DELIVERY SYSTEMS FOR AFFORDABLE RURAL HOUSING FINANCE

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EXECUTIVE SUMMARYEXECUTIVE SUMMARY

This paper describes the way in which affordable housing is financed in rural areas. It focuses on the federal and state programs that provide housing finance specifically to rural and nonmetro areas, and on the private and nonprofit organizations that help make financing available. The paper assesses the accomplishments of the rural housing finance delivery system and suggests ways in which the various programs and actors should respond to the federal retreat from the direct financing of rural housing.

To prepare this paper, the National Rural Housing Foundation conducted several telephone interviews with state and federal housing officials, nonprofit housing developers, housing advocates, and representatives of national organizations; analyzed Census and federal agency data; and reviewed current literature on rural housing needs and programs.

Summary of the Programs

The largest federal source of rural housing finance is the Rural Housing Service of the U.S. Department of Agriculture. In fiscal year 1994, RHS programs provided more than $2.8 billion in direct loans and grants to rural households and developers for affordable housing. The major RHS programs include:

- *Section 502 single-family housing program.* This program has created over 1.8 million units of affordable housing for low- and very low-income households. Appropriations for the direct loan program are at their lowest since the mid-1970's. The guaranteed loan program has received increasing appropriations throughout the 1990's, but this program primarily benefits moderate-income borrowers.
- *Section 515 rural rental housing program.* This program finances multifamily housing for some of the the lowest income families in rural areas, but both Congress and the U.S. General Accounting Office have criticized it for poor program administration and the high costs associated with the use of Low-Income Housing Tax Credits. Congress has cut appropriations for this program drastically in recent years.

The U.S. Department of Housing and Urban Development provides housing finance to rural areas through its HOME and States and Small Cities Block Grant programs.

- *The HOME program.* Under HOME, HUD funds state and local governments' locally-designed housing programs. The program does not require states to target their funds to rural areas, and the states' record of doing so is varied.

- *The States and Small Cities Block Grant Program.* This program provides Community Development Block Grant funds to communities of 50,000 population or less. States may use the funding for a number of purposes including housing rehabilitation, public facilities and economic development. Like HOME, this program does not include any set-aside to small rural communities.

HUD also provides housing subsidies through the public housing, section 8, and and other production/subsidy programs. These programs are not targeted specifically to nonmetro areas, however.

HUD delivers its funds to rural areas differently than does RHS. Whereas RHS allocates its funding for a specific program, and delivers it directly through its own network of state, district and local offices, HUD allocates its funding in block grant form to states and localities which then distribute it according to their own criteria. Generally, the state agencies do not have a delivery network that is comparable to RHS to ensure uniform rural access to funding.

The state agencies that administer the HUD programs also may administer their own state revenue- or bond-funded programs. These programs may be easier for developers to use than federal programs to the extent that there are fewer restrictions or regulations to follow. These agencies may target a portion or all of the funds to rural areas.

Private Sources. On the private side of the delivery system, it appears that small and rural banks are reluctant to make affordable mortgages. Rural banks offer less favorable loan terms than do their urban counterparts. Minorities particularly do not appear to have the same access to private mortgage credit as white borrowers. To varying degrees, the government-sponsored enterprises and state housing finance agencies work with banks and with nonprofits to expand the mortgage credit supply to rural areas.

Nonprofits. Nonprofits play a vital role in bringing housing finance to rural areas. They develop housing with the RHS and other public programs, often building in neglected rural markets. Moreover, they undertake important counseling and outreach efforts to rural households. There are national and state intermediaries that assist nonprofits in these efforts, and there is a growing secondary market for nonprofit-originated loans.

Recommendations

1. The RHS system provides the greatest assistance to poor rural households, but there is some question about the political viability of an extensive system of federally financed field offices. There must be some local presence to ensure that small communities have access to affordable federal and state funds since rural areas often are isolated and have a relative lack of financial resources and technical expertise. Nonprofits can inform communities about available subsidies, provide technical assistance, and serve as conduits for funding. Therefore:

- *Where there cannot be a local RHS office to provide direct assistance, RHS should coordinate with nonprofit technical assistance providers to ensure that the area receives service. The nonprofits should receive the necessary operational support to help fill this gap.*

2. RHS should refocus its programs on more isolated rural areas since its offices overall are making a high percentage of their single-family housing loans in metro counties. In addition, RHS' proposed regulations will raise the borrowing costs of section 502 direct loans to low-income borrowers and reduce the Agency's underwriting flexibility. Congress is providing more funding for guaranteed loans, but these loans do not benefit minorities and lower-income households in large numbers.

- *RHS should improve its targeting of single-family housing resources to meet underserved markets and low-income borrowers.*

- *RHS should promote leveraging for its programs, particularly by supporting self-help housing development to* *reduce households' borrowing costs and stretch existing subsidies. However, RHS should ensure that the leveraging benefits lower-income households and does shift resources toward higher-income borrowers.*

Congressional and Departmental investigators have repeatedly questioned the project selection process and other workings of the section 515 program. The perceived weaknesses of section 515 have undermined Congressional support for the only federal program to target rural areas for much-needed low-income rental housing. Therefore:

- *RHS should develop reforms to the section 515 program that will resolve Congressional criticisms as expeditiously as possible. In particular, it should promote legislative and administrative action to implement the H.R. 1691 reforms and to ensure that subsidies are used cost-effectively. If the section 515 program is not viable, however, then other approaches to rural rental housing must be developed.*

3. It is clear from HUD data that the HOME and CDBG programs can be used in rural communities. Nonetheless, it is not clear that there is an adequate delivery mechanism in all states to ensure that rural communities receive sufficient assistance. Therefore:

- *HUD programs should include a rural area set-aside to communities with populations of 10,000 or less.*

- *Match requirements should be clarified and adapted to rural communities' needs. Either states should not be allowed to pass the HOME match requirements onto lower-income communities or the match regulations should be amended to account for the resources that rural states and areas have to offer.*

- *HUD should focus its financial and technical support for nonprofit and CHDO development on nonprofits serving small and rural communities to enhance their ability to serve as delivery mechanisms for HOME funds. States should be encouraged to use their CHDO capacity-building and operating funds for CHDOs serving rural areas.*

- *The HOME program should permit CHDOs to recycle program funds, in a manner similar to the CDBG or HPG program, in areas where HUD has determined that there is no local jurisdiction able to establish its own HOME Trust Fund to capture HOME repayments.*

4. It appears that some of the federal regulations governing the use of funds create difficulties for some developers as they use the HUD programs to develop rural housing. Therefore:

- *RHS and HUD should work with a task force of rural government representatives and rural nonprofit and for-profit developers to examine federal site standard regulations, Davis-Bacon wage requirements, environmental requirements and other rules. The task force should determine whether the regulations are appropriate for rural conditions or whether there are local problems of interpretating and implementing them.*

5. The "system" will be more variable as more actors and funding sources are involved. An efficient delivery system should be predictable in terms of the products available, the resources appropriated, and the ease of access. If a reduction of federal subsidies leads to a need for more inputs, then it is vital for the system's success that there be national, state and regional forums to help groups exchange ideas, develop cooperative arrangements, and promote ongoing communication. Therefore:

- *There should be nationwide encouragement of interagency arrangements that can leverage the expertise of RHS' field network with other agencies' resources, including those of the Farm Credit System.*

6. Current political trends call for greater involvement by the private sector in addressing social needs. For housing, the expansion of conventional and nonprofit secondary market activity can induce more rural banks to make affordable mortgages. Such efforts will require a firm and long-term commitment of resources for outreach and education. Therefore:

- *Fannie Mae and Freddie Mac should increase their purchase of rural mortgages, to ensure that these mortgages compose a fair share of loans purchased to meet the underserved areas goal.*

- *The GSEs should continue their education and product development efforts with an aim toward involving more nonmetro banks in mortgage lending. They also should continue their partnership efforts to help develop local bank staffing capacity, including the assurance of sufficient deal flow to make staff training feasible.*

7. The experience of the some nonprofit lenders suggests that, with appropriate servicing and borrower counseling, loans that do not meet traditional underwriting criteria can be safe investments for the secondary market. Therefore:

- *The conventional secondary market should support proven nonprofit lending models which accommodate non-traditional underwriting standards, by purchasing their loans or swapping them for GSE securities.*

- *Small banks should continue to be held to the standards of the Community Reinvestment Act. The GSEs and the Federal Housing Finance Board, through their programs, can assist in making CRA-type loans more attractive to these banks.*

PART I: INTRODUCTIONPART I: INTRODUCTION

1. Purpose and Organization. Purpose and Organization

The purpose of this paper is to describe the current system of rural housing finance, to assess its accomplishments, and to suggest ways in which it can be strengthened. Rural housing finance is delivered primarily by the Rural Housing Service of the U.S. Department of Agriculture and its network of offices and nonprofit and for-profit developers. This system is augmented by state agencies which use the programs of the U.S. Department of Housing and Urban Development; state Housing Finance Agencies and community development agencies; rural banks and nonprofits; and the government-sponsored enterprises. This latter group includes the secondary market institutions and the Federal Home Finance Board.

Because the federal government is reducing the funding and subsidy it will provide to rural areas for housing, these other actors must expand their role to meet rural housing needs. In particular, renewed Congressional interest in block grants suggests that state agencies using HUD's HOME and CDBG programs may have to devote more of their resources to rural housing. Federal and state agencies alike may have to rely more on private banks and other organizations to help fill the gap that the federal retreat leaves in the housing finance delivery system.

This paper discusses how each of the above programs and institutions deliver financing to rural areas and considers whether they can meet the challenges that Congress has posed through its funding cuts. It answers the questions: how effective have the RHS programs been in meeting rural housing needs? how do the HUD programs compare? which delivery systems appear most effective at reaching rural areas? how can states and national organizations be most helpful? and, what is the role and need of nonprofit organizations in delivering housing assistance?

The paper is organized into the following sections:

- <u>Introduction</u>, which describes the recent changes in federal rural housing policy and in the delivery of housing finance. This section also describes the demographic, housing and mortgage credit conditions of rural areas which indicate a continued need for a targeted rural housing assistance policy.

- <u>Federal and State Programs</u>, which summarizes the operation and accomplish-ments of the major RHS and HUD programs and the ways in which states themselves address rural housing needs. This section also discusses the nonprofit housing sector's use of these programs.

- <u>Government-Sponsored Enterprises</u>, which explains how the secondary market and other GSEs have contributed to the rural mortgage market and how that contribution can be broadened.

- <u>Nonprofits</u>, which explores some of the activities of nonprofit agencies, developers, and intermediaries in using public and private capital to make affordable housing available to rural households.

2. Recent Changes in Rural Housing Finance Policy. Recent Changes in Rural Housing Finance Policy

Recent events suggest that the nation's commitment to affordable rural housing is undergoing a significant reevaluation. In fiscal 1994, Congress appropriated $1.8 billion for the section 502 direct single-family housing loan program, $540 million for the section 515 multifamily rental housing program, and $245 million for a number of smaller housing production loan and grant programs. In fiscal 1995, Congress reduced funding for these programs, appropriating $1.2 billion for the section 502 program, $220 million for the section 515 program, and $110.4 million for the other production programs—a total reduction of 40 percent.

At the same time, Congress increased the funding for the section 502 guaranteed single-family loan program from $750 million to $1 billion. This realignment of direct and guaranteed lending authority shifted federal assistance from subsidized lending that benefits low-income households to unsubsidized guarantees affordable primarily to moderate-income borrowers.

As drastic as it was, Congress' reduction of direct rural housing funding was not unprecedented. The President's fiscal 1995 request for rural housing appropriations moved in the same directions, cutting the section 515 program to $220 million and increasing the section 502 guarantee authority to $1.3 billion. Although the Administration did request a direct section 502 loan level of $1.8 billion, it sought only a marginal increase in farmworker housing loans and left the other program levels untouched.

Why are the rural housing programs under attack? The immediate answer may be that, in a time of shrinking discretionary domestic spending, Congress is looking for easy targets. Moreover, the Congress now is engaged in a wholesale reexamination and reformulation of many federal housing and social services programs. Welfare, Medicare, and the programs of the U.S. Department of Housing and Urban Development each may be delivered to the states as block grants. The "New Federalism" again is in vogue, and the Congressional interest in administering housing and community development programs is at an all-time low.

Against this backdrop of attacks, it should be noted that the delivery system for the rural housing programs has not changed significantly since the programs were authorized in Title V of the National Housing Act of 1949. New programs have been authorized and existing programs have been expanded since 1949, but the basic shape of the rural housing delivery system—loan and grant-making through a network of state, district and county offices—has changed little. In contrast, HUD has proposed and developed new programs and ideas, most notably the HOME Investment Partnerships Program in 1992 which devolved responsibility for program design and delivery to state and local governments.

It now may be time for the rural housing advocates to consider whether there be new programs or delivery systems for rural housing finance. Of the current programs, what should be changed, what should be maintained, and which actors should be involved?

The following section provides a setting for the policy discussion by describing recent changes in rural America demographics and income relative to those in urban areas. These changes indicate a continuing need for targeted rural housing assistance. The section also describes current rural housing and banking conditions and concludes on their implications for a rural versus urban housing policy.

3. Rural Demographic, Economic and Housing Conditions. Rural Demographic, Economic and Housing Conditions[i]

A. Population, Income and EmploymentA.Population, Income and Employment

Between 1970 and 1990, the nation's population increased by 22 percent, from 203 million to nearly 249 million. Through migration, population growth and the redesignation of previously nonmetro areas as metropolitan, the metro population saw most of this increase: it rose from 139 million to 192 million over this period, changing from 68 percent of the national total to 77 percent. There was a corresponding decline in the nonmetro population of 12 percent, from nearly 64 million to 56 million.[ii,iii]

The nonmetro population also grew older. The percentage of the nonmetro population that is 65 or more years old grew by more than 2.7 million between 1970 and 1990, increasing from 11.3 percent of the total population to 14.7 percent. The share of the nonmetro population that is 0-17 years fell from 34.2 percent to 25.3 percent. Although these changes are mirrored in metro areas, the 65 and older population in metro areas is only 12 percent of the total metro population.[iv]

Nonmetro family incomes grew more slowly than metro family incomes. In 1970, the median nonmetro family income was $7,832, 75 percent of the metro median of $10,474. In 1980, the nonmetro median family income was $16,592, 78 percent of the metro median family income of $21,128; but over the next decade, nonmetro incomes fell so that by 1990 the median nonmetro family income of $27,591 was only 73 percent of the median metro family income of $37,896. In 1979 dollars, nonmetro incomes fell by 3 percent between 1980 and 1990 while metro incomes rose by 5 percent.

	1970	1980	1990
United States	**13.7**	**12.4**	**13.1**
Metro	**11.5**	**11.4**	**12.0**
Large	10.3	11.0	11.5
Small	13.3	11.9	12.9
Nonmetro	**20.9**	**15.7**	**16.8**
Adjacent to large metro	15.0	11.9	13.2
Adjacent to small metro	20.2	15.1	15.8
Not adjacent to a metro area and with a city	19.6	15.2	17.3
Not adjacent to a metro area, and without a city	25.2	18.4	19.4

A city has a population of 10,000 to 49,999 residents.

N.B.: The 1970, 1980 and 1990 figures are all based on metro-nonmetro classifications as of 1983.

Exhibit 1: Poverty rates by county location, 1990.

Employment indicators for rural areas followed a similar pattern. The labor force grew by 31.4 percent in the 1970s but only by 11.8 percent in the 1980s. In the remote rural counties, the growth rate fell from 28.7 percent in the 1970s to 6.9 percent during the 1980s. Nonmetro employment fell in agriculture, mining, and manufacturing, and nearly all employment growth came in the lower-paying service sector.[v]

These changes led to a rising nonmetro poverty rate. As 1 shows, nonmetro poverty has been higher than metro poverty throughout the 1970-1990 period. Although the difference between metro and nonmetro poverty rates narrowed during the 1970s, it grew during the 1980s as poverty rates increased nationwide. More importantly from a policy standpoint, poverty is more pronounced the further one moves from metro areas. At one end of the spectrum, large metro areas had a poverty rate in 1990 of 11.5 percent; at the other end, nonmetro areas without large cities and not adjacent to metro areas had a poverty rate of 19.4 percent.[vi,vii]

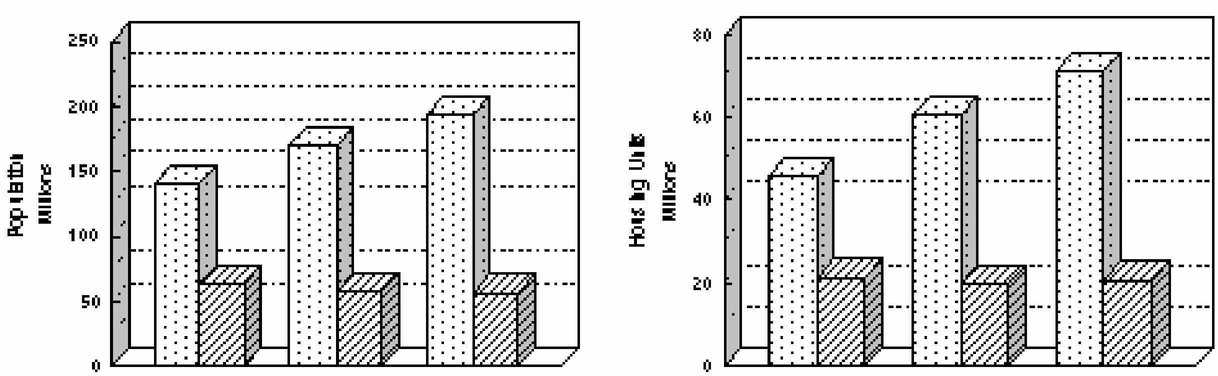
B.HousingB.Housing

The changes in the rural housing inventory reflect the trends in rural population and income. The stock in metro areas increased by 62 percent between 1970 and 1990 while the nonmetro stock declined by 4.2 percent.[viii] 0 compares the changes in population and housing in metro and nonmetro areas. For the most part, the changes parallel each other, except that between 1980 and 1990, there was an increase in the number of occupied housing units. This increase may have been a reflection of the relative improvements in rural economies during the 1980s.

Homeownership. The rate of homeownership in nonmetro counties in 1990 was 72.4 percent, compared to 61.8 percent in metro counties. Although homeownership is generally a sign of higher income on an individual basis, the overall higher nonmetro area homeownership rate is not due to this factor, given that nonmetro household incomes on average are lower than metro household incomes. Instead, the rate appears to be a result of historical settlement and land use patterns. Many housing professionals have noted that, more so than urban households, rural households prefer to own their own homes; there is a strong attachment to owning land and to having space between one's family and the neighbors in rural areas.

The preference for homeownership coupled with lower rural incomes leads families to purchase low-cost homes. As a result, much of the difference in the nonmetro-metro rate of homeownership is due to higher rates of mobile home ownership in rural areas. Some 15.3 percent of the nonmetro owner-occupied units are mobile

Figure 1: Metro and nonmetro population and housing units, 1970 - 1990.



	1970	1980	1990
Metro	139,418,811	169,430,623	192,725,741
Nonmetro	63,793,115	57,115,182	55,984,132

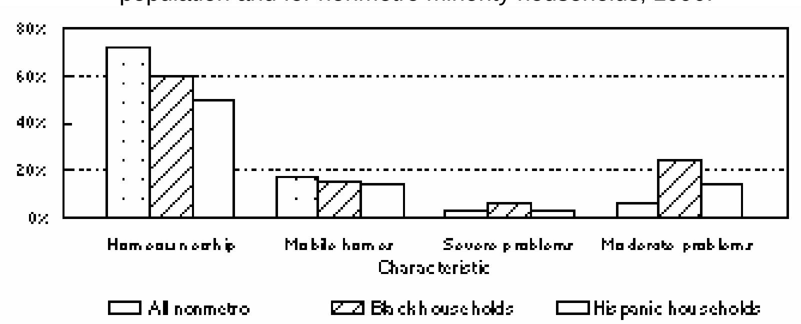
	1970	1980	1990
Metro	46,075,866	60,497,718	71,265,264
Nonmetro	21,580,700	19,891,955	20,682,146

homes, compared to 5.9 percent of the metro units.

In both metro and nonmetro areas, the percentage of homeowners living in mobile homes increased during the 1980s, but the nonmetro rate increased by 5.3 percentage points (up from 10.0 percent) while the metro rate increased by only 1.6 percentage points (up from 4.3 percent).[ix] At the same time, the rate of overall homeownership in nonmetro areas fell by 0.7 percentage points while it increased in metro areas by 0.2 points. These changes in tenure and mobile home ownership suggest that single-family housing and conventional mortgage credit may have became less affordable during the 1980s for nonmetro families than they did for metro families.

Quality and cost. Housing costs are lower in nonmetro areas, but since incomes are as well, cost burden is a problem for the poor in rural areas. More than 22 percent of the nation's 20.4 million nonmetro households—and 57 percent of the 3.8 million nonmetro households at or below the poverty line—paid 30 percent or more of their income for shelter in 1991; 8 percent of nonmetro households and 31.5 percent of poor nonmetro households paid 50 percent of their income or more.[x] Although cost burden is still a greater problem in metro areas, the incidence of burden among nonmetro households is on the rise. The Housing Assistance Council, a nonprofit housing technical assistance provider and research organization based in Washington DC, analyzed the 1989 and 1991 American Housing Survey (AHS) Data and found that nonmetro household income fell by 3.9 percent between these years alone while housing costs rose by 2.7 percent.

Figure 2: Selected housing characteristics for the general nonmetro population and for nonmetro minority households, 1990.



Nonmetro units also tend to have a greater incidence of moderate or severe housing problems than metro units. The AHS classifies as "moderate" and "severe" problems any failed or missing heating, electrical and plumbing system, structural damage or other significant repair needs.

According to the 1991 AHS, 10.4 percent of nonmetro units experienced these problems as compared to 7.3 percent of metro units. (For nonmetro mobile homes, the incidence of problems is even higher, 11.7 percent.) Moreover, between 1985 and 1991, the number of reported problems in units occupied by nonmetro households increased by 1 percent while decreasing by 7 percent for metro households.[xi]

Race/ethnicity and housing conditions. American Housing Survey figures for nonmetro black and Hispanic households suggest that minority households have worse housing conditions than the nonmetro population at large. As illustrated in 1, the rate of homeownership among all nonmetro households is 72.3 percent. Among nonmetro black households, however, it is less than 60 percent, and among nonmetro Hispanic households it is less than 50 percent. Black households are four times as likely to live in housing with moderate problems as the general nonmetro population; Hispanics are more than twice as likely. Minority households are less likely to live in mobile homes than white households, but this may reflect their generally lower rate of homeownership.[xii]

Native Americans also represent a sizable portion of the minority population with housing problems. Although they represent only 1.3 percent of the nation's rural population, they are 4.1 percent of the rural population below poverty, and their poverty rate is 36.6 percent[xiii]

Much of the information on housing conditions for Native Americans is available indirectly, based on data for Native American areas as a whole. Only 41 percent of the households in Native American areas live in rural communities, and 73 percent of the residents in Native American areas identify themselves as "white." Even if this data serves only as a proxy for data on Native Americans, however, it suggests that Native Americans' housing conditions are dire: for example, 46 percent of the households in Native American areas are cost-burdened and 10 percent of renter households in Native American areas are over-crowded and/or lack complete plumbing. Thirteen percent of rural Native American households nationwide lived in homes without complete plumbing in 1990.[xiv]

The resolution of housing problems in Native American lands is complicated by the fact that these lands generally are held in trust. As a result, individual households cannot alienate the land on which their homes sit nor can borrowers cannot place a lien on those homes. RHS, the Housing Assistance Council and Fannie Mae are considering ways to deliver housing finance to these areas that will take the land's trust status into account; HUD also offers a loan guarantee program for Native American lands (the section 184 program) that allows lenders to take forms of collateral other than the home. At present, however, efforts to assist Native American households lag behind those to assist other rural families.

C.National and Rural Credit MarketsC.National and Rural Credit Markets

Data on banking institutions suggests that small, locally-owned banks are vanishing from rural areas. Between 1980 and 1993, the number of U.S. banking institutions fell from 12,363 to 8,415, and almost the entire change occurred within the ranks of the smaller banks (those with assets under $2.3 billion). Their numbers fell from 11,653 to 7,761, a decrease which represents 98 percent of the total change in the number of banks nationwide.[xv]

The savings and loan crisis of the 1980s also took its toll on rural areas. Between 1985 and 1989, the number of thrift institutions headquartered in rural areas fell from 1,031 to 909.[xvi] (These figures do not reflect the closure of individual branches.) This loss may have had a significant impact on the availability of mortgage credit in rural areas since thrifts are generally required to make at least 65 percent of their loans in housing related activities and they traditionally originated many of the mortgages in rural areas.

With the deregulation of the banking industry and the rise of interstate banking, it appears that more urban-based banks have moved into rural areas. The USDA Economic Research Service has released figures that show that while there are more commercial banks now serving rural areas, the number of FDIC-insured commercial banks *headquartered* in rural locations fell by 30 percent between 1980 and 1994, from approximately 8,350 to 5,841. Their figures show that between 1980 and 1993, the typical rural county gained one banking office but the number of rural counties with at least one banking office fell from 2,356 to 2,227—in other words, while most rural counties saw in increase in the number of banking offices, at least 100 rural counties lost local access to service. (2 provides more detail.)[xvii] In summary, these numbers show that there are fewer rural-based mortgage institutions now than there were in the early 1980s.

The Availability and Affordability of Mortgage Credit. There is ample anecdotal evidence of smaller rural banks that offer 5-year, 20 percent downpayment mortgages. Various researchers have suggested that smaller banks are more conservative lenders generally. They have found that:

- Small banks have lower loan-to-deposit and loan-to-asset ratios than larger banks.
- Community-based banks invest more of their deposits in securities, federal funds transactions, etc., than large money-center banks. However, multimarket banking firms may also move locally-raised deposits to other areas to meet demand.
- In communities with undiversified local economies, small community-based banks are more likely to turn down viable loan requests.
- Small banks are less likely to participate in loan guarantee programs.[xviii]

AHS data confirms that affordable mortgage credit is more scarce in rural areas than in urban areas. According to the 1991 American Housing Survey:

	Metro		Nonmetro	
	1980	1993	1980	1993
	Number			
Counties with one or more bank offices	713	835	2,356	2,227
Banking firms per county	10.6	13.9	4.1	5.2
Bank offices per county	45.6	52.7	7.3	8.3
	Percent			
Counties served by				
1-2 banking firms	5.6	2.3	31.1	20.0
3-5 banking firms	24.0	13.3	45.8	41.8
6-9 banking firms	31.4	30.4	18.9	28.3
10 or more banking firms	39.0	54.0	4.1	10.0

Exhibit 2: Changes in commercial bank office numbers in metro and nonmetro areas, 1980-1993.

- Only 53 percent of nonmetro homes (and only 46 percent of rural nonmetro homes) had mortgages compared to 62 percent of metro homes. Even adjusting for age and income, a higher percentage of metro homeowners had mortgages than nonmetro homeowners.

- The median interest rate and term for a rural mortgage were 9.3 percent and 27 years, versus 9.0 percent and 29 years for an urban mortgage. For more rural nonmetro areas, the terms were even more unfavorable: 9.5 percent at 21 years.[xix]

- Last, 6.4 percent of nonmetro borrowers, and 7.4 percent of rural nonmetro borrowers, obtained funding from nonbank sources such as the seller or a private individual (either alone or in combination with bank financing), compared to 4.3 percent of metro borrowers.[xx]

There are many factors which may contribute to the less favorable mortgage terms smaller banks may offer. Economy of scale is one; rural settlements are more dispersed, making it more difficult for mortgage lenders to achieve the loan volume they need to operate efficiently. Small banks may not have the resources they need to maintain a trained underwriting staff. Last, some small banks may find it difficult to comply with FHA processes and procedures or may lack the capital required to become FHA- or Fannie Mae-approved lenders.[xxi] Without access to the secondary market, these banks have less incentive to make mortgages on the same terms as those commonly sold to Fannie Mae.

Minority Access to Mortgage Credit. 1993 American Housing Survey data suggests that nonmetro minority borrowers use private market credit less often, and publicly-assisted mortgages more often, than non-minority borrowers. Forty-two percent of minority homeowners have mortgages compared with 47.9 percent of white homeowners.

However, the flip side of this picture is that low-income minority homeowners appear more likely to have mortgages than white homeowners. Based on the 1993 AHS data (albeit a small population), 29.9 percent of nonmetro minority homeowners with incomes at 80 percent or less of the national nonmetro median had mortgages; in contrast, only 25.9 percent of nonmetro white homeowners with similar incomes did. Some 27.7 percent of these minority borrowers reported that they received a low-cost mortgages with the assistance of a government program, compared to 14.4 percent of the white borrowers.[xxii]

4. Ramifications for Housing Policy. Ramifications for Housing Policy

The characteristics of rural areas are such that these areas need housing assistance targeted specifically to them. This assistance would include more outreach than might be necessary for urban areas, direct subsidized lending and grantmaking, and support for homeownership (including support for housing rehabilitation programs).

The need for outreach and targeting is based on the fact that rural populations are more spread out, and rural municipal governments tend to be smaller and in some cases part-time. These communities generally have a lesser technical capacity to seek out and win federal or state assistance or to direct it to the neediest households. Federal intervention, either directly or through nonprofit and other service organizations, would overcome this lack of local capacity.

Subsidized loans are needed because rural households have lower and slower-growing incomes than urban households. Homeownership should be stressed because it is the traditional means of housing in rural areas. However, given the poorer housing quality of nonmetro units, the very low household incomes in some cases, and the aging of the population, there must also be a sufficient supply of rental housing made available to meet the need of families who cannot afford or do not desire homeownership.

Direct federal lending—or the creation of real regulatory and financial incentives for private lenders—is important because rural banks currently appear to be reluctant to make affordable mortgage credit available in adequate supply and at adequate terms. This reluctance also means that the increased federal emphasis on using guaranteed loans to meet rural housing needs will not help lower-income people. In particular, given the difficulties minorities face in obtaining conventional financing, the substitution of federal loan guarantee programs for direct lending will not help them in a meaningful way.

Finally, the apparent success that minority-headed households have had in obtaining mortgages with federal assistance is a clear sign that federal programs do help low-income and disadvantaged people when the market fails. This success shows that the importance of maintaining federal efforts—even while supplementing them with other programs—cannot be questioned if the nation's affordable rural housing needs are to be met.

PART II: FEDERAL AND STATE PROGRAMSPART II: FEDERAL AND STATE PROGRAMS

1. Rural Housing Service Programs. Rural Housing Service Programs

This section considers the delivery, accomplishments and future direction of the largest RHS financing programs: the section 502 single-family housing direct and guaranteed loan programs and the section 515 multifamily housing loan program. It also briefly discusses the section 521 rural rental assistance program and the smaller Title V programs, and also the role that private nonprofit and for-profit developers play in delivering the programs to low-income households.

A. Changes in Funding and StructureA.Changes in Funding and Structure

The nation's direct loan and grant rural housing programs are administered by the Rural Housing Service (RHS) of the U.S. Department of Agriculture and its network of state, district and local offices. RHS is the successor agency to the Farmers Home Administration; originally called the Rural Housing and Community Development Service it was created through the 1994 restructuring of USDA, to administer the Department's housing and community facilities loan and grant programs. The rural housing programs are authorized under Title V of the Housing Act of 1949 and are targeted to non-urban communities of 10,000 or fewer population, or 20,000 or fewer if the area is nonmetro and has a serious lack of mortgage credit for low- and moderate-income households.

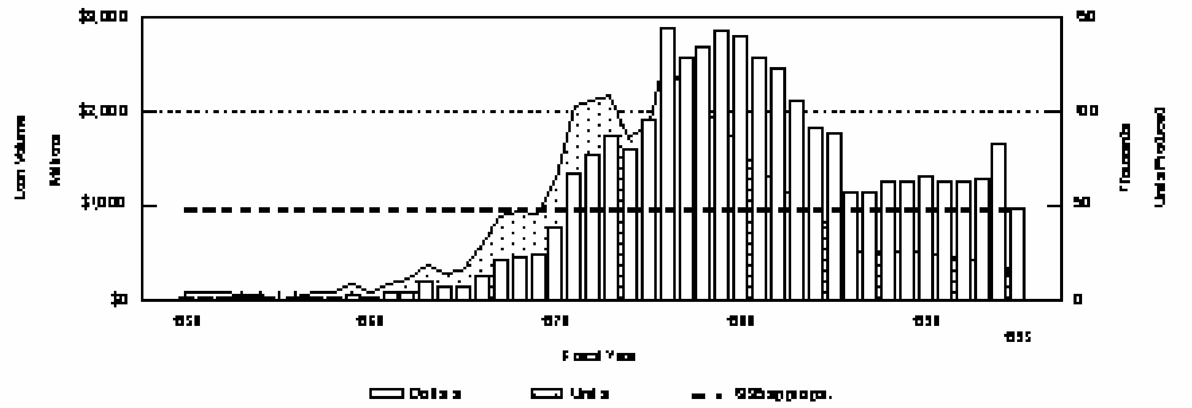
Although the government invested in a new organization for delivering rural housing, its support for financing rural housing through direct lending and grantmaking is in decline. In 1976, the government lent nearly $2.9 billion for the single family housing direct loan program of the Farmers Home Administration (FmHA). For 1996, the House of Representatives has recommended an appropriation of only $1 billion. Moreover, RHS' delivery system itself is shrinking with the planned consolidation of FmHA/RHS county offices into more centralized units.

In 1994, Congress passed the Department of Agriculture Reorganization Act (H.R. 3171). Through the Act, USDA restructured the Farmers Home Administration, splitting its field presence into two agencies, the Rural Economic and Community Development Service (RECD) and the Farm Service Agency. Within RECD there are three new services: the Rural Housing Service (RHS) for the housing and community facilities program; the Rural Utility Service for the water, wastewater, electric, and other utility programs; and the Rural Business-Cooperative Service (originally the Rural Business and Cooperative Development Service) for the various business development programs. The intent was to streamline program delivery and improve the efficiency and cost-effectiveness of the delivery system.

The reorganization will reduce the field presence of RHS. The Act requires the Department to consolidate field offices of the various agencies. Some county offices will be consolidated regionally. It is estimated that the number of field offices handling RECD programs will fall from approximately 1,600 to 1,200.

The shape of the final system remains to be seen. The Department has given the state directors a budget ceiling and will allow them to design their own network of offices. Some housing programs will be handled at the state level rather than at the district or county level, and overall the uniformity of old FmHA system will be diminished. However, since the field offices now can specialize on the housing programs, staff will be better deployed to assist borrowers. Some states may adopt

Figure 3: Section 502 direct loans and units produced since 1950.



circuit rider systems to make up for losses of offices.

B.Section 502B.Section 502

Direct loans—program description and funding. The section 502 single-family loan program is the nation's largest direct loan program for rural housing. RHS administers this program in its county offices. Section 502 provides up to 100 percent of the cost to eligible low- and very low-income households for the purchase, construction, repair, renovation or relocation of single-family homes for homeownership. The program was designed to be a source of credit for households who could not obtain affordable mortgage credit elsewhere. To enhance affordability, section 502 requires no downpayment and only minimal closing costs.

To be eligible for a direct loan, a household must have a low or very low income, i.e. 80 percent or less of the area median income or the statewide nonmetro median income, whichever is higher. RHS must lend forty percent of the program funds to very low-income households, i.e. those with incomes at or below 50 percent of the area or statewide nonmetro median. The interest rate may be as high as the market rate for a conventional mortgage—as of July 1995, it was 7.5 percent—but borrowers may be eligible for interest subsidies that can lower the rate to 1 percent based on the household's income, number of dependents, and tax and insurance costs.[xxiii] An analysis by the Housing Assistance Council shows that the average adjusted income of a direct section 502 borrower in fiscal 1994 was $15,165, or 55.2 percent of the rural median household income as defined by the U.S. Census and approximately 120 percent of the national poverty level.[xxiv]

As 3 on the following page shows, the high point for section 502 funding occurred during the late 1976, when nearly $2.9 billion produced 133,000 units. Funding fell steeply in the latter half of the 1980s (even as rural housing and economic conditions worsened), to the point where the proposed authorization level for the section 502 direct loan program in fiscal 1996 is $1 billion—34 percent of its 1976 high,[xxv] and a 44 percent funding decrease since fiscal 1994 alone. Appropriations and production levels now are at their lowest points in two decades.

Program assessment. In all, the section 502 direct loan program has resulted in more than 1.8 million units since 1950. Despite the decrease in funding there has been no sign of a decreased demand for assistance: from fiscal 1991 to 1994, FmHA received approximately 120,000 applications on average, and at the end of fiscal 1994, there still were 60,000 applications on hand, most of which had not been processed yet. If even one-third of these applications were approved for funding, these loans would have exceeded the full 1995 appropriation with no funds left for fiscal 1995 applicants.

It appears that RHS has been less effective at reaching low-income minority households with this program. The rate of minority participation in the section 502 direct lending is 23 percent nationally.[xxvi] The share of the poverty-level household population that is minority-headed is much higher: in 1990, the rural poverty rate for black-headed households was 34 percent; for American Indian households, it was 37 percent; and Hispanic-headed households (of any race) it was 30 percent.[xxvii] HAC suggests "[c]redit history requirements and the disproprortionate levels of poverty incomes may be a factor in the low rate of Section 502 assistance to minorities."[xxviii,xxix]

Moreover, the program does not appear to serve geographic areas equally within each state. A June 1993 report by the U.S. General Accounting Office noted that section 502 loan funds were spent in and around metropolitan statistical areas (MSAs) in amounts that were disproportionately high in comparison to the rural population and the number of substandard rural housing units in these areas.

> For example, during a 5-year period that ended September 30, 1991, eligible rural counties in or around Missouri's MSAs received about 76 percent of the state's program funds ($110 million) even though they contained about 56 percent of the state's rural population and 51 percent of the state's substandard rural housing units. During the same period, Missouri's remote rural areas received about 24 percent of the state's program funds ($36 million), but they contained about 44 percent and 49 percent of the state's rural population and substandard rural housing units, respectively. [Similarly,] all 49 remote rural counties in Iowa, which collectively contain 43.5 percent of the rural population and 44.3 percent of the substandard rural housing units in the state, obligated only 29.6 percent ($33.5 million) of the state's program funds.

Of the 100 counties nationwide that received the highest amount of program funds in fiscal year 1991, 84 were located in or around MSAs. These counties received more than 20 percent of the funds for fiscal 1991 yet contained only 9 percent of the nation's rural population and 7 percent of the nation's substandard housing units. According to the GAO report, RHS has a bias toward metro lending because (1) low program income limits make lending infeasible in remote rural areas—i.e., households with low incomes within low-income areas cannot afford even a 1 percent mortgage—and (2) the staff subjectively applies its housing standards to applicants in a way which leads them to exclude many homes for program participation.[xxx]

An analysis of the current portfolio of section 502 loans confirms a growing bias toward metro areas. Although the entire portfolio is distributed equally between metro, nonmetro adjacent, and nonmetro non-adjacent counties, 44 percent of the loans made in fiscal 1994 were made in metro counties. Given that the purpose of section 502 is to provide mortgage credit to households without access to other credit—i.e., to underserved markets—one would expect section 502 assistance to be more heavily weighted toward rural and nonmetro areas in which there generally are weaker credit markets and fewer alternative sources.

Finally, the program is about to become less affordable to lower-income households. Under the section 502 program rules current as of September 1995, borrowers must be able to afford monthly payments of principal, interest, taxes and insurance (PITI) equal to 20 percent of their adjusted income. In

Dollars ($ mil.) and Units (000s)	Direct 502	Guaranteed 502
FY 1991	$1,269.7 23,122	$38.4 660
FY 1992	$1,253.8 21,862	$214.4 3,828
FY 1993	$1,291.3 22,340	$539.8 8,901
FY 1994	$1,656.8 27,351	$725.9 11,523
FY 1995	$960 (est.)	$1,000 (est.)
FY 1996	$1,000 (est.)	$1,700 (est.)

Exhibit 3: Direct and guaranteed section 502 loans and units produced, FY 1991-1994, and appropriations FY 1995-1996.

October 1995, however, RHS issued regulations that raised this minimum payment to 22, 24 or 26 percent of income based on the borrower's income level.

A Housing Assistance Council analysis which modeled borrowers' cost burden showed that 45 percent of HAC's sample of 288 hypothetical section 502 borrowers currently pay more than 30 percent of their income for total shelter costs. Under the new rules, HAC estimated that 93 percent of the sample would pay more than 30 percent of their income for total shelter costs.[xxxi] Current borrowers would not be affected by the rule change, but new borrowers in similar economic situations would face higher payments.

The proposed rule also substitutes an income ratio analysis for a family budget analysis in determining whether a household can afford a section 502 loan. Allowing RHS to evaluate a borrower's ability to repay based on income ratios standardizes the underwriting procedure. Nonetheless, many of the organizations responding to RHS' proposal felt that income ratios were inappropriate for RHS' clientele since low- and very-low income people "live within their TOTAL income and not a percent of their income", and that the ratios could be too inflexible.[xxxii] RHS does propose exceptions to its analysis when income ratios do not support adequate repayment ability; taken in combination with the increase in payments, however, this rule could reduce local RHS offices' ability and willingness to make loans to lower-income households and may exclude many currently eligible households from participating in the program.

Guaranteed Loans. The guaranteed loan program is an unsubsidized program for households with incomes up to 115 percent of median. RHS guarantees the mortgages that eligible lenders make on modest housing. Because of the security offered by the federal guarantee, lenders may make some concession on the loan terms. There is no federal interest subsidy, however, and unlike the direct loans, the guarantees require the borrower to pay a downpayment and closing costs.

Congress and the Administration have relied increasingly on loan guarantees in recent years to support the flow of mortgage credit to rural areas. One attraction is budgetary: whereas the fiscal 1995 subsidy cost for the section 502 direct loan program was $24.36 per $100 of loan, for example, the subsidy cost for the guarantee was $1.64 per $100. Thus, while the guarantee program received an appropriation of $38 million in fiscal year 1991, by fiscal 1996, this level had risen to $1.7 billion. (See Exhibit 3.)

The absence of any subsidy means that the private loans generally are affordable only to moderate-income households. According to the Housing Assistance Council, the average adjusted income of a section 502 guaranteed loan borrower was $30,057, or 109.5 percent of median.[xxxiii] This is twice the average income for the typical section 502 direct loan borrower. The different market segment served by the guarantee also is reflected in the percentage of minorities served by the program—9.5 percent, less than half that for direct loans.[xxxiv] This reflects the earlier finding that minority borrowers have less access to private mortgage credit, and it calls into question the program's effectiveness at meeting this credit need.[xxxv]

Future Directions for Section 502. Many of the nonprofit organizations interviewed for this paper believe that the section 502 direct program is the most effective and easy-to-use federal program for promoting low-income homeownership in rural areas. The proposed reductions in funding to the program will significantly reduce RHS' ability to lend to low- and very low-income families, however, and RHS' apparent metro bias suggests that the program has drifted from its mission of providing credit of last resort to rural low-income families. The Agency's proposal to increase direct borrowers' minimum payment only reinforces this trend.

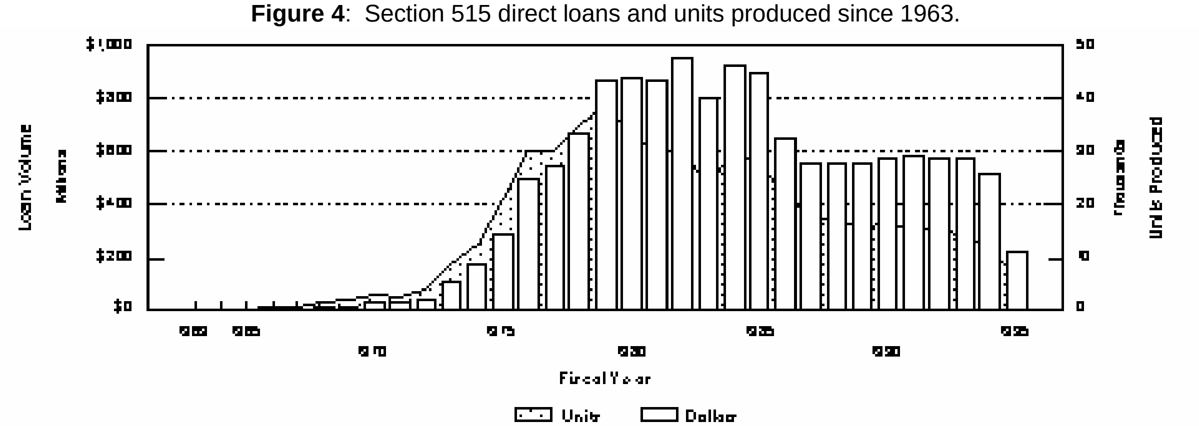
RHS now is considering new ways to stretch the program dollars. In August 1995, RHS hosted a forum on leveraging section 502 loans with private financing. At that time, many RHS offices already had begun leveraging their funds with funds from private lenders and other institutions to serve as many households as possible.

Although leveraging can help bring new participants into rural housing finance, the leveraged deals generally will only help RHS to the extent that they serve higher-income borrowers. Unless the other lender provides subsidized funds to the mix, RHS must provide the full borrower subsidy to make the loan payments equivalent to those the borrower would have been able to afford in the absence of leveraging. Thus, it makes little sense for RHS to combine its financing with market-rate loans unless the borrower already can afford to pay close to the market rate.[xxxvi]

The section 523 mutual and self-help housing program represents a more affordable form of leveraging, that of human capital. Under the self-help program, groups of families come together under the supervision of a local agency to provide labor on their own and each others' homes; the labor contribution lowers the purchase price of the home, which is financed with a section 502 housing loan, by 10-25 percent. The owners' sweat equity effectively is a deep subsidy that makes section 502 loans affordable to very low-income households: 53 percent of the 1,057 self-help section 502 loans in fiscal 1994 went to very low-income households, compared to 40 percent for the overall section 502 program.[xxxvii]

The section 523 self-help housing technical assistance grant pays some of the costs that local self-help agencies incur in

Figure 4: Section 515 direct loans and units produced since 1963.



developing and helping self-help family groups. Section 523 also provides contracts to four nonprofit regional self-help technical assistance providers who train and assist the local providers.

Because it enhances affordability, self-help housing is particularly helpful in rural areas where household resources (and private developers) are fewer. As housing funds become less available, section 523 can play a stronger role in stretching subsidy dollars, provided that the technical assistance program itself receives adequate funding.

C.Section 515C.Section 515

Program description and funding. The section 515 program provides direct loans from RHS to for-profit and nonprofit developers and cooperatives to construct multifamily rental housing.[xxxviii] To for-profit developers, the program provides 95 percent of the project cost at a subsidized rate of as low as 1 percent for a term of up to 50 years. Nonprofits may receive 102 percent financing at these same terms; the higher loan level replaces the need for equity and also covers initial operating costs. For-profit and limited-equity developers generally provide the equity through syndication proceeds from Low-Income Housing Tax Credits, although nonprofit developers have used LIHTCs as well.[xxxix] Unlike the section 502 program, section 515 is administered from district offices.

Since program inception in 1963 through fiscal 1994, section 515 has financed 510,627 units through with a total of 25,953 loans worth $13.9 billion. There currently are more than 18,000 section 515 developments housing 440,000 families.

As shown in 3, program funding and unit production peaked during the early 1980s. The fiscal 1995 pre-rescission level of $220 million represented an 87 percent decline from the 1982 funding high point. The reduction of funding has not come as a response to a lack of demand, however: there still is a $1.5 billion backlog in approved preapplications for the program.[xl]

Assessment. Section 515 serves the lowest-income rural households. The average income of a section 515 household is $7,000,[xli] and as of fiscal 1992, the income mix of section 515 tenants included 87.1 percent very low-income, 10.8 percent low-income, and 0.8 percent moderate or above-moderate income.[xlii] While the tenant rent is the greater of 30 percent of adjusted income or the rent needed to amortize the loan at 1 percent interest, section 515 tenants generally have such low incomes that supplemental rental assistance is required. RHS may provide section 521 rental assistance to these projects (see page 18 for further detail on this program).

The minority population in section 515 housing is 22 percent. Again, this is far lower than the percentage of rural minorities in poverty cited above. The Housing Assistance Council suggests that in addition to the credit history requirements and high incidences of poverty that influence low minority participation in the

The Nonprofit Record on Section 515

In 1993 and 1994, nonprofit owners of section 515 projects had a lower incidence of project delinquencies than for-profit owners. The delinquency rate for full profit developers was 5 percent in 1993 and 5.1 percent in 1994. The delinquency rate for limited profit developers was 1.7 percent in 1993 and 2.1 percent in 1994. The delinquency rate for nonprofit developers was only 1 percent in 1993 and 0.7 percent in 1994. In other words, nonprofit developers, which account for 19 percent of all projects with active loans, account for less than 7 percent of the delinquencies.

section 502 program, "[the] resulting screening by [project] owners, together with location selection, may be significant in low minority tenancy" in section 515 projects.[xliii] (The issue of project location selection is discussed below.)

The section 515 program has been beset by program weaknesses and political challenges. For example, it has been argued that funds have not been targeted well to the needy areas. A June 1994 U.S. General Accounting Office report noted that, while funds generally are allocated to states based on estimated statewide need, disadvantaged areas within states may not receive assistance. This occurs for three reasons: first, the allocation formula is based on the most recent Census data and does not reflect inter-Census year changes in formula criteria[xliv]; second, the allocation formula does not account for local construction costs; and third, developers may not submit applications for the neediest areas within states.[xlv]

It can be argued that this final problem is a function of for-profit developers' project location criteria, since profit-motivated firms are unlikely to submit project applications to build in depressed markets. The National Rural Housing Coalition has noted that projects developed under section 515 tend to target "easier" markets: approximately 40 percent of the section 515 population are elderly households, and as of fiscal 1992 50 percent of the units were 0- or 1-bedroom that are not appropriate for rural families. Because of this, the National Rural Housing Coalition has expressed its concern that the program does not provide sufficient access to nonprofit organizations which—unlike for-profit developers— generally build projects with larger units and in depressed areas. The program allows only a 9 percent set-aside for private nonprofit organizations. (Also see text box.)

Congress has identified additional problems with the section 515 program in the development and management of (largely) profit-motivated projects, as well as in FmHA's failure to administer the program adequately. After a highly-publicized report of poor maintenance and apparent race-based discrimination in a number of 515 projects, the U.S. House of Representatives Committee on Appropriations ordered its Surveys and Investigations Staff to report on FmHA's management of the section 515 and 521 (rental assistance) programs.[xlvi] This report, issued in April 1994, specifically focused on (1) whether section 515 owners were defaulting on loans in order to remove low-income tenants, (2) the participants' need for federal assistance, and (3) the relationship of rental assistance to the 515 program.

The Surveys and Investigation Staff found fault with a number of FmHA's policies and developer's actions toward the program. Reported developers' abuses of the program included:

- Developers secure and pay for their own market studies which often support the developers' ends rather than those of the community. FmHA is frequently unable to dispute the study findings effectively.

- Project developers underfund project reserve accounts or withdraw the reserves for unrelated uses. FmHA headquarters does not keep records on delinquent reserve funds.

- Some project owners are failing to pay local taxes on the projects, placing the burden on FmHA to pay back taxes.

- The tax credits used to raise equity for developers are very costly and may represent excessive use of subsidies.

- The Housing and Community Development Act of 1992 requires FmHA to give preference to projects that will be located 20 miles or more from an urban area. This standard can result in projects being developed in unsuitable locations, towns with low demand for rural housing, or areas that are losing population.[xlvii]

The report further alleged that FmHA practices allowed developers to raise the cost of the program, and that the agency also did not maintain sound management practices:

- FmHA makes equity loans to project owners as an incentive to keep them from prepaying their loans and taking the projects out of the 515 program. These loans, which are funded from construction funds, may be less cost-effective to the program than building new units, they "represent windfall profits to the project owners," and they may not be necessary to maintain low-income use.

- FmHA transfers failing projects to other developers rather than institute foreclosure proceedings. FmHA subsequently is unable to pursue delinquent former borrowers for the difference between the fair market value at transfer and the outstanding loan balance.

- FmHA's application scoring system does not always locate projects in the areas of greatest need.

- FmHA has not instituted wage matching procedures to ensure that tenants report their incomes in full.

- FmHA's projections of the need for section 521 rental assistance to maintain existing 515 projects are unrealistically moderate.

- FmHA headquarters has failed to resolve or address these number of issues and has not maintained current or accurate program data.

These issues provided a political rationale for cutting the program's funding.

Congress has passed a number of reforms for the program (most lately in H.R. 1691, which the House passed on October 30, 1995; it now is before the Senate Banking Committee). To address the problem of market studies and project location, RHS would allocate 515 funds to areas selected by the Secretary based on need. To address the question of excessive developer profits and program losses, the bill would reduce projects' eligibility for equity loans and project transfers. The Senate has not taken up a similar bill.

RHS has considered similar regulatory proposals and other changes. As of September 1995, RHS had increased controls over withdrawals from project reserve accounts, and it was preparing rules to address subsidy layering reviews and beginning to draft a rule on project preservation. RHS also will submit reforms similar to those in H.R. 1691 in its own legislative package.

Future Direction for Section 515. H.R. 1691 authorized a loan guarantee program for rural rental housing. Under this program, projects with guaranteed loans would be available for low- or moderate-income occupancy. The loans may have an amortization schedule of no more than 40 years and may be for no more than 90 percent of the development cost for for-profit developers or 97 percent for nonprofit developers and public agencies. At least 20 percent of the loans must be made in conjunction with section 521 rental assistance. The Secretary will target the loan guarantees to rural areas "in which borrowers can best utilize and most need"[xlviii] guarantees. Lenders must meet HUD's guidelines under the National Housing Act, the GSEs' guidelines for participation in their multifamily housing loan portfolio, or standards set by USDA.

A recent analysis by the National Rural Housing Coalition suggests that these projects will not use federal funds efficiently.

Although the cost of the guarantee indeed is far lower than the cost of a direct section 515 loan, the projects are likely to require massive amounts of rental assistance to make the rents affordable to lower-income tenants. Most section 515 developers raise the equity for their projects through LIHTCs, which limit the tenant eligibility to 60 percent of median income for 40 percent of the units (and in practice, 100 percent of the units); however, the tenant rents would still have to amortize market-rate debt. Without a long-term commitment of assistance to fill the gap between the capped rents and the debt service and operating expenses, the viability of the underlying loans would be in doubt.[xlix]

D.Rural Rental Assistance ProgramsD.Rural Rental Assistance Programs

RHS offers rental assistance (RA) through the section 521 program, which operates in conjunction with section 515. RA pays the difference between 30 percent of the 515 project tenant's adjusted monthly income and the rent needed to amortize the loan at a 1 percent interest rate. (All 515 projects participating in the RA program must already have 1 percent interest rate loans.)

The Rental Assistance Program is the only direct RHS program to receive an increase in fiscal 1996 funding over its fiscal 1995 level. This fact highlights its importance to the integrity of the section 515 program; nationwide, there were approximately 411,000 section 515 units in 1994 and nearly 210,000 required rental subsidies. Even with the existence of the 521 program, however, a January 1994 FmHA survey showed that still 22 percent of section 515 tenants nationwide—about 90,000 households—pay more than 30 percent of their incomes for shelter. This condition is not limited to any single state or region. The survey also showed that 12 percent of the units with rental assistance—25,500 out of 209,500—were unused.[l] This may be due to turnover at the time when the data was taken; also, it may indicate a need for the state director to reassign unused deep subsidy units to other projects as they are needed.

Currently, 50,000 section 515 units in 1,800 developments receive project-based section 8 subsidies rather than section 521 rental assistance.[li] Most of these contracts were awarded in the 1970s under a memo of understanding between HUD and FmHA. However, many of them are due to expire in the next few fiscal years. RHS has begun to consider ways to replace the section 8 subsidies with section 521 assistance to avoid the disruption these expirations would cause to existing tenants and projects.

E.Other Direct Loan and Grant ProgramsE.Other Direct Loan and Grant Programs

RHS administers smaller, more specialized construction and rehabilitation programs. These include section 504 very low income rural housing repair loans and grants, section 514/516 farmworker housing loans and grants, and section 533 housing preservation grants.

- The section 504 program provides loans up to $15,000 and grants up to $5,000 to very low-income homeowners to repair, improve or modernize their dwellings or to remove health and safety hazards. Grants are only available to elderly homeowners who cannot repay part or all of a section 504 loan.[lii]

- The section 514/516 farmworker housing program provides loans and grants to build, buy, improve or repair (primarily) rental housing for farm laborers. Sponsors may include farmers, farmer associations, family farm corporations, nonprofit organizations, Indian tribes, public agencies and farmworkers associations. Only nonprofit organizations, Indian tribes, public agencies and farmworkers associations are eligible for the grants. These programs are administered at the state and district office level, rather than at the county office level.

- The section 533 housing preservation grant program (HPG) provides funding to organizations that assist low- and very low-income homeowners and landlords serving these populations to repair or rehabilitate their dwellings.

Under HPG, grantees are permitted "wide latitude" (according to the regulations) in designing and administering their individual programs; the grantees may provide the assistance to recipients as loans, grants or interest reduction payments. Borrower repayments revolve back to the grantee for reuse under HPG.[liii] Again, only nonprofits, Indian tribes and public agencies are eligible for these funds. RHS also administers this program at the state and district level.

Both the HPG program and the section 504 programs benefit small and rural communities in slightly greater proportion than these areas' populations would suggest. RHS has awarded 43 percent of the number of section 504 loans and grants and 38 percent of the section 533 grants to nonmetropolitan counties not adjacent to metro counties; these counties hold just 25 percent of the nation's rural population. Moreover, RHS has awarded nearly 13 percent of these loans and grants to counties under 10,000 population even though these counties hold 6 percent of the rural population. Thus, the metro bias that is evident in section 502 lending is not apparent in these programs.

Section 514 and 516 are vital resources for agricultural states, since farmworkers play a major role in their economies yet are some of the worst-housed groups in the country. Again, RHS relies significantly on nonprofits to develop this type of housing; RHS has contracts with 7 nonprofit technical assistance providers to find sponsors for the farmworker housing projects in underserved areas (areas where state offices have not been able to promote the program well) and package the applications for funding.

Despite the importance of these programs, their funding has decreased. In fiscal 1995, Congress appropriated $35 million for the section 504 loans, $24.9 million for the section 504 grants, and $22 million for the section 533 grants. The appropriation level for section 504 was unchanged for fiscal 1996, but Congress reduced the 514 loan level by $915,000, the 516 grant level by $900,000, and the 533 grant level by $11 million (50 percent for this program alone). Federal budgetary constraints make it unlikely that there will be any significant increases in funding soon.

F.CommentsF.Comments

The nonprofit developers interviewed for this paper praise the RHS programs for their effectiveness. They note that the section 502 direct program is relatively simple to use and that the programs generally provide the subsidies needed to serve lower-income people. Nonetheless, there are growing concerns regarding the RHS programs. The section 502 program is beginning to resemble private market lending both in its metro bias for single-family housing originations and its new emphasis on income ratios for underwriting. In addition, the section 515 program has lost much of the political support it once had in the face of numerous Congressional and administration reports. Both of these trends threaten to reduce the ability of the programs to provide affordable rural housing.

RHS has begun to emphasize leveraging as a means of stretching program resources. County offices are leveraging section 502 loans with bank and housing finance agency mortgages; some developers have begun to use farmworker and multifamily housing funds with HOME and other sources. Although leveraging may be a necessary response to the shortage of RHS funding, it raises the concern that these finance packages will not provide enough subsidy to be affordable to the low-income households who are RHS' traditional constituency. As RHS continues to explore leveraging opportunities, the Agency should seek out the lowest cost funds with which to pair its resources, to continue to meet the credit needs of low-income households.

With regard to the delivery system itself, the RHS system is well designed for rural areas, particularly for the single-family programs. Given nonmetro communities' distances from their state governments, the presence of an RHS office in each county means that there is a nearby source of financial assistance and advice. This local presence is key since many rural town leaders do not know how to seek out and apply for federal assistance, and most state housing agencies do not have offices in the hinterland. Without the RHS county office structure, many rural areas would have no alternative source of housing assistance.

The RHS delivery system ultimately relies on local organizations, particularly nonprofit and for-profit developers, to complete housing projects. Under section 502, small- and larger-scale builders often develop homes in quantity so that individual households do not have to apply for loans and then find builders on their own.

The nonprofit role is particularly significant in that nonprofits develop much of the farmworker housing financed by section 514 and 516; they provide the training to participants in self-help programs; and they often build section 515 projects in areas with depressed or underserved real estate markets. Moreover, they provide vital community services in connection with RHS programs, conducting outreach on behalf of the RHS county offices.

Some of the nonprofits interviewed for this paper had noted that it was difficult to get assistance from county offices that focused on the farm program side of their business, so the separation of Farm Service Agency responsibilities from RECD programs should be a boon to these groups. If the Agency reorganization leads to a significant loss of field offices, then there may be a greater need for these nonprofits to help local families and towns access the RHS programs.

2. HUD Programs. HUD Programs

Within the Department of Housing and Urban Development, two programs that present alternative delivery systems for rural housing include the HOME program and the State and Small Cities Block Grant program of the Community Development Block Grant program. HUD has delegated the delivery of these programs to state or local agencies which are assumed to be more able to identify local needs and to meet the administrative requirements. This is a contrast to the single agency approach of RHS, which relies on its own agencies in local settings to deliver the programs.

The HOME and CDBG programs in particular can be complicated to administer, and some nonprofits have questioned whether they are effective in rural areas. Many nonmetro areas have been able to use the HOME and CDBG successfully, but others have not. The increased federal interest in block grants may mean that they will have to do so more in the future, however. The important question, then, is how the HUD block grant model can be adapted to better fit rural conditions.

A.HOME Investment Partnerships ProgramA.HOME Investment Partnerships Program

The HOME program of the U.S. Department of Housing and Urban Development is HUD's latest and most flexible mechanism for producing affordable housing. The program gives grants to local and state governments and consortia of local governments, called participating jurisdictions, or PJs. The PJs use the funds to support housing programs which they have designed to meet local needs and priorities. Single-family and multifamily construction, rehabilitation, special needs housing development, first-time homebuyer assistance and tenant-based rental assistance all are eligible activities.

One percent of the initial allocation goes directly from HUD to eligible Tribal governments. Of the rest, 60 percent of the funding is awarded to local PJs and 40 percent to state PJs. Congress appropriated $1.5 billion for the program in fiscal 1992, $1 billion in fiscal 1993, $1.4 billion in fiscal 1994, and $1.4 billion in fiscal 1995.

Nonmetropolitan areas rely on the states to award them HOME funds from the state allocation since local PJs must be metropolitan cities, urban counties or consortia of local governments. Unlike the Community Development Block Grant Program, however, HOME does not establish a nonmetro or rural set-aside of funding. Section 222 of the National Affordable Housing Act only requires the state to distribute assistance to rural areas taking into account "the nonmetropolitan share of the State's total population and objective measures of rural housing need, such as poverty and substandard housing, as set forth in the State's housing strategy"—not a clear mandate for a designated amount of rural spending.

In 1993, 35 states responding to a survey by the National Council of State Housing Agencies reported that used nearly one-third of their funding, $108.8 million, to support owner-occupied rehabilitation projects. They committed another $14.8 million on first-time homebuyer programs and $28.6 million on other single-family programs. In total, 46 percent of the state HOME money went to single-family housing projects. Some 51 percent of the funds were committed to multifamily housing projects, and the remainder—$15.5 million—was spent on tenant-based rental assistance (TBRA). In terms of units assisted, the break-out was 44 percent single-family, 45 percent multifamily, and 11 percent TBRA.[liv]

In general, HOME can be less prescriptive than RHS in how program funds are used. Whereas RHS allocates funds for one project or subdevelopment, HOME project sponsors can receive funds to use for more than one purpose. For example, a nonprofit can submit an application to the state HOME administrator that proposes a housing program including single-family home purchase and rehabilitation, substantial rehabilitation, and first-time homebuyer assistance. Only the RHS section 533 housing preservation grant allows a comparable degree of flexibility to the sponsor in designing how the funds will be used.

The flexibility that is written into the HOME regulations allows states to take innovative approaches to rural areas. Project sponsors may design their own underwriting criteria to assess applications for HOME loans and grants, and also may establish their own repayment schedules. (The section 502 program, in comparison, does not offer these opportunities.) Examples of the ways HOME can be used creatively include:

- South Carolina's HFA is developing a $1 million HOME-funded pilot program to finance homeownership for rural section 8 renters. The agency determined that section 8 households who are paying at least $250 for their monthly rent would be able to afford a 3 percent, uninsured, 30 year HOME-funded mortgage. Many housing finance agencies also use HOME funds to write down the cost of their mortgages.

- To ensure that HOME funds benefit special needs groups, Utah's Department of Community and Economic Development requires all HOME-funded multifamily unit developments to include a set number of units for households with special needs. Also, Utah's single-family HOME-funded projects have been able to assist households with incomes as low as 35 percent of median, in part because the Department can make deferred payment loans and limit loan repayments to 30 percent of the borrower's income.

HOME in Rural Areas. There is great variability in how—and in what amounts—HOME funds states allocate to rural areas. According to the NCSHA survey, the 35 states reported that 28 percent of their HOME funds were used in "rural" areas. (The survey did not define "rural".) While Idaho, Kentucky and Louisiana reported that nearly all of their HOME funds were used in rural areas in 1993, Maryland, Missouri and Nevada reported that none were.[lv]

Data provided by HUD's Office of Affordable Housing Programs allows a closer analysis of the variations in rural spending. Fifteen states[lvi] reported that they had provided $10.8 million in commitments specifically to communities of under 10,000 population in fiscal 1993 and $51.6 million in commitments to such communities in fiscal 1994. These figures represent 8.6 percent of these states' HOME funds in 1993 but 32.1 percent in 1994. Such an increase suggests that states improved their ability to serve small communities as their experience with the program grew. Nonetheless, the fact that the 1994 reported amounts vary from 3 percent (Florida) to 84 percent (Arizona) suggests that all small communities may not have equal access to HOME funds. See 4 on the following page.

With regard to their uses, it appears that HOME funds are being used increasingly for bricks-and-mortar projects in small communities, but the data also suggest that smaller communities are less likely to do such projects than larger communities. In 1993, 45 percent of the units assisted in the small communities in HUD's sample of 15 states were tenant-based rental assistance (TBRA) units; 28 percent were owner-occupied rehab units and 21 percent were rental units. In comparison, the NCSHA sample of states used their HOME funds to assist only 11 percent of their units with TBRA. In other words, communities of 10,000 or less in the HOME data sample were less likely to use HOME funds to construct or repair units than the (state-funded) larger municipalities in the NCSHA sample. In 1994, however, TBRA units composed less than one-third of the small communities' HOME-assisted units; 27 percent were owner-occupied rehab units, 26 percent were rental units, and 18 percent were first-time homebuyer units. Thus, while it appears that small communities are less likely to use their funds for housing production, their record at doing so is improving.

Delivery of HOME funds. States use both public bodies and nonprofits to deliver HOME funds to rural areas. Sometimes, many types of recipients are capable of using the program; in South Carolina, for example, the funding left after the Community Housing Development Organization (CHDO) set-aside is split evenly between for-profit and nonprofit developers and small municipalities specifically for rental projects, on one hand, and Councils of Governments (COGs) on the other. (In 1994, CHDOs received $1.51 million for homeownership programs; $3.15 million was allocated to the state rental housing program; and $3.15 million was allocated to the COGs. Of the $3.15 million for the state rental housing program, approximately $1 million was awarded to nonprofits.)

Exhibit 4: States' use of HOME funds in communities of 10,000 population or less.

State	1993 $ (000's)	Amount to small comms.	Percent	1994 $ (000's)	Amount to small comms.	Percent
AL	9,916	0	0%	11,369	4,008	35%
AK	3,000	123	4%	3,000	1,458	49%
AZ	3,000	1,774	59%	4,370	3,657	84%
AR	7,520	872	12%	8,620	3,574	41%
CA	28,390	947	3%	37,972	4,028	11%
CT	6,044	0	0%	6,788	2,913	43%
DE	3,000	242	8%	3,000	1,419	47%
FL	9,806	45	0%	14,269	456	3%
GA	12,262	117	1%	14,578	2,918	20%
ID	3,000	0	0%	3,247	672	21%
IN	8,625	235	3%	10,330	6,956	67%
IA	6,516	2,389	37%	8,358	2,703	32%
KS	4,414	1,052	24%	5,631	4,022	71%
KY	10,409	2,977	29%	13,159	8,028	61%
LA	8,854	0	0%	10,771	4,798	45%
Total	129,358	10,773	8%	160,720	51,610	32%

The COGs generally have used their funding for owner-occupied rehabilitation projects. All of this funding goes to rural areas. Similarly, New York's HOME program allows localities to administer their own moderate rehabilitation programs but it administers new construction and substantial rehabilitation projects itself in order to facilitate the more complicated regulatory approvals needed for those types of projects.

In other states, by comparison, there is a greater reliance on one or the other type of entity. Oregon's Department of Housing and Community Services relies almost entirely on nonprofits to act as project sponsors. This reliance is in part due to the Department's decision that it did not have the capacity to train and monitor both nonprofits and state recipients at the same time. The program manager also noted that many of the smaller local governments do not have the technical capacity to operate HOME programs given the complexity of accompanying rules such as Davis-Bacon or Uniform Relocation Act.

West Virginia's HOME program also relies on nonprofits to originate HOME applications. The West Virginia Housing Development Fund (HDF), which administers the HOME program, has targeted nearly all of the funds for single-family homeownership: the nonprofits work with banks and mortgage companies to originate mortgage loans which the HDF then purchases with HOME money. Through July 1995, HDF has purchased 380 loans for new and rehabilitated homes worth $16 million; nonprofits have originated approximately 85-90 percent of these loans, with banks and one housing developer originating the rest.

CHDOs. HOME requires PJs to set aside at least 15 percent of their funds for CHDOs to develop, sponsor or own housing. Given the importance of nonprofits in delivering RHS programs to rural areas, it would be reasonable to expect that they could play a similarly important role in delivering the HOME program. Despite the examples of West Virginia and Oregon, however, it is not clear that this is the case nationwide.

According to data collected by the National Council of State Housing Agencies, CHDOs received 23.5 percent of states' HOME allocation in 1993 and other nonprofits received 17 percent of the funds. However, the range of assistance that states gave to CHDOs spanned 0 (Alaska) to 94 percent (Massachusetts), and 25 states provided no capacity-building and/or operating cost support to CHDOs despite the fact that this is an eligible activity. Moreover, 8 of the states provided no funding to non-CHDO nonprofits in 1993.

CHDO's access to HOME funds in small communities is similarly varied. This is of concern because, in the absence of government capacity, CHDO and nonprofit expertise becomes more important (particularly where the local governments are not using the funds for bricks-and-mortar housing development). The HUD data shows that of the HOME funding committed to communities with populations under 10,000, CHDOs did receive nearly 15 percent of the state funding in 1994, but in some states, they received far less. For example, while 72 percent of the Idaho small community funds were awarded to CHDOs, less than 2 percent of the small communities funds in Arkansas, Arizona and Louisiana were awarded to CHDOs. Moreover, the percentage of HOME funds that went to CHDOs for small communities in 1993 was 11 percent, less than the 23.5 percentage of HOME funds that went to CHDOs overall in that year. This difference shows that CHDOs—and by implication, nonprofits—are either less active in smaller communities or have difficulty in accessing the funds.

The reason for the low and variable levels of funding that states award to CHDOs and nonprofits likely contains elements both of administrative difficulties with the program and a lack of local nonprofit capacity. In Colorado and Louisiana, for example, HOME program managers noted that there are few or no CHDOs in parts of each state. The Arizona program manager noted that the nonprofit community in the state is generally less than 10 years old, and that many rural nonprofits work on owner-occupied rehabilitation or weatherization, not development. These organizations do not have the capacity to do CHDO-type work and do not want the liability of being a developer or property manager, nor do they have the financial management systems and procedures in place to comply with CHDO requirements. On the other hand, as noted above, many states do not provide support to CHDOs, and some CHDOs in California have been engaged in a disagreement with the state Department of Housing and Community Development over whether or not CHDOs may keep HOME loan repayments. This disagreement may keep them from recycling the funds in rural areas.

Assessment. Many rural communities have benefitted from the HOME program. In states where the program is well administered, rural housing groups have been able to access and use the program well. It is of concern, however, that HOME funds do not reach rural areas consistently. Since there is no allocation of funding to the county level, as with the RHS section 502 program, whole rural areas of a state may receive no HOME assistance whatsoever.

Moreover, HOME is not generally used to fully finance projects. Developers have to leverage other federal and state monies, Low-Income Housing Tax Credits, and private funds (among other sources). Not only can it be difficult to apply for and coordinate the various sources (with their different use requirements), but also since smaller rural banks are conservative in their lending practices, it can be difficult in some areas for developers to obtain private credit to make these deals complete.

There also are a number of program requirements that can create barriers to using the funds in rural areas. (Many of these were identified by the National Rural Housing Coalition in 1993 and are described in the appendix.) Three HOME program administrators interviewed for this paper noted that smaller rural communities had difficulties in complying with regulations such as Davis-Bacon, section 3 (regarding use of local labor), environmental reviews, and the Uniform Relocation Act. Some nonprofits have had similar complaints; for example, the director of Tierra del Sol noted that HUD prohibits construction using HUD funds in areas of minority concentration unless no other locations are feasible. In Tierra del Sol's service area (New Mexico and parts of surrounding states), the minority population is so high that it is difficult to not build in an area of minority concentration. It is possible, however, that some of the regulatory problems result from individual offices' interpretation of the rules, since other nonprofits have experienced few difficulties with program funds.

Another concern is the matching funds requirement. PJs must provide a 25 percent match for their HOME allocation (although this match may be reduced for PJs experiencing fiscal distress as defined by the HOME regulations). Some states require local project sponsors to supply the matching funds. Wealthier communities can provide the match through tax waivers, donated land, state funds, grants, etc., but poorer rural communities do not have these resources. (Owners' sweat equity, which is a readily available resource in rural areas, is not an eligible source of match—this is a particular complaint of some of the self-help groups that operate in rural areas.) One HOME program administrator has recognized that some localities cannot obtain HOME funding because they cannot provide the match.

The absence of a rural set-aside further limits small communities' access to the HOME program, by placing them in competition with larger communities for the funds. Although it is clear that some small towns do get HOME funding, others do not. It is also true that some states turn over their portions of their funding for use in local PJs or enter into joint funding with local PJs for particular projects, thereby reducing the overall amount of funds available for rural communities; in 1993, at least 14 states transferred some of their funds to local PJs.[lvii] The variability in states' targeting of HOME funds to rural areas, as described above, indicates that the program does not provide a nationally-consistent stream of funding to rural areas.

Among some CHDOs there is a related complaint that they are not allowed to establish their own HOME trust funds to recycle HOME loan repayments and project income within their service area; instead, they must return them to the state. The CHDOs' inability to hold onto the funds means that there is no assurance that the state will keep the HOME funds working within the CHDO service areas. In comparison, the Housing Preservation Grant program of RHS and the Community Development Block Grant program allow the grantee to recycle program repayments into additional, program-eligible activities. Where there is no other subrecipient to set up a HOME trust fund to recycle the payments, the CHDOs are the only alternative way to keep the funds working within the area.

B.States and Small Cities Block GrantB.States and Small Cities Block Grant

HUD provides Community Development Block Grant (CDBG) funding through the State and Small Cities Block Grants program to local governments that do not receive direct CDBG allocations (i.e., to "non-entitlement communities"). Under the allocation rules, 70 percent of the CDBG funding is allocated to CDBG entitlement communities which include metropolitan cities (population of 50,000 or more) and urban counties. The remaining 30 percent is allocated to the states for nonmetropolitan areas through the State and Small Cities program.

The State and Small Cities project eligibility requirements mirror the national CDBG requirements—e.g., that project beneficiaries must be low- or moderate-income households. Funds may be used to develop public facilities, to promote economic development, to rehabilitate (and under limited circumstances, construct) housing, to acquire land, and for other miscellaneous purposes. HUD allocates the State and Small Cities funds to the states on a formula that measures population, poverty and housing overcrowding in the non-entitlement areas.

The state awards the CDBG funds to local communities generally through a competitive process, although in at least three states (Arizona, Pennsylvania and Utah) the state allocates the funding to communities and regions on a formula basis.[lviii] Private and nonprofit developers cannot apply to the state directly for CDBG funding, however; the local government must apply for the money on their behalf. This requirement bars community groups (rural and otherwise) from obtaining grants in situations where the local government does not want to sponsor the group's project.

As with HOME, it appears that the extent to which CDBG is used for rural housing is uneven across the country. In fiscal 1991, states spent 27.4 percent of their funding on housing-related activities such as acquisition, rehabilitation, and program administration. While 8 states spent more than half of their grants on housing activities, 12 spent less than 10 percent.[lix] In fiscal 1993, states spent 24 percent of the total State and Small Cities Block Grant allocation, $249 million, on housing activities, but while communities of under 2,500 population used 23 percent of their CDBG funds for housing, communities of over 10,000 used 36 percent. (Counties used 17 percent of their CDBG awards for housing, and HUD assumes that these county funds are spent largely in communities of under 2,500 population. There is little hard evidence to support this assumption, however.) See Exhibit 5.

In addition to the fact that community groups cannot apply for CDBG funds on their own (which gives the local government veto power over whether the project may receive funding even before the competition takes place), the most significant problem with the State and Small Cities Block Grant program from a targeting standpoint is that states may award the grants to communities with populations up to 50,000. This means that small rural communities must compete with larger jurisdictions for funding. Nonetheless, the program has been successfully used for housing rehabilitation in many small communities; Colorado, for example, provides $3.5 million in CDBG and HOME funds annually to 9 Councils of Government and one nonprofit that operate ongoing housing repair programs. Together, these organizations repair 150-250 homes per year.

C.CommentsC.Comments

The variation between states in the extent to which HOME and CDBG are used in rural areas and small communities shows that while some rural areas can successfully obtain and use HUD funding, others cannot. Rural communities often are at a disadvantage in competing for block grants since larger communities generally have the technical and professional staff needed to prepare timely, competitive applications while smaller and more rural communities generally do not. Smaller communities also may be more reliant on nonprofits and CHDOs to help them apply for and use block grant funds, but interviews with nonprofit developers and HOME administrators suggest that nonprofit capacity in small communities is uneven.

It is worth noting that a study of all HUD rental assistance programs (public housing, section 8, and other rental development programs) showed that while eligible metro and nonmetro renter households received assistance in approximately the same percentages—30 percent vs. 27 percent—only 15 percent of eligible rural nonmetro households received assistance.[lx] In other words, the HUD rental program delivery system of housing authorities and developers did not reach the more remote rural areas to anywhere near the same extent it reached other communities. In contrast, RHS allocates program funding to every county of the state.

To rectify these problems, there needs to be a nationwide standard, with appropriate outreach, to ensure fair access for small communities in all states. The current House proposal to block grant the RECD rural development programs allows funds to be used in communities of up to 25,000 but it includes a set-aside for smaller communities. A similar mechanism may be appropriate for HOME and the States and Small Cities Block Grant.

3. State-funded Programs. State-funded Programs

Using their own funding, state agencies can design programs that leverage or supplement the federal programs. While these programs' rules may be more flexible than the federal programs, they also rely on local organizations to ensure the delivery of the funds to rural areas.

A. Housing Finance AgenciesA.Housing Finance Agencies

Housing finance agencies (HFAs) are state or regional organizations that finance affordable housing for low- and moderate-income households through the issuance of tax-exempt bonds. The first HFA was begun in New York state in 1960. Every state now has an HFA, most of which are quasi-public or private entities. Some cities

Use by Community Size ($ millions)	Counties	Population < 2,500	Population 2,500-9,999	Population 10,000+	Total
Housing	$ 61	$ 72	$ 56	$ 60	$249
Total	$359	$319	$212	$168	$1,058
% on Housing	17%	23%	26%	36%	24%

Exhibit 5: State and Small Cities Block Grant use by purpose and community size, 1993.

have their own HFAs as well.

HFAs use the bond proceeds either to make the loan directly to homebuyers or, more commonly, to purchase mortgages made by private lenders. HFA bonds are purchased by investors; thus, HFAs serve as conduits for private capital. The bonds are tax-exempt, so the savings on the issuer's interest costs can be passed to mortgage borrowers in the form of slightly below-market lending rates. Because the bonds must provide a reasonable rate of return, however, the mortgage rates generally cannot be very far below the conventional market rate. Thus, HFA beneficiaries tend not to have incomes much below 70 percent of the state median. In response, many HFAs have developed leveraging programs that allow them to serve lower and even very low-income households.

Issues in Bond Financing for Rural Areas. HFAs are constrained from serving rural areas by a number of factors. In addition to rural areas' dispersal, which makes outreach difficult, HFAs generally have to enlist the support of local banks through which to make their loans. As noted in Part I, some banks may be reluctant to participate in public lending programs.

Moreover, rural incomes are low. As noted above, typical MRB mortgages generally do not carry interest rates so far below the market that they are affordable to households with incomes below 70-75 percent of the state median income. A 1988 GAO report suggests that many households assisted through MRB loans could have purchased the same homes using generally available loans or would otherwise have become homeowners. (The GAO estimated that the median difference between a bond financed mortgage and a conventional loan was only $40 per month.)[lxi] Since the nonmetro median income is less than 75 percent of the metro median nationally, bond-funded mortgages may be less affordable to some nonmetro households from the outset.[lxii]

Last, the amount that HFAs can use for financing is restricted by the overall cap on the amount of tax-exempt bonds the state can issue. Federal statute limits the issue of mortgage, small-issue, student loan, and redevelopment bonds to the greater of $50 per capita or $150 million. Moreover, unless the state has ruled differently, the allocation is split 50-50 between the state and its localities. Thus, one staff member at the South Carolina State Housing Finance and Development Agency (SHFDA) estimated that the agency would have less than $20 million in bonds for all its programs. How have some HFAs overcome these limitations?

a. <u>Enlisting bank support</u>. Although small, local banks can be conservative lenders, it appears that they will participate in MRB-financed mortgages if they understand the nature of the risks and if they can obtain fee income from originating or servicing the loans. The HFAs must provide education and outreach to establish a rural delivery program, and the banks also must receive tangible incentives and an assurance that there will be sufficient volume to compensate them for their efforts.

The Colorado Housing and Finance Authority (CHFA) has addressed rural banks' concerns in two ways. First, it ensures a level playing field for participating banks. One week prior to a bond issuance, CHFA issues instructions to lenders on how to reserve funds for MRB loans.[lxiii] On the issue date, bank offices are limited to making five reservations a day, and they must prioritize the requests in amount order, submitting the lowest requests first. This helps ensure that many banking offices can participate. Moreover, 10 percent of the funds are earmarked specifically for rural areas. The last two MRB issuances totalled $50 million, so at least $5 million was reserved for rural homebuyers.

CHFA also has attracted rural lenders by being flexible in its program requirements. Although CHFA generally uses three master servicing agents for the loans it purchases, it has allowed some rural banks to service their own loans. These banks earn the servicing fees for the mortgages without having to hold them in their portfolios. The South Carolina State Housing Finance and Development Agency (SHFDA) shows a similar degree of flexibility in building its network of rural lenders: if the bank does not have the staff to make the mortgage on behalf of an applicant for its MRB program, SHFDA staff will visit the local bank branch, close the loan themselves, and engage in a lot of "hand-holding" for the smaller banks.

Colorado's efforts—which include recruiting efforts among realtors, nonprofits, and housing authorities as well as rural banks—have led to a sizeable increase in the level of rural bank participation in the MRB program. In 1994, CHFA made $28.3 million in MRB loans, and $1.9 million of that amount (6.7 percent) was originated in rural communities through five rural banks. In 1995, CHFA made $80 million in MRB loans, and $8.6 million (10.8 percent) was originated in rural communities through 16 rural banks. The $8.6 million figure represents a 60 percent increase in the relative share of rural business over 1994.

Finally, West Virginia's Housing Development Fund (HDF), the state HFA, goes a step further by purchasing secondary market quality loans from its small rural lenders. These purchases, combined with the HDF's MRB activity, ensures small lenders a reliable stream of loan activity and income needed to maintain an experienced underwriting staff. Without this income stream, these lenders would not do so on their own. Thus, HDF's assurance of business allows lenders to maintain a profitable mortgage lending infrastructure in rural areas.

b. Deepening the subsidy. The above methods may make mortgage credit more available to moderate- and "higher" low-income borrowers, but they do not immediately address the need for affordable mortgage credit for lower-income borrowers. Many HFAs recognize that additional assistance for these households is necessary, and the HFAs interviewed for this paper all offer some type of downpayment assistance program, either as low-interest second mortgages, deferred payment loans or outright grants.

Leveraging is the key to deepening the MRB subsidy. The Louisiana Housing Finance Agency makes 70 percent loan-to-value loans with MRB proceeds and provides a 1 percent deferred payment HOME loan for the rest. It also offers HOME-funded downpayment and closing cost assistance. Other states offer similar programs.

The funds that cover these deeper subsidies come from a variety of sources. West Virginia's downpayment assistance program is funded through the agency's capital reserves. The Mississippi Home Corporation (MHC) finances its downpayment loan program through a combination of reserves and local bank contributions, and initially it had used Federal Housing Finance Board Affordable Housing Program funds. The Colorado Housing and Finance Agency offsets the cost of its 4 percent grant downpayment assistance program by charging a -point higher interest rate on the mortgage.

c. Extending the use of MRB proceeds. Some HFAs recycle the prepayments from MRB-financed mortgages to make new low-interest loans rather than using them to retire the bond issue. The Colorado HFA recycles its MRB loan prepayments exclusively in rural areas, setting 10 percent of the prepayments aside to purchase section 502 guaranteed loans, and lending the rest to nonprofit and government homeownership programs. In 1995, the

Agency also agreed to work with RHS to use a portion of the recycled funds to make uninsured first mortgages backed by section 502 direct loans as second mortgages. A rural lender will originate and service the first mortgage, and RHS will provide counseling.

The interest rate on CHFA's recycled loans is tied to the latest MRB rate with a floor of 7.09 percent. Although this rate is high for some lower-income households, CHFA commits the funds for 2 years which gives the sponsors time to package other subsidies and prepare the families for homeownership.

d. Developing specialized products. Many HFAs offer specialized products, either alone or with other financiers, to fill gaps in the types of credit available or to meet the needs of particular organizations. For example:

- The West Virginia Housing Development Fund (HDF) recognized that self-help housing efforts needed support. It developed and now manages a trust fund to purchase loans from Habitat for Humanity and other self-help groups. HDF provides approximately one-third of the capital and local banks provide approximately two-thirds; the nonprofits provide the residual. HDF establishes an escrow account for each loan purchased by the trust, which mitigates any credit risk. Mississippi operates a similar program under which local banks provide interim financing for Habitat loans and the HFA provides the permanent financing by purchasing the loans.

- The Kentucky Housing Corporation has recently combined two grant programs—the Kentucky Indoor Plumbing program for very low-income households and the Grants to Elderly for Energy Repairs—with its emergency housing funds to create a single loan program that can pay for energy-related rehabilitation, plumbing, or other needs. While the program ostensibly is a loan program, the program accounts for the income needs of its borrowers: the loans carry a 0 percent interest rate and the repayment schedule is based on the borrower's ability to repay, requiring a minimal monthly payment of $25.

- The lack of infrastructure in rural areas can raise the cost of housing development significantly. In fact, one obstacle to building rural housing is the shortage of developable land; many rural builders operate on such a small scale that they cannot install infrastructure on undeveloped sites. West Virginia's HDF offers short-term loans to finance water and sewer line construction to reduce these costs. The loans have ranged from $50,000 to $800,000, and carry a 5-6 percent interest rate and a 4-5 year term. HDF takes collateral for these loans, for example in the form of tap fee assignments. These loans may support economic development projects as well as housing development, and can be used in conjunction with other facilities financing.

- According to Tierra del Sol, a nonprofit housing development agency operating in the southwestern United States, Texas' HFA has issued a $5 million bond at approximately 6 percent interest to finance first mortgages for families with up to 115 percent of median income. (HOME will be used to finance the second mortgages.) Unlike most mortgages, these loans will not use underwriting standards that hold the borrowers to particular income ratios, but they will require them to have impeccible credit. Tierra del Sol is working with applicants to ensure that their credit histories are clean.

In this last example, the Allstate Insurance Company will purchase the Texas bond. The National Housing Service of America, a secondary market agency for affordable housing loans (see page 48) will assist with the originations. This arrangement is notable for involving both purely private and quasi-public agencies and funds, and it illustrates HFAs' potential for harnessing private funding for public purposes.[lxiv]

B.Housing Trust FundsB.Housing Trust Funds

"State housing trust funds are dedicated capital pools which receive and target funds to projects, programs, and activities which produce, preserve or support affordable housing opportunities for targeted state residents and purposes", primarily low- and very low-income residents. Generally, housing trust funds operate as revolving funds and are administered by the state Housing Finance Agency or housing and community development agency. Most states began their funds as a response to the federal cutbacks of the 1980s and the greater awareness of housing needs that developed as they prepared their Comprehensive Housing Affordability Strategies.[lxv]

Thirty-seven states currently operate housing trust funds, frequently leveraging them with HOME, MRBs, LIHTCs, and other sources. While nearly all funds support single- and multifamily housing development, a few specialize in specific types of housing or target populations. Some funds assist specific types of housing, such as rental housing or housing for the homeless; other funds operate individual programs for special housing needs (SROs and transitional housing development; downpayment assistance; home improvement; etc.). A number of housing trust funds have set-asides for rural areas. States finance their trust funds through a variety of tax and fee revenues, unclaimed property, program income and HFA capital.

Three examples illustrate the variations between funds:

- The Kentucky Housing Corporation (KHC) places at least half of the excess from its required debt service reserve, approximately $6-9 million annually, into a Housing Trust Fund. KHC uses these funds for a single-family homebuyer program that is targeted to special needs households that cannot meet the requirements of KHC's MRB program. These needs include very low incomes, single-parent headed households, disabled households, and large family sizes. The rates on the Trust Fund loans can be as low as 1 percent. The eligibility requirements are similar to those for the HOME program.

KHC uses participating lenders to originate these Trust Fund loans and purchases the loans from them. In areas where the field staff is aware that there are no lenders, it allows local nonprofits to originate the loans and it provides the funding directly.

- The Mississippi Home Corporation (MHC) runs a revolving trust fund program for larger projects. This fund was capitalized through a state general obligation bond. Eligible borrowers include for-profit and nonprofit corporations and public and quasi-public bodies. Unlike the KHC program, the MHC sees its trust fund loans as a gap financing tool for moderate-income borrowers who cannot obtain full bank financing but who do not need high subsidies. The program is not meant to provide 100 percent financing, but to help bring in bank funds. Projects may also leverage AHP, HOME, LIHTCs and other sources of financing.

(While the program may serve up to 115 percent of income, the program criteria also prioritize projects involving nonprofit corporations, projects that empower poor families through resident management, self-help housing, other self-sufficiency measures, and similar programs.)

The MHC staff noted that this program was simpler to use than the federal programs. The application process is like that for a bank loan than for a federal loan; MHC takes applications on a rolling, rather than one-time competitive basis; and the funds do not carry the regulations such as Davis-Bacon that make the federal programs more difficult to administer.

Finally, Utah's housing trust fund is capitalized through state appropriations and program income from HOME and RHS section 533. (The state serves as the HPG grantee.) Each source of funding is accounted for separately to ensure that the monies are used in ways that meet program requirements.

Utah sets aside 30 percent of its housing trust fund monies for rural areas each year. It makes low- or no-interest loans from homeownership using HOME program income, and it uses state-provided funds to purchase properties for special needs housing in rural areas, which it then leases to service providers for $1 per year. Utah also uses the funds to provide matching funds for its HPG applications.

C.Other ProgramsC.Other Programs

New York operates a number of capital programs, funded by state appropriations, targeted toward rural areas. These include:

Rental assistance. The Rural Rental Assistance Program (RRAP) is similar to the RHS section 521 program. The program was created in 1982 and is funded from state revenues. According to the New York State Rural Housing Coalition, the program was developed to help the state utilize all of its section 515 allocation. There was a need for rental assistance to make MFH development feasible; without it, the state would lose its 515 allocation to national pooling.

The RRAP offers five-year rental subsidies which may be extended twice up to a maximum of 15 years, specifically for use with new construction RHS section 515 projects. Like the federal program, the RRAP pays the difference between 30 percent of the tenant's monthly income and the monthly housing expense. The average subsidy for the state program is currently $2,100 per unit. There are 4,499 units participating in the program, compared to approximately 4,100 section 521 units in the state as of 1994. (There are approximately 12,000 section 515 units in the state.)

The program has helped the state RHS office to move its 515 funds and to transfer its section 521 allocation toward existing units and servicing obligations. New York State has obligated more than 100 percent of its initial 515 allocation in each of 1992 through 1994, but has used less than two-thirds of its new project RA allocation in each of those years, a rate which is far below the national average. A weakness of the program, however, is the rigidity of its statutory link to section 515 new construction. With the cuts in the program, there may not be enough units to assist, and the RRAP funds may be diverted to other programs in the state.

Mobile Homes. The New York State HFA also administers the state-funded Mobile Home Cooperative Fund Program. This program provides resources to facilitate the cooperative ownership of mobile home parks. The cooperatives can use the funds to purchase the underlying land, make infrastructure improvements, and control park operations. The loan may cover up to 95 percent of project costs. The initial term is 10 years, but it may be extended for up to 30 years. This fund is a revolving loan fund which was capitalized with an $11 million appropriation in 1988.

Infrastructure development. The New York State Housing Finance Agency offered a program similar to West Virginia's infrastructure program which was financed through state appropriations. The Infrastructure Development Demonstration Program operated in tandem with the state's other housing programs to allow applicants for housing assistance apply for grants of up to $5,000 per unit for water/sewer lines and other needs. The program targeted at least 75 percent of the funding to communities of 30,000 or less, ensuring its use in rural areas. The program was more flexible than the RHS and HUD programs; for example, it paid for utility line extentions that the federal housing programs would not include as eligible.

Unfortunately, the state was unable to provide additional funding for the program after 1988 because of its budget crisis. This points out the most significant weakness of the state-financed housing programs; unlike MRB programs, states' programs are largely dependent on appropriations which may not be forthcoming in lean budgetary years.

4. Remarks. Remarks

There are significant differences between the federal program and the state programs and, within the federal programs, between those of RHS and those of HUD. First, the RHS programs are fairly uniform.

Funds are allocated to the state or the county for specific purposes; and the programs are designed to provide permanent financing on their own. This makes the programs predictable for nonprofit and for-profit developers to use. Developers know how much money is available for any project type, and they know that the criteria for judging their applications are uniform throughout the state.

In contrast, funding for the HUD programs (HOME and CDBG) is delivered to the state as a block grant. Applicants are required to develop and propose their own housing programs which must be in line with the priorities that the state has set for the use of the funds. They generally must leverage these funds with other sources to finance their deals. These requirements inject a greater degree of uncertainty into the application process. Moreover, since the funds are not allocated to each county, the availability of HOME or CDBG funds in a given county (or other area) depends on the presence of a local sponsor. Whereas section 502 money is available in every county, for example, there will only be HOME money available for single-family housing in that county if a local housing organization has applied for, and won, HOME funds to develop such units. This in turn is predicated on the state making single-family housing development an eligible use of its HOME funds.

Despite the extra work involved, however, the fact that the HUD programs do allow developers more flexibility in designing their programs and projects also allows them to target specific needs and borrower repayment capabilities. For example, the developers can use the HOME funds to make grants to first-time homebuyers; they cannot use section 520 funds for the same purpose. The program regulations also permit the states and their subrecipients to set up trust funds to recapture program income rather than return it to the federal treasury. While this has different implications for budget scoring the HUD programs against the RHS programs, it also ensures that the HUD monies are recycled into new projects within the communities.

With regard to the state programs, they maintain a level of flexibility between those of the RHS and of HUD. The MRB programs, like the RHS section 502 and 515 programs, are categorical. Other state programs—such as Utah's housing trust fund program which allows the State to purchase and lease out special needs housing—allow more innovation.

State program subsidies also are more uncertain. MRB programs bring private capital into the affordable housing market but the subsidy derived from the bonds' tax-exempt status is shallower than that of the federal programs. To achieve deeper subsidies, the states must leverage federal and other resources (and the work involved in leveraging can exceed some developers' abilities). Other state programs rely on state appropriations which may or may not be available consistently or in sufficient amounts.

These differences are in part due to the differences in the delivery systems themselves. An RHS dollar is categorical and it flows within a single agency. Therefore, the same products are available everywhere and the project selection criteria are uniform throughout the agency. In contrast, the HUD programs pass from HUD to a separate state agency which can set its own priorities for funding. It then must seek local agents to carry out the program activities, which adds a greater degree of variability to the programs. The state-funded programs, although theirfunding originates at the state level, operate under the same conditions as the HUD programs. Since the state agency field network that assists with delivery generally is much smaller than than of RHS—Colorado's Division of Housing, for example, has only 7 staff, all but 2 of which are based in Denver, and New York's Division of Housing and Community Renewal has 4 regional offices for the entire state—the variability in the delivery of the HUD and state programs within or between states is that much greater.

If the housing finance delivery system does continue to devolve to the states—with more but smaller supplies of funding—then interagency communication will be vital to ensuring that the resources are targeted to rural areas. Colorado is one state where rural housing needs receive interagency attention: the executives of the four housing agencies—CHFA, the Division of Housing of the Department of Local Affairs, the local office of HUD, and RHS—meet every other month to share information on rural housing programs and projects. This group tries to identify areas of need and to develop ways to leverage each others' resources. One result of their meetings was a multifamily housing project in the City of Sterling that combined funds from all four agencies. Reportedly, this project was the first 515 project in the nation to use so many sources.[lxvi] This approach goes beyond the RHS leveraging efforts with individual HFAs to take a more holistic, albeit more complex, approach to housing finance delivery.

PART III: GOVERNMENT-SPONSORED ENTERPRISESPART III: GOVERNMENT-SPONSORED ENTERPRISES

1. Secondary Market Institutions: Fannie Mae and Freddie Mac. Secondary Market Institutions: Fannie Mae and Freddie Mac

The problem of credit availability, particularly for lower-income borrowers but for mortgage borrowers in general, stems from banks' reluctance to hold mortgages in their portfolio. Mortgages tie up capital for 20-30 years and expose the banks to interest rate risk. The creation of the government-sponsored enterprises removed this constraint by developing a secondary market for mortgage loans. Two of the most significant sources of mortgage credit in the U.S. through the secondary market are the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation—Fannie Mae and Freddie Mac.[lxvii]

In 1968, Congress chartered Fannie Mae as a stockholder-owned, privately managed corporation to provide a secondary market for home mortgages insured by the Federal Housing Administration and the Veterans Administration. The intent was to create a purchaser for banks' FHA- and VA-insured loans, thereby replenishing their supply of lendable funds. In 1970, Congress chartered Freddie Mac to serve the same purpose for the savings and loan institutions' mortgages.

The GSE's Charter Acts set forth identical purposes for Fannie Mae and Freddie Mac, essentially to (1) provide stability in the secondary market for residential mortgages and (2) increase the flow of capital to borrowers including low- and moderate-income households and households in central cities, rural areas, and other underserved areas.[lxviii] Since the early 1990s, Congress and the Administration have paid particular attention to the promotion of geographic and income equity in the mortgage markets by establishing mortgage purchasing goals for the GSEs. These goal, which took effect in 1993, are shown in 6.

The Secondary Market, National Accomplishments and Rural Areas. In a fairly short period of time, the GSEs have changed the market for conventional mortgages from portfolio lending to securitization. In the 1970s, the majority of mortgages were held in the portfolio of the primary lender, generally the savings and loan or thrift institution that originated the mortgage. Securitized mortgages (as opposed to portfolio-held loans) now account for nearly 47 percent of the mortgage debt outstanding, and the two GSEs have issued 61 percent of that market.[lxix] See Exhibit 7 on the following page.[lxx]

	1993	1994	1995[b]	1996[b]
Low- and moderate-income housing	30%/28%	30%	38%	40%
Central cities, rural, underserved areas	28%/26%[a]	30%[a]	18%	21%
Special affordable housing	$2.0/$1.5 b over 2 years		11%	12%

Under 1993 and 1994, the first figure refers to FNMA, the second refers to FHLMC.
[a]Central cities only. [b]Proposed.

Exhibit 6: GSE mortgage purchasing goals, 1993-1996.

	1968 ($b)	1980 ($b)	1989 ($b)	1992 ($b)	1968 (%)	1980 (%)	1989 (%)	1992 (%)
Portfolio lending								
FNMA portfolio	7	52	91	124	2.6	5.4	3.8	4.2
FHLMC portfolio	0	4	18	31	0.0	0.4	0.7	1.0
S&Ls	110	411	512	375	41.5	42.6	21.3	12.7
Comm'l banks	39	160	336	452	14.7	16.6	14.0	15.3
Others	109	229	529	591	41.1	23.7	22.0	20.0
Subtotal	265	856	1,486	1,573	100.0	88.7	61.7	53.3
Securities issued								
FNMA	0	0	220	436	0.0	0.0	9.1	14.8
FHLMC	0	14	266	402	0.0	1.5	11.1	13.6
GNMA	0	92	358	411	0.0	9.5	14.9	13.9
Private pools	0	4	77	132	0.0	0.4	3.2	4.5
Subtotal	0	110	921	1,380	0.0	11.4	38.2	46.7
Total	265	965	2,408	2,954	100.0	100.0	100.0	100.0

Exhibit 7: Size and market share, portfolio and secondary mortgage lenders, 1968-1992.

As Exhibit 7 shows, the size of the mortgage market itself expanded enormously, from $965 billion in 1980 to $2.9 trillion in 1992. It is likely that banks' increased lending activity has been driven at least in part by their ability to sell the loans to the secondary market for new capital. Despite this market influence, however, the GSEs' ability to reach to low-income and rural households has been limited. According to HUD:

> Loans originated for families with incomes below 80 percent of area median income are less likely to be purchased by GSEs. Five out of six single-family mortgages purchased by the GSEs are for borrowers with incomes above 80 percent of area median income. Almost 60 percent of the GSEs' single-family business is for borrowers with incomes above 120 percent of area median income.... Based on 1993 mortgage market data, the GSEs purchased 55 percent of the loans originated by the primary market for borrowers with incomes above 120 percent of area median income, but only 41 percent of the mortgages originated for borrowers with incomes less than 60 percent of area median income. This occurred notwithstanding that, in response to the Community Reinvestment Act and their desire to meet the mortgage needs of a broad range of families, lenders are originating many more mortgages for very low- and low-income families than the GSEs are purchasing.[lxxi]

The GSEs particularly have had difficulty targeting their purchases to underserved rural areas. HUD's definition for rural—areas outside of metropolitan statistical areas (MSAs)—does not adequately identify areas that are underserved. There is a concern that the GSEs' inability to target their purchases to rural areas could lead them to rely more heavily on central city purchases to satisfy their underserved areas goal.

The GSEs and Banks. The liquidity and protection against interest rate risk that the secondary market provides may be sufficient incentive for small banks to increase their mortgage lending. For example, Fannie Mae has begun to purchase private loans that leverage section 502 direct loans, and from the banks' perspective it appears that Fannie Mae participation is a key inducement to enter these deals.[lxxii] Currently, however, many of Fannie Mae's rural mortgage purchases are FmHA 502 guaranteed loans,[lxxiii] which implies that (1) rural borrowers who benefit from Fannie Mae's presence have moderate incomes rather than lower incomes, and (2) those bankers who do not participate in the guaranteed program also may not participate in the secondary market.

The GSEs' difficulty in purchasing rural loans may also be due to a mismatch between the secondary market's underwriting criteria and the characteristics of rural borrowers. Some nonprofits questions whether low-income borrowers fit the GSEs' lending standards. For example, it is often the case that low-income rural borrowers do not have sufficiently "clean" credit histories to qualify for loans, or that they require high loan-to-value mortgages that exceed conventional limits. While banks may make mortgages to low-income households nonetheless to meet their Community Reinvestment Act obligations, if they cannot sell them on the secondary market then their mortgage portfolios will reach a ceiling beyond which the banks cannot make additional loans. The Center for Community Self-Help (Self-Help), a nonprofit community development financial institution located in Durham, North Carolina, is addressing this problem by developing a secondary market for these low-income mortgages.[lxxiv] See page 49 for a further discussion of Self-Help's efforts.

Federal Housing Administration Mortgage Insurance. Federal HOusing Administration (FHA) mortgage insurance is a federal guarantee to private lenders against default for the mortgages they make to eligible borrowers under the National Housing Act. Participating mortgagees include banks, savings and loan institutions, mortgage companies, and other approved lenders. Borrowers with FHA-insured mortgages generally see benefits in the form of reduced interest rates or other favorable terms, which the mortgagee grants because of the reduced default risk.

The most widely used FHA program is the 203(b) single-family housing insurance program. FHA generally insures only single-family homes (defined as homes with one-to-four units), although condominiums and manufactured homes are eligible under other FHA programs. FHA imposes certain underwriting standards on participating lenders, including maximum loan amounts and loan-to-value ratios. Borrowers deal with the lending institution directly; thus, where there are few mortgage lenders, this arrangement limits rural homeowners' ability to obtain insurance.

The record of FHA mortgage insurance program in rural areas suggests that banks originate fewer nonmetro loans, per household, for the GSEs to purchase. The FHA has insured 23,270,000 mortgages worth $841 billion since 1934. In calendar 1994, the Agency insured 1.2 million mortgages worth $91.6 billion. The majority of this activity occurred in metropolitan areas, however. According to the 1990 Census' Residential Finance survey, only 8 percent FHA-insured mortgages have been made in nonmetro areas, and only 9 percent of mortgaged non-metro homes have FHA-insured mortgages compared to 21 percent of mortgaged metro homes.

The National Rural Housing Foundation's analysis of housing unit and FHA-provided data suggests that homes in the smallest counties are least likely to have FHA coverage: only 3.2 percent of all owner-occupied homes in counties of 20,000 or fewer population have FHA insurance, as compared to more than 11 percent of homes in counties with populations between 50,000 and 499,999.[lxxv] See 8. Although this exhibit compares all owner-occupied homes to those insured by FHA, rather than just all mortgaged homes to those insured by FHA, the results still suggest that the volume and coverage of FHA mortgage insurance is far higher in urbanized areas than in rural areas.

There are a number of factors that may explain the difference in FHA coverage between metro and nonmetro counties and between larger and smaller counties. First, as discussed earlier, borrowers in nonmetro and smaller counties have less access to mortgage credit than those in larger or metro counties. Second, smaller banks may have less staff capacity to work with the FHA program than larger banks. Finally, rural borrowers use non-bank financing more often than do urban borrowers. These conditions all imply that borrowers in nonmetro and smaller communities may be less able to find banks that offer FHA insurance, but also that the GSEs may be less able to find mortgage loans to purchase in general, and loans that meet their underwriting criteria in particular.

County location and population	Number and share of owner-occupied homes	Number and share of FHA insured homes	Percent of homes insured by FHA
By location:			
Metro	45,388,536 (77%)	6,130,825 (92%)	13.5%
Nonmetro, adjacent to metro	7,598,558 (13%)	269,340 (4%)	3.5%
Nonmetro, not adj. to metro	6,066,177 (10%)	270,840 (4%)	4.5%
By size:			
500,000+	22,309,903 (38%)	3,279,600 (49%)	14.7%
50,000-499,999	25,479,085 (43%)	2,924,067 (44%)	11.5%
20,000-49,999	7,171,284 (12%)	335,467 (5%)	4.7%
Under 20,000	4,092,999 (7%)	131,871 (2%)	3.2%

Exhibit 8: FHA-insured mortgages in counties by county location and size, 1994.

2. Other GSEs2. Other GSEs

A.The Federal Home Loan Bank SystemA.The Federal Home Loan Bank System

The Federal Home Loan Bank system was established in 1932 to provide liquidity to thrifts facing a mismatch between their short-term deposits, and long-term mortgages: if a thrift's funds were tied up in long-term mortgage loans, it could be unable to pay depositors their money on demand. Prior to 1932, this mismatch caused a number of thrifts to fail and others to stop making mortgage loans. The FHLBanks make capital advances to thrifts and insurance companies (and, since 1989, commercial banks and credit unions) that are members of the FHLB system to enable them to make new loans.[lxxvi] Since 1989, with the passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the FHLBanks have been governed by the Federal Housing Finance Board.

The Affordable Housing Program. The Federal Housing Finance Board's Affordable Housing Program (AHP) is a grant program for the development of affordable housing. Created as part of FIRREA, the program has funded 2,620 projects and more than 99,000 units as of September 1995, 19 percent of which are in rural areas (see below). Congress directed that the FHLBanks contribute the greater of $100 million or 10 percent of their net incomes each year for the AHP for calendar years 1995 and beyond.

Each FHLBank offers two funding competitions yearly for member banks within its district. To apply for AHP funds, housing developers contact the member banks which in turn sponsor the developers' applications before the regional Federal Home Loan Bank. The FHLBank compares the applications on the basis of seven priorities:

(1) To finance the purchase, construction, and/or rehabilitation of owner-occupied housing for very low-, low- and moderate-income households.

(2) To finance the purchase, construction, and/or rehabilitation of rental housing, at least 20 percent of the units of which will be occupied by and affordable for very low-income households for the remaining useful life of the housing or the mortgage term.

(3) To finance the purchase and/or rehabilitation of housing owned or held by U.S. Government agencies including HUD, RTC, RHS, VA, FNMA, and FHLMC.

(4) To finance the purchase, construction, and/or rehabilitation of housing that is sponsored by any nonprofit organization, state and local housing finance authorities or other political subdivisions.

(5) To empower the urban or rural poor through resident management, homesteading, self-help housing, or similar programs that meet critical urban or rural needs.

(6) To provide permanent housing for the homeless.

(7) To meet an FHLBank's objective recommended by its Affordable Housing Advisory Council, adopted by its Board of Directors, and approved by the FHFB.

The FHLBank awards the funds to member banks who in turn provide them to the developers.

The Atlanta, Cincinnati, Pittsburgh, San Francisco and Seattle regional FHLBanks selected "rural" (as defined by RHS) as one of their individual objectives during 1995. In addition, Dallas included areas outside of HUD entitlement cities and Topeka selected non-urban areas.

As mentioned above, 19 percent of all AHP-funded units are in rural areas. As of March 1995, 39 percent of the rural units—nearly 5,900 units in 200 projects—were in multifamily developments, and 84 percent of these served very low-income households.[lxxvii] These uses and beneficiaries are like those of the RHS section 515 program, suggesting that the AHP and 515 program are compatible, especially in those regions where the FHLBank has made "rural" its priority. See 9 on the following page.

The AHP awards points for:	Section 515:
achieving each of the program priorities	is used in rural areas
targeting to families below the statutory maximum incomes	section 515 tenants are generally very low-income
fostering long-term affordability	has a 50-year term
leveraging other funds; the AHP funds may be awarded as a grant, loan, interest rate subsidy, or any other form of needed financing	has its own funding stream and uses LIHTCS; the decrease in funding has led developers to seek additional sources of funding
involving nonprofit or community organizations	has a 5 percent set-aside for nonprofit developers

The FHFB does not track RHS participation in AHP-funded projects so it is not clear whether there has been much leveraging of section 515 funding or other RHS program funding with the AHP.

Exhibit 9: Similarities between the AHP and section 515.

The Community Investment Program. The FHFB also sponsors the Community Investment Program (CIP) which provides discounted advances (loans) to FHLBank System members. These members in turn use the funds to make loans for home purchase or rehabilitation by moderate-income families, or for commercial and economic development projects that benefit low-income families and neighborhoods. CIP advances are not priced as far below the market as AHP advances are; the interest is usually ? percent below the cost of a regular advance. However, unlike the AHP, the advances are noncompetitive, long-term and fixed-rate, so they are a dependable source of financing. Banks may use CIP loans to comply with Community Reinvestment Act requirements.

Since 1990, FHLBanks have made $7.1 billion in CIP advances and have financed more than 178,000 housing units. The number of CIP advances in rural areas increased from 61 in 1993 to 100 in 1994 (for both housing and economic development projects); in 1994, FHLBank System members provided $324.1 million for housing, up from $108.7 million in 1993. The increase in usage suggests that, although CIP funds may benefit households with incomes higher than those targeted by the RHS and similar programs, CIP's importance is growing in rural areas as a means of meeting mortgage credit needs. Since the FHLBanks also have pledged to make $200 million in CIP advances available to their members over the next 4 years to support program activities under the Rural LISC initiative (see page 47) and to support related financings by LISC's National Equity Fund and Local Initiatives Managed Assets Corporation, the program will gain even more significance for rural projects.

B.The Farm Credit System and Farmer MacB.The Farm Credit System and Farmer Mac

Farm Credit System. Congress created the Farm Credit System (FCS) in 1916 to meet agricultural credit needs. At the time, commercial banks had pulled back from lending to the farm sector because of poor economic conditions. Congress' intent was to ensure a competitive agricultural credit market in rural areas. Unlike the other GSEs, however, the FCS is authorized to make direct loans to farmers, ranchers and other clients.

In 1971, Congress gave the FCS the authority to make real estate loans in areas of 2,500 residents or less. These mortgages are made at market rates; there is no interest subsidy for low- or moderate-income borrowers. Although the Farm Credit Council, the FCS representative in Washington, DC, did approach members of the Clinton Administration at one point with a proposal to develop an AHP-like program in exchange for increased lending authority, its proposal was not accepted.[lxxviii]

The FCS maintains a presence in very small rural communities that might position it well as a deliverer of subsidized mortgage credit but it appears unlikely that the FCS will take on this role. The FCS has no financial capacity or mandate to develop a low- and moderate-income mortgage program. Moreover, the FCS is seeking expanded lending authority to work in communities of up to 20,000 residents, since (one system representative has suggested) very small communities present greater credit risks. Larger communities present greater business opportunities, both because the interstate banking law changes may lead to reduced competition otherwise, and because some large industries are relocating to rural areas. These considerations imply that FCS is pursuing a market-rate clientele and that it sees itself as a source of capital for commercial bank-quality, but credit constrained, borrowers.

The Federal Agricultural Mortgage Corporation. The Federal Agricultural Mortgage Corporation (Farmer Mac) was chartered by the federal government in 1988 to establish a secondary market for agricultural real estate and rural housing loans. Farmer Mac operates like Ginnie Mae in that it guarantees mortgage pools that have been assembled by private certified poolers, generally larger banks and insurance companies. Farmer Mac's business is also more diverse: in 1990, Congress authorized the Farmer Mac II program which created a secondary market for RHS-guaranteed farm ownership and operating loans and Business and Industry (B&I) guaranteed loans.

Despite having the authority to purchase housing loans, Farmer Mac has entered the rural housing market only recently, in a joint venture with AgFirst Farm Credit Bank of South Carolina and Fannie Mae. In 1994, Farmer Mac purchased $47.7 million in agricultural and rural mortgages compared $594 million in other investments. One difficulty in entering the market, according to Farmer Mac staff, is that Farmer Mac is not authorized to purchase subsidized loans, even section 502 guaranteed loans. Moreover, the active poolers themselves showed little interest in housing loans, preferring to work with the larger agricultural loans. The only bank to show strong interest in serving as a pooler was AgFirst, but its focus was on conventional-quality mortgages. It took a few years to develop this joint venture, under which Farmer Mac will guarantee loans purchased from lenders both within and outside the Farm Credit System. Fannie Mae will purchase the Farmer Mac-guaranteed pools and also loans that AgFirst obtains from its affiliates. While it is likely that this venture will increase the flow of mortgage capital to small rural communities, it is unlikely that lower-income households will benefit directly, primarily because they fall beyond AgFirst and Farmer Mac's mission or statutory authority.

3. Remarks. Remarks

Fannie Mae and Freddie Mac are trying to adequately identify the rural underserved areas through which to meet their purchasing goals. It is clear, however, that rural households do not have the same access to conventional mortgage products as their urban counterparts; rural banks appear to be less willing to make mortgage loans in general or Community Reinvestment Act-type mortgage loans in particular (and Congress threatens to reduce CRA obligations on small banks as well). The relative lack of FHA insurance in rural and small counties is evidence that a system relying on private lenders alone to provide benefit to rural areas is unreliable, particularly if the program requirements are beyond the capacity of small banks' staffing.

Therefore, GSE education and incentives are vital to improving the flow of credit to rural areas, particularly for the higher end of the low-income market. FHLBanks should also continue to promote the CIP and AHP programs in rural areas as a means of inducing more banks to make lower-income mortgages, although this strategy will only be effective to the extent that the smaller rural banks are members of the FHLBank System.

If the Farm Credit System and Farmer Mac had expanded authority to make and securitize subsidized loans—perhaps in partnership with Fannie Mae or Freddie Mac—then the secondary market could take advantage of the FCS's presence to serve as a powerful conduit to rural areas. In the meantime, the GSEs could look to nonprofits and other organizations serving rural areas to act as seller-servicers, community educators, and credit counselors as ways of improving their rural business and meeting their purchasing goals.

PART IV: NONPROFITSPART IV: NONPROFITS

Along with banks, nonprofit organizations are among the private financiers in the development of affordable housing. Unlike banks, however, nonprofits do not operate under a profit motive; they are driven by a commitment to the social and economic well-being of their communities. Rural nonprofits fill a gap in services that federal and state agencies and other private institutions do not have the resources to meet, such as the packaging of complex financial deals or the provision of housing counseling and outreach to low-income households.

The capacity of rural nonprofits is growing, but it still is varied. The RHS section 523 mutual and self-help housing programs demonstrate that nonprofits can successfully link resources and households, often on a broad, regional basis. The isolation of rural areas may limit some organizations' limited ability to develop housing or to access resources, however. This section looks at the nonprofit sector's capacity to meet rural housing needs and at the organizations that can help expand that capacity.

1. Rural Nonprofits: Profile and Needs. Rural Nonprofits: Profile and Needs

The Local Initiatives Support Corporation (LISC) recently began a rural initiative, Rural LISC, to marshall resources from foundations, corporations and financial institutions to support community development corporations in rural areas, as it has in urban areas. This project is described below. To begin, LISC surveyed 138 rural and partly rural community development corporations (CDCs) about their activities and needs.[lxxix] The statistical information in this section is drawn from the survey findings unless otherwise noted.[lxxx]

Although the survey sample is not necessarily representative of the entire rural nonprofit population, the responses suggest that rural nonprofits operate over larger areas, and that the partly rural nonprofits have better access to many important financing sources than do their wholly rural counterparts:

- Just over half of these rural and partly rural CDCs operate in areas of 100,000 or more residents. Only 12 CDCs (9 percent) serve areas with less than 10,000 residents. In other words, the majority of these CDCs must spread their resources over large population areas.

- More than half of the rural and partly rural CDCs receive funding from federal resources, state resources, and fee income. However, the partly rural CDCs use local or state CDBG and HOME funds and foundation grants in a higher percentage than do the wholly rural CDCs. The wholly rural CDCs rely more on RHS financing.

- More than 60 percent of both types of CDCs obtain their private sector project finance from local lenders, but again the percentage of partly rural CDCs using this source of funding is higher. Partly rural CDCs are also more likely to obtain private project funding from foundations, HFAs, AHP, LIHTCs, and LISC.

These findings suggest that rural CDCs are more reliant on federal funding than their more urbanized counterparts. As RHS funding becomes more limited, they may be at a greater disadvantage compared to the partly rural CDCs.

All of the CDCs surveyed by LISC engage in housing construction and renovation, and more than half also own or manage housing units. A study by the Urban Institute suggests that development capacity is uneven, however. Among urban and rural CDCs,

> [t]hose CDCs producing over 200 units per annum—under 2 percent of all organizations—accounted for more than one-quarter of all unit production between 1988 and 1990.... Ten percent of CDCs (those producing more than 50 units a year) sponsored approximately one-half of all units over the same period. At the other extreme, one-half of all CDCs (those producing fewer than 10 units) accounted for only 8 percent of sector output.... the sector as a whole is marked by this extreme concentration of capacity.[lxxxi]

The study further notes that approximately 38 percent of the CDCs and 22 percent of CDC-produced units are found in communities of under 200,000 but that these communities hold 55 percent of the nation's population. In some portions of the country, particularly the midwestern states, rural CDCs produce far fewer units than their regional share of the rural population would warrant.[lxxxii]

Among the groups that Rural LISC will assist, the concentration of capacity is clearly evident. Rural LISC's target group of 52 CDCs as a whole have produced approximately 22,300 housing units since the 1960s. Eight of the CDCs produced 16,000 of those units, however.[lxxxiii] The other 44 CDCs are fairly young or are just beginning to take on housing production activities, thus partially explaining the eight CDCs' predominance in housing production. Nonetheless, the fact that a small number of CDCs produced more than 70 percent of the units in LISC's rural sample mirrors the broad disparities in housing development capacity that exists in rural areas. Such findings suggest that there is a need for more intermediary support and technical and financial assistance to build greater nonprofit capacity in rural communities, to help newer and smaller groups match the record of more established housing organizations.

2. Financial Intermediaries for Nonprofits. Financial Intermediaries for Nonprofits

LISC's survey found that rural nonprofits are more likely to be undercapitalized, and short of operating revenues and predevelopment funds, than urban nonprofits. It also found that many nonprofits see the need to patch together different sources of funds as a significant barrier for obtaining housing finance. For rural nonprofits, the difficulty is multiplied because their staffs tend to be smaller and less experienced than partly rural or urban CDC staffs, and given the dispersal of rural organizations, it is difficult for them to network with more experienced nonprofits.

There are a number of national and state-level intermediaries that can help these rural nonprofits. These nonprofit intermediary organizations mobilize capital, operating and predevelopment funds for nonprofits, provide technical assistance for project development and packaging, and help build capacity. It is important to recognize, however, that the vast majority of intermediary resources have assisted urban nonprofits. While the following organizations have turned their attention to rural areas more recently—or, as in the case of the Housing Assistance Council, have been dedicated to assisting rural areas since its inception—there is a need to bring more resources to rural areas.

A. National IntermediariesA. National Intermediaries

The Neighborhood Reinvestment Corporation. The Neighborhood Reinvestment Corporation (NRC) is a public, nonprofit corporation that was established by Congress in 1978. NRC's mission is to promote the revitalization of declining low-and moderate-income communities for the benefit of their residents and to expand the supply of affordable housing and home ownership opportunities.

NRC accomplishes this goal in part through its sponsorship of the NeighborWorks® organization (NWO) network. NWOs are community-based housing programs that receive NRC support by meeting certain criteria for production, financial management, and resident control.

Within this group of organization is the Rural NeighborWorks® Alliance (RNA), an affinity group of organizations operating in RHS-eligible areas. The RNA organizations formed their alliance to counter-balance the urban orientation of the NWO system and obtain funding for rural groups. In support of their efforts, NRC has devoted extra resources to the RNA, providing staff resources, operating grants, and capital grants for the establishment of the RNA organizations' revolving loan funds. NRC has also agreed to pursue opportunities to develop new rural members.

Many RNA members take innovative approaches to project financing. For example, Rutland West Neighborhood Housing Services, Inc., of Vermont, an RNA organization, has developed a model for rural development which relies on sharing resources between communities. If a community approaches Rutland West for help in obtaining a CDBG grant, Rutland West agrees to provide its assistance if the community will give the repayments from the grant to Rutland West. Rutland West places the repayments into its revolving loan fund to make housing loans on a region-wide basis. The fund also has capital from NRC, RHS section 533 repayments, and other sources.

Rutland West also provides credit and anti-foreclosure counseling. While the agency's focus is on rural lending, other RNA organizations focus on housing development. NWOs generally perform these services as well as neighborhood promotion, community organization, and community service activities.

According to data provided by the National Reinvestment Corporation, the NeighborWorks organizations have been very effective at assisting low-income and disadvantaged groups:

- As of 1992, 71 percent of their borrowers were low-income; 39 percent were female heads of households; and 43 percent were African-American. By comparison on this last point, only 12 percent of RHS section 502 assistance went to African-Americans in that year.

- Fifty-one percent of RNA revolving loan fund borrowers were racial or ethnic minorities; 67 percent were very low-income; and 51 percent were female heads of households.

- The sum of revolving loan fund and leveraged fund investment was $265.8 million in 1994. (Leveraged fund sources included banks, state and local programs, foundations, NRC organizations, corporations, owners and other sources.) This amount financed 7,551 new or rehabilitated units and 7,299 repaired units.

- The RNA organizations accounted for approximately 5 percent of this activity, investing $13.4 million in 399 new/rehabilitated units and 252 repaired units.[lxxxiv]

Although figures are not available for the RNA organizations alone, the per-unit cost from NRC's Homeownership Campaign—including rehabilitation costs, mortgages, and downpayment and closing cost assistance—averaged $42,700 in 1993 and $48,600 in 1994, comparable to the average cost of the dwelling unit subsidized with HOME funds. Moreover, the NWO revolving loan funds leveraged nearly $4.50 in private funds for every $1.00 spent, and leveraged more than $7.50 in private funds for homeownership projects alone. These figures suggest that community-based organizations such as the NeighborWorks organizations can effectively support and supplement federal efforts to develop affordable rural housing.

The Housing Assistance Council. The Housing Assistance Council (HAC) is probably the nation's oldest intermediary for housing and community development. Since its founding in 1971, HAC has worked to help bring decent and affordable housing to low-income rural communities. Headquartered in Washington, DC, HAC has regional offices in Georgia, New Mexico and California.

HAC's mission is to improve housing conditions for the rural poor, with an emphasis on the poorest of the poor in the most rural places. HAC has focused its efforts on certain high-need groups and regions including Indian country, the Mississippi Delta, farmworkers, the Southwest border colonias, and Appalachia.

HAC offers several services to community-based nonprofits, public agencies, minority developers, and others interested in creating more rural housing. These services include:

- *Loan funds.* Borrowers use HAC's seed money loans for the start-up costs of project development. HAC makes $2-3 million in local commitments yearly and has made almost 900 loans worth $38 million over the past two decades. HAC frequently works with other private and public lenders to share financial commitments. HAC also provides pass-through administrative funds from HUD and foundations to community-based housing groups.

- *Rental housing development and management.* HAC's subsidiary, Rural Housing Services, develops rental housing using LIHTCs. RHS has created and co-owns 20 tax credit projects in nine states.

- *Technical assistance.* HAC's staff deliver over 10,000 hours of technical advice to groups and individuals yearly. This TA often accompanies HAC's loans but is available to any organization or individual.

- *Training.* HAC holds 4-8 intensive training workshops yearly in various regions of the country on affordable rural housing development, financing, and nonprofit management. HAC also convenes a National Rural Housing Conference every 2-3 years.

- *Research and information.* HAC publishes a biweekly newsletter and 12-15 analytical reports annually. In all, HAC has published more than 200 reports and manuals on rural housing.

Rural LISC. Rural LISC is designed to do for rural CDCs what LISC already has done for urban CDCs: to "make the overall policy and resource environment more supportive of rural CDCs; document what rural CDCs are accomplishing; demonstrate what rural CDCs can achieve with increased training, technical assistance and financial resources; and help rural CDCs advocate more effectively for their interests."[lxxxv] Specifically, LISC will channel resources from private and public sources to a core group of 52 rural CDCs in 37 states. LISC also will offer training to a broader group of CDCs, to develop their capacity to engage in housing and community development activities.

Rural LISC is a departure from LISC's urban model of assistance. In urban areas, LISC opens a local office, marshalls local funds for community development projects, and operates in that one area. Even LISC's Mid-South Delta initiative, which operates across 56 counties in the Delta region, is organized to serve a contiguous area. In contrast, Rural LISC will have no local offices; instead, it will bring technical assistance providers out to a local site. LISC also will use nationally-based funds for the effort rather than local funds. This strategy recognizes the particular characteristics of rural areas and their differences from urban sites. As the program develops, however, LISC may employ a more site-specific approach.

LISC's budget for this project totals $102 million over the first four years. Sources include $16.7 million in grant funds, $16 million in low cost loans, $60 million in project equity and equity bridge financing, and $10 million in loan purchases through Local Initiatives Managed Assets Corporation (LIMAC), LISC's secondary market for community development loans.

B.State ProgramsB.State Programs

The New York State Division of Housing and Community Renewal (DHCR) administers the Rural Preservation Program (RPP) which provides planning and administrative funds to nonprofit Rural Preservation Companies (RPC) for housing-related activities. There is a similar program for urban neighborhoods. The rural program was established in 1980 because the state legislature recognized that local nonprofits needed funding to pay for the administrative and planning costs of their development work.

Under the RPP, the DHCR is authorized to contract with rural nonprofit organizations through a competitive process for the performance of housing preservation and community renewal activities that benefit low- and moderate-income households. The general categories of eligible activities include housing management, tenant assistance (organizing, mediation), loan/grant application assistance for individuals, program assistance for other organizations and municipalities, homeownership financial counseling, housing rehabilitation and development, revolving loan fund administration, and coordination of community security issues. RPCs may also conduct commercial revitalization within the context of a housing-related program or may administer rent subsidy programs.

The assistance under the RPP is a grant of up to $100,000 per annum to the RPC for administrative and planning expenses. Hard costs are not eligible expenses. DHCR may renew the grant annually until a cap of $300,000 is reached. Subsequent grants are limited to up to $65,000 per year. There is a lifetime cap for RPCs of $1.3 million. RPCs must match the grants with a local share equal to at least one-third of the state grant. Through 1994, DHCR has provided $58 million to 67 RPCs.

The Kentucky Housing Corporation also offers a series of programs targeted to nonprofit developers. Like its Housing Trust Fund, the Corporation's Housing Assistance Fund is financed from the Corporation's earnings. In 1995, KHC set aside approximately $1.8 million for four competitive programs within the Fund that are focused toward nonprofits. (KHC also uses the Fund for other loan and grant programs and for other purposes.) These include administrative support grants, project-related grants, challenge grants, i.e. grants that KHC awards if the nonprofit can provide a matching amount, and fee for service grants, i.e. grants that KHC awards to nonprofits based on the number of housing units they produce. KHC supports the nonprofits because it recognizes that as locally-based institutions, they can identify housing needs effectively and tailor programs to meet those needs.

3. Nonprofit-Based Secondary Markets for Affordable Housing Loans.

Nonprofit-Based Secondary Markets for Affordable Housing Loans

The success of the secondary markets for conventional housing loans suggests that a secondary market for affordable housing loans could increase banks' willingness to make these loans and could also provide more capital for nonprofit intermediaries to make mortgages. The NeighborWorks® Organizations (discussed above) have access to their own secondary market, the Neighborhood Housing Services of America (NHSA).

NHSA was formed in 1977 to purchase the home rehabilitation loans made by private banks on behalf of NWO clients. NHSA packages these loans into securities that social investors (including Fannie Mae) are willing purchase at below market returns. Unlike the GSEs NHSA will finance rehabilitation loans. It also provides specialized financing products, including mortgage purchases for "unbankable" homeownership projects that require only a 2 percent downpayment; direct lending and purchasing of nonprofit/cooperative multifamily housing mortgages; and direct intermediate (bridge) lending for nonprofit housing development. NHSA's combined loan purchases and direct lending average $20-25 million yearly, and its investments in RNA deals totalled $6.8 million as of June 1995.

While this model is helpful for the urban NWOs, some Rural NeighborWorks® Alliance members' ability to access this market is limited by the shortage of permanent financing in rural areas, as well as by the difficulties they face in creating deal flow. According to one executive at NHSA, an RNA member, Colorado Rural Housing, has difficulty finding lenders to make permanent mortgages even with NHSA commitments. However, another RNA member, Tierra del Sol of New Mexico, has worked out an arrangement with local banks whereby NHSA provides forward commitments if they will provide construction financing. The director of Tierra del Sol noted that, next to section 502, NHSA's mortgage standards were the most helpful for rural areas, allowing low interest rates, downpayments as low as 2 percent, and front- and rear-end ratios of 38 and 42 percent.

At the local level, the Center for Community Self-Help (Self-Help) is developing a secondary market for non-conventional home loans made by local banks. Self-Help has purchased a $20 million portfolio of below market rate, Community Reinvestment Act mortgages from Wachovia Bank and Trust Company. (Wachovia made a concessionary rate loan to Self-Help for the purchase.) Under the terms of the purchase agreement, Wachovia used the proceeds from the loan sale to make another $20 million in CRA mortgages. For its part, Self-Help used grants awarded by HUD and the North Carolina General Assembly to create a loan loss reserve and guarantee the performance of the portfolio. To date, Self-Help has sold $1 million in these loans to Duke University.

Self-Help would allow the banks to charge slightly higher interest rates that reflect the market perception of risk inherent in lending to lower-income borrowers. These loans still would carry a total cost lower than a conventional loan, however, since Self-Help's borrowers do not have to pay for private mortgage insurance—Self-Help provides credit enhancement for the loans instead, and the savings from the insurance offset the higher interest cost. After providing credit enhancement, Self-Help would either sell the loans to the GSEs, swap them for GSE securities, or securitize them itself. The Center for Community Self-Help is working with the GSEs now to develop its course of action.

Clearly, making and servicing loans to low-income borrowers is a more labor-intensive process than making and servicing loans to conventional customers. These borrowers need greater hand-holding and training in financial management. These difficulties make secondary-market quality loans to low-income rural borrowers hard to find. Nonetheless, Self-Help's experience suggests that low-income mortgages can be safe investments for the GSEs, and that nonprofits and CDFIs can serve as conduits to rural areas and partners with whom the GSEs can work to satisfy their mortgage purchase goals. More generally, the success of the nonprofit sector in providing housing finance—and its key role in making federal and state programs available to rural areas—suggests that public agencies should continue to support nonprofits even as they consider new ways of delivering housing finance to rural areas.

4. Public vs. Private Efforts to Support Nonprofits. Public vs. Private Efforts to Support Nonprofits

New York's capacity-building program is important for the state's rural housing efforts because New York relies on intermediaries to produce affordable housing. The Division of Housing and Community Renewal, the state HFA, the State of New York Mortgage Agency and the Department of Social Services operate 16 state-funded housing programs—many of which can benefit rural areas—but they provide the funds generally to nonprofit organizations, municipalities and housing authorities. (For-profit developers may apply for some of the programs but generally they must agree to limit their profits.)

The nonprofits also can market federal programs, such as those of RHS, to isolated areas. In Kentucky (as noted above), nonprofits originate loans from the Kentucky Housing Corporation Housing Trust Fund. The West Virginia Housing Development Fund uses nonprofits to originate its single-family HOME program loans and is considering using them to originate mortgages for its MRB program as well. Moreover, nonprofits play a crucial role in providing credit and housing counseling for low-income rural families. Counseling can be the needed ingredient to make a household credit-worthy; many

Fannie Mae and state housing programs require counseling as a component of a homeownership program, and often the agencies will allow borrowers to have higher income ratios if they have undergone pre-purchase counseling. There is a proposed AHP rule to set aside funding for first-time homebuyers which requires participating member banks to enroll homebuyers in a counseling program based on those offered by or in conjunction with a nonprofit housing agencies or other recognized counseling organization, and requires participants to enroll in counseling.[lxxxvi]

Despite nonprofits' positive contributions, state support for nonprofits is inconsistent while federal support for nonprofits appears to be in decline. As noted above, most of the states that were surveyed by the National Council of State Housing Agencies offered no operating or capacity-building support to CHDOs through their HOME programs. Moreover, Congress rescinded $38 million of the $50 million from HUD's housing counseling program for nonprofits and public agencies which, through competition, provides funding to multi-state, regional or national intermediaries and local housing counseling agencies for the provision of pre- and post-purchase counseling to homebuyers.

For its part, RHS has its section 509/525 program. The 509(f) "half" of the program remunerates nonprofits for each loan or grant application they package in an RHS-designated underserved area. The 525 "half" of the program funds homebuyers' education programs; in fiscal 1994, nonprofits received 45 grants to offer homebuyer education programs in nine states. Despite the importance that the GSEs and other financing agencies place on counseling, however, it would appear that federal support for this program is low: the 509/525 program only received $2.5 million in appropriations in fiscal 1994 and no appropriation for fiscal 1995.

On the positive side, HUD does offer competitive technical assistance funds for providers to assist CHDOs and recipients under the HOME, CDBG and Supportive Housing programs, and HUD made $25 million available for CHDO technical assistance in fiscal 1995. Nonetheless, the demand for the services of the Neighborhood Reinvestment Corporation, Rural LISC and HAC clearly indicate that more assistance is needed to bring the nonprofit sector's capacity up to the point where it can more squarely shoulder the burden that reduced federal funding will place in meeting rural housing needs for the smallest communities.

PART V: CONCLUSIONSPART V: CONCLUSIONS

The federal retrenchment in rural housing expenditures has raised some difficult issues for Congress, the states, and rural housing providers alike. First, the combination of funding reductions with the renewed emphasis on block grants together imply that the federal government will pass to the states a greater responsibility to provide aid that it is unwilling to shoulder itself.

The prevailing belief behind block grants is that states can do the job better and cheaper. Past experience does not support this contention, however. When the federal government last provided assistance to states by block granting a number of categorical programs under the Omnibus Budget Reconciliation Act of 1981, it also reduced the overall level of funding by 12 percent, and the states had to offset the reductions through increases in their own funding.[lxxxvii] Given that many states are facing their own budget crises at this time, there is no guarantee they will supplement diminished federal resources this time. From this standpoint, block granting alone is not the answer to reduced funding.

Second, the shift to guarantees begs the question of what the federal government's role in providing housing assistance should be. Should the federal government provide subsidies to the most needy, or should it provide incentives and guarantees for private institutions to make market-rate loans? Either way, if it does not develop incentives for other institutions to assist the neediest households (e.g., by attaching subsidies to loan guarantees), then the federal government is effectively telling the states and the poor alike that they must fend for themselves.

Last, Congress' actions leave a gap that more non-federal actors will have to fill in order to maintain rural housing production at even its current levels. The simple "system" of RHS lending—a direct path from Washington DC to the county through the offices of one agency—will have to be supplemented and expanded by state agencies, nonprofit providers, and outside sources of capital.

Many state agencies—HFAs in particular—and nonprofits have answered this call by designing programs that are targeted to rural areas. Many of the HFA efforts focus on homeownership for households with 70 percent of income or more, but many finance affordable housing for lower income people, plus multifamily and special needs housing. Again, however, the agencies come up against the conflict between providing deep subsidies for a limited number of very low-income households and spreading the subsidy among more low- and moderate-income households. The nonprofit housing organizations also have shown their ability to assist families through outreach, counseling, and housing programs, but they need to have a reliable source of funding with which to implement their programs.

Recommendations

1. The RHS system still provides the greatest assistance to poor rural households. There is some question about the political viability of an extensive system of federally financed field offices, but it is clear that with rural areas' isolation and relative lack of financial resources and technical expertise, there must be some local presence to ensure that small communities have access to affordable federal and state funds. Nonprofits can inform communities about available subsidies, provide technical assistance, and serve as conduits for funding. Therefore:

- *Where there cannot be a local RHS office to provide direct assistance, RHS should coordinate with nonprofit technical assistance providers to ensure that the area receives service. The nonprofits should receive operational support to help fill this gap.*

2. It also is clear that RHS should refocus its programs on more isolated rural areas since its offices overall are making a high percentage of their single-family housing loans in metro counties. RHS' proposed regulations will raise the borrowing costs of section 502 direct loans to low-income borrowers and reduce the Agency's underwriting flexibility. At the same time, Congress is providing more funding for guaranteed loans that do not benefit minorities and lower-income households in large numbers.

- *RHS should improve its targeting of single-family housing resources to meet underserved markets and low-income borrowers.*

- *There should be greater promotion of leveraging opportunities for all RHS programs (including a greater promotion of self-help housing development) to reduce the borrowing costs for low-income households and stretch the existing* *subsidies. Successful leveraging should not be permitted to come about through shifting RHS' resources toward higher-income populations.*

Moreover, Congressional and Departmental investigators have repeatedly questioned the project selection process and other workings of the section 515 program. The perceived weaknesses of section 515 have undermined Congressional support for the only federal program to target rural areas for much-needed low-income rental housing. Therefore:

- *RHS should develop reforms to the section 515 program that will resolve Congressional criticisms as expeditiously as possible. In particular, it should promote legislative and administrative action to implement the H.R. 1691 reforms and to ensure that LIHTC subsidies are used cost-effectively. If the section 515 program is not viable, however, then other approaches to rural rental housing must be developed.*

3. It is clear from HUD data that the HOME and CDBG programs can be used in rural communities. Nonetheless, in some states, the nonprofits play a vital role in ensuring that small communities receive their share of these funds, and nonprofit capacity is uneven among and within states. Therefore:

- *HUD programs should include a rural area set-aside to communities with populations of 10,000 or less.*

- *Match requirements should be clarified and adapted to rural communities' needs, to allow them easier access to HOME funds. Either states should not be allowed to pass the HOME match requirements onto lower-income communities or the match regulations should be amended to account for the resources that rural states and areas have to offer.*

- *HUD should focus its financial and technical support for nonprofit and CHDO development on nonprofits serving small and rural communities to enhance their ability to serve as delivery mechanisms for HOME funds. States should be encouraged to use their CHDO capacity-building and operating support funds for CHDOs serving rural areas.*

- *The HOME program should permit CHDOs to recycle program funds, in a manner similar to the CDBG or HPG program, in areas where HUD has determined that there is no local jurisdiction able to establish its own HOME Trust Fund to capture HOME repayments.*

4. It appears that some of the federal regulations governing the use of funds create difficulties for some developers as they use the HUD programs to develop rural housing. Therefore:

- *RHS and HUD should work with a task force of rural government representatives and rural nonprofit and for-profit developers to examine federal site standard regulations, Davis-Bacon wage requirements, environmental reviews and other rules. The task force should determine whether the regulations are appropriate for rural conditions or whether there are local problems of interpretation and implementation.*

5. As stated earlier, the "system" will be more variable as more actors and funding sources are involved. An efficient delivery system should be predictable in terms of the products available, the resources appropriated and the ease of access. If a reduction of federal subsidies leads to a need for more inputs, then it is vital for the system's success that there be national, state and regional forums for the exchange of ideas and development of cooperative arrangements to promote ongoing communication. Therefore:

- *There should be nationwide encouragement of interagency arrangements such as Colorado's that can leverage the expertise of RHS' field network with other agencies' resources, including those of the Farm Credit System.*

- *RHS should continue to explore financial leveraging arrangements where they would result in the provision of low-cost financing for low- and very low-income households.*

6. Current political trends call for greater involvement by the private sector in addressing social needs. For housing, the expansion of GSE and nonprofit secondary market activity can induce more rural banks to make affordable mortgages. Such efforts will require a firm and long-term commitment of resources for outreach and education. Therefore:

- *The GSEs should increase their purchase of rural mortgages, to ensure that these mortgages compose a fair share of loans purchased to meet the underserved areas goal.*

- *The GSEs should continue their education and product development efforts with an aim toward involving more nonmetro banks in mortgage lending. GSEs should also continue their partnership efforts to help develop local bank staffing capacity, including the assurance of sufficient deal flow to make staff training feasible.*

7. The experience of the Center for Community Self-Help with Wachovia

Bank and Trust's portfolio of low-income mortgages indicates that, with appropriate servicing and counseling, loans that do not meet traditional underwriting criteria can be safe investments. Therefore:

- *GSEs should support proven nonprofit lending models which accomodate non-traditional underwriting standards, by purchasing their loans or swapping them for GSE securities.*

- *Small banks should continue to be held to the standards of the Community Reinvestment Act.*

APPENDIX: "The Home Program from a Rural Perspective"APPENDIX: "The Home Program from a Rural Perspective"

The National Rural Housing Coalition prepared a paper in 1993 describing rural areas' difficulties in using the HOME program. Based on a survey of nonprofits, the Coalition reported these concerns:

- Rural areas have difficulty meeting their match requirements because they have few financial resources (limited tax bases, for example), and they sometimes require CHDOs to contribute the match.

- Very small rural communities cannot compete easily with larger communities for state HOME dollars.

- HUD uses jurisdiction-wide statistics to determine whether the jurisdiction qualifies for a reduction in its matching fund requirement because of fiscal distress. Distressed rural communities within a state may not benefit from match reduction unless the state as a whole is fiscally distressed.

- HOME funds are targeted to households with incomes at or below 60 percent of the area median income. For very low-income rural households to benefit from HOME spending, a 35 percent of median income target would be more appropriate. The absence of a requirement for deep targeting means that rural households may not receive sufficient subsidy, or that states may devote their HOME funding to projects that require less assistance.

- Davis-Bacon wage requirements apply to HOME-funded projects of 12 units or more. HUD should conform these requirements to those of the CDBG program, which allow federal funds to be spent on land acquisition and development without triggering Davis-Bacon. This change would allow HOME funds to be used for land acquisition without contributing to higher overall project costs.

- The HOME rental property requirements are inappropriate for owner-occupied, 1-4 unit buildings. HUD should adopt the CDBG program rental requirements for these structures, which require only that 51 percent of the units be income-restricted to low- and moderate-income tenants.

- Some states appear to discourage the formation of consortia that could receive funding by not working with the communities interested in forming the consortium.

- States have discretion in whether or not to give up to 5 percent of their HOME funds to CHDOs for operating expenses. Some states make no funds available for this use.

- States may reallocate unused CHDO set-aside funds to other entities within the state (with preference given to communities that are not participating jurisdictions). The Coalition expressed its concern that these funds were redistributed to CHDOs in local participating jurisdictions.

- A state may transfer a portion of their own allocation to a local community to raise the local community's allocation to the minimum required for program participation. This reduces the state's own resources for helping rural areas.

- A state may pass the monitoring and administrative requirements for a project onto the local government. Since many rural governments do not have the capacity to carry out these duties, they may not be granted HOME funds. If a nonprofit is given these duties, it will be unable to participate as a CHDO because of conflict-of-interest issues.

- Rural areas generally have a limited developer network capable of receiving HOME funds under the CHDO category. These areas need assistance in developing nonprofit capacity.

- CHDOs in the State of California appear to have had particular difficulties in using set-aside funds.

The Coalition also recommended that FmHA (now RHS) and HUD coordinate their policies and programs and work together to promote better housing in rural areas.

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[i]This paper uses nonmetro data as a proxy for rural, and uses the terms "rural" and "nonmetro" (and "urban" and "metro") interchangeably except when referring specifically to "rural, nonmetro" areas, which are communities of less than 2,500 residents in nonmetro counties.

[ii]U.S. Department of Commerce, Bureau of the Census. General Housing Characteristics, 1970, p. 1-10 and 1990, p. 1.

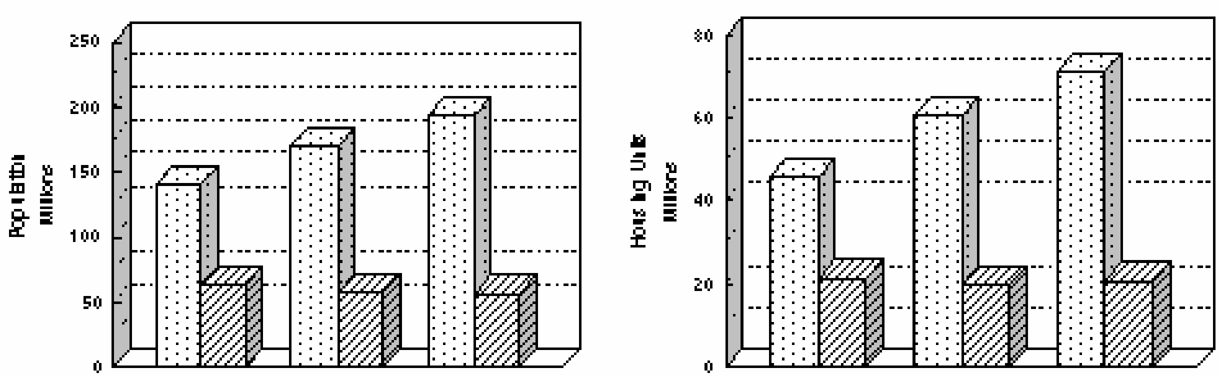
[iii]Note that these numbers are based on metro and nonmetro county designations in use at the time of each Census. The USDA Economic Research Service figures, using the 1983 metro/nonmetro designation for its tabulations, showed that the nonmetro population *grew* over the 1970-1990 period from 47.6 million to 56.7 million while the metro population grew only from 155.6 million to 192.0 million.

[iv]U.S. Department of Agriculture Economic Research Service (USDA-ERS). "Rural Conditions and Trends" (4:3), Fall 1993, pp. 69-70.

[v]USDA-ERS, pp. 81-88.

[vi]USDA-ERS, p. 94.

Figure Error! Main Document Only.: Metro and nonmetro population and housing units, 1970 - 1990.



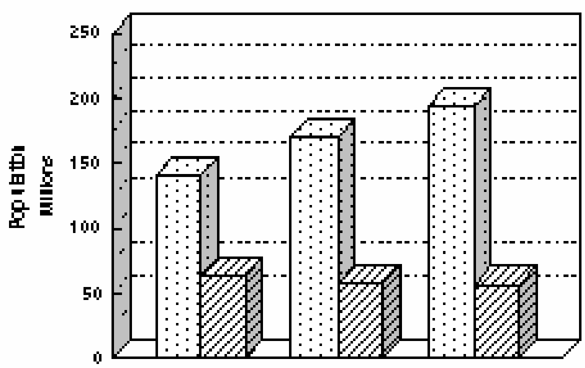
	1970	1980	1990
Metro	139,418,811	169,430,623	192,725,741
Nonmetro	63,793,115	57,115,182	55,984,132

	1970	1980	1990
Metro	46,075,866	60,497,718	71,265,264
Nonmetro	21,580,700	19,891,955	20,682,146

[vii]In many cases, the poor nonmetro counties are areas of long-time, persistent poverty. The USDA

Economic Research Service has identified "persistent poverty" counties as those in which 20 percent or more of the population have poverty-level incomes in each of the four preceding decennial censuses. The persistent poverty counties largely are concentrated in the South and particularly include remote rural counties. More than half the nonmetro counties in each of Alabama, Georgia, Kentucky, Louisiana, Mississippi and South Carolina are persistent poverty counties. Along with Arkansas, where 48 percent of the nonmetro counties are in persistent poverty, they account for more than half the persistent poverty counties nationwide. High poverty rates are also found in counties in Appalachia and in areas with high proportions of nonwhites. See USDA-ERS, pp. 10, 49, 94.

Figure Error! Main Document Only.: Metro and nonmetro population and housing units, 1970 - 1990.



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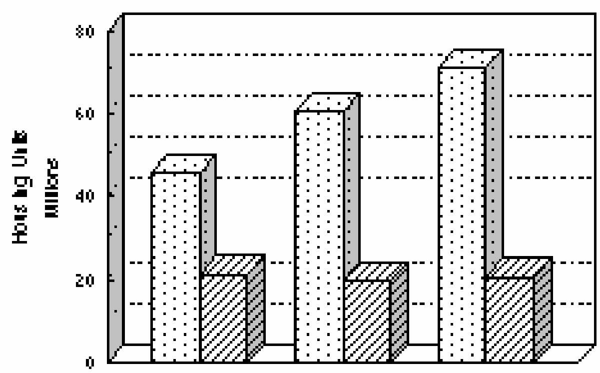

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viii. Census 1970, p. 1-10, 1980, p. 1-19, and 1990, p. 1.

ix. Census 1980, p. 1-59, and 1990, p. 19.

x. American Housing Survey (AHS) 1991, table 10-12.

xi. American Housing Survey 1985 and 1991.

xii. These housing conditions among minority-headed households may be related to their lower incomes. The total 1990 nonmetro median household income is $23,075. In contrast, the nonmetro black median household is $12,881 and the nonmetro Hispanic median household income is $18,969. Moreover, 35 percent of nonmetro black households are cost-burdened compared to 31 percent of the overall nonmetro population; however, only 25 percent of nonmetro Hispanic households are cost-burdened. See 1991 AHS, tables 5-7, 5-12, 5-13, 6-7, 6-12 and 6-13.

xiii. Housing Assistance Council, State Data Sheets: An Overview of Poverty and Housing Data from the 1990 Census (January 1994).

xiv. Housing Assistance Council, Taking Stock of Rural Poverty and Housing for the 1990s (1994), pp. 49 and 55.

xv. Robert R. Moore and Karen Couch. "Have Small Banks Been Caught Off-Balance?" Financial Industry Studies (December 1994), p. 14.

xvi. Data provided by Daniel Milkove, USDA-ERS by telephone, August 28, 1995 from data developed by Clifford Rossi.

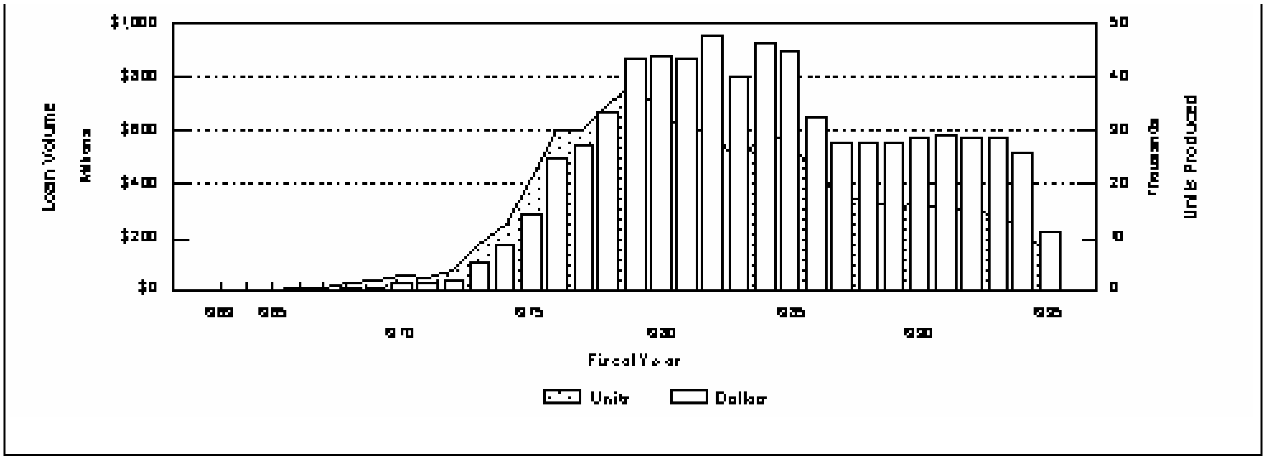
xvii. USDA Economic Research Service. "Changing Rural Financial Markets" (briefing paper). Rural Economic and Community Development Service, April 1995, pp. 2-3.

xviii. USDA-ERS (1995), p. 4.

xix. Given nonmetro areas' greater reliance on mobile homes, it is worth noting that the mobile homes surveyed in the American Housing Survey carried a median interest rate of 11.9 percent and median loan term of 14 years. In some cases, mobile homes are financed by through consumer loans rather than mortgage credit, which may account for the more expensive loan terms. (Carol B. Meeks, "Rural Housing: Status and Issues", Massachusetts Institute of Technology Center for Real Estate [1988], p. 8.)

[xx.]AHS, 1991, Table 3-15.
[xxi.]Johanna Shreve, National Association of Home Builders. Proceedings: The Nonmetropolitan Housing Challenge in America. Remarks, December 7, 1991, p. 26.
[xxii.]Figures derived from 1993 AHS data.
[xxiii.]According to Don Brooks in the Budget Office of USDA, the average subsidized loan rate on the portfolio is approximately 3.3 percent. This average reflects the interest rates on older loans which have risen with borrowers' ability to pay. New loans have rates of 1-1⍰ percent.
[xxiv.]Art Collings, "The Affordability Factor, a Good Reason for Sec. 502 Direct Loans", unpublished paper, 1995, p. 3.
[xxv.]Adjusting this level by the Producer Price Index for intermediate goods and supplies, $1 million in 1994 dollars represents a real funding decrease of approximately 80 percent from 1976.
[xxvi.]Housing Assistance Council. The FmHA Housing Program in Fiscal Year 1994: "A Difficult Year" (February 1995), Appendix H-2.
[xxvii.]Housing Assistance Council (January 1994).
[xxviii.]Housing Assistance Council (February 1995), p. 25.
[xxix.]RHS historically has not maintained a strong presence in Native American areas. The Agency currently is working to improve its services to Native American areas through programs with HAC and with Fannie Mae.
[xxx.]U.S. General Accounting Office. Report to the Chairman, Subcommittee on Housing and Community Development, Committee on Banking, Finance and Urban Affairs, House of Representatives. Rural Housing: FmHA's Home Loan Program Not Meeting the Needs of All Rural Residents. June 1993, pp. 1-2, 6, 9.
[xxxi.]Data provided by Art Collings, HAC. This analysis was based on the proposed rule which set the minimum payment at 22 percent of income for PITI for very low-income borrowers and 26 percent of income for PITI for other borrowers.
[xxxii.]Federal Register (60:92), Friday, May 12, 1995, p. 25632.
[xxxiii.]Collings, p. 3.
[xxxiv.]Housing Assistance Council. "FmHA Rural Housing Direct Lending vrs. Loan Guarantees", p. 4.
[xxxv.]Interestingly, Title V prohibits RHS from using the loan guarantees to refinance direct section 502 loans despite the fact that RHS is supposed to graduate its borrowers to private market credit once they are able to afford it. The U.S. General Accounting Office, in a December 1994, report, noted that "movement from a direct loan to a guaranteed loan is a logical progression for borrowers whose financial condition has improved but is still not sufficient to qualify for nonguaranteed private credit." The GAO estimated that there were 92,000 borrowers with $2.2 billion of unsubsidized direct loans who were paying interest rates above the current market rate, and that these borrowers could benefit from refinancing. (Some of these loans had been made without subsidy; others no longer qualified for subsidy because the borrower's income had increased sufficiently.) The report recommended that Congress consider legislative changes to make refinancing existing RHS debt an eligible use for the loan guarantee. See U.S. General Accounting Office. Report to Congressional Requesters. Rural Housing: Shift to Guaranteed Program Can Benefit Borrowers and Reduce Government's Exposure (December 1994); the quote is found on page 4.
[xxxvi.]Telephone conversation with Maureen Kennedy, Acting Administrator (on leave), Rural Housing Service, July 1995.
[xxxvii.]Housing Assistance Council (February 1995), Appendix C-8.

Figure Error! Main Document Only.: Section 515 direct loans and units produced since 1963.



[xxxviii]To date there have been almost no loans made to cooperatives.
[xxxix]Staff from the State of Utah Department of Community and Economic Development, Division of Community Development note that the use of LIHTCs in smaller projects may not be cost-effective given the cost of legal fees associated with the credits. Since smaller projects generally are more appropriate for rural settings, there is a bias toward using LIHTCs in more urbanized or more metropolitan areas.
[xl]National Rural Housing Coalition,"Section 515: History and New Directions". 1995 Rural Housing Program Policy Papers, p. 2.
[xli]U.S. Department of Agriculture, Office of Communications news release. "Congressional Recissions Unfairly Target Rural Housing." Release No. 0192.95. March 6, 1995.
[xlii]Farmers Home Administration, U.S. Department of Agriculture. The Beneficiaries of USDA Housing Programs in Rural America (Washington, DC: 1995) p. 26.
[xliii]Housing Assistance Council (February 1995), p. 25.
[xliv]The allocation formula criteria include the state's percentage of the nation's rural (1) population, (2) occupied substandard housing units, and (3) families with incomes below the poverty level.
[xlv]U.S. General Accounting Office. Report to the Chairman, Information, Justice, Transportation, and Agriculture Subcommittee, Committee on Government Operations, House of Representatives. Rental Housing: Distribution and Use of FmHA's Rural Rental Housing Program Funds. Report GAO/RCED-94-141(Washington, DC: June 1994) pp. 6-8.
[xlvi]U.S. House of Representatives, Committee on Appropriations, Surveys and Investigations Staff. "A Report to the Committee on Appropriations, U.S. House of Representatives on the Practices and Procedures Regarding Certain Housing and Loan Assistance Programs under the Farmers Home Administration." (Washington, DC: April 1994)
[xlvii]Note that the National Rural Housing Coalition does not agree with the criticism behind this finding. It is this 20 mile rule that ensures that developers do target funds to needier areas, those that are less wealthy markets.
[xlviii]H.R. 1691, p. 28.
[xlix]National Rural Housing Coalition. "The Rural Rental Housing Guarantee Program and Other Federal Project-Based Housing Assistance Programs," January 1995.
[l]Farmers Home Administration "Results of Annual Multiple Family Housing Occupancy Surveys— January, 1994" provided by Art Collings, Housing Assistance Council, Washington, DC.
[li]Estimates provided by Larry Anderson, RHS, August 29. 1995.
[lii]A proposed rule of May 12, 1995 (FR 60:92, p. 25658) increases the loan and grant limits to $20,000 and $7,500 respectively.
[liii]This is an important benefit for building the capacity of rural nonprofits, particularly those that lack other sources of project capital. (A similar benefit does not accrue to Community Housing Development Organizations, CHDOs, under the HOME program, and this is a source of contention for them—see page 27).
[liv]National Council of State Housing Agencies. State HFA Factbook (NCSHA: Washington DC), pp. 88, 90.

[lv] NCSHA, pp. 87, 90, 91 and 93.
[lvi] Alaska, Alabama, Arizona, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky and Louisiana.
[lvii] NCSHA, p. 96.
[lviii] New York and Hawaii are the only two states that do not operate their own State and Small Cities program. HUD operates the program directly in these states.
[lix] California, Connecticut, Delaware, Massachusetts, North Carolina, Ohio, Rhode Island and Virginia spent more than 50 percent on housing activities; Alaska, Arkansas, Idaho, Indiana, Kansas, Louisiana, Nevada, South Dakota, Texas, Utah, West Virginia and Wyoming spent between 0 and 10 percent.
[lx] Connie H. Casey, U.S. Department of Housing and Urban Development Office of Policy Development and Research. Characteristics of HUD-Assisted Renters and their Units (HUD: Washington DC), AHS tables.
[lxi] U.S. General Accounting Office Report to the Chairman, Joint Committee on Taxation, U.S. Congress: "Home Ownership: Mortgage Bonds Are Costly and Provide Little Assistance to Those in Need" (March 1988), p. 19.
[lxii] The low household incomes also make bond-funded multifamily housing projects infeasible. In combination with the small scale of rural multifamily projects, the low incomes mean that the projects cannot develop enough cash flow from rents to pay operating costs and the debt service required by the interest rate on the bonds.
[lxiii] These loans have a 30-year term and generally carry an interest rate 40-50 basis points below the market rate.
[lxiv] West Virginia also offers an example of the potential interface between public and quasi-public programs. The HDF provides construction financing and some site loan monies for section 515 projects. This involvement allows the HDF to steer projects to town where it wants development. The HDF also provided the construction review staff, which made RHS' job easier.
[lxv] Petherick, p. 1, 3-4.
[lxvi] Comments of Don Pierce, RHS-CO. Telephone interview, July 7, 1995.
[lxvii] A third GSE, the Government National Mortgage Association (Ginnie Mae) also sells federally-guaranteed loans, such as section 502 guaranteed loans, on the secondary market. Ginnie Mae does not securitize the loans, however; it insures the securities of other issuers. Through June 1995, Ginnie Mae has insured 7,900 section 502 guaranteed loans worth $515 million.
[lxviii] Federal Register 60:32, February 16, 1995. "The Secretary of HUD's Regulation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), Proposed Rule", pp. 9154-55.
[lxix] Fannie Mae also is a significantly large purchaser of state housing finance agency mortgage revenue bonds (MRBs). In West Virginia, for example, Fannie Mae purchased the agency's last two issuances of MRBs in whole.
[lxx] John C. Weicher, "The New Structure of the Housing Finance System", Federal Reserve Bank of St. Louis Review (July-August 1994), p. 52.
[lxxi] Federal Register 60:32, p. 9158.
[lxxii] Comments of Russell Higgins, Rural Housing Chief, RHS-VT, "Information-Gathering Meeting for Leveraging Opportunities," Arlington, VA, May 31, 1995.
[lxxiii] Telephone conversation with Joel Dulmage, Account Manager, Federal National Mortgage Association, Chicago, IL. June 21, 1995.
[lxxiv] According to Self-Help, one barrier to selling low-income mortgages on the secondary market is that banks and GSEs do not have enough data to evaluate the loans' performance. Self-Help has purchased a pool of CRA loans from Wachovia Bank and Trust and so has been able to study these loans' default rate. Self-Help has found that after three years, the pool has less than a 4 percent 30-day delinquency rate and that none of the borrowers have defaulted.
[lxxv] This analysis uses housing counts as of 1990. FHA insurance numbers are as of 1994, however. Therefore, the percentages shown should be considered approximations.
[lxxvi] FHLB system members may use advances for other purposes than mortgage lending, however. According to a Congressional Budget Office study, "there is no evidence that members that heavily borrow FHLB advances are more likely to finance a low-income mortgage.... FHLB advances could fund

any asset on its members' balance sheets—even those completely unrelated to home mortgage lending." See Congress of the United States, Congressional Budget Office. "The Federal Home Loan Banks in the Housing Finance System." July 1993, p. xiii.

[lxxvii.] Federal Housing Finance Board. "Seasonal Workers, Elderly, Homeless Benefit from AHP Rural Rental Projects." Building Blocks (3:3), Spring 1995, p.2.

[lxxviii.] Personal interview with Jeff Shipp, Vice President for Governmental Affairs, Farm Credit Council, Washington, DC. May 26, 1995.

[lxxix.] LISC defines CDCs as resident-based nonprofit organizations. LISC identified more than 400 rural CDCs and sent surveys to them. One hundred and thirty-eight (34.5%) responded.

[lxxx.] See Local Initiative Support Corporation. "National Survey of Rural Community Development Corporation Training Needs." LISC: Washington, DC, undated.

[lxxxi.] Christopher Walker, "Nonprofit Housing Development: Status, Trends, and Prospects." Housing Policy Debate (4:3), p. 375.

[lxxxii.] Walker, pp. 378-380.

[lxxxiii.] These eight groups' housing production accounted for $672 million in financing, including $179 million in private financing. The average per-unit cost was approximately $41,800; their leveraging ratio of private to public funds was approximately 36:100.

[lxxxiv.] Data provided by Esmail Baku, Department of Research and Information Services, National Reinvestment Corporation, Washington, DC, July 18, 1995.

[lxxxv.] Local Initiatives Support Corporation. "Rural Lisc" (draft).

[lxxxvi.] Federal Register 60:145, July 28, 1995, p. 38770.

[lxxxvii.] United States General Accounting Office. Report to the Chairman, Committee on Economic and Educational Opportunities, House of Representatives. Block Grants: Characteristics, Experience, and Lessons Learned, p. 8.