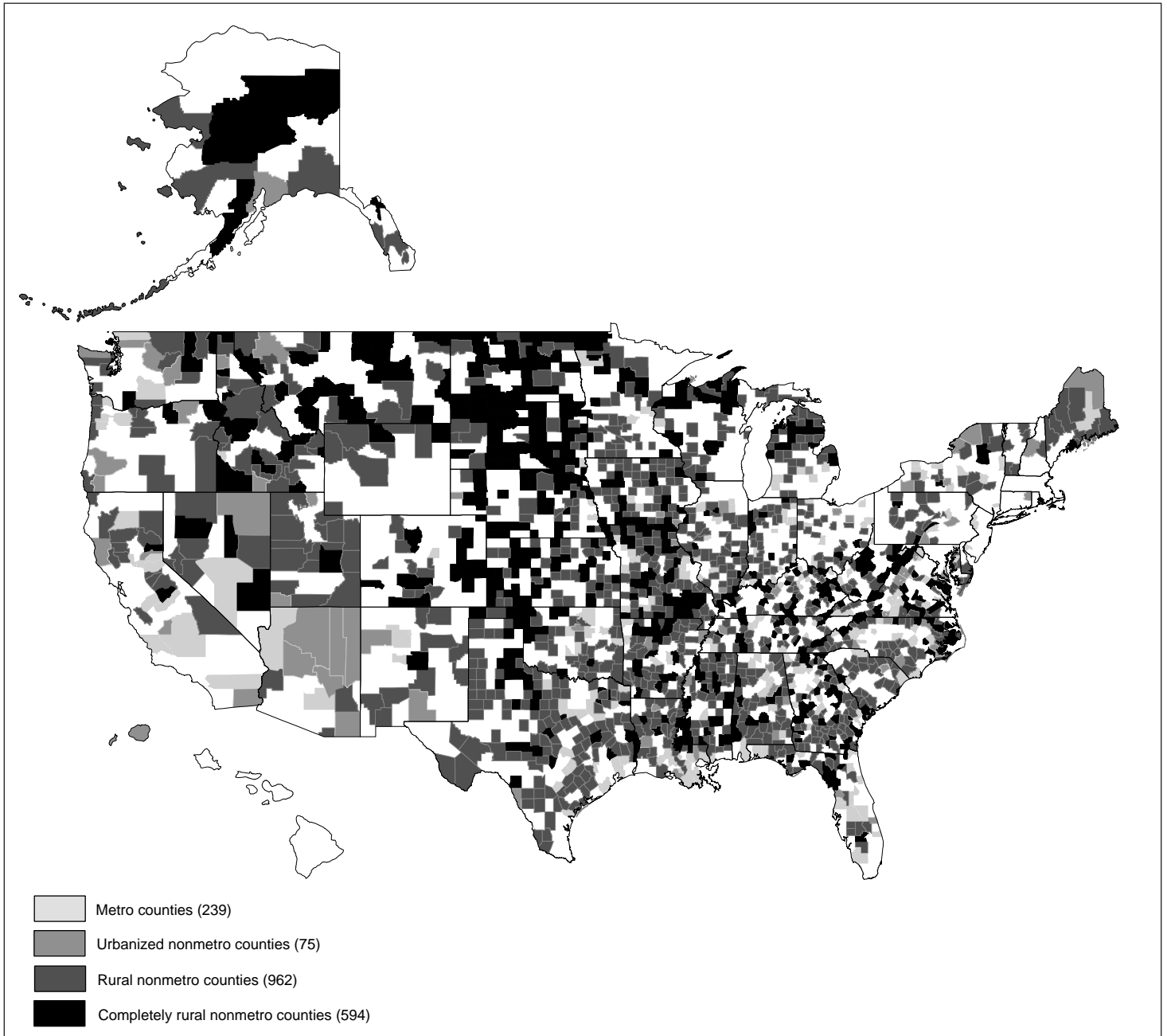
Figure 4: Locations of Units Subsidized by HUD and RHS in Nonmetro Areas
Subsidized units in thousands



Note: Not included in the figure are approximately 1.1 million HUD-subsidized and 163,000 RHS-subsidized units in metro counties.

As shown in figure 5, RHS has more subsidized units in its portfolio than HUD for 1,870 counties. These counties have a total population of 54 million, or 20 percent of the U.S. population. About 322,000 units, or about 69 percent of RHS' multifamily portfolio, and about 122,000 units, or about 9 percent of HUD's multifamily portfolio, are located in these 1,870 counties. Thus, although RHS' overall multifamily market share is small relative to HUD's, in 60 percent of the primarily rural nonmetro counties spread throughout the nation, RHS subsidizes more multifamily units than does HUD.

Figure 5: Counties Where RHS Subsidizes More Units Than HUD



RHS' and HUD's multifamily programs differ in the way they are managed. Most rural HUD multifamily developments are managed from a distance, from 18 hubs and 33 program centers, typically located in urban areas. RHS multifamily developments are typically managed from district or local offices, although program administration varies greatly by state. RHS officials believe their developments are better monitored with closer local supervision. HUD believes its newly consolidated, regional structure allows it to quickly identify weaknesses in its portfolio. Developers and property managers told us that differences in the management of low-income housing tax credits, RHS' and HUD's multifamily programs, and various RHS state programs create inconsistent rules that lead to frustration and extra paperwork.

Despite differences in the way they manage their multifamily programs, RHS and HUD are facing similar challenges. Both agencies are dealing with aging properties that have increasing rehabilitation needs. In addition, both agencies may lose affordable housing units if owners decide to leave the programs, and both are offering incentives for owners to stay. For example, RHS offered equity loan incentives to 43 developments in fiscal year 1999. In addition, the Congress and HUD have taken steps to encourage property owners to renew their rental assistance contracts or mitigate the impact on households when owners decide to not renew their rental assistance contracts. Finally, in recent years, HUD and RHS have set up separate systems to monitor the physical and financial condition of their properties.

Variation in the Degree of Overlap With RHS' Specialized Programs

In addition to its primary single-family and multifamily programs, RHS offers a number of programs that target special employment, age, or ethnic groups or offer services to communities in general. The degree of overlap between these and other programs varies in terms of the products they offer and the people they serve. In some instances, RHS is the only source of funding. In other instances, a number of agencies offer similar programs. Table 4 shows the key features of the specialized programs offered by RHS and other organizations in rural areas. A discussion of the programs follows the table.

Table 4: Key Features of Specialized Programs Offered in Rural Areas

Agency/entity	Farm worker housing	Self-help housing	Indian housing	Elderly housing repairs	Weatherization	Community development
RHS	X	X		X	X	X
Bureau of Indian Affairs			X			
HUD		X	X	X		X
Department of Energy					X	
State HFAs		X	X	X	X	
Nonprofit organizations	X	X		X	X	X

- RHS is the only national source of funds for the construction of farm worker housing. Farm workers are frequently the most poorly housed people in the country, often found living in tents, shacks without running water, or crowded, poorly built dormitories. Since the early 1960s, RHS has provided low-interest loans and grants to public or nonprofit agencies or to individual farmers to build affordable rental housing. The program is limited to housing employees that are involved in production agriculture, including aquaculture and on-farm processing. In some states, such as California, farm laborers have been able to build their own homes through RHS' self-help housing program.
- RHS has administered the self-help housing program since 1971. This program, which allows families to obtain small direct mortgage loans in amounts based on how much "sweat equity" they put into the construction of their homes, is one of the few RHS programs whose funding levels have increased. RHS contracts with four regional organizations to provide (1) training and technical assistance to self-help sponsors and (2) assistance to applicants to become self-help sponsors. Habitat for Humanity International, a religious-based nonprofit organization, which receives grants for land and infrastructure costs from HUD's Self-Help Homeownership Opportunities Program, and Fannie Mae also offer "sweat equity" programs in urban and rural areas.
- HUD and the Department of the Interior's Bureau of Indian Affairs offer direct housing assistance programs for Native Americans. HUD started two new rural housing assistance programs for Native Americans in the

1990s. The Native American Loan Guarantee Program, first offered in 1994, provides homeownership opportunities to Native Americans interested in owning a home on tribal, individual trust, or Indian area lands. The Native American Housing Assistance and Self-Determination Act of 1996 established a block grant approach to housing for Native Americans. Tribes or tribally designated entities are now empowered to determine how housing and community development funds should be used to address community-specific needs. In addition, the Department of the Interior's Bureau of Indian Affairs administers the Housing Improvement Program, which provides grants to repair, renovate, replace, or provide housing for the neediest Indian families living in substandard housing or lacking recourse for assistance. Although RHS does not offer housing programs specifically for Native Americans, it uses its existing housing programs to fund single-family and multifamily loans to Native Americans. For example, in fiscal year 1999, RHS made 250 single-family direct loans and over 250 single-family direct repair loans and grants to Native Americans, and it provided direct and guaranteed financing for 263 multifamily units of rental housing on Native American reservations or in communities where the majority of tenants are Native Americans. Furthermore, according to RHS Indian housing staff, coordination with HUD has improved as RHS' programs are being included in many of the tribal housing plans required under the Native American Housing Assistance and Self-Determination Act of 1996. RHS anticipates that coordination with Indian tribes and HUD will increase as Native American communities become more familiar with RHS' programs.

- RHS serves rural elderly homeowners by offering repair grants and low-interest loans. FHA, Fannie Mae, and some state HFAs have developed reverse mortgage programs that are available throughout the country. These programs allow elderly homeowners to take equity out of their homes to pay for needed repairs. Because income has nothing to do with getting a loan or the amount of the loan, reverse mortgages are a viable way for low-income rural elderly families who own their homes outright to make needed repairs. RHS does not have its own reverse mortgage program. An RHS outreach staffer in Vermont told us that he educates consumers whenever possible about reverse mortgage programs available in his area. In two other states, RHS officials told us that they were not sufficiently informed about reverse mortgage programs to offer advice.

- RHS' predecessor agency made weatherization loans from 1977 through 1983. Today, weatherization grants of up to \$2,032 per household are available nationwide through a program administered by the Department of Energy. In fiscal year 1999, the \$133 million formula grant program weatherized about 70,000 low-income dwellings nationwide. RHS and community development officials told us that they often use Department of Energy weatherization grants to supplement repair grants for the elderly that can go up to \$7,500 per household. In addition, RHS' repair loan program, which is available to all very-low-income families and allows them to borrow up to \$20,000 at 1 percent interest, can be used to weatherize homes.
- As part of USDA's state Rural Development offices, RHS serves rural communities in general by packaging its housing and community development programs to fit the development needs of small towns. For example, a state Rural Development office could offer financing for a new fire station, a health care facility, and a new sewer plant along with a self-help housing program grant for a particular town. As such, RHS has a great deal in common with HUD's community builders program, which began in 1998 and is run out of HUD's 81 field offices. Similar to RHS staff in more proactive states, HUD community builders focus on improving relationships between HUD and banks, local governments, and businesses. However, few HUD community builders have been active in rural areas, and the noncareer fellows portion of the program has been terminated. In addition, both RHS and HUD officials noted that coordination between RHS staff and HUD community builders varied by state.

Options for Optimizing the Federal Role in Rural Housing Development

The rural housing environment has changed dramatically since rural housing programs were first created. As the quality of housing in rural areas has improved, technology has advanced, and access to credit has become more prevalent, the distinctions between rural and urban areas have blurred. These changes—along with RHS' growing reliance on guaranteed lending, leveraged funds, and partners—raise questions about how best to ensure the availability of decent affordable housing in rural areas. For example, is the housing market in rural areas different enough from other housing markets for federal housing programs to (1) be targeted to rural areas, (2) carry better rates and terms in rural areas, and (3) have a separate rural delivery system?

Rural housing experts we spoke with discussed proposals for optimizing the federal role in rural housing development. These proposals typically involved changes in RHS' product features, targeting, or delivery systems. Specifically, to optimize the federal role, a range of options is available, including options to continue or discontinue targeting housing programs to rural areas, providing households in rural areas with greater subsidies than their urban counterparts, and operating separate systems for delivering rural programs. In addition, the best working features of rural housing programs could be merged with other comparable federal housing programs. Arguments for and against these options follow.

- Targeting Housing Programs to Rural Areas

Arguments for continuing to target housing programs to rural areas	Arguments against continuing to target housing programs to rural areas
<ul style="list-style-type: none"> • Some rural areas continue to have substandard housing • Some rural areas have few resources and lack the capacity to obtain funding on their own • Overall, national programs, particularly those offered by HUD and VA, do not target rural areas and some do not target low-income households • Rural housing assistance is a part of the community development packages offered by state Rural Development offices • RHS is the major agency offering single-family direct loans and grants and farm worker housing to very-low-income rural residents 	<ul style="list-style-type: none"> • The single-family program's emphasis has shifted from direct to guaranteed loans, which have more in common with FHA's insured loans • With little new funding for construction, RHS' multifamily program is targeting few new units in rural areas

• Providing Better Rates and Terms on Mortgages for Households in Rural Areas

Arguments for providing better terms in rural areas	Arguments against providing better terms in rural areas
<ul style="list-style-type: none">• Rural borrowers often pay higher mortgage interest rates because the costs of doing business are greater in sparsely populated areas• Such terms support the basic tenet that homeownership is a part of the culture of rural America• Median incomes are generally lower in rural areas, but housing development costs are about the same as or higher than in urban areas• Some rural areas do not have the capacity to take advantage of HUD's CDBG, HOME, and other assistance programs that often focus on urban areas	<ul style="list-style-type: none">• There is no urban counterpart to RHS' direct loan program that would allow very-low-income urban residents to become homeowners• FHA cannot compete with RHS guaranteed loans requiring no money down and no monthly mortgage insurance payments

• Maintaining a Separate System for Delivering Housing Programs in Rural Areas

Arguments for a separate system	Arguments against a separate system
<ul style="list-style-type: none">• RHS believes some rural residents do not have access to modern telecommunications or other means to obtain information on affordable housing opportunities• RHS believes borrowers often need local servicing in the first year of the loan	<ul style="list-style-type: none">• RHS' field role has changed from primarily originating and servicing direct loans to leveraging deals with partner organizations• In some states, local banks, nonprofit organizations, social workers, and other local organizations are doing much of the front-line interaction with rural households that was previously done by RHS staff• RHS' new community development mission serves much the same function as HUD's community builders program• Most of RHS' direct loan servicing is done by the Centralized Servicing Center

• Merging Rural Housing Programs With Other Housing Programs

Arguments for merging housing programs	Arguments against merging housing programs
<ul style="list-style-type: none"> • Current RHS staff with local contacts could provide a field presence for HUD, and for other public partners, applying their leveraging/partnering skills to all communities • RHS' centralized servicing center could seek to increase its servicing workload by competing to service loans for other federal agencies or private companies • RHS and HUD could combine multifamily portfolio management functions that are now provided under separate systems • RHS' mortgage guarantee and FHA's mortgage insurance programs could be combined because both operate throughout rural areas • State HFAs could use the increased funding from the increase in the bond cap to operate a more highly subsidized single-family direct loan program 	<ul style="list-style-type: none"> • Rural areas could lose their federal voice • Rural areas could lose the benefits of lower rates and terms offered by current RHS direct and guaranteed loan programs • HUD, other federal partners, and some state HFAs have not focused on rural areas • State HFAs could have less funding for other programs

Conclusions

In some rural areas, particularly those that are far from urban centers, housing quality is still below par and credit costs are slightly higher than elsewhere. But many former problems with infrastructure, housing quality, and credit are no longer prevalent in rural areas today, and in much of the country, the divisions between rural and urban areas are not clearly defined. Budget cutbacks; technology improvements; and greater reliance on guaranteed lending, leveraged funds, and public and private partners have also led to fundamental changes in the ways rural housing programs operate. Some of these changes have occurred since the Congress last restructured USDA's rural housing delivery system in 1994, and their effect has generally been to reduce the distinctions between RHS' rural housing programs and other agencies' programs that are available in rural areas. For example, RHS' single-family guaranteed loan program and FHA's single-family insured loan program both primarily target low- and moderate-income households, use the same qualifying ratios, and operate in the same markets. Even though RHS' program offers slightly more attractive terms for the borrower and is available only in rural areas, whereas FHA's program is available nationwide, both programs could be offered through the same network of lenders. Similarly, efficiencies could be achieved by merging RHS' and FHA's multifamily programs, adapting each one's best practices for use by the other, and eliminating inconsistencies in the rules applicable to private owners under the current programs. However, without prodding by the Congress, it is unlikely that RHS and FHA would consider examining the benefits and costs of merging these programs. Although state HFAs have expanded their programs offering below-market interest rates to low-income homebuyers, RHS' single-family direct loan program remains unique in offering highly subsidized home mortgages to low-income homebuyers unable to qualify for credit elsewhere. Similarly, RHS is the only major provider of farm worker housing and self-help housing programs for very-low-income rural residents. However, questions exist as to whether a separate field structure is needed to deliver these programs or whether local public and private organizations could provide the same services more efficiently. Finally, competing to service other agencies' direct loans could increase the efficiencies of RHS' Centralized Servicing Center. Appendix I expands on these and other ideas that could be considered in merging some of RHS' programs with those of HUD and others, as well as in improving the effectiveness of the current programs.

Matter for Congressional Consideration

To optimize the federal role in rural housing, the Congress may wish to consider requiring USDA and HUD to examine the benefits and costs of merging those programs that serve similar markets and provide similar products. As a first step, the Congress could consider requiring RHS and HUD to explore merging their single-family insured lending programs and multifamily portfolio management programs, taking advantage of the best practices of each and ensuring that targeted populations are not adversely affected.

Agency Comments

We provided USDA and HUD with a draft of this report for their review and comment. USDA said it believes that the report does an excellent job of describing the general picture of rural housing programs and the general condition of rural homes. USDA said it believes that some of the suggestions made in the report to improve the effectiveness of current programs may better serve rural areas and that the agency will further explore some of these issues over the next 6 months. However, USDA also said it believes that the gap in housing affordability between rural and urban areas, as well as the importance of rural housing programs to the Department's broader Rural Development mission area, would make merging RHS' programs with HUD's programs unfeasible and detrimental to rural America. USDA also believes that merging programs would result in rural areas' losing a federal voice. The report recognizes that some rural areas, particularly remote ones, have severe housing affordability gaps. However, others, including USDA's Economic Research Service, have reported that, overall, the affordability gap in rural areas is no worse than in urban areas. Furthermore, the report recognizes that rural housing is part of USDA's broader Rural Development mission area. Now that HUD is also adopting a holistic management approach with its community builders program, we believe both agencies could benefit from evaluating best practices and exploring opportunities to merge common programs. We also recognize that an argument against merging programs is that rural areas could lose a federal voice. For this and other reasons, we maintain that the Congress needs to consider whether the housing market in rural areas is sufficiently distinct to justify targeted programs, better terms, and a separate program delivery system. USDA's complete letter and our response to specific areas of disagreement with USDA appear in appendix III.

HUD also commended the report in general, stating that it presents an informed description and analysis of the quality of rural housing, access of

rural households to mortgage credit, and relationship of RHS' programs to other public and private affordable housing programs today. HUD also stated that it believes any opportunity to improve the delivery of rural housing services should be explored. However, HUD believes the differences between RHS' and FHA's single-family programs are sizable and that without legislative changes to product terms, efforts to merge the programs would likely result in a more cumbersome rather than a more efficient delivery system. HUD added that it has been working and will continue to work with USDA in a mutual exchange of information on best practices and will explore possible avenues of coordination. While HUD and RHS are working on best practices and exploring opportunities for improving coordination, we believe that they should also explore the potential benefits of merging similar programs because merged programs need not be more cumbersome or inefficient than separate programs are today. The complete text of HUD's comments and our evaluation of them appear in appendix IV.

Scope and Methodology

Overall, our work was based on our review of published data and visits to Maine, Mississippi, Missouri, New Hampshire, Ohio, and Vermont, where we were able to observe a variety of rural housing conditions, RHS' methods of delivering its products, and RHS' interactions with partner organizations. We judgmentally selected these six states to obtain a cross section of rural housing conditions, delivery structures, and states with differing concentrations of rural counties. We also used data from RHS, FHA, and state HFAs to measure the markets they serve.

To describe the physical condition of today's rural housing, we reviewed published information from HUD's American Housing Survey and the decennial Census. To describe rural households' access to affordable housing credit, we relied on information supplied by USDA's Economic Research Service, RHS, and others.

To document the rural housing programs offered by RHS and the ways in which its programs have adapted to changes in federal housing assistance levels, we interviewed appropriate officials at USDA's RHS headquarters, Centralized Servicing Center, and Office of Budget Program Analysis; HUD's offices of Housing, Community Planning and Development, Public and Indian Housing, and Policy Development and Research; and other public and private organizations involved in delivering rural housing programs. To measure the effectiveness of different RHS state offices' program delivery systems, we analyzed data on lending activity and staffing

by state. During our visits to the six states, we also met with RHS officials and officials of nonprofit organizations, banks, state HFAs, and other public and private partners to get firsthand knowledge of how rural housing programs are implemented and received.

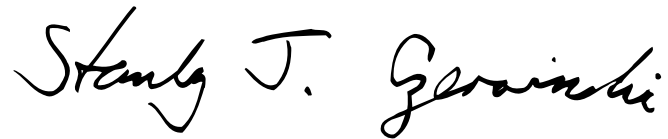
To assess any overlap between RHS' and other agencies' programs, we analyzed RHS, FHA, and HFA databases to evaluate single-family and multifamily programs at the county level. Where possible, we used the Economic Research Service's codes, used to describe counties' "ruralness," to place nonmetro county data into three subcategories that best correspond to RHS' program eligibility criteria. Appendix II associates these county data with corresponding population statistics.

We developed options for maximizing the efficiency and effectiveness of the federal role in rural housing after synthesizing the information developed under the first three objectives and proposals set forth by rural housing experts. We discussed these options, as well as individual proposals affecting RHS only, with these rural housing experts.

We performed our work from January through August 2000 in accordance with generally accepted government auditing standards.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies of the report to interested congressional committees and Members of Congress; the Honorable Dan Glickman, Secretary of Agriculture; the Honorable Andrew M. Cuomo, Secretary of Housing and Urban Development; the Honorable Jacob J. Lew, Director, Office of Management and Budget; and other interested parties. We will also make copies available to others on request.

If you or your staff have any questions about this report, please contact me at (202) 512-7631. Key contributors to this report are Andy Finkel, Jerry Hall, Rich LaMore, and Matt Scire.

A handwritten signature in black ink that reads "Stanley J. Czerwinski". The signature is written in a cursive style with a large, stylized 'S' at the beginning.

Stanley J. Czerwinski
Associate Director, Housing and
Community Development Issues

Opportunities to Improve the Effectiveness of Current Rural Housing Programs

Through discussions with Rural Housing Service (RHS) officials and others, we identified a number of proposals that could be used for improving the efficiency of existing rural housing programs, whether they are merged or not. For example, some RHS state officials believe that the requirement to operate housing programs out of the U.S. Department of Agriculture's (USDA) service centers does not match RHS' new mission of serving communities. In addition, some state and industry officials believe that the eligibility criteria for certain programs could be modified to reach more rural residents and the procedures for administering other programs could be changed to increase their efficiency or accessibility. We are presenting the options below with arguments for and against each one.

Centralize RHS State Delivery Systems

When state Rural Development offices were given the authority to develop their own program delivery systems as part of the 1994 reorganization, some states did not change, believing that they needed to maintain a county-based structure with a fixed local presence to deliver services one-on-one to potential homeowners. Other states tried innovative, less costly approaches to delivering services, such as consolidating local offices to form district offices and using traveling loan originators for single-family programs. However, RHS has undergone a major shift in mission during the past few years. RHS is still a lending agency like its predecessor, the Farmers Home Administration, but it now emphasizes community development, using leveraging for rural communities to develop housing, community centers, schools, fire stations, health care centers, child care facilities, and other community service buildings. Some state Rural Development officials we spoke with questioned the efficiency and cost-effectiveness of maintaining a county-based field structure in a streamlined environment where leveraging, rather than one-on-one lending, has become the focus of the work.

For example, Mississippi, which maintains a county-based Rural Development field structure, has the most staff and field offices of any state; its productivity is also next to the lowest, as measured by dollar program activity per staff member. Ohio, on the other hand, ranks fifth in overall productivity, operating at less than one-fifth of Mississippi's cost per staff member. We recognize that it is more difficult to underwrite loans in the Mississippi Delta and other economically depressed areas than in rural areas generally, and Mississippi does have a substantial multifamily portfolio. Nevertheless, the number of field staff in Mississippi far exceeds that in most other states. Ohio, whose loan originators are based in four offices and travel across the state with laptop computers, ranks seventh in

the dollar value of single-family guaranteed loans made, and fifth in the dollar amount of direct loans made, per staff member. Ohio has also done a good job of serving all of its counties, while Mississippi has experienced a drop in business in the counties where it has closed local offices. Ohio's travel and equipment costs have increased with the use of traveling loan originators.

The Maine Rural Development office also fundamentally changed its operational structure, moving from 28 offices before the reorganization to 15 afterwards, and it now operates out of 3 district offices. The current state director, who also headed the Farmers Home Administration state office in the 1970s, said he has headed the agency under both models and believes the centralized system is much more effective. He said he believes centralized offices are more productive because his staff work better as a team than spread across the state in county offices with small staffs. He added that by centralizing, the state was able to reduce its leasing costs and better manage its resources overall. This idea was reflected in the state's 1996 office-restructuring plan that said centralization would allow for flexibility in accommodating the changes that occur between programs and resources. He added that under the current structure, staff can no longer sit in the office waiting for clients to come to them. He also maintained that a centralized structure is better suited to building the partnerships with real estate agents, banks, and other financial institutions that have become the core element of RHS' work.

Option 1: Centralize RHS State Delivery Systems	
For	Against
<ul style="list-style-type: none"> • Could increase productivity • Could lower overall costs • Could result in a more manageable structure 	<ul style="list-style-type: none"> • Would lose fixed local presence • Could increase travel and equipment costs

Allow RHS Personnel to Locate Separately From USDA Service Centers

Consistent with its 1994 reorganization legislation, USDA closed or consolidated hundreds of county offices and established "USDA service centers" that include staff representing farm services, conservation, and rural development programs. However, the primary goal of the original USDA/Office of Management and Budget (OMB) task team that designed the service centers was to place all the county-based agencies together, particularly those that dealt directly with farmers and ranchers, to reduce

personnel and overhead expenses by sharing resources. But while the farm finance functions from the old Farmers Home Administration fit well into the new county-based Farm Service Agency, the housing finance functions that moved to the new state Rural Development offices were never a natural fit in the centers. According to a USDA Rural Development program budget office specialist, the decision to collocate Rural Development and Farm Service offices was based on the fact that Rural Development had a similar county-based field structure and the Department needed to fill space in the new service centers. He added, however, that collocating Rural Development and Farm Service offices makes less sense today, especially in states where Rural Development operations have been centralized.

All the states we visited had centralized some operations. Staff in several offices emphasized their belief that cost savings result from sharing building space and telecommunications systems. Some also said it makes sense for staff to be close to their customers. But for Rural Development staff, the move to the new USDA service centers often meant moving from town centers to more remote areas that were closer to farm clients. In particular, some staff questioned the benefits of placing Rural Development outreach personnel in small, county-based service centers that were designed to serve farmers or ranchers. These personnel spend their days in rural communities working with bankers, in nonprofit homeownership centers providing homeownership education and outreach, and with real estate brokers marketing their programs. For example, the majority of Vermont's Rural Development staff work out of one USDA service center in the state capital. But five outreach staff maintain offices in county-based USDA service centers. The outreach staff we met with emphasized that they have nothing in common with the farm and resource agencies that operate out of the centers, and they said they typically visit the service centers only once or twice a week to pick up their mail. In Ohio, personnel use four USDA service centers as their home bases. Like the Vermont outreach workers, they spend the majority of their time meeting with nonfarm clients wherever they can find acceptable space. Staff in Maine cited what they believe to be cultural differences between Rural Development and Farm Service agencies. They said they prefer to meet at their customers' locations because USDA service centers are "jeans and workboot" places that are fine for meeting with farmers, but Rural Development's customers expect business dress.

**Appendix I
Opportunities to Improve the Effectiveness
of Current Rural Housing Programs**

In 1993 testimony before the Senate Committee on Governmental Affairs, we reported that USDA should be restructured in the context of the newer management concepts that guide private-sector corporations and that the new management concepts should emphasize flexibility, flattened hierarchies, and a customer focus. We also stated that USDA's missions and corresponding restructuring should be continually reassessed and updated to address changing conditions.¹ USDA's November 1999 report Modernization Plan of the USDA County-Based Agencies examines a number of important issues, such as how to deal with outmoded business practices and technology and reduce program delivery costs. But it does not consider the more fundamental question of how to deal with an increasingly centralized Rural Development mission area in a county-based USDA service center environment. Consequently, some suggest that Rural Development offices be located apart from USDA service centers. For example, outreach personnel could be collocated with community development partners. This option could, however, create the appearance of a conflict of interest.

Option 2: Allow RHS Personnel to Locate Separately From USDA Service Centers	
For	Against
<ul style="list-style-type: none"> • Would place Rural Development staff where customers are located • Staff in some states already spend much of their time running community education/outreach programs with community development partners 	<ul style="list-style-type: none"> • Would increase vacant space in USDA service centers • Could create an appearance of conflict of interest by other lending partners if staff are collocated with community development agencies

¹Revitalizing USDA: A Challenge for the 21st Century (GAO/T-93-62, July 21, 1993)

Combine All Rural Capacity-Building Initiatives Into One Notice of Funding Availability Under One Organization

While the disparities between average weekly earnings for rural and other areas of the United States decreased over the past decade, some rural areas still have fewer resources and lack the capacity needed to obtain funds for housing and community development. A local organization that can successfully compete for limited funds can be the difference between the success or failure of a local housing initiative. We witnessed this during our state visits, where a strong local nonprofit group was often the lead in community outreach and in leveraging funding from a variety of federal, state, and local organizations. For example, in northwest Mississippi, the combination of an active nonprofit group and a proactive RHS office put together a new single-family development with funding from RHS, the Department of Housing and Urban Development's (HUD) Community Development Block Grant (CDBG), the Federal Home Loan Bank (FHLBank), and the local government. According to a local official, the new development also had the benefit of revitalizing the area, as other homeowners adjacent to the new development began fixing up their homes after they saw the new homes going in.

Recognizing the need for more local involvement in rural areas, the Congress recently enacted programs in HUD and RHS aimed at building capacity at the state and local levels for rural housing and community development. HUD's program made \$25 million available for fiscal years 1999 and 2000 for building the capacity of local rural nonprofit organizations, community development corporations, and other local organizations. Over 700 organizations responded to a notice of funding availability in fiscal year 1999, and over 600 responded in fiscal year 2000. In a separate notice, RHS announced the availability of a \$6 million grant program in fiscal year 2000 to develop the capacity and ability of private nonprofit organizations and low-income communities to improve housing, essential community facilities, or community and economic development through a program of technical assistance in rural areas. Qualified private and public (including tribal) intermediary organizations proposing to carry out technical assistance programs are eligible to receive funding. The intermediary must provide matching funds from nonfederal sources in an amount at least equal to the grant. More recently, the administration proposed a third program, a \$22 million CDBG set-aside for developing capacity in the Lower Mississippi Delta. While each grant program has its unique goals and application requirements, all three are designed to meet a common goal of rural capacity building. Merging the programs into one notice of funding availability and under one organization could make the process more efficient and cost-effective. However, special funding for the

Mississippi Delta would have to be legislatively targeted. Requiring matching funds would ensure local commitment, allow more applicants to be funded, and—assuming fewer applicants applied—further reduce processing costs. A matching requirement could, however, eliminate some areas that need capacity building most but do not have access to matching funds.

Option 3: Combine All Rural Capacity-Building Initiatives Into One Notice of Funding Availability Under One Organization	
For	Against
One lead agency and one notice of funding availability would be more efficient than two or three	Mississippi Delta funds would have to be legislatively targeted

Make Funds Available for Off-Farm Worker Housing

RHS’ farm worker housing loans and grants can be used only to house employees that are involved in production agriculture, including aquaculture and on-farm processing. However, in some rural areas of the country, new agribusiness jobs are available in off-farm processing plants, particularly in aquaculture, poultry, and pork-processing operations. Officials in Mississippi and Missouri told us that poor, primarily minority workers, many of whom would have worked in the fields before the use of mechanization, are now accepting these agricultural processing jobs. Often, there are housing shortages in towns where the new plants are built. According to the director of Missouri’s RHS single-family housing program, three or four families end up sharing small, often substandard, single-family homes. However, these processing workers are not eligible for farm worker housing. Expanding the farm worker housing program’s eligibility criteria to include these off-farm workers or developing a separate program for them could help alleviate this problem; at the same time, though, it would reduce the funding available for farm worker housing.

Another possibility would be to target HUD/CDBG state and small cities funds for off-farm worker housing. A recent legislative proposal includes \$5

million for a housing demonstration program for agriculture, aquaculture, and seafood-processing workers

Option 4: Make Funds Available for Off-Farm Worker Housing	
For	Against
<ul style="list-style-type: none"> • Would recognize changes in rural labor markets • Would update programs to fill a current need 	<ul style="list-style-type: none"> • Without new funding, off-farm worker housing would compete with on-farm worker housing • Could concentrate worker housing in one location

Encourage Families With Sufficient Equity to Obtain Reverse Mortgages Instead of Repair Grants and Loans

RHS offers direct grant and loan programs for home repair, basing eligibility on income level and need. Equity in the home is not considered. RHS state officials said that the grant funds typically run out early in the year but that loan funds are usually available because often families cannot afford to repay loans, even at interest rates as low as 1 percent. Reverse mortgages, however, are based solely on equity; income is not a factor. As a result, rural homeowners who have sufficient equity are eligible to take cash out of their homes for repairs or other purposes. In addition, reverse mortgages for the elderly require no monthly payments and involve minimum out-of-pocket costs, such as transaction fees, for the borrower. Some state Rural Development staff we met with suggested that RHS' elderly repair grants and loans go only to families that do not have sufficient equity in their homes to qualify for a privately placed reverse mortgage. Encouraging borrowers with sufficient equity to obtain a reverse mortgage is in line with the repair grant and loan program's eligibility criteria, which limit funds to very-low-income borrowers who are unable to obtain affordable credit elsewhere and whose homes present health and safety issues. RHS could also partner with banks, state housing finance agencies (HFA), and other lending institutions that offer programs to further subsidize the loans.

Figure 6 shows a home that received an RHS repair grant to pay for the residents' first indoor bathroom. RHS state officials said they did not consider a reverse mortgage as a possibility, but they are confident that the owner did not have sufficient equity in the home to qualify. In contrast, figure 7 shows a home purchased in 1959 by a couple using a \$4,000 RHS direct loan. In 1999, the couple, who are now retired and living on a fixed income, received a \$10,745 RHS repair loan, at 1 percent interest, for

Appendix I
Opportunities to Improve the Effectiveness
of Current Rural Housing Programs

rehabilitation work. The major repairs included a new roof, siding, and insulation, and the kitchen and bathroom were remodeled. RHS state officials told us they had not considered a reverse mortgage as a possibility when the loan was made, but they believed the couple had sufficient equity in the home to qualify for a reverse mortgage and cover the needed repairs.

Figure 6: RHS Elderly Repair Grant Home



**Appendix I
Opportunities to Improve the Effectiveness
of Current Rural Housing Programs**

Figure 7: RHS Repair Loan Home



Front view



Side view

Rural housing officials told us that, in their view, the instances in which prior RHS borrowers would have sufficient equity in their homes to justify a reverse mortgage would generally be limited to areas adjacent to growing metropolitan areas. They also expressed concern that most of their repair grants and loans are for only a few thousand dollars and that their clientele would be hurt by high transaction costs and possibly by predatory lenders. However, Fannie Mae, HUD, and the American Association of Retired Persons are strong advocates of reverse mortgages. All three organizations see reverse mortgages as a way for house-rich but cash-poor seniors to tap into their home equity to make repairs, pay bills, or supplement Social Security. As such, the reverse mortgage option would be particularly

helpful for RHS clients interested in taking out more equity than needed to cover the average home repair. In addition, all three organizations do outreach to inform seniors about reverse mortgages, and HUD offers free counseling and referrals to HUD-approved lenders.

On the basis of our visits to rural areas in six states, we agree that the typical RHS client would likely not have sufficient equity to qualify for a reverse mortgage. However, there are exceptions, such as in the case illustrated in figure 7, which was not near a growing metropolitan area. Each client with sufficient equity that chose to use a reverse mortgage loan instead of an RHS grant or loan would free RHS funds for a client without equity whose home is in need of health and safety repairs.

Reverse mortgages can have the additional benefit of allowing borrowers who have paid off their RHS direct loans but deferred the repayment of interest subsidies to repay these subsidies. RHS policy allows borrowers who pay off their direct RHS loans but continue to occupy their properties to defer this repayment, commonly known as interest credit recapture. As of July 31, 1999, RHS' records showed that about \$140 million of interest credit recapture was owed by borrowers who had paid off or refinanced their mortgages but were continuing to occupy their properties. RHS does not charge interest on the amounts owed by these borrowers. To receive a reverse mortgage, a borrower must either pay off any debt against his or her home before applying for the mortgage or, as most borrowers do, use an immediate cash advance from the reverse mortgage to pay off the debt. It is likely that, in some cases, the size of the interest credit recapture would be too great, leaving little equity to make the reverse mortgage worthwhile for the elderly homeowner. But when the borrower has sufficient equity to cover the money needed for home repairs and pay off the interest credit recapture, the reverse mortgage can be used for both purposes.

**Appendix I
 Opportunities to Improve the Effectiveness
 of Current Rural Housing Programs**

Option 5: Encourage Families With Sufficient Equity to Obtain Reverse Mortgages Instead of Repair Grants and Loans	
For	Against
<ul style="list-style-type: none"> • Would allow homeowners to use equity in homes for repairs or other purposes • Programs are already available in private sector • Would save limited repair grant and loan funds for homes without equity • Would create opportunities to partner with banks and others to make funding go farther • Could enable RHS to collect outstanding interest recapture 	<ul style="list-style-type: none"> • Clients would incur transaction costs to obtain reverse mortgages • Would deplete limited wealth for some homeowners

Estimated 1999 Census by Metro and Nonmetro Categories

County type	Number of counties ^a	Percent of counties	Population	Percent of population	Average by county
Metro	836	26.6	217,911,140	79.9	260,659
Urbanized nonmetro	252	8.0	17,209,599	6.3	68,292
Rural nonmetro	1,270	40.5	31,059,199	11.4	24,456
Completely rural nonmetro	783	24.9	6,510,875	2.4	8,315
Total	3,141	100	272,690,813	100	86,817

^aNumbers also include some cities or census areas.

Comments From the Department of Agriculture



United States Department of Agriculture
Rural Development

Rural Business-Cooperative Service • Rural Housing Service • Rural Utilities Service
Washington, DC 20250

TO: Stanley J. Czerwinski
Associate Director
Housing and Community Development Issues

FROM: ^{FD} James C. Kearney
Administrator
Rural Housing Service

DATE: August 24, 2000

SUBJECT: GAO Report on Options for Optimizing the Federal Role in Rural Housing Development

Summary

Thank you for the opportunity to provide comments on this report. In summary, the report does an excellent job describing the housing programs of the Rural Housing Service (RHS), and improvements in the quality of homes throughout rural America. It also does an excellent job of describing how the Agency has successfully evolved to face new challenges and improve the delivery of our programs. We also appreciate the recommendations on possibilities for enhancing the program and organizational structure of the mission area. We would like to thank Andy Finkel, Rich LaMore and Matt Scire for their professionalism and their courteous manner throughout the review in both the National Office and in the field. We appreciate their perspective and the open exchange of information and ideas.

See comment 1.

The report, however, overlooks some very important distinctions between urban and rural areas and the issues facing each. The report fails to recognize how our housing programs, including the guaranteed programs, are just one component of the Rural Development mission area. Rural Development relies upon all of its programs to holistically address the infrastructure, community development and housing needs of rural America.

See comment 2.

While the report focuses on improvements in the quality of housing in rural America, it does not address rural America's current housing dilemma – affordability. No one would deny that mortgage brokers and the Internet have expanded the availability of mortgage credit; however, there is an affordability crisis in rural America.

The Rural Development mission area is committed to improving the quality of life in rural America. In 1949, Congress recognized the need for separate rural programs, and

Rural Development is an Equal Opportunity Lender
Complaints of discrimination should be sent to:
Secretary of Agriculture, Washington, DC 20250

**Appendix III
Comments From the Department of
Agriculture**

2

See comment 3.

Congress has continued to recognize this need throughout the years by authorizing additional rural programs and continued appropriations. This is attributable to the success of the mission area in delivering its programs holistically, effectively, and efficiently. Rural Development has proven its ability to meet the needs of rural America.

See comment 4.

GAO suggests that USDA and HUD discuss the merger of our single family loan guarantee and insurance programs and the servicing of our multifamily housing programs but the intent is to merge the other programs as well. Merging any rural development programs with those of their urban counterparts will have a devastating impact on rural America. There is an old adage that the squeaky wheel gets greased. Since there are more urban families than rural families, rural America's wheels will come to a slow and irrevocable halt if rural and urban programs are merged. Nowhere does GAO present any evidence that a such merger will improve the delivery of service to rural America or even result in a savings to the taxpayer. We discuss these issues in greater detail in this response.

See comment 5.

Distinctions between rural and urban

GAO's report suggests that the "distinctions between rural and urban life have been blurred." The question is raised as to "the need for separate rural housing programs that were first created in the mid-1930s to stimulate the rural economy and assist needy rural families." We agree that the original distinctions between rural and urban life have been somewhat lessened since the mid-1930s. There is still a gap in access to affordable housing credit for those who cannot qualify for HUD or conventional single family housing loans and the differences between rural and urban areas are still significant.

See comment 6.

"Financing affordable housing is challenging in general, but the small project located in a small town probably poses the greatest challenge of them all. Because of its size, a small project does not have the economies of scale that a larger project has, which creates a financial challenge to acquire resources into these areas. These projects cannot be ignored."

Senator Bob Kerrey
Congressional Record June 17, 1998

In its February 1995 report, "Understanding Rural America," the Economic Research Service of the USDA states:

"The well-being of America's rural people and places depends upon many things--the availability of good-paying jobs; access to critical services such as education, health care, and communication; strong communities; and a healthy natural environment to name a few. And while urban America is equally dependent upon these things, **the challenges to well-being look very different in rural areas than in urban.** [emphasis added] Small-scale, low-density settlement patterns make it more costly for communities and businesses to provide critical services. Declining jobs and income in the natural resource-based industries that many rural areas depend on force workers in those industries to find new ways to make

a living. Often those new ways are found only in the city. Low-skill, low-wage rural manufacturing industries must find new ways to challenge the increasing number of foreign competitors. Distance and remoteness impede many rural areas from being connected to the urban centers of economic activity. Finally, changes in the availability and use of natural resources located in rural areas affect the people who earn a living from those resources, as well as those who derive recreational and other benefits from them.”

In the mid-1960s, a presidential commission called the rural poor “the people left behind.” Today, thirty-some years later, there are still severe unmet rural housing needs in every part of the nation. In their book, “Housing in Rural America: Building Affordable and Inclusive Communities,” Belden and Wiener state that the rural poor and their conditions are not widely discussed or examined because most housing policymakers, administrators, researchers, and advocates live in cities and take an urban-centric view. Inner city problems are the main topics of most conversation about both affordable housing and poverty. Thus, the voices of rural poor often go unheard as the majority of the attention is focused on their urban counterparts. To ensure the housing needs of people in rural areas are not overlooked it is important to keep separate rural and urban Federal housing programs.

Congress recognized the fundamental difference between rural and urban communities when it gave the Secretary of Agriculture the responsibility for coordinating rural policy (USC Title 7, Chapter 55, Sec. 2204b, Rural Development Policy). Congress reinforced this by designating both rural and urban Empowerment Zones and Enterprise Communities. USDA is responsible for the rural communities. Responsibility for the urban communities lies with HUD.

Further confirmation of the need for rural programs is evidenced in the 1990s. In 1991, Congress recognized the need for rural housing programs to be separate from urban when it revised the Housing Act of 1949 to create the single family housing loan guarantee program. In 1996, Congress reaffirmed the difference between urban and rural when it authorized a rural loan guarantee program for multi-family housing.

Lack of Rural Lenders Sparks Pilot Program

Thanks to a unique partnership between Rural Development and the Georgia Housing Finance Authority, many rural families will achieve their dream of affordable homeownership. In southern Georgia, many families have incomes that exceed those which qualified for the Agency’s direct loan program – however; they lack the downpayment required by local lenders. Despite repeated efforts, local banks were not interested in participating in affordable housing programs. Similarly, the State of Georgia Housing Finance Authority (FHA) was unable to find lenders willing to assist lower income families in these rural communities, until a unique collaboration surfaced. Rural Development staff will underwrite guaranteed loans for the Georgia Housing Finance Authority in four rural southern Georgia counties. Separate Agency personnel will review the applications for compliance with Agency regulations, and the HFA will complete the underwriting and funding of the loans.

To illustrate the rural specific issues, let's look at the issues for servicing a rural multi-family housing portfolio. Small, scattered projects in rural areas face challenges in filling vacancies in a timely manner because there is only a small eligible population from which to draw tenants. Many rural areas have only one or two major employers. When these employers suffer financial reverses and lay off employees or close their businesses, the workers have fewer options for new employment than would urban workers. This can have a major impact on rental income. The closing of a single employer in an urban area does not have the same level of impact on an urban rental housing project. The unique staffing structure of Rural Development and the fact that the section 515 program

involves direct Multi-Family Housing (MFH) loans allow Rural Development to work directly with tenants, community leaders, management agents and borrowers as issues arise concerning the operation of MFH projects.

There is an inherent danger in merging rural and urban programs together. Sheer density and economies of scale will push resources from rural to urban. In addition, rural communities seldom have the necessary infrastructure with which to compete with urban areas for funding. Combining the resources of several agencies having different urban/rural mission emphasis will almost certainly result in fewer resources allocated to rural areas. All of the above are fundamental reasons for not merging the programs.

La Jicarita, New Mexico is an example of one of the unique problems faced by rural areas. As the timber and textile industries, which were the primary sources of employment for the residents, gradually left the community, local residents gave up hope that new manufacturers would "rescue" their community with new jobs. The predictable decline of area incomes and housing stock accompanied this transition. Through the community-driven strategic planning process, assisted by Rural Development staff, the town of La Jicarita identified business development and housing as basic needs that should have priority.

Residents recognized the value of their natural resources (hardwood timber, pottery clay, and wool production), cultural heritage, and unique local crafts and food products. They developed a Community Arts Marketing Project to promote local crafts and food products and increase tourism in the region. This initiative focused on crafts being locally produced with local materials, ensuring the sustainability of the effort. In addition to several state and foundation sources, nearly \$400,000 of USDA Rural Business Enterprise Grant (RBEG) money was invested in this project.

To complement the economic enhancements to the area, the housing needs of the community also were considered. Currently, there is a housing initiative for the development, rehabilitation and construction of additional housing units. There is another initiative to improve housing services in the area. USDA Rural Development Housing Preservation Grants and Single Family Housing 504 and 502 funding will be needed for this purpose.

See comment 7.

Holistic Approach to Rural Development

Rural Development is a mission area that takes a holistic approach to rural development. The RHS is part of the USDA Rural Development mission area which delivers programs through three agencies: Rural Utilities Service (RUS) addresses rural America's need for basic services such as clean running water, sewers and waste disposal, electricity, and telecommunications. RHS addresses rural America's need for affordable single-family

**Appendix III
Comments From the Department of
Agriculture**

5

and multi-family housing as well as health facilities, child care centers, fire and police stations, and other essential community facilities. The Rural Business-Cooperative Service (RBS) provides assistance to rural areas that need to develop new job opportunities, assisting businesses and cooperatives to remain viable in a changing economy. RBS, RHS, and RUS work collectively as the Rural Development mission area to help the people of rural America develop sustainable communities and improve their quality of life.

Key to this concept is the Rural Development's ability to coordinate its own programs and services in a way that will most effectively use dwindling resources in these communities. Rural Development has shifted from a project-based approach to a community-based approach to providing support.

The objective of Rural Development's community development function is not only to create jobs, build housing, and improve public services, but also to enhance the quality of local decision making processes and build local leadership. This stronger leadership and organizational capacity will help sustain their community enhancement. The Rural Housing programs are an integral part of this process.

Oskaloosa, Iowa is a rural community with a population of 10,000 located in Mahaska County. Like many rural communities, Oskaloosa had become stagnant and had not seen much growth or development in years. Wanting to reinvigorate the economy in Oskaloosa, the county rural development committee called on USDA's Rural Development mission area to lead the way in establishing community development strategies.

Rural Development, along with its local partners, responded in various ways. After receiving a \$3.4 million Business and Industry loan from Rural Development, the World Food Processing Company (WFP) decided to locate in Oskaloosa. WFP is a soybean processing company. The USDA Rural Development office staff took the lead in providing technical assistance to WFP. This included assistance in business structuring, business plan writing, and partnering with the state, county, community, and local banks.

Rural Development provided \$3.7 million in funding to build 59 family and 130 elderly rental units. A total of \$4.9 million in loans was provided to 268 families through direct RHS housing programs. Additionally, to meet the needs of those families who could not qualify for other mortgage credit, Rural Development worked with local lenders to provide \$3.5 million in section 502 guarantees to 68 families in the county.

In a further effort to help allow residents become homeowners, the local Rural Development office partnered with the town to provide a first time homebuyer workshop. Employees from Rural Development help teach the homebuyer education class. A mobile office unit provides homebuyer education and financing advice within the local rural counties. This mobile unit was financed with a community facility loan of \$50,000 and a grant of \$25,000.

To meet the critical infrastructure needs, Rural Development provided \$8.5 million in loans and grants to the Mahaska Rural Water District to ensure the entire county had safe drinking water and adequate wastewater facilities.

Today, Oskaloosa is a community that continues to grow and attract new business.

GAO Report issues:

In the response to Congress, GAO looked at four different issues. Our comments on each of these issues follow:

(1) Physical condition of today's rural housing and rural households' access to affordable housing credit

While the physical condition of rural housing has improved dramatically, rural America faces more challenges than ever in housing affordability. We agree that credit is more available today to creditworthy rural applicants with the ability to make the necessary down payment, however, the report does not address the availability of affordable housing credit to those applicants that conventional lenders cannot serve. In its report, "Rural Rental Housing: HAC's 1999 Report on the State of the Nation's Rural Housing," the Housing Assistance Council (HAC) states: "For many years, substandard housing has been the predominant rural housing problem. Although dilapidated housing remains a concern for many rural households, participants at each of the HAC facilitated roundtables agreed that housing cost burden is a growing and very serious problem in rural America." The report goes on to state: "The booming economy of the last few years has not closed the gap between income and housing costs for many rural Americans."

A Win-Win-Win in Virginia

The Virginia Housing Development Authority (VHDA) requires all first-time homebuyers to successfully complete homeownership education. However, in many rural areas throughout the state, local organizations do not exist to provide this invaluable service. At the same time, Rural Development was also looking for organizations to provide homeownership education and counseling for many direct loan customers. To accomplish our missions, VHDA and Rural Development have teamed up. In rural communities without organizations that provide homeownership education, Rural Development staff has been certified to teach this class. In exchange, direct single family housing customers in rural areas can now access free VHDA sponsored homeownership education throughout the state. This is a win-win-win! VHDA gets statewide coverage; Rural Development now can offer this course its customers. And most importantly, the customer benefits by learning those skills necessary to become a successful homeowner.

See comment 2.

There are a number of aspects to the concept of "affordable housing credit." GAO overlooks the significance of their finding that "rural bank officials cited the no money down aspect of RHS guaranteed loans and the assistance provided by local RHS staff as primary reasons for choosing to participate in the program." There is a void in rural areas of affordable credit for those who lack the resources for a down payment. Unlike the typical FHA lender, the primary business of a typical rural lender is not providing affordable housing credit. Affordable housing finance is complex. The assistance Rural Development staff provides to these rural lenders is often key to their participation. For example, the Illinois Housing Development Authority had tried for years to increase its lending activities in rural parts of the state. It was only after it became an active

See comment 8.

participant in Rural Development's Guaranteed Rural Housing program that it was able to greatly expand its list of participating lenders in rural parts of the state.

In its report "Credit in Rural America," the USDA/ERS found that **"access to credit and other financial services remains a problem for those who fail to qualify for commercial loans because of low incomes, low skills, and lack of collateral." Rural borrowers who lack the resources for a down payment need the RHS guaranteed loan program.**

In a research paper entitled, "A Home in the Country: The Housing Challenges Facing Rural America" the Fannie Mae Foundation states:

See comment 9.

"Access to credit is a crucial step in meeting the challenges faced by rural residents. Access is hindered because private mortgage lending practices in rural areas differ greatly from their urban counterparts, partly due to remoteness and low population densities. Remoteness disconnects rural areas from institutions and resources that provide technical capacity to effectively evaluate risk. Remoteness and low population density also discourage competition, resulting in higher costs associated with making mortgages."

"Direct government intervention through the Rural Housing and Community Development Service (RHCDS, which administers most programs of the former Farmers Home Administration) has successfully provided direct housing and rehabilitation financing and guarantees for small remote communities. Research presented at the conference highlighted the importance of RHCDS lending programs, and conference participants urged that it continue to be the lender of last resort, supplementing the private market. RHCDS programs also provide housing that is affordable and flexible to accommodate diverse needs."
(Copyrighted material used with permission)¹

(2) Rural Housing Programs offered by USDA and the ways RHS programs have adapted to changes in the level of federal housing assistance

All of the services delivered by Rural Development are part of its community development function. Rural Development is working harder than ever to make affordable housing credit available to those qualified persons who need it. The agency has been proactive in finding ways to deliver its programs despite diminishing resources. The job is far from done, though. Rural Development has been successful in getting more government sponsored enterprise (GSE) activity in rural areas but GSEs (Fannie Mae and Freddie Mac) are involved in only a portion of the portfolio. RHS has developed new partnerships and expanded existing ones with nonprofits to help deliver

¹Danielsen, Karen A. 1996. "A Home in the Country: The Housing Challenges Facing Rural America." Housing Research News 4(2):7-8.

its programs, but the job is not done. None of this would have been possible in rural areas from a centralized location. It is Rural Development's direct and intimate knowledge of the local areas that allows it to do this job.

Guaranteed Loan Programs

The guaranteed loan programs are not a move away from the traditional direct loan programs. The guaranteed programs are designed to serve different income groups than the direct programs. While some low-income rural residents benefit from the guaranteed SFH program, it is designed to supplement the direct loan program and serves mainly moderate-income borrowers. The same is true of the guaranteed MFH program. With higher incomes, and therefore more capacity for mortgage or rent payments, borrowers do not need the deep subsidy of the direct programs to make these loans feasible. On the other hand, most borrowers with lower incomes cannot be served without this deep subsidy. Likewise, the tenants in MFH projects funded with the guaranteed program are higher income tenants. Other funding sources have not filled the gap in credit for small rural MFH projects. Even with RHS' MFH guarantees, secondary market partners and private lenders have been reluctant to participate in financing properties that involve smaller loans, resulting in less profitability and requiring more involved underwriting. In fact, this lack of participation is one of the reasons that specific goals for reaching small rural affordable MFH properties have been placed on the GSEs.

“The bill is designed to assist low and moderate income people in rural areas where there is a serious lack of mortgage credit availability. It would accomplish this in a cost-effective manner and in a way that would not compete with or reduce authorizations for very low income assistance.”

Hon. Joseph M. McDade, in the House of Representatives, May 17, 1989

RHS is fulfilling its mandate of assuring that lower income rural families and communities have access to the credit they need for housing and community facilities. However, through increased appropriations for our guaranteed programs, there has been an increasing level of service for assistance to moderate-income rural Americans. Much of this has been predicated not on a reduced need for credit for very low- or low- income rural residents, but on budgetary constraints that have curtailed funding for our subsidized direct programs that serve lower income families. It is unfortunate that the expansion of guaranteed programs comes at a time of reduction in the much-needed direct programs. This only feeds the general misconception that the guaranteed programs are a cheap replacement for direct loans.

For many years, RHS and its predecessor agencies had no program to serve moderate income families. These families had incomes too high to qualify for direct loans yet there was no alternative source of mortgage credit for those who cannot make the required down payment. Recognizing this gap, the then-Farmers Home Administration (FmHA) piloted a small loan guarantee program. Using its experience with direct loans, FmHA

See comment 10

worked with lenders and the program grew. The guaranteed loan programs are not costly to administer. In recommending merger of RHS and HUD programs, GAO does not discuss where there would be savings, how resources currently are not being used efficiently, or what the benefit would be to the family in need of affordable housing.

Collectively, these programs enable Rural Development to provide the best possible assistance to all qualified rural customers in the manner that best meets their needs at the lowest cost to the government.

Leveraging

Rural Development built on the relationships established with lenders in the guaranteed program to implement the leveraging program for the direct SFH program.

Leveraging does more than extend limited program funds, it helps foster community development and establish relationships for lower income rural families with local banks that help them learn how to access and use commercial credit.

Leveraging also led to partnerships between Rural Development and local non-profit groups such as Community Development Corporations (CDC) that provide such services as homebuyer education and application packaging that benefit both Rural Development and the potential homebuyer. Rural Development promotes flexible partnerships where the CDC, local lender, and Agency work in partnership to assist a rural family. In cases where CDCs are not available, Rural Development helps build the necessary capacity.

GAO states that: "Multiple funding sources are becoming the norm in financing rural single family homes." RHS provides 80% of the financing on an averaged leveraged loan. This is done through the same direct section 502 Single-Family Housing program we use without leveraging. These loans must be processed and underwritten with the same level of scrutiny as any other direct loan.

In Utah, Rural Development participates in a partnership with the Federal Reserve Bank, Federal Deposit Insurance Corporation, Small Business Administration, Indian Health Service, Association of Governments, state and community development offices, commercial lenders, and tribal governments. This group of about 40 people, known as the Sovereign Lending Task Force, conducts informal bimonthly meetings, sometimes on one of the reservations. The group's goal is to ease the legal and social barriers associated with loans to Native Americans on trust land.

These meetings provide an opportunity for housing and economic development coordinators from the various Native American tribes to gather information about programs offered by Rural Development and other agencies. In recent years, RUS has provided assistance in upgrading water services, RHS provided CF funds for an early childhood intervention center, and RBS provided funding for small businesses.

The Little Blossom Early Intervention and Development School, which received a CF grant for \$75,000, offers early childhood intervention and developmental and learning disorder programs to meet the special needs of children in the community. The center was built in Uintah County on the Ouray and Uintah Indian Reservation. Median household income on the reservation is only 47 percent of the State of Utah's average. The center was opened in the fall of 1998, to serve the reservation and surrounding areas. It can assist up to 30 children, from birth to 3 years of age. Programs offered include home visits, play groups at the center, on-site visits, pre-screening and testing of children, and workshops for parents.

So, while leveraging does allow RHS to assist more families with limited funds, it does not minimize or replace our loan origination role.

Multi-Family Housing

The issues that make rural and urban challenges different also apply in the servicing of the MFH portfolio. The unique qualities of rural areas create the need for our rural staffing structure. Because the section 515 program involves direct Rural Development MFH loans, this allows us to work directly with tenants, community leaders, management agents and borrowers as issues arise concerning the operation of MFH projects. In fact, many potential problems are avoided due to Rural Development staff's knowledge of the dynamics of the community and the performance of the loan. The direct working relationship of Rural Development staff with borrowers and management agents has the side benefit of ensuring an extremely low program delinquency rate, only 1.8%, and fewer than 20 inventory properties out of approximately 18,000 program properties – statistics any affordable or conventional MFH housing lender would envy.

GAO cites the availability of the Rural Development guaranteed rental housing program and tax credits as alternative and less expensive ways to provide rental housing. As stated above, these programs are less expensive to the government because they serve higher income tenants. The per unit development cost of section 515 apartment complex is less than the average per unit development cost of projects developed under the tax credit program or other non-RHS MFH lending programs. This is achieved even while assisting households that average \$7,600 per year in adjusted income. The guaranteed programs do not replace the direct loan programs. They complement them.

The low income housing tax credit has been promoted as being a replacement for direct RHS MFH loans in rural areas. In fact, GAO states that 53% of tax credit properties were in rural areas. However, many state tax credit agencies define rural areas differently than RHS does. These areas are often not eligible rural areas under the RHS programs. The same report states that during the period ending 1994, 32% of the tax credit properties had RHS financing. The section 515 program is the only federal program that reaches the neediest remote rural residents. Appropriations for section 515 funds have dropped from \$512,000,000 in 1994 to approximately \$55,000,000 in 2000 for new construction. Tax credits alone cannot reach the very low-income rural tenant households in the most remote areas.

A New Home, A New Career

An eastern Idaho resident found a new vocation as well as a new home when she applied to build her house through the RHS Mutual Self Help Housing program administered by the Eastern Idaho Special Services Agency (EISSA). A single mother with two sons, she worked in a local potato processing plant. Although she had done some home remodeling, she had little experience with construction. In addition to putting in the required weekly hours working on her house, she took a second job to pay for the extra gasoline she used in traveling to and from the construction site. As she learned construction work, she discovered that she enjoyed it and was good at it. When an opportunity arose, EISSA hired her for Phase II of the project. Not only was her family excited by their new home, but also by the new career that "changed my whole life."

(3) Overlap between HUD programs and other federal, state, and private organizations

While there is some geographic overlap since HUD has jurisdiction everywhere in the nation, RHS is limited to rural areas and its programs are not intended to be competitive with other programs. In order to avoid duplicative efforts and overbuilding, RHS loan approval officials are required to consult with HUD and State Housing Finance Agencies before approving a new MFH loan.

State Housing Finance Agencies (HFA) partner with Rural Development in order to reach rural areas. Many HFAs were not reaching rural areas until they partnered with Rural Development. GAO cites that 74% of the Vermont HFA borrowers are in rural counties. At a stakeholder meeting sponsored by Rural Development, the Vermont HFA acknowledged that prior to partnering with Rural Development, they were not serving the most rural areas in the state.

As examples of programs with possible overlap, GAO references the Habitat for Humanity program and the “Fannie Mae Self Help” initiatives. We wish to point out that the Habitat program is not a Mutual Self-Help Housing program like the RHS program, it is more like a charity program. Under the Mutual Self-Help

Housing program 6 to 12 families work together to build their homes. Under the Habitat model volunteers work together with the homebuyer to help build the home.

Fannie Mae is not a direct lender, rather they purchase loans that meet their criteria which are made by other lenders. Fannie Mae has been active in purchasing loans made to borrowers using the self-help method of construction. In fact, many of these are RHS leveraged loans made to participants in our Mutual Self-Help program.

HUD’s Self-Help Homeownership Opportunities Program (SHOP) provides funds for non-profit organizations to purchase home sites and improve the infrastructure needed to set the stage for sweat equity and volunteer-based homeownership programs for low-income families. It is not a technical assistance program like the RHS program nor does it provide the purchase financing for the homeowner.

The GAO report looks at arguments for and against various options for “optimizing the Federal role in rural housing development.” While we agree with many of the possible arguments, we would like to look more closely at a few of them.

Pulaski County, Illinois has the most critical shortage of housing in the state. Their strategic plan addresses their housing needs and the persistent poverty in the area. A full time USDA rural housing specialist has been assigned to work in Pulaski County to increase the use of Rural Development money toward the housing shortage in the area. Plans are underway for a water and sewer loan/grant for a low-income section of Pulaski County. EZ/EC program money will be used to upgrade the roads in the neighborhood. In conjunction with applying for Rural Development self-help housing funding, the neighboring community college is developing a construction education program to increase the number of qualified construction workers in the area. Additionally, \$150,000 in RBEG funding, a \$2.2 million Business & Industry loan, and \$1.4 million in IRP loans have been put into the community.

Maintaining a separate system for delivering housing programs in rural areas

See comment 11.

A significant argument for maintaining the current system that should be included in GAO's list is that by combining programs, resources will be diverted from rural to urban areas. In the arguments against, we dispute the argument that "RHS field role had changed from originating and servicing direct loans to leveraging deals with partner organizations." Rural Development continues to originate loans. In fact, GAO states that in leveraged loans, RHS carries 80 percent of the debt. Many times the leveraged loans are made because Rural Development refers a homebuyer to another lending entity. Regardless of where the package begins, Rural Development has a significant role in the loan origination process. Also, Rural Development is actively involved at the field level in first year loan servicing. Experience has shown us that it is essential to provide an extra level of loan servicing in the first year of a loan because this is often a family's first encounter with this type of credit.

See comment 12.

GAO argues that Rural Development's community development mission parallels that of HUD's community builders function. GAO overlooks the tie-in between the delivery system and the merging of programs. As we point out in the beginning of our discussion, rural and urban areas have unique challenges that are best addressed through continuance of our Congressionally mandated programs.

(4) Options to Improve Effectiveness

GAO presents a number of interesting ideas on how to improve the effectiveness of our programs. We are always open to better ideas and we would like to take time to look at them more thoroughly. Some of these concepts require legislative changes. Others involve working closely with the HUD. We have already begun some preliminary discussion with HUD and we expect to meet with the appropriate HUD officials to further explore those options. We have initial comments on some of the ideas and will follow up with more detail in 6 months.

Allow Farm Worker Housing Dollars to be Used to Help Off-Farm Processing Workers

Farm workers are one of the two worst housed groups in America. Our extremely limited and oversubscribed funding for the only Federal housing program for farm workers cannot be used to serve a larger population. However, we agree that there is a huge unmet need for housing for off-farm processing workers. To help meet this need, Rural Development is conducting a pilot program for housing for processing workers this year in Salinas, California. There is already congressional recognition of this need and the Senate Appropriations Bill for 2001 has a \$5M demonstration program for housing agriculture processing workers.

Encourage Reverse Mortgages In Lieu of Repair Grants and Loans to Families With Sufficient Equity in Their Home To Qualify

As pointed out by GAO, there are simply not enough 504-grant funds to remove the dire health and safety hazards in the homes of rural senior citizens. In the case of our 504 program, however, RHS disagrees that reverse mortgages are a replacement or substitute to address the tremendous needs.

The GAO Report states that Fannie Mae and the American Association of Retired People (AARP) are strong advocates for reverse mortgages. In an August 19, 2000, article on "The Nation's Housing," the *Washington Post* reports that "Fannie Mae Ends High-Cost Reverse Mortgages." The article states that "The nations largest source of mortgage money, Fannie Mae, has quietly terminated a loan program that ... (has) the potential to cost some borrowers 30 percent or higher a year in combined fees and interest." The article continues, stating that "AARP ... is appreciative of Fannie Mae's decision to kill the program."

Section 504 grants are only available to senior citizens who are unable to repay a Section 504 loan at 1% interest. The average 504 grant in Fiscal Year 2000 is \$4,700. Private lenders typically do not originate reverse mortgages of \$4,700 because the loans are too expensive to originate and too small to sell in the secondary market. Even if a private lender were willing to originate a \$4,700 mortgage, RHS believes the transaction costs of securing such a small loan would be excessive. The recent Washington Post article further confirms this. The Agency is also concerned with denying access to financial resources to senior citizens who need funds to remove health and safety hazards to their home. These senior citizens, without any financial resources other than potential equity in the home, would be subject to the well-documented predatory lending arena.

If the industry can fully address these concerns as well as predatory lending issues, a reverse mortgage may be an option in rare cases. An example of such a case would be where a senior citizen applies for repair assistance in excess of \$20,000 through the RHS programs and has sufficient equity in the home to support the loan.

The following are GAO's comments on the Department of Agriculture's letter dated August 24, 2000.

GAO's Comments

1. We recognize that RHS' housing programs are a component of the Rural Development mission area. However, with 89 percent of Rural Development's fixed funding and 86 percent of its staff years, RHS is the largest component of the Rural Development mission area. We also recognize that HUD, like Rural Development, is moving toward a holistic approach through its community builders program.
2. We agree that there is a housing affordability crisis in parts of rural America, just as there is a housing affordability crisis in parts of urban America. In particular, we recognize that in some remote areas, such as the Mississippi Delta, the Colonias on the Mexican border, Appalachia, and Indian trust lands, residents have unique problems obtaining financing. However, as we state in our report, USDA's Economic Research Service found, in its 1997 study entitled *Credit in Rural America*, that the increased competition in rural housing markets and the increased secondary market activity of Fannie Mae, Freddie Mac, and other secondary market institutions in rural areas have reduced the rural financial market inefficiencies that plagued the sector in the past. In addition, in the 1999 study by Belden and Wiener that RHS cites in its comments, a leading housing expert maintains that, overall, the affordability issue is less severe in rural areas than in urban ones. Specifically, she states, "Although incomes in rural areas tend to be somewhat lower than those in urban areas, housing costs are also lower. Therefore, rural households are less likely to face affordability problems than are households in central cities or urbanized areas."¹
3. Although the Congress placed most new rural housing and other rural development functions in USDA, the Congress did locate a recent rural program, a rural capacity-building grant program, in HUD. We examined today's rural housing programs from an historical perspective to see whether continuing the overall policy is still the most efficient and effective way for the Congress to maximize the federal role in rural housing. Our conclusion—that budget cutbacks, technology improvements, and other factors have led to changes in the

¹Joseph N. Belden and Robert J. Wiener, *Housing in Rural America* (SAGE Publications, 1999), p. 17.

ways rural housing programs operate—led us to suggest that the Congress consider requiring USDA and HUD to take steps towards merging those programs that provide similar products and serve similar markets.

4. We do not understand USDA's basis for commenting that merging these programs would be devastating to rural areas. In fact, as part of our matter for congressional consideration, we noted that it was important to ensure that targeted populations are not adversely affected.
5. We did not perform detailed cost-benefit analyses of merging rural and urban housing programs in this review. However, we believe the changes in the rural environment and the overlap in the markets served by RHS and HUD indicate a need to identify best practices, including the efficiencies resulting from those practices.
6. There is also a gap in access to affordable housing credit in urban areas for those who cannot qualify for single-family housing loans from HUD or the private sector. Urban areas have no counterpart to RHS' direct loan program, and HUD's Federal Housing Administration (FHA) cannot compete with the terms of RHS' guaranteed loans—no money down and no monthly mortgage insurance payments.
7. We agree, as stated in our report, that many smaller communities have few resources and lack the capacity to compete with more urban areas. Recognizing this situation, the Congress recently enacted programs in HUD and RHS aimed at building capacity at the state and local levels for rural housing and community development. We see this as another area where RHS and HUD could examine their best practices and explore the benefits of merging similar programs.
8. We believe that this statement is equally true for urban and rural households. Households with low incomes, low skills, and little collateral fail to qualify for loans in both urban and rural areas. But the disparity between a rural borrower, who can obtain a guaranteed loan with no money down, and an urban borrower, who must pay 3 percent down under FHA's terms, raises the question of whether the economic differences between rural and urban areas are still great enough to support the provision of better terms in rural areas.
9. The paragraph referenced in USDA's comments on access to credit is from the introduction to the proceedings of a 1996 Fannie Mae policy

roundtable conference on rural housing issues, the highlights of which were published in Belden and Wiener's 1999 study entitled *Housing in Rural America*. It should be noted that the next paragraph in the introduction states that "credit access problems may be reduced by using computer technology, increasing the role of nonprofit intermediaries to establish public-private partnerships, and providing technical assistance to remote rural lenders." We believe that progress has been made in all three areas since 1996.

10. We focused on single-family insured loan programs because these programs have the greatest similarities and operate in markets where distinctions between rural and urban areas have blurred. In merging similar programs, USDA and HUD should consider the savings that may be achieved and the impact that merging may have on targeted populations. Such an analysis should be part of any review of "best practices," as we mention in the report. With regard to RHS' guaranteed loan program in particular, the report already recognizes that RHS offers better terms than FHA, which explains, in part, its greater cost. In contrast, FHA's single-family insurance program is self-sufficient.
11. We agree that originating direct loans is still an important part of Rural Development's mission. We changed the wording in this section of our report to match the wording in the body of the report. However, we maintain that several factors—budget cuts in direct loan funding, the new centralized servicing operation, and the emphasis in Rural Development's new community development mission on leveraging deals with partner organizations—reflect a fundamental change in program operations.
12. We recognize the tie between the delivery system and the potential to merge programs. For example, we recognize that the single-family direct loan program, the farm worker housing program, and the self-help housing program are unique in both the products they offer and the way they are delivered. In contrast, RHS' delivery system for guaranteed loans program is not unique. Both RHS and FHA rely on private lenders to deliver their products. Given the diminishing distinctions between rural and urban areas, we believe aspects of delivery systems should be examined in the course of reviewing best practices, not only between HUD and RHS but also within RHS itself, where delivery systems vary greatly from state to state.

Comments From the Department of Housing and Urban Development



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
THE DEPUTY SECRETARY
WASHINGTON, DC 20410-0050

AUG 23 2000

Mr. Stanley J. Czerwinski
Associate Director,
Housing and Community
Development Issues
General Accounting Office
Washington, D.C. 20548

Dear Mr. Czerwinski:

Thank you for the opportunity to comment on your draft report entitled, "Options for Optimizing the Federal Role in Rural Housing Development" (GAO/RCED-00-241). HUD commends the GAO for its informed description and analysis of the quality of rural housing today, the access of rural households to mortgage credit, and the Rural Housing Service (RHS) programs and how they relate to other public and private affordable housing efforts in rural areas.

The report's major observation is that there may be opportunities for efficiencies in the delivery of rural housing services by merging programs that serve similar markets or provide similar products. While GAO does not appear to endorse any specific changes, and lists pros and cons for each option presented, the report does suggest that "as a first step Congress could consider requiring USDA and HUD to merge their single-family insured lending programs and multifamily portfolio management programs, taking advantage of the best practices of each." (Page 33).

Any opportunities to improve the delivery of rural housing services should be explored, but it is not clear that merging programs will achieve this end. For example, both RHS and FHA single family programs operate in rural areas, but they are very different. As the report itself notes in several places, the RHS loan guarantee program offers much more attractive terms to borrowers than FHA's mortgage insurance program, including no downpayment and no monthly mortgage insurance premium. Merging the programs would require major statutory changes. RHS would be understandably reluctant to make its loans less affordable to rural borrowers and providing these benefits in the much larger FHA program would be very expensive. In addition, providing a special set-aside for rural borrowers in a merged program would probably result in a more cumbersome rather than more efficient delivery system in rural areas.

See comment 1.

**Appendix IV
Comments From the Department of Housing
and Urban Development**

2

See comment 2.

In the multifamily programs, we are pleased that GAO has recognized the value of HUD's improved portfolio management practices. These include the property disposition centers with specialized staff for foreclosing defaulted insured properties and then selling them; the Real Estate Assessment Center with centralized physical inspection, financial review, and other large scale activities; and the Department's Enforcement Center with skilled staff for more intensive "servicing." These concepts have been shared with USDA. HUD will continue to work with USDA in a mutual exchange of information on best practices and to explore possible avenues of coordination.

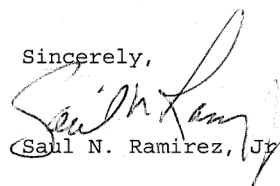
In addition to these general comments, we offer the following specific observations:

- Page 32 states as a pro that any increased funding from statutory increases in the State cap on private activity bonds could be used by state housing finance agencies (HFAs) to operate a "more highly subsidized direct single-family loan program." This is really not an argument for merging programs, but rather a proposal to use an increase in the higher cap for a specific purpose. Private activity bonds are meant to support many different activities and HFAs/States might have other priorities. In addition, an increase in the cap would only increase the amount of bond authority available and not the depth of the tax-exempt interest subsidy. HFAs/States might decide to have a larger single family program for rural areas, but the increased cap would not, by itself, result in a deeper subsidy program.
- The statement on page 29 of the report that the Community Builder program "has been significantly curtailed" is not accurate. While the Community Builders Fellows program has been terminated, a cadre of career employees are continuing this important work. Additionally, community builders have been active in rural areas, and we have several Community Builder "specialists" devoted to rural issues such as the Delta, colonias, etc.

See comment 3.

Thank you for your consideration and the opportunity to comment.

Sincerely,



Saul N. Ramirez, Jr.

The following are GAO's comments on the Department of Housing and Urban Development's letter dated August 23, 2000.

GAO's Comments

1. We agree that merging programs would require statutory changes and that in some cases the costs may exceed the benefits. That is why we are focusing on having RHS and HUD explore the potential benefits of merging similar programs, focusing on the best practices of each and insuring that the targeted populations are not adversely affected.
2. In our July report on HUD's housing portfolios, we noted that HUD had established quality assurance procedures; however, we also found that gaps or weaknesses in some of those procedures substantially limited their effectiveness.¹
3. We revised the report to make it clear that only the noncareer fellows portion of the community builders program has been terminated.

¹HUD Housing Portfolios: HUD Has Strengthened Physical Inspections but Needs to Resolve Concerns About Their Reliability (GAO/RCED-00-168; July 25, 2000).

Ordering Information

The first copy of each GAO report is free. Additional copies of reports are \$2 each. A check or money order should be made out to the Superintendent of Documents. VISA and MasterCard credit cards are accepted, also.

Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013

Orders by visiting:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders by phone:

(202) 512-6000
fax: (202) 512-6061
TDD (202) 512-2537

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

Orders by Internet:

For information on how to access GAO reports on the Internet, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web home page at:

<http://www.gao.gov>

To Report Fraud, Waste, or Abuse in Federal Programs

Contact one:

- Web site: <http://www.gao.gov/fraudnet/fraudnet.htm>
- e-mail: fraudnet@gao.gov
- 1-800-424-5454 (automated answering system)

**United States
General Accounting Office
Washington, D.C. 20548-0001**

**Official Business
Penalty for Private Use \$300**

Address Correction Requested

<p>Bulk Rate Postage & Fees Paid GAO Permit No. GI00</p>

