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Senate
Committee on Appropriation

RURAL HOUSING PROGRAM

Statement of Arthur A. Garcia, Administrator, before the Subcommittee on Agriculture, Rural Development, and Related Agencies

April 8, 2004

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify on the proposed Fiscal Year (FY) 2005 budget for the USDA Rural Development, rural housing program. As an integral part of Rural Development, rural housing program assists rural communities in many fundamental ways. We provide a variety of both single and multi-family housing options to residents of rural communities. We also help to fund medical facilities, local government buildings, childcare centers, and other essential community facilities.

Rural Development programs are delivered through a network of 47 state offices and approximately 800 local offices. In addition, approximately 2,000 guaranteed lenders participate in the guaranteed single-family housing (SFH) program.

The proposed budget for rural housing program in FY 2005 supports a program level of approximately $5.3 billion in loans, grants and technical assistance. The FY 2005 budget for the rural housing program maintains the Administration’s strong commitment to addressing the needs of rural America, including the needs of minority homeownership. We believe that our efforts, combined with the best of both the nonprofit and private sectors, will ensure that this budget makes a tremendous difference in rural communities. Let me

share with you how we plan to continue improving the lives of rural residents under the President's FY 2005 budget proposal for our rural housing programs.

Single Family Housing Programs

The single-family homeownership programs provide several opportunities for rural Americans with very low- to moderate-incomes to obtain homes of their own. Of the $3.8 billion in program level requested for the SFH programs in FY 2005, $2.5 billion will be available as loan guarantees of private sector loans. An additional $225 million in loan guarantees will be used to refinance more affordable loans for rural families.

The 2005 budget reflects an increase in the fee on new SFH guaranteed loans from 1.5 to 1.75 percent. To offset this increase, the proposed legislation will not only allow the loan amount to exceed 100 percent of approved value by the amount of the fee. This proposal will help ensure that families with limited resources are not prevented from participating in the program.

Our commitment to serving those most in need in rural areas through our direct homeownership program remains strong. The FY 2005 budget includes $1.1 billion in loans to create housing opportunities for low and very low-income families.

Self-Help Technical Assistance and Other Single Family Housing Programs

The FY 2005 proposed budget requests $76.7 million in budget authority to make over $120 million in program level funding available to assist up to 12,000 families with incomes below 50 percent of the area median income. This

includes $35 million in program level for home repair loan funds for 5,800 very low-income families and $31.5 million for grants to assist approximately 6,000 elderly homeowners. The FY 2005 proposed budget for SFH programs also includes $34 million to support the Section 523 mutual and self-help technical assistance grant program, $5 million in loan level for each of two site loan programs, and $10 million in loan level for sales of acquired properties, and $1 million for supervisory and technical assistance grants.

Multi-Family Housing Programs

The Multi-Family Housing (MFH) budget preserves Rural Development's commitment to maintaining the availability of affordable housing for the many rural Americans who rent their homes.

With a total request of $822.5 million program level, of this amount $592 million would be used for rental assistance payments. The majority of these funds will be used to renew more than 42,000 4-year RA contracts. Most of the remainder will be used to provide new rental assistance contract for farm labor housing programs. We estimate using $60 million for MFH direct loans to provide much needed repairs or rehabilitation to approximately 3,400 units of the 17,800 rental properties in the portfolio. These apartments provide decent, safe, sanitary, and affordable residences for more than 450,000 tenant households.

The budget request will fund $100 million in guaranteed loans that may be used for new construction. In addition, the request funds $42 million in loans and $17 million in grants for the Section 514/516 Farm Labor Housing program, $1.5 million in loans for MFH credit sales, and $10 million for housing preservation grants.

Under the President's FY 2005 budget, MFH guarantee loans will enable 2,500 rental units to be built. In the farm labor-housing program, about 3,000 units will be built or repaired. Both programs provide year-round homes to migrant and farm workers.

COMMUNITY PROGRAMS

The Community Facilities budget will enable rural housing program to provide essential community facilities, such as educational facilities, fire, rescue and public safety facilities, health care facilities, and childcare centers in rural areas and towns of up to 20,000 in population. The total requested program level of $527 million includes $300 million for direct loans, $210 million for loan guarantees, and $17 million for grants.

In FY 2003, we assisted 83 communities by investing over $66 million in educational and cultural facilities, over $54 million in public safety facilities in 359 rural communities, and over $162 million in health care facilities in 124 rural communities. Funding for these types of facilities totaled $282 million. The remaining balance was used for other essential community facilities.

In partnership with local governments, state governments, and Federally-recognized Indian Tribes, the FY 2005 Community Facilities budget will support more than 375 new or improved public safety facilities, 140 new and improved health care facilities, and approximately 100 new and improved educational facilities.

PROGRAM HIGHLIGHTS & INITIATIVES

I am pleased to provide you with an update on several highlights from our major programs, as well as key initiatives being undertaken.

SINGLE FAMILY HOUSING UPDATE

Section 523 Mutual and Self-Help Housing

Funding for our mutual and self-help housing technical assistance (TA) program increased significantly in the 1990s from $13 million per year to $35 million per year. I am proud to report that FY 2003 was the best year ever for our mutual and self-help housing program. A total of $40 million was awarded in contracts and two-year grants to conduct self-help housing programs or assist sponsor groups.

The demand for TA funding continues to grow rapidly. There were 46 “pre-development” grants awarded in FY 2002-03, including many first-time sponsors and groups in states with no self-help housing programs. Pre-development funds may be used for market analysis, determining feasibility of potential sites and applicants, and as seed money to develop a full-fledged application. Groups in the pre-development phase typically need 6 to 12 months before they are ready to apply for full funding. We expect a considerable portion of these groups to seek full funding in FY 2005.

Section 502 Guaranteed Program

Demand for our section 502 guaranteed program continues to be strong based upon:

- Aggressive outreach and customer service by Rural Development staff;

- Growing recognition and acceptance of the program by the mortgage industry as an outstanding loan product for lower income rural families. The program requires no down payment and no monthly mortgage insurance premiums;

- Historic low interest rates, which coupled with a Rural Development guarantee, have helped moderate income families achieve homeownership;

- Rural Development's commitment to reducing barriers to homeownership, especially for lower-income and minority families;

- Redirecting low-income families who can afford current low interest rates from our Direct homeownership program to our Guaranteed program;

- The Secretary's Five-Star Commitment to increase homeownership, including minority homeownership.

We developed an Automated Underwriting System (AUS), which will allow lenders to input customer application data and determine immediately whether the Agency will issue a commitment. This system should be fully operational by next summer.

Our Centralized Servicing Center in St. Louis, Missouri will soon begin centralizing loss claims submitted by lenders under our guarantee SFH

program. This process is currently being done in State Offices. Centralization will improve efficiency, consistency, and provide better management data to program officials.

USDA's Five Star Commitment to Increase Minority Homeownership

The rural housing program is committed to increasing homeownership for all Americans, including minorities. Approximately 13 percent of rural America is comprised of minorities. We are pleased to report that over 20 percent of our housing resources reach minority families. Several of our programs, most notably our mutual and self-help housing program, serve over 50 percent minorities. In response to the President's minority homeownership goals, USDA is committed to increasing its success. In October 2002, USDA issued a Five Star Commitment to expand homeownership opportunities for all Americans. We believe this plan will also expand minority homeownership by 10 percent by 2010. Our Five Star Commitment includes the following:

- Doubling the number of self-help participants by 2010;
- Increasing participation by minority lenders through outreach;
- Lowering fees to reduce barriers to minority homeownership;
- Promoting credit counseling and homeownership education; and
- Monitoring lending activities to expand minority homeownership opportunities.

Since announcing the Five-Star Commitment, USDA has:

- Awarded a total of $40 million in self-help housing grants in FY 2003, which was the best year ever for the program. Demand for funding continues to grow. There were 46 “pre-development” grants awarded in FY 2002-2003, including many first-time sponsors and groups in states with no self-help programs.

- Entered into a memorandum of agreement with the Federal Deposit Insurance Corporation (FDIC) to promote and utilize their “Money Smart” training program. FDIC assisted us by providing training to all of our State Offices on delivery of this valuable financial literacy program.

- Lowered the fee for the guaranteed SFH loan program from 2 percent to 1.5 percent for purchase loans and .5 percent for refinance transactions. This change, coupled with record low interest rates, has increased demand for the program. Although the Administration’s FY 2005 budget proposes a small increase in the fee (25 basis points), this is coupled with proposed legislation that will allow the Agency to include the entire fee in the loan. This small increase (less than $500 per loan) will help reduce government outlays and the accompanying legislative proposal ensures that families will not be adversely impacted.

- Obtained commitment from Rural Development State Offices to increase the number of American homeowners, including minority homeowners, served through our direct and guaranteed programs. All states have developed individual plans to increase

homeownership levels for all Americans, including minority homeownership, and to expand the availability of the self-help program. We met our overall objectives for FY 2003 and are on target for FY 2004.

MULTI-FAMILY UPDATE

Comprehensive Program Assessment

We are addressing concerns about our aging portfolio of multi-family housing properties through a Comprehensive Program Assessment (CPA). The CPA was designed to evaluate the multi-family housing programs from several perspectives, including program delivery, organizational structure, effectiveness of programs and alternative financing tools, and a comprehensive analysis of the Section 515 properties in our portfolio.

We selected a statistically random sample of properties from the portfolio (333 of 17,800 or about 2 percent) and they are being evaluated for:

- Assessment of a property’s physical condition;
- Assessment of a property’s financial health;
- Assessment of a property’s position in the real estate rental market;
- Determination of continuing need for this rental housing;
- Assessment of needed capital improvements and cost;
- Assessment of future capital reserves needs;

- Analysis of prepayment potential and;
- Analysis of prepayment incentive costs to retain properties and use restrictions.

From this assessment and analysis, we will develop a model to apply to all portfolio properties. It will tell us the cost of capital needs, the current funds available in reserve accounts, and where revitalization efforts should be concentrated.

The CPA review is on schedule. All sample properties were inspected last year. We expect a report on the physical and market analyses by this spring.

The CPA is also evaluating the organizational structure of the MFH division and determining better ways of delivering our loan programs. Through discussions with stakeholders and HUD, the CPA will determine the best organizational method to address prepayment issues. The evaluations are being done by our contractor, ICF Consulting, in concert with Rural Development senior management and our MFH Advisory Board, consisting of National and State Office staff. As the comprehensive program assessment concludes, we will present results and recommendations to the Subcommittee.

Rental Assistance

During the past year, the Agency undertook an initiative to automate the forecasting of the cost of renewals of Rental Assistance (RA) contracts. This automated system uses actual operating and rental data from each MFH

property that receives RA and predicts the cost of RA needed for these very low and low-income tenants. The automation initiative started in March 2003 and is currently being tested. We expect the forecasting tool to be available by March of FY 2004.

In other efforts to improve internal controls, we plan to add several staff members to the RA program and to develop an internal operating manual. This month, the Department will undertake a Management Control Review of the Section 521 Rental Assistance program, which entails auditing the performance of State Offices in program and funds delivery, and in compliance with program and National Office policy requirements.

We will continue our efforts to more efficiently deliver RA. Last year, we reported on outstanding unliquidated obligations from prior years' RA contracts. The majority of the unliquidated obligations come from RA contracts entered into between 1978 and 1982. These contracts were vastly overestimated at the time by a methodology that incorporated the lowest social security payment, a 25 percent tenant contribution (since increased to 30 percent), and double-digit inflation. Additionally, over 50 percent of these contracts are concentrated in areas that continue to experience low rents, low tenant incomes, and out migration of the population. These factors combined to yield an extremely low rate of RA usage. In the end, the funds for those contracts between 1978 and 1982 have lasted much longer than originally planned. The funds remain in the form of unliquidated obligations on our books, and will continue to be drawn on until they have been exhausted. For those units, this alleviates having to renew the contract until they have exhausted all funds.

The removal of the 20-year time frame for projections coupled with an improved and automated forecasting methodology over the last 4-5 years has contributed to better accuracy in providing just the right amount of RA to last through the term of the contract. We believe that only a very small amount of the FY 2005 funds, if any, will last longer than 4 years. Administratively, continuation of the original purpose of these funds is the most efficient way to handle any of these small and unanticipated surpluses.

Concerning the unliquidated obligations for the old 20-year contracts, last year, the House Financial Services Committee – Oversight and Investigations Subcommittee asked us to investigate using these outstanding balances. When a rental assistance agreement is terminated because the project owner no longer needs units that are receiving RA or by means of a loan payoff or foreclosure, the unexpended funds are applied to other units in the MFH program. However, our Office of the General Counsel has advised that we do not have the authority to recapture obligated, but unexpended RA funds associated with a still active RA agreement. Even if we had that specific authority, there would be substantial litigative risks that affected project owners would be able to successfully bring breach of contract action against rural housing program under the agreement and the ability to use these funds would be the same as if the funds were appropriated from the General Fund.

Proposed Rule 3560

Proposed Rule 3560 consolidates 13 regulations and a number of administrative notices affecting Sections 514, 515, 516, and 521 MFH programs. RHS received 3,000 comments on the proposed rule. We have

completed our review and consideration of these comments and are working on drafting the final rule.

Section 538 Guaranteed Rural Rental Housing Program

Currently, the Section 538 Loan Guarantee Program has 16 properties containing 1,111 units that are built and occupied. There are 26 properties containing 1,345 units under construction and another 65 properties containing 3,610 units with the funds obligated. Also, there are applications representing 32 projects containing 2,569 units awaiting approval.

In the built and occupied units, the average monthly rent is $481. This translates to a median income of about 17 percent of area median income. We also have Section 8 vouchers in about 10 percent of the units to serve low and very-low income residents.

This program can be combined with several other funding sources, such as, Low Income Housing Tax Credits; HOME; and Federal Home Loan Bank Affordable Housing Program funds to provide affordable housing to rural residents presently not assisted.

MFH Automation Initiatives

In addition to the automation of RA forecasting, rural housing program has continued to improve its management information systems. The Agency is developing a data warehouse for both its SFH and MFH loans, which will dramatically improve our reporting capabilities. The data warehouse is now

functional and continues to be populated with data from several existing databases.

Phase 4 of the Multi-Family Information System (MFIS), scheduled for implementation in May 2004, will provide for electronic debiting and crediting of borrowers' accounts, thereby eliminating funds handling in area offices. Phase 4 will also provide the public with a website to locate all the MFH properties, with pictures, property information, contact information, and links to property or management company websites.

Another automation improvement is the Management Agent Interactive Network Connection, which allows property managers to transmit tenant and property data to RHS via the Internet. This data goes directly into the MFIS database and the data warehouse. This web-based system is now being used voluntarily, and is scheduled to become mandatory this summer with the publication of the MFH Final Rule 3560.

Prepayment

The efforts to preserve the Section 515 multifamily portfolio are a top priority of the rural housing program. These efforts are needed because of the increasing age of the portfolio and the need for existing owners to seek viable exit strategies. However, exceptional efforts are needed by existing owners, potential purchasers, non- rural housing program housing financiers, and rural housing program to make these efforts work. At stake is an irreplaceable affordable housing option in rural America that addresses a critical need for rural residents with few housing alternatives.

Owners wishing to sell their Section 515 properties or their ownership interests in a borrower entity may do so at any time. If the property is sold to another owner who will keep their project in the program, we may make resources available or agree to allow third-party resources to be used to compensate the seller for its equity and make repairs to the buildings. If the owner seeks to sell the property to another owner outside the section 515 program, we offer incentives to the owners to stay in the program or provide a 100 percent equity loan to sell it to a non-profit or public body.

Key factors that affect many owners when selling their property is the effect of exit taxes and expectations for equity. We continue to work with owners to develop realistic exit strategies within the limited resources available to affordable housing providers.

In our efforts to preserve the portfolio, a “revitalization tool kit” is being developed that will enable us to offer several alternatives to rural housing program borrowers in financing, debt write-off and subordination, third party financing, and transfer approvals. Rural housing program is currently working to accelerate the loan approval process at the state level by reducing the number of exceptions and waivers, and streamlining the overall transfer approval process.

We are continuing to work with lenders and nonprofits to leverage our subsidy dollars to the maximum extent. For example, we partnered with Fannie Mae to preserve a 44-unit apartment complex in Saranac Lake, NY by subordinating our debt. We eliminated underwriting duplication and established processes going forward that would permit acceptance of underwriting, appraisals, inspections, and reserve account requirements between partners. This is our first joint effort and it will establish a

precedent that we intend to use with other partners in preserving the portfolio.

We continue to work with industry partners to develop options for the preservation of the portfolio. Completion of the comprehensive program assessment and implementation of recommendations to improve program efficiency will enable us to better utilize existing resources such as Fannie Mae, HUD, the Federal Home Loan Bank Board, and others.

RURAL PARTNERS

In our programming for FY 2005, we are stretching the rural housing programs' resources and its ability to serve the housing needs of rural America through increased cooperation with the Department of Housing and Urban Development (HUD) and other partners. We are committed to working with these partners to leverage resources for rural communities. For example, we expect to adopt HUD's TOTAL scorecard for single-family loans. This cooperation between USDA and HUD will save time and money in system development.

In our multi-family housing program, HUD has been extremely helpful in sharing data on their own rural portfolio. We were able to access this information to use in developing comparable properties to those in our section 515 portfolio for our comprehensive property assessment. Additionally, we have approximately 1,700 properties with a rural housing program mortgage and project-based Section 8 from HUD. On these properties, we have an established agreement with HUD that the rural housing program will review and approve operating budgets and rent increases. This eliminates duplicative work and ensures better consistency.

In addition, last June USDA and HUD entered into a Memorandum of Agreement committing our mutual efforts and resources to improving the quality of life in the Southwest Border Region. USDA and HUD have also formed an Interagency Task Force that now includes other federal agencies to better direct limited resources to the region, address jurisdictional issues, and further enhance our collaborative efforts.

CONCLUSION

Mr. Chairman and members of the Committee, we thank you for your support, and with your continued support, Rural Development looks forward to improving the quality of life in rural America by providing housing opportunities and building competitive, active rural communities.

We recognize that we cannot address the homeownership and rural community facilities issues alone, and will continue to identify and work with partners who have joined with the President to improve the lives of rural residents. We will continue to reach out to and partner with lenders, the many non-profit organizations, as well as federal, state, local, and Indian Tribal governments to meet the housing and community needs of low-income families and individuals in rural America.