

RURAL HOUSING SERVICE

Statement of Tony Hernandez, Administrator
Before the Subcommittee on Housing and Insurance
Committee on Financial Services

Chairman Luetkemeyer, Ranking Member Cleaver, and Members of the Subcommittee, thank you for the opportunity to testify before this committee regarding the work we are doing to ensure rural families have access to safe and affordable homes.

Rural communities are often isolated from population centers and product markets. They benefit most from initiatives integrating local institutions and businesses with State and Federal agencies that have intimate knowledge of local needs. Congress had the forethought to strategically place comprehensive programs for rural America in one agency: Rural Development. My Agency – the Rural Housing Service – is one of three within the Rural Development mission area. We seek to help address the unique challenges faced by rural residents as they relate to safe and affordable housing and community facilities and services. The Rural Housing Service administers programs that can make the dream of homeownership a reality, provide access to a safe and affordable rental home, and help develop community facilities and services like hospitals, fire stations, libraries, and schools. As the only federal department with the primary responsibility of serving rural areas, the presence of USDA field offices in every State and several territories helps us to serve the specific needs of local communities.

USDA Rural Development employees are able to identify a wide range of community and economic development resources for locally elected officials, business owners, families, farmers and ranchers, schools, nonprofits, cooperatives and tribes. We utilize a network of approximately 400 field offices throughout the Nation to serve rural America. Our staff are members of the communities they serve and possess expert knowledge of the economic challenges and opportunities that exist in their particular region. This intimate, hands-on approach enables us to provide the technical assistance and oversight often necessary for communities with limited means.

I can assure you that USDA Rural Development has done much with the resources and authority Congress has provided. Since 2009, Rural Development has directly invested in or guaranteed more than \$169 billion in broadband, business, housing, water, community facilities, and electric infrastructure projects that benefit not only rural communities, but our overall economy.

In housing specifically for Fiscal Year (FY) 2014, we helped more than 146,300 families with modest incomes purchase, refinance or repair their homes. Additionally about 870 families built their own homes through the Mutual Self-Help Housing program, earning “sweat equity” in their homes through contribution of their own labor. This program is highly-valued in tribal communities as it allows tribal members to increase the volume of construction of homes on reservations. More than 85 percent of our borrowers were first-time homebuyers. We also helped more than 7,000 very low-income rural families repair their homes through our home repair loan and grant program. Roughly two-thirds of that total was to elderly households who received grants to remove health and safety hazards from their homes. In addition to providing homeownership opportunities, we continued to support more than 678,600 low- and very-low income households with safe and affordable rental housing through the Rural Rental Housing and Farm Labor Housing Programs. We also provided 33,000 very-low, low and moderate-income families with safe and affordable rental housing through the rental housing loan guarantee program. We revitalized more than 10,000 units of multifamily housing and continued to support 252,000 rural families with limited means pay rent. Finally, we helped develop critically needed new housing for more than 615 farm worker families and served 13,900 families through existing farm labor housing. These farm workers, who, despite being essential to the agriculture industry, have historically struggled with severe poverty and substandard housing conditions.

We are proud of our accomplishments. Without our programs, people like Rita Fincher of Park Hills, Missouri, to whom we provided a Single Family Housing Direct loan would be living in substandard housing...or homeless. Ms. Fincher lived in a small, dilapidated mobile home. Rural Development State Office in Missouri, working with a local realtor, the hometown bank, a church, and numerous neighbors and friends was able to get Ms. Fincher a safe and affordable home. Today, Ms. Fincher is happy with her house, volunteers at the local church, and will probably sing and play the guitar or piano with you if you stop in to visit.

While this success and thousands more like it across the country are admirable, let me assure you that we are not content. We know that we can continue to improve our service in rural areas. Over the past 18 months, the Rural Housing Service has been embracing innovation and improvement through automation

and streamlining of processes. We are utilizing technology to create efficiencies that benefit rural families, our lenders, our staff and ultimately taxpayers. In April we modernized the Section 502 Guaranteed Single Family Housing Loan Program by implementing a paperless operation. Field Offices are now able to transact business – collecting underwriting documentation, issuing Conditional Commitments, and delivering Loan Note Guarantees – with approved lenders via a web-based interface. This has resulted in significant savings in paper, postage and time. We estimate \$4.2 million will be saved in just one year using the process nationwide. Similarly, we have begun rolling out new assessment and underwriting tools in our multifamily program to make our transfer process more transparent and predictable so that nonprofits and others are willing to partner with us to extend the affordable use of our portfolio of Section 515 rental properties.

We are committed to continuing our automation efforts and improving our program delivery. The continued development of automation enables us to better manage our workloads, understand housing trends and risks, improve communication with stakeholders, staff and clientele, and ensure accountability. We truly believe that our housing programs are an important element in the Rural Development mission of increasing economic opportunity and improving the quality of life for rural Americans.

Our goal for 2016 is providing more than 170,000 rural residents the assistance needed to become homeowners through \$25 billion in single family direct loans and guarantees. This includes \$900 million in single family direct loans to ensure that the very-low and low-income rural borrowers with the ability to repay mortgage debt are provided access to affordable mortgage financing. The multi-family housing programs request of \$1.45 billion will accommodate the renewals of more than 255,000 rental assistance agreements and support about 5,200 new rental assistance units for preservation of the existing rental portfolio.

Funding alone cannot ensure long-term viability to address programmatic challenges. We included seven legislative proposals in the Fiscal Year 2016 budget.

1. Section 502 Single Family Housing Guaranteed Loan Program User Fee

This proposal will (1) charge a Guaranteed Underwriting User Fee; and (2) allow the User Fee to be retained for Administrative purposes related to the enhancement and maintenance costs for the Guaranteed Underwriting System (GUS) and supporting systems. The goal of this proposal is to ensure that GUS capability keeps pace with changing industry standards so the 502 Guaranteed program, through ongoing technology enhancements, benefits from superior risk management, improved program oversight and more efficient application processing.

2. **Section 502 Single Family Housing Guaranteed Loan Program – Delegated Lender Authority**
This proposal is to provide statutory authority for the guaranteed loan program to delegate loan approval authority to preferred lenders. This authority is similar to current practices at the Federal Housing Administration and the Department of Veteran’s Affairs, and is already available in the Section 538 Multi-Family Guaranteed Loan program.
3. **Section 515 Multi-family Housing Preservation and Revitalization Program (MPR)**
This proposal seeks permanent authority for the program, which has been a demonstration program since 2006. By reducing preservation costs, MPR helps reduce the need to invest additional rental assistance to support the project’s additional debt-service needs. Advantages include greater program certainty in program funding for tenants in need of affordable housing; a certain funding source for rehabilitation and repairs for borrowers; and a permanent program for the agency to make long-term strategic plans.
4. **Rental Assistance Program – Eliminate Automatic Renewals**
Both the Housing Act and the Regulation language at 7 CFR 3560.255(a) direct Rural Development to automatically replenish Rental Assistance agreements to the extent that sufficient funds are available. The agency estimates rental needs on an annual basis; however, Rural Housing Service has processed a second obligation in the same 12-month period in approximately 3 percent of the renewals in a fiscal year. With this proposal, the agency seeks to eliminate the automatic renewal process. Properties will receive an allocation for up to one-year period and will be renewed on the funding anniversary date. This change will enable the agency to more confidently estimate renewal needs for budgeting purposes.
5. **Rental Assistance Program – Minimum Rent Requirement**
This proposal will allow Rural Development to charge a minimum rent of up to \$50 for all of its multi-family housing programs.
6. **Rental Assistance Program – Selective Renewal of Rental Assistance Agreements**
This proposal will provide management flexibility to effectively utilize Rental Assistance during times of budgetary uncertainty. At this time, the agency has no ability to prioritize or determine renewals for properties in most need. Appropriation language currently requires the agency to provide full funding to agreements on a first-come-first-served basis, until all Rental Assistance funds are expended.

7. Process Improvement Income Verification of Rural Housing Service Programs

In response to the Inspector General's findings of fraud, waste and abuse within the Multi-family Housing program, Rural Development is requesting the authority to access both the Internal Revenue Service and the Department of Health and Human Services' income verification databases for use by the multi-family and the single family housing programs. The primary cause for errors is related to information received from applicants that Rural Development cannot verify by an independent source. This proposal addresses that need. Over time, once fully implemented, this proposal is expected to save \$20 million a year.

We believe these proposals will continue to strengthen the availability and integrity of rural housing programs.

Since passage of the Housing Act of 1949, nearly 3.85 million rural Americans have received housing loans and have accumulated assets through equity in their homes. The Single Family Housing programs fill a gap in the private market and are among the most critical tools available to help smaller, poorer, and remote rural communities gain access to mortgage credit and achieve the dream of homeownership.

Despite serving very-low- to moderate-income families with zero down-payment loan products, the performance of our program is strong. Although rural America lags in recovery from the 2008 recession, the delinquency and foreclosure rates in our housing portfolio are modest. This is a testament to our prudent underwriting, strong loan servicing and loss mitigation strategies, and careful oversight that includes individual loan review by agency staff.

As of March, the foreclosure rate of the guaranteed loan portfolio is 1.37 percent, the lowest it has been in nearly 5 years. Even in the direct loan portfolio, which serves households with average incomes of \$29,500, more than 9 out of 10 families served succeed in maintaining homeownership. The total net delinquency rate of the direct program is 11.55 percent. This includes delinquency workout agreements (about 3 percent of the portfolio) whereby special servicing options offered by the agency allow borrowers at any stage of a delinquency to resolve their issues. Many of the families that are delinquent will utilize these options and remain successful homeowners.

We are undertaking an in-depth review of our data to further help us improvements for enhancing Single Family Direct program delivery and performance. By the end of FY 2015, we will implement an automated underwriting system, permit third parties such as certified loan packagers to submit

applications electronically, and move to electronic customer files. These improvements will provide underwriting consistency nationwide and the ability to seamlessly transfer work between States when needed. These improvements will relieve the field staff's operational workload during high-volume periods, enabling States to fully utilize program funds, and expand outreach efforts to communities in need. We are also addressing the loss claims payment and Real Estate Owned (REO)/Foreclosure processes by streamlining business practices and eliminating operational redundancies both within and among States.

The growth in our programs and improved efficiencies are balanced with risk mitigation strategies that include a tiered review process to assess compliance with underwriting standards and program regulations through pre- and post-closing reviews. These procedures are supplemented with Management Control Reviews (MCRs) that examine policies and procedures for making and servicing loans and are performed on all programs on a 5-year cycle, and State Internal Reviews (SIRs) that evaluate program delivery within each State and are also completed every 5 years. Together, the Single Family Direct and Guaranteed housing programs support the specialized needs of smaller, segmented rural markets and economies and offer service along a continuum to meet the needs of very low income to moderate income rural Americans, conveying to them financial security and upward mobility and helping achieve the "American Dream" of home ownership.

We also recognize that home ownership is not possible for many rural families. We are just as committed to providing decent, safe, and affordable housing options to those residents. The average income of Multifamily Housing program households is approximately \$12,000 per year. Many are elderly and disabled. Our Section 515 Multifamily Housing program helps to avert homelessness for this population. Our Section 514 Farm Labor Housing Programs provide critically needed housing for farm laborers, especially those who move from place to place to find work and suffer some of the worst housing conditions and are essential to maintaining a dependable and viable agricultural workforce.

The Multifamily Housing Direct Loan Portfolio (Section 515 and Section 514 Farm Labor housing) has averaged very stable delinquency rates of 2.4 percent and 3.4 percent respectively over the past 10 years. These rates are comparable to the affordable housing industry as a whole. The Section 514 delinquency rate runs slightly higher because of the small portfolio of loans (620), half of which are seasonal. Many of these residents are migrant workers who occupy the housing for 6 to 8 months and then move on to follow the harvesting of crops. As a consequence, these properties do not have consistent rental income, and owners may be late in making mortgage payments. Despite serving extremely low income tenants, we

consistently average a noteworthy low foreclosure rate of 0.5 percent. Even more impressive is that there are no delinquencies in the guaranteed portfolio.

Preservation of these critically needed multi-family units is essential for continuing to meet the rental housing needs of rural America, especially since no new rental properties have been developed under Section 515 since 2011. The agency faces several challenges to accomplishing this goal:

- Prepayment of mortgages by owners for varying reasons, resulting in the removal of government affordability requirements on these properties;
- Aging properties that need repairs to prevent physical deterioration. (A 2004 Comprehensive Property Assessment study commissioned by USDA estimated the total cost of needed repairs at \$2.6 billion over 20 years); and
- Maturing mortgages that are nearing the end of their terms. We estimate that loans on more than 11,500 properties representing nearly 333,845 units will mature by the year 2024.

In addition to the legislative proposals mentioned above, we are pursuing several additional strategies to preserve the availability and affordability of the portfolio of multi-family housing. The condition of the property and the interests of the owner dictate which strategies will work best. These can range from debt deferrals to revitalization and extension of affordable housing use restrictions through our Multi-family Housing Preservation and Revitalization (MPR) demonstration program. We are also working with willing borrowers to extend the life of affordable housing use restrictions through re-amortizations of existing loans. Owners wishing to exit the program can sell or transfer the property to an interested party thereby enabling the property to remain in the program and affordable for tenants. We allow tenants in maturing properties to take their rental assistance with them to other eligible Rural Development properties after pay off. We also are helping owners restructure their loans. This is usually accompanied by an infusion of cash from other sources such as the Low-Income Housing Tax Credit. These funds are used to rehabilitate the property, resolve physical deterioration, and improve energy efficiency.

As we have in the Single Family Housing programs, we are adopting an intense review of our data to identify and undertake improvements to the transfer process in our Multi-family Housing programs. We are implementing a process that is predictable and transparent so that other investors are willing to partner with us to make needed repairs and extend the affordable use of Section 515 properties. Improvements include the roll out of a new Preliminary Assessment Tool (PAT) that provides interested developers the

ability to develop transfer proposals that will comply with RD underwriting thresholds and guidelines and includes relevant policy guidance. In addition, we are developing a new underwriting tool to improve consistency and accuracy. Furthermore, we are hiring National office underwriters to assist field staff with loan underwriting and processing.

Combined, the Multifamily Programs have an outstanding balance of nearly \$12 billion. We manage portfolio risk through both careful underwriting and servicing of loans. The Section 515 and 514 regulations provide for monitoring of borrower and property performance on a routine basis. Rural Development conducts monitoring with an emphasis on working with borrowers who own properties that require additional oversight and possible workouts due to financial management, physical or ownership problems. Management Control Reviews (MCRs), desk reviews, and on-site reviews are conducted regularly. Triennial supervisory visits to review management company operations, physical inspections, and Civil Rights Compliance Reviews are also conducted. These efforts serve to safeguard the portfolio of rural rental properties.

Finally, Rural Development has established a committee to explore the function and implementation of a Chief Risk Officer. We appreciate Congress' support for this position and look forward to the Chief Risk Officer's role in coordinating the mission area's larger risk management strategy.

I am proud to serve as Administrator for an agency that uses mortgage finance and refinance, as well as rental subsidies to ensure affordable housing in rural America. We are making it possible for many rural families to climb into the middle class by using our programs as a ladder of opportunity to success. Thank you for the chance to testify today and for your support of rural housing programs. We look forward to working together to fulfill the promise of rural communities. I am happy to answer your questions at this time.