

# USDA's Self-Help Loan Program Provides Unique Opportunities for Home Ownership

George Wallace

*USDA's 502 Direct Loan Homeownership Program offers a limited number of borrowers the option of participating in mutual self-help programs. Through these programs, nonprofit entities organize 5 to 12 borrowers into a self-help team that works together to complete each other's homes. Evidence from a survey of 502 borrowers suggests that the "sweat-equity" method of building a home improves the chances of successfully owning a modest home while enhancing the wealth of the borrower.*

The current economic expansion has produced several record years for new housing starts, but this statistic may misrepresent America's housing market. Even with the record expansion, many rural residents continue either to be without housing or to live in housing that is deemed to be inadequate. In 1995, 1.6 million nonmetro households lived in housing classified as substandard, many households—both nonmetro and metro—were burdened by housing costs that exceeded 30 percent of their income (Whitener). These adequacy and affordability problems occur in both growing and declining areas. In declining areas, demand for new housing may never arise and much of the existing housing stock may depreciate and/or deteriorate. In growing areas, demand may exceed supply, driving up housing prices and putting adequate affordable housing outside the reach of low-income households.

In response, the Federal Government has over the past 50

years enacted policies that recognize housing as a basic need and homeownership as a desirable goal (Mikesell). Subsequent programs include those operated through USDA, Housing and Urban Development (HUD), State and local governments, and nonprofit organizations such as Habitat For Humanity. USDA programs have provided home mortgages to very-low- and low-income rural families, resulting in higher levels of homeownership in rural communities. USDA's Rural Housing Service (RHS) offers the only direct loan homeownership program—the Section 502 program—available in rural areas (see "Section 502 Single Family Direct Loan Program").

For over a quarter-century, the common denominator in rural self-help housing has been operational funding for self-help organizations under USDA's rural housing program. Known as the Section 523 program, it provides grant funds to hire staff necessary to make mutual self-help housing a reality. When

coupled with home loans through the Section 502 program, these programs become a self-help-financing package, which has been the core of rural self-help housing efforts (Carey). This program substitutes "sweat equity" for cash outlays, reducing home construction and rehabilitation costs, as well as borrowers' capital contributions. Through their labor investment in the home, or "sweat equity," each homeowner pays less for his or her home and ends up having a larger initial equity stake. Each qualified applicant is required to complete 65 percent of the construction labor to build his or her own home. Beneficiaries and volunteers in the program receive training in construction and home repair techniques that increase the homeowners' capacity to extend the life of their housing stock. Since the program began in 1971, 28,217 mutual self-help homes have been built by grantees (nonprofit housing developers) in 45 States and territories. Currently, there are 121 grantees in

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operation, with an additional 26 that have applied for technical assistance grants to also administer the self-help program.

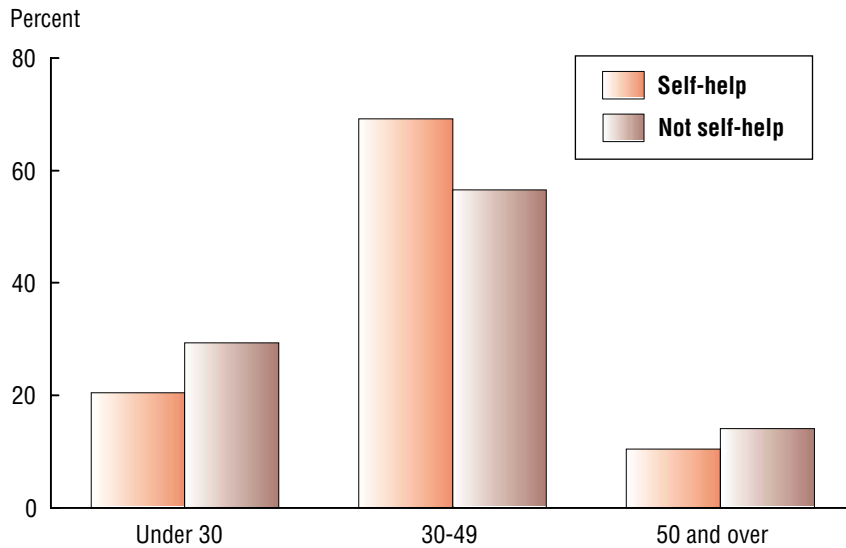
Technical assistance grants and site loans are provided to nonprofit and local government organizations, which supervise groups of 5 to 12 families in the self-help program. Members of each group work on each other's homes, moving in only when all the homes are completed. Once accepted into the self-help program, each enrollee generally applies for and receives a section 502 loan.

At the request of the USDA's Rural Development mission area, the Economic Research Service (ERS), in cooperation with the Social and Economic Sciences Research Center at Washington State University, conducted the 1998 Survey of USDA's Single Family Direct Loan Housing Program. This national survey provides detailed information on 3,027 section 502 borrowers who obtained loans between 1994 and

Figure 2

### Age of section 502 borrowers

The majority of self-help borrowers are between 30 and 49 years of age



Source: 1998 Survey of USDA's Single Family Direct Loan Housing Program, ERS.

1998. Of these, 230 respondents (7.7 percent) participated in a mutual self-help program (see "Survey Data").

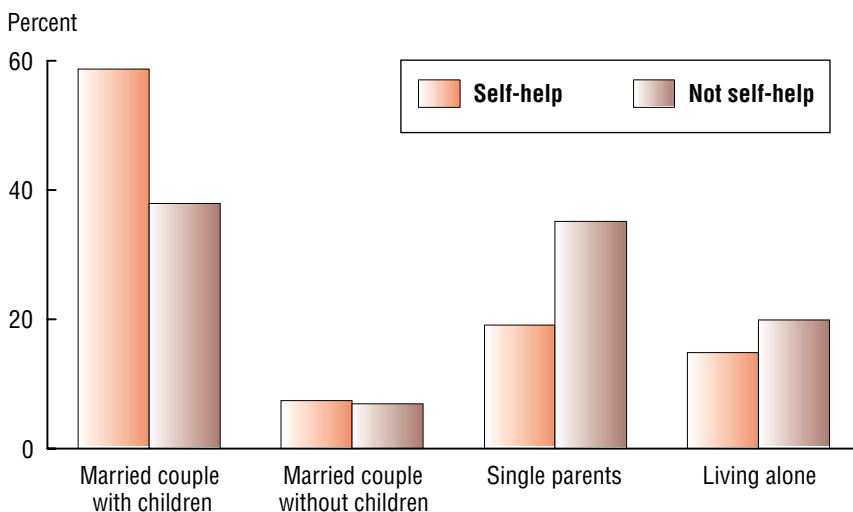
Because self-help borrowers typically qualify for the 502 direct

loan program in a manner similar to other 502 borrowers, they share many characteristics. But whereas an earlier analysis examined how the 502 program as a whole improves the well-being of its participants (Mikesell and others; Wallace and others), this article explores self-help program borrowers' circumstances, motivations, and opinions of the program.

Figure 1

### Household composition of self-help borrower households

Married couples with children are the predominant self-help household type



Source: 1998 Survey of USDA's Single Family Direct Loan Housing Program, ERS.

### Who Participates in the Section 502 Self-Help Program?

**Household Type.** The requirement that self-help borrowers contribute 65 percent of the construction labor needed to build their homes may discourage many applicants. Self-help borrowers are more likely to be married couples with children (59 percent), while other 502 borrowers are just as likely to be single parents as couples (fig. 1). Requiring that all team members' homes be completed before anyone can occupy their home suggests a significant com-

Table 1

**Financial measures of self-help and all other 502 households, 1998**

*Self-help borrowers have higher average incomes and larger returns to home equity*

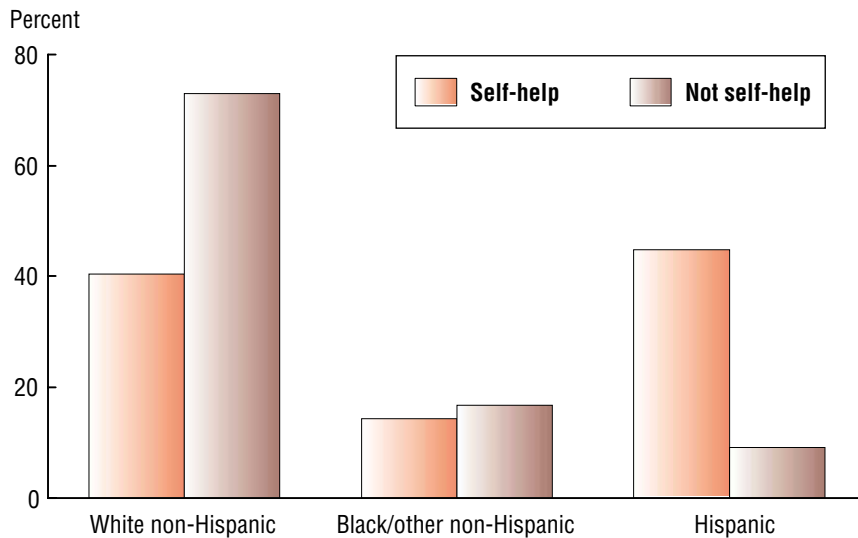
| Item                                 | Self-help households | Other 502 households |
|--------------------------------------|----------------------|----------------------|
| <i>Dollars</i>                       |                      |                      |
| Total income:                        |                      |                      |
| Overall household income             | 21,462               | 20,957               |
| White non-Hispanic                   | 22,448               | 21,709               |
| Minority households                  | 20,852               | 18,706               |
| Single-parent households             | 18,615               | 18,947               |
| <i>Percent</i>                       |                      |                      |
| Annualized rate of return to equity: |                      |                      |
| All households                       | 16.4                 | 7.8                  |
| White non-Hispanic                   | 22.4                 | 8.2                  |
| Minority households                  | 10.5                 | 6.2                  |
| Single-parent households             | 19.4                 | 6.4                  |

Source: 1998 Survey of USDA's Single Family Direct Loan Housing Program, ERS.

Figure 3

**Race/ethnicity of section 502 borrowers**

*Self-help borrowers are more likely to be Hispanic than other section 502 borrowers*



Source: 1998 Survey of USDA's Single Family Direct Loan Housing Program, ERS.

*Respondent Age.* Self-help borrowers tend to be older than other section 502 borrowers. The majority of both groups were between age 30 and 49, but more self-help borrowers (69 percent) fell into this age group (fig. 2).

Borrowers over 50 and under 30 participated in the self-help program, but in lower proportions than other 502 borrowers.

*Race/Ethnicity.* The largest group of self-help borrowers (45 percent) is Hispanic, whereas other 502 borrowers are predominately non-Hispanic Whites (fig. 3). The large proportion of Hispanics among self-help participants explains some of the other characteristics we report. For example, Hispanic households tend to be married couples with children and have larger than average households.

*Household Income and Its Sources.* The mean household income of self-help borrowers was \$21,462 in 1998, versus \$20,957 for all other 502 borrowers. However, racial/ethnic minorities in the self-help program have higher average incomes than other 502 minorities (table 1). The incomes of single-parent households are lower than those of other borrowers in both the self-help and other 502 groups. Both self-help and other 502 borrowers receive the majority of their income (94 percent) from wages and salary.

*Region.* Almost half of all section 502 borrowers are in the South, but only 4.3 percent of self-help borrowers are located there (fig. 4). Self-help borrowers are primarily in the West, where 32.6 percent of 502 borrowers participated in a self-help project. Location of self-help loans is determined in large part by the location of participating nonprofits. These organiza-

mitment of time. Single parents may have more difficulty working around schedule demands, such as work, or childcare. Married cou-

ples may be better able to divide their responsibilities so that one is working while the other contributes to home building.

tions plan, organize, and develop self-help building sites, thus giving self-help borrowers the infrastructure needed for a successful program.

### **Section 502 Self-Help Loans Lead to Improved Housing Conditions**

Self-help homes are new when the borrower moves in. The complementary USDA Section 523 program, which funds the development of the building sites, requires that these homes be served by adequate public infrastructure such as modern water and sewer systems and safe streets. However, most self-help site development is funded through programs other than USDA's. Self-help borrowers typically occupy new homes in planned developments.

#### **General Housing Characteristics**

Over 98 percent of self-help borrowers in the survey were first-time homeowners, compared with 35 percent of other 502 borrowers.

For both, single-family detached houses were most common, typically a three-bedroom unit with at least one full bath. Forty-eight percent of self-help homes had two bathrooms, compared with 24 percent of other 502 borrowers. Forty-six percent of 502 borrowers had only one bathroom, compared with 21 percent of self-help borrowers.

The average price for self-help homes was \$75,956, compared with \$64,000 for other borrowers. This likely results from more of the self-help homes being new and from differences in regional housing markets. The average price paid for a house was not significantly different when controlling for race.

#### **Indicators of Housing Improvement**

Almost 70 percent of self-help borrowers said their housing cost either declined or stayed the same. Housing costs include mortgage payments, taxes, insurance, utilities, and general maintenance. In con-

trast, more than 45 percent of other 502 borrowers indicated that their housing costs had increased. Over 90 percent of self-help borrowers believed that their new housing was better than their previous housing, compared with 82 percent for other 502 borrowers. And 62 percent of self-help borrowers indicated their new neighborhood was better than the previous one, versus 56 percent of other 502 borrowers.

The monetary dividends afforded to sweat equity can be deduced by comparing the self-help group's average rate of return to equity with those of other 502 borrowers. The return to equity measures in percentage terms how much the equity in possession of the borrowers has increased or declined. For our purposes, this percentage change has been annualized to control for differences in length of ownership. On average, self-help borrowers earned 16.4 percent on their equity, twice the 7.8-percent return to other 502 borrowers (table

### **Section 502 Single Family Direct Loan Program**

For over 50 years, USDA programs have provided home mortgages to low-income rural families. The Rural Housing Service (RHS), formerly the Farmers Home Administration, operates a broad range of programs to promote and support affordable housing development in rural areas. Through the Section 502 Single Family Direct Loan Housing Program, RHS offers subsidized homeownership loans to low-income rural families that are without adequate housing and cannot obtain mortgage financing elsewhere. Low-income families are those with adjusted incomes under HUD's applicable low-income limit, usually 80 percent of the median income of the local area; very-low-income families have adjusted incomes under 50 percent of the median income of the area. Loans can be used to build, repair, renovate or relocate a home, or to purchase and prepare sites, including providing water and sewage facilities. They may also be used to refinance debts when necessary to avoid losing a home or when required to make necessary rehabilitation of a house affordable.

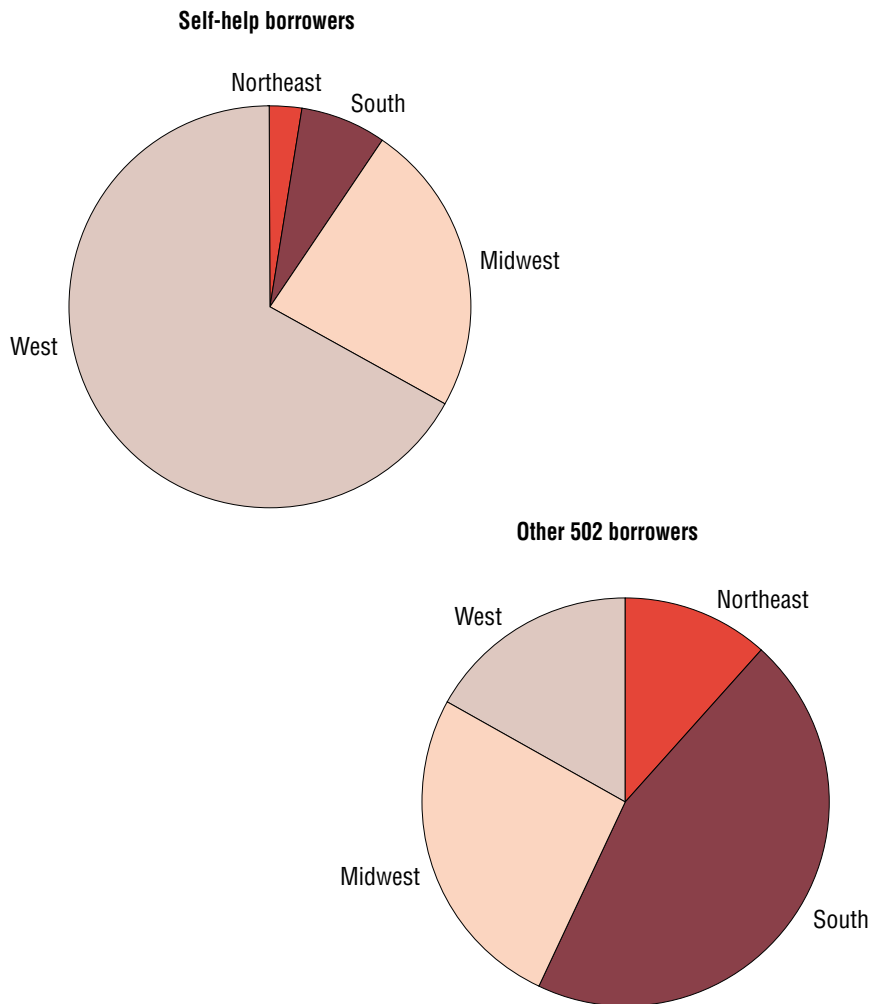
The program provides subsidized loans with effective interest rates as low as 1 percent. The term of the loan is usually 33 years (38 for very-low-income borrowers who cannot afford 33-year terms), no down payment is required, and closing costs can be financed in the mortgage. Interest rates are subsidized, but for most borrowers the payment amount is determined by their income level rather than by the interest rate. Housing must be modest in size, design, and cost. Modest housing is defined as costing less than the HUD dollar cap, which in 1997 was \$81,548, with adjustments for high-cost areas.

RHS provides assistance in rural portions of both nonmetro and metro counties. Eligible areas are defined as open country and rural places under 20,000 population or under 10,000 population in a metropolitan statistical area (MSA). Today, over 600,000 rural borrowers participate in the section 502 program.

Figure 4

### Regional distribution of self-help and other 502 borrowers

A plurality of 502 borrowers are in the South, but most self-help borrowers are in the West



Source: 1998 Survey of USDA's Single Family Direct Loan Housing Program, ERS.

1). However, when controlling for race/ethnicity, this difference in rate of return goes away. This may be a result of a racial or ethnic bias in how survey respondents interpreted the question about the value of their property, or it may suggest that racial/ethnic properties are located in depressed housing markets. Minority borrowers earned the lowest average rate of return among both self-help and other

502 borrowers. Surprisingly, single-parent households in the self-help program had significantly higher rates of return to equity than other single-parent 502 households.

Administrative data on delinquency rates (loans are reported delinquent when payments are 30 days past due) provides additional evidence that self-help borrowers realize a benefit from their sweat equity. The 502 borrowers have

delinquency rates above 15 percent; self-help borrowers average closer to 12 percent. This 3-percent difference persists regardless of the time period when delinquencies are reported.

### Self-Help Borrowers Give High Marks to Program

About half of self-help borrowers believed that it would have taken more than 2 years for them to afford a similar home, and another 45 percent believed they would never have been able to afford a home without the 502 program. In addition, over 65 percent of self-help borrowers rate their experience with Rural Development as having been good or very good. Less than 8 percent rated the experience as poor or very poor. These numbers are very similar to those of other 502 borrowers.

*Satisfaction With Housing.* Most recent self-help borrowers are satisfied with their homes. About 85 percent reported high satisfaction (score of 8 or higher out of 10). This level of satisfaction is similar to that reported by other section 502 borrowers. In addition, borrowers evaluated individual features such as the home's exterior appearance, construction quality, and adequacy of size. Over 80 percent of self-help borrowers rated appearance and size as good or very good. Self-help borrowers rated quality of construction lower than did other 502 borrowers. This disapproval may seem odd since self-help borrowers constructed at least 65 percent of their home structures. Both self-help and other 502 borrowers criticized the quality of subcontractor work. Still less than 3 percent of self-help borrowers rated any features (exterior appearance, quality of construction, size of home

## Survey Data

The 1998 Survey of USDA's Single Family Direct Loan Housing Program was conducted by the Economic Research Service, in cooperation with the Social and Economic Sciences Research Center at Washington State University, at the request of USDA's Rural Housing Service. The survey was designed to provide information on the characteristics of the low-income rural residents who participate. In 1998, a national telephone survey collected information from 3,027 recent participants in the section 502 rural housing loan program whose loans closed between 1994 and 1998. These individuals represent nearly 60,000 recent borrowers nationwide, excluding those in Guam, Puerto Rico, and the Virgin Islands. The survey collected information on the demographic, education, and employment characteristics of borrowers and their household members; current and past housing conditions and costs; satisfaction with current residence, neighborhood, and the USDA financing experience; extent of participation in public assistance programs; and sources and amounts of household income. The survey response rate was 70.3 percent, with a margin of error of  $\pm 1.7$  percent at the 95-percent confidence level. All differences reported in this article are significant at the 95-percent level. See Mikesell and others for more detail on the survey findings, methods, and reliability of estimates.



Photo courtesy Economic Research Service, USDA.

relative to needs) as poor or very poor.

*Satisfaction With Neighborhood and Services.* Self-help borrowers ranked neighborhood quality high, but consistently gave lower ratings on the convenience to services and safety/security of their neighbor-

hoods. Over 30 percent of self-help borrowers rated these neighborhood features as average, poor, or very poor.

Overall, results of this survey suggest that borrowers are generally satisfied with USDA's mutual self-help housing program.

## For Further Reading . . .

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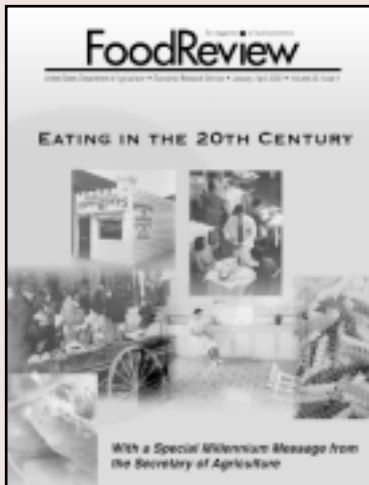
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