Opening Doors to Rural Homeownership:

Outcomes from the National Rural Housing Coalition Rural Homeownership Symposium

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National Rural Housing Coalition
1250 Eye Street, NW, Suite 902
Washington, D.C. 20005
(202) 393-5229

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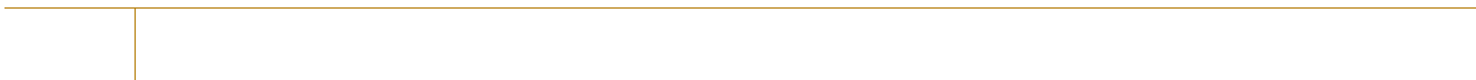


Contents

Executive Summary iii

I. Introduction 1

II. Barriers to Homeownership in Rural America 3

III. The Current Environment for Rural Homeownership Programs 9

A. Rural Housing Service Homeownership Programs 9
B. HUD Programs 15
C. State Housing Finance Programs – Mortgage Revenue Bonds 18
D. Secondary Mortgage Market – Rural Programs 20
E. Other Funding Partners 23

IV. Key Findings and Recommendations 25

Appendix: Homeownership Symposium Panelists 29

Endnotes 30

Executive Summary

In April 2000, the National Rural Housing Coalition (NRHC) sponsored a Rural Homeownership Symposium to explore the changing policy and programmatic landscape for homeownership by rural low-income families.

More than 60 policymakers, local practitioners, federal agency staff, and private-sector representatives convened to apply their knowledge to a debate on federal housing policy. A core feature of the one-day symposium was a panel of eleven experts who shared information on programs that have been successful in increasing homeownership in rural areas. These panelists included practitioners and representatives from the secondary mortgage market, the Rural Housing Service, the Federal Home Loan Bank system, state housing finance agencies, national intermediaries and non-profit housing providers. (See Appendix for the list of panelists.)

Homeownership is the prevailing form of housing in rural America. The homeownership rate in rural areas exceeds that of central cities and the nation as whole. However, there are a number of obstacles to improving homeownership in rural areas. The four most outstanding are high rates of poverty, poor quality of housing, limited availability of credit, and low and declining levels of federal assistance. Poverty rates in rural America are generally higher than in metropolitan areas. The Census Bureau's *Poverty in the United States: 1999* released in September 2000 shows that the economic boom has not reached rural areas as much as it has other areas of the country. Although poverty has decreased to its lowest level in 20 years, almost all of the changes occurred in central cities and metropolitan areas. Rural homeowners are more likely than homeowners as a whole to live in substandard housing. Rural homeowners, particularly minority households, face excessive housing related costs. The limited availability of credit on reasonable, affordable terms and conditions makes it harder to get a loan and limits the utility of the secondary market for rural housing loans. Thus the homeownership issue in rural areas is more subtle, complex, and challenging than statistics alone can convey.

A key barrier affecting homeownership is the low level of federal assistance for rural housing. The rate of assistance to non-metro households is only about half that for metro households. There is substantial evidence that more remote rural areas, which are also usually the poorest with the worst housing conditions, fare even worse in garnering federal housing aid.

For many years, the Section 502 program administered by the U.S. Department of Agriculture's Farmers Home Administration (FmHA) was the principal federal tool for combating the problems confronted by low-income rural households seeking to own their own homes. By providing long-term, low-interest loans to rural households, Section 502 effectively addressed issues of poverty and lack of credit in rural America. Through its history, Section 502 has financed some two million units. This has had an important impact on reducing the incidence of substandard housing in rural areas.

Perhaps the biggest single change affecting rural homeownership has been the decline in the assistance provided by the USDA. In 1985, USDA through the FmHA financed over 30,000 homeownership units to very low- and low-income families with direct, subsidized loans. The current rate of production is about 15,000 units annually. In addition, the subsidy available to low-income families is lower. The focus of the Rural Housing Service (RHS), successor to FmHA, is now on guaranteed loans that, on average, serve house-

holds with significantly higher incomes than the direct loan program.

RHS has, nonetheless, made important improvements in the direct loan program. The agency now encourages partnerships with lenders and other entities wishing to finance homeownership. These partnerships allow the agency to stretch its subsidy dollars and assist more low-income families. While it is true that families qualifying for leveraged loans are not as poor as those receiving only direct loan financing, RHS's leveraged loan program is an important innovation in an era of shrinking federal support for low-income homeownership.

RHS has also paid increased attention to mutual and self-help housing as a strategy to assist low-income families. As appropriations for mutual and self-help housing increase, RHS is providing funding to some 100 non-profit organizations, which in turn give technical assistance across the country, and has allocated greater amounts of Section 502 assistance for self-help housing in recent years. Mutual and self-help housing organizations are currently constructing more than 1,000 units per year nationwide; in some states, the largest single component of Section 502 new construction is self-help housing. There is substantial evidence that self-help housing is a good strategy for improving housing conditions for minority families and is particularly successful in assisting migrant and seasonal farmworker families.

Another factor in the changing landscape is the role of states, which have emerged as more important players in rural housing finance. With the ability to allocate federal housing block grant funds, as well as relatively low-interest loans available through the sale of mortgage revenue bonds, states have flexible resources that may be put to use for low- to moderate-income homeownership. In this period of low interest rates, private financing and secondary markets are more important than ever in rural areas. Innovations are making it possible for the secondary market players to assist in financing self-help housing and in acquiring loans made to "low wealth" borrowers.

The overall decline in Section 502 funding has caused a further shift in the manner in which low-income homeownership assistance is delivered in rural America. In the days of relatively high Section 502 funding levels, private homebuilders were a principal intermediary for those seeking rural homeownership. They often assisted families in preparing applications for Section 502 and navigating the paperwork maze. Today's conditions require new, innovative approaches to assembling financing with adequate subsidy for low-income families. Many builders, especially those working at maximum capacity to meet the burgeoning demands of the conventional housing market in an expanding economy, have neither the motivation nor the expertise to assemble such products. Non-profit organizations have stepped in to develop a delivery system capable of meeting this important need.

Numerous non-profit housing and community development organizations are working to patch together programs using a variety of public and private sources to enable single-family homeownership. Many organizations are successfully using Section 502 leveraged loans as a way to build partnerships with local private financial institutions. These programs often include emphasis on pre- and post-purchase counseling to ensure rural homeowners are both well-informed and able to meet the responsibilities of homeownership.

These collaborative efforts can result in housing assistance to very low-income families. However, many practitioners are concerned about the efficiency of a system that requires cobbling together the many funding sources and subsidies necessary to improve housing conditions for low-income rural families. A stitched-together system, while less dependent on government funding, becomes more dependent on non-profit organizations, most of which have quite limited staff and other resources to handle complex programmatic and financial services.

Taking all of these circumstances into account, participants in the Rural Homeownership Symposium made a series of recommendations to improve efforts

on behalf of rural homeownership. Recognizing that much of the work involved in securing the multiple funding sources required to finance low-income housing is the search for subsidy, and that Section 502 has historically been the single most important resource for low-income homeownership by providing a subsidy to very low-income families, symposium participants agreed that RHS Section 502 direct loans are still the key ingredient in any low-income homeownership strategy. There was strong support for reinvigorating the program. A number of specific steps described in this report were proposed to improve services to low-income households, to provide housing counseling to borrowers, and to modify related programs in order to support using Section 502.

Symposium participants agreed that the HOME program operated by the U.S. Department of Housing and Urban Development (HUD) in conjunction with state housing agencies is equally important as a source of flexible funding to be used with other public and private funding sources. Participants were concerned about HOME funding levels but otherwise had few criticisms of the program. Many felt, however, that states should allow repayments of HOME funds to remain with grantees in order to help build organizational capacity as well as continue assistance to the community.

Finally, the symposium participants agreed that non-profits urgently need capacity-building assistance. Rooted in communities and increasingly experienced in responding to community housing needs, non-profits have taken on a central role in promoting homeownership for lower-income rural families. In order to build on their effectiveness, their capacity to provide technical assistance, financial planning, and counseling must be improved through increased federal support.

I. Introduction

The purpose of this paper is to report on the Rural Homeownership Symposium sponsored by the National Rural Housing Coalition. The symposium brought together experts in rural housing — from local programs, from federal, state, and local government, and from the private sector — to discuss and define the progress and obstacles to increasing homeownership opportunities for low-income rural families.

A strong national economy and unemployment rates at their lowest levels since the 1960s combined to create a record-setting 66.8 percent national homeownership rate for 1999.[1] Home buyers also spent $2.2 billion improving their new purchases. Total spending on home building and remodeling in 1998 grew by 9 percent, to $300 billion. Businesses and state and local governments benefitted as well, with revenues from home buying and selling activity up by 17 percent.

The vibrant economy has stimulated development which, in turn, has pushed metropolitan areas and their suburbs beyond their boundaries, causing them to spill over into surrounding non-metropolitan areas. As a result, for the first time since the 1970s, the pace of growth of the non-metro population is approaching that of the metropolitan/suburban population. Sixty percent of the 1.6 million non-metropolitan housing permits issued since 1990 were in counties adjacent to metropolitan centers. Population growth in non-metropolitan retirement communities, mostly in the South and the West to accommodate middle-income retirees, grew 19 percent between 1990 and 1997.

But this wave of prosperity has not reached everyone. Many rural communities, usually more distant from urban areas, especially those where poverty has been long entrenched, have been largely bypassed by economic growth. With many residents forced to migrate elsewhere in search of employment, their continued viability as communities is uncertain.

From 1990 to 1997, there were ongoing population losses in Appalachia, the Great Plains, the Mississippi Delta, Indian Country, and the U.S.-Mexico border town *colonias*. These and other rural communities have been struggling with poverty for decades and face enormous challenges in capitalizing on the nation's prosperity to reshape their own economies.[2] Homeownership opportunities that have become reality for more Americans than ever before continue to be an elusive dream for hundreds of thousands of low-income rural families. Poverty coupled with overwhelming obstacles to decent shelter has a two-fold impact on rural families, forcing many to leave their communities while confounding the hopes and aspirations of those who remain.

In recent years, federal policy toward rural housing has shifted. Federal resources have been reduced and with them the possibility of uniform opportunity across rural America for access to homeownership. Symposium participants addressed the changing nature of the rural housing problem, the barriers to providing affordable homeownership to low-income families, the opportunities presented by the changing policy landscape and the charting of a course for future policy action.

II. Barriers to Homeownership in Rural America

Homeownership is the principal form of housing in rural America. Yet, due to the following barriers, it is apparent many rural families do not have access to decent affordable housing. According to preliminary results from the 1997 American Housing Survey (AHS), households in non-metropolitan areas are far more likely to be homeowners than urban households, with 75 percent of all non-metro households owning a home compared to the central-cities rate of 49 percent. (The rate in suburban areas was 73 percent.)[3] These statistics, however, do not speak to the quality of homeownership, nor do they portray the hundreds of thousands of rural minorities who are far less likely to own their homes than rural white households.

Rural minorities are far less likely to own their homes than rural white households. Of the households who own their homes in rural areas, 91 percent are white. The remaining 9 percent are comprised of African Americans (5 percent), Hispanics (3 percent) and "other" racial groups, a category that includes Native Americans (1 percent).[4]

Rural households pay more of their income for housing than their urban counterparts. Housing "cost burdens" are generally measured as a percentage of income, with 30 percent being the acceptable standard for housing. Overall, 22 percent of all rural households pay more than 30 percent of their income for housing, which means that some 5 million rural homeowners are cost-burdened. Of these, more than 1.1 million are severely cost-burdened, paying over 70 percent of their incomes for housing, while another 1.9 million homeowners pay over 50 percent of their incomes in housing costs.[5]

Rural households are less likely to receive government-assisted mortgages. According to the 1995 American Housing Survey, 14.6 percent of non-metro and 24 percent of metro residents receive federal assistance. Only 6 percent of Federal Housing Administration (FHA) FY 1996 assistance went to non-metro areas. On a per-capita basis, rural counties fared worse with FHA, getting only $25 per capita versus $264 in metro areas. Rural experience with the Veterans Affairs housing program is similar, with only about 11 percent going to non-metro areas and per-capita spending in rural counties at only about one-third that of metro areas.

For many years, the U.S. Department of Agriculture (USDA) has been the designated lead agency for rural development. In that role, Farmers Home Administration (FmHA) and its successor, Rural Housing Service (RHS), provided a range of assistance to low-income families to improve housing opportunities in rural areas.

Beginning in the 1980s and accelerating in the mid 1990s, resources available from USDA declined. In particular, spending on loans for low-income homeownership fell dramatically, rendering lending levels available today less than half those of a decade ago. This means that not only do rural areas get less than a fair share of resources for housing from other federal agencies, the federal agency with the lead role in addressing such problems has seen its budget dramatically reduced.

Rural areas lack an adequate supply of decent housing. Although AHS data indicate that the quality of rural housing has improved in recent years, there are still a tremendous number of rural housing units that are in need of repair and rehabilitation, particularly for the poor. More than 1.6 million rural households who earn 80 percent or less of the area median income (AMI) live in moderately to severely inadequate housing.[6] These are units without hot or cold piped water, and/or have leaking roofs, walls, rodent problems, inadequate heating systems, and peeling paint, often

lead-based. Overall, more rural families live in inadequate housing than their urban counterparts, with 2.6 million rural residents living in inadequate homes compared to 2.4 million in cities and 1.3 million in the suburbs.

Rural households are poorer than urban households. In 1996 the poverty rate in rural America was 15.9 percent, compared to 13.2 percent in urban areas.[7] Minorities in rural areas have much higher rates of poverty, with an average of 34.1 percent compared to urban minorities at 28.1 percent. Persistent poverty is also a major problem. In 1990, 765 rural counties nationwide had 20 percent or more of their population living below the poverty level; 535 of these counties are persistent poverty counties, defined as 20 percent or more of the population who were below the poverty level in each of the years 1960, 1970, 1980, and 1990.[8]

Homelessness in rural areas, like urban homelessness, is the result of poverty and a lack of affordable housing.[9] Rural homelessness is most pronounced in regions experiencing economic growth and where economies are dependent primarily on one activity like agriculture or a specific recreational activity such as skiing. Often if the growth area is located near an urban center which is attracting new businesses and higher income residents, taxes and living expenses are being driven up beyond the affordability of lower income households.[10]

There is an inadequate supply of affordable housing. In some rural housing markets, an adequate supply of affordable housing simply does not exist to meet demand. Many small, rural communities have only a limited number of available homes, and only a few that are affordable to low- and moderate-income households, with those often in need of extensive repair or improvements. While everyone agrees that there is a shortage of affordable housing in rural areas, there is less agreement on why the market does not produce the kind of housing to meet these demands.

Mobile homes are increasingly pervasive in rural areas, in part because of the lack of available housing. While mobile homes may meet the short-term need to house lower-income families, their prevalence in a local housing market acts as a deterrent to construction of permanent housing. According to the 1990 census, mobile-home manufacture is the fastest-growing housing industry in the United States. Since 1980, the number of mobile homes has increased by 57 percent, while single-family homes increased by only 13 percent.[11] AHS data show that 14 percent of rural homeowners lived in mobile homes in 1995, compared to 2 percent of urban homeowners. Mobile homes decrease markedly in value over time and generally do not endure long enough to be passed down.[12] But with permanent housing in short supply, mobile homes are often the only choice for very low- to low-income families.

Development costs in rural areas are higher. Rural construction costs are only slightly lower than those in urban areas, due in part to the substantial infrastructure development that must accompany rural housing construction. Water and sewer systems and roads must be improved, if not built, in many rural communities when a project is being constructed.[13] In some instances, the existing water and sewer systems are over-capacity, outdated, and not up to government standards. When these costs are superimposed on the low incomes of many rural residents, they prove a significant barrier to housing development.

Rural residents have limited access to mortgage credit. The consolidation of the banking industry that accelerated throughout the 1990s has had a significant impact on rural communities. Mergers among lending institutions have replaced local community lenders with large centralized institutions located in urban areas. Aside from shifting the locus of loan-making, this has resulted in the diminishment of a competitive environment which, in the past, encouraged rural lenders to offer terms and conditions that were attractive to borrowers. With fewer local lending institutions to turn to, rural consumers — especially lower-income borrowers — must accept the lenders' requirements or go without a loan.

Between 1980 and 1993, the number of U.S. banking institutions fell from 12,363 to 8,415.[14] Almost the entire change occurred within the ranks of smaller banks with assets under $2.3 billion. The number of small banks fell from 11,653 to 7,761, a decrease which represents 98.6 percent of the total change in the number of banks nationwide.[15] In 1994, 27 percent of rural counties were served by two or fewer banks including the branches of banks headquartered elsewhere. (In contrast, 40 percent of urban counties were served by ten or more banks.)[16] This condition is compounded by a dramatic loss in the number of savings and loan (S&L) organizations serving rural communities. At the end of 1994, 496 S&Ls were headquartered in rural America, compared to 663 in 1990 and 1,031 in 1985[17] — an overall decrease of 52 percent from the mid-1980s.[18]

The inequities in rural lending are reflected in a study Congress mandated under the Federal Agriculture Improvement and Reform Act of 1996. USDA's Economic Research Service (ERS) analysis of the availability of credit in rural areas for agriculture, housing and rural development, completed in April 1997, found that some financial markets serving rural communities, borrowers, and classes of credit are inefficient.[19] The study found that the small size of rural communities with limited populations of potential borrowers restricts the number of lenders that can profitably compete for rural loans. As a result, not all rural markets are equally well served, with the poorest counties tending to have the least competitive banking markets.[20]

"The San Joaquin Valley, the 'other California,' is facing growth and higher incomes — but this is causing more problems for people who work there. These people are becoming increasingly priced out of the housing market in communities where they have lived all their lives."

— Peter Carey, Self-Help Enterprises, CA

"Even though in the past 15 years bankers have become much more secondary-mortgage-market conscious, the hoops that people must go through to become homeowners rather than mobile homeowners are incomprehensible."

— Tom Carew, Kentucky Housing Corporation

Even low-income households that qualify for loans face higher prevailing interest rates than their urban counterparts. Thirty-year fixed mortgages average 5 to 11 basis points more in rural areas than in urban communities.[21] Mortgages from rural lenders also tend to have shorter terms than loans from urban lenders. A 1995 study of lending in rural America found that 34 percent of all loans by rural lenders were for 15-year terms or less compared to only 16 percent of all loans by urban lenders.[22] Shorter-term loans typically carry higher interest rates and larger monthly payments, thus making them less affordable for lower-income would-be borrowers.

Participants noted that in this time of low-interest rates many low-income families have become homeowners, often with complex mortgage packages that include relatively short-term financing. Concern was expressed that if the interest rate environment changes and mortgages become more expensive, some low-income families will be priced out of the market and others will be in danger of losing their homes as housing costs rise.

Rural households are targeted by predatory lenders. Because of the gap left by traditional lenders, rural households are prime targets for predatory lenders. Predatory lending practices

include excessive fees, prepayment penalties, and loan flipping into high cost subprime loans. Participants told about their borrowers' being convinced to convert their mortgages to high cost subprime loans, unaware of the higher interest rates. Even RHS borrowers paying a one percent interest rate were approached and convinced to switch.

The secondary mortgage market is limited in rural areas. The lack of capital via secondary mortgage markets is also a problem, although rural markets have recently opened up to this option. Resistance by lenders and inability to access these markets is confirmed in a survey of 20 small rural banks that NRHC undertook in November 1998 for Fannie Mae.[23] Reasons ranged from banks being too small to employ the people needed to process the required paperwork to a statement that "the bank has a strong loan base and does not want to mess with the secondary market." By keeping loans in portfolio, lenders are more cautious in the loans they make, and most serve the affluent and other borrowers perceived as "less risky." This practice almost eliminates the possibility of a low-income family getting a home loan from a rural lender. Moreover, many rural lenders believe that rural homes do not sell quickly, especially in remote communities, and in the case of default can be a burden on the bank both administratively and financially.

Many low-income rural families lack information and experience with regard to the nation's credit and lending institutions. As a result, thousands of low-income families have never used the system and do not understand how a mortgage works, why there is a need to save for a down payment, and why building a credit history is important in getting a loan. Moreover, the limited availability of loanable dollars within rural banks means that lenders are much more selective and risk-averse — an attitude that works against low-income borrowers, who because of their economic circumstances tend to be perceived as risky whether or not they really are.

> "What is the use of all this work in building equity when it gets stolen or stripped away by predatory lending practices?"
>
> — Janneke Ratcliffe, Center for Community Self-Help, NC

There is a lack of pre- and post-purchase counseling for rural homeowners. The Rural Housing Service does not have any funds in its loan programs for such services, despite having over 450,000 low-income borrowers in its single family direct loan portfolio. While RHS Section 523 self-help housing grantees provide this counseling, post-purchase counseling is not included in their federal grants. Nonetheless, many organizations provide this assistance to families going through the program; few rural organizations have access to funding for pre- and post-purchase counseling.

There is no uniform delivery system for rural homeownership. In the period in which Section 502 direct loans were at higher levels, the principal delivery system for low-income homeownership was predominately private contractors and home builders. These organizations recruited eligible families and shepherded them through the FmHA system. This informal system was in existence in most rural areas because Section 502 mortgages were available. With the dramatic reduction in Section 502 and opportunities presented by a good economy for building higher end housing, the private sector delivery system is no longer dominant and in many rural communities does not exist.

In some rural areas, non-profits have picked up the slack and pursued a multiple funding strategy for homeownership. Funding for home mortgages comes from several sources — federal, state, and local, as well as private. Skilled local organizations meld these resources together to provide financing packages affordable to low-income families.

This approach is more complex and time-consuming and is contingent upon the capacity — both technical and financial — of local organizations. Therefore, when a rural community does not have such an organization, it often goes without this important assistance to low-income homeowners.

There is not a dedicated source of federal support to promote a non-profit delivery system for rural homeownership. Nor is there an easy mechanism for replicating successful models. With the exception of self-help housing technical assistance grants, a uniform method of support or encouragement for low-income homeownership efforts is not available to rural communities across the country.

As the federal commitment to low-income homeownership has waned, a number of important state and local efforts have come to fill the gap. In addition, the current interest rate environment makes it possible for innovative programs to assist low-income borrowers. However, the availability of low-cost mortgage credit for low-income rural homeowners is increasingly a function of local and state policies and programs. Therefore, naturally, there is a decreasing equality of opportunity in homeownership opportunities for low-income rural families.

III. The Current Environment for Rural Homeownership Programs

The effort to provide affordable rural housing requires all players — federal, state and local governments, non-profit housing providers, national intermediaries and secondary mortgage market entities — to come together to identify solutions. This collaborative effort has evolved into the current environment with programs that depend on partnering, leveraging, flexibility and innovation. The following section describes approaches that providers have used to help very low- and low-income families become homeowners. It explores the purpose and current status of USDA/RHS Section 502 homeownership programs, state programs including HOME and mortgage revenue bonds, secondary mortgage market programs, and other partners.

A. Rural Housing Service Homeownership Programs

Section 502 of the Housing Act of 1949 is the only remaining federal program that provides direct homeownership assistance to low-income households in rural areas.[24] The agency responsible for administering the rural affordable housing programs is the Rural Housing Service (RHS), an agency within the U.S. Department of Agriculture (USDA). RHS is the successor to the Farmers Home Administration (FmHA), which administered USDA's rural housing programs until 1995.

Eligible communities include open country and places with populations of 10,000 or less that are rural in character and not closely associated with urban areas. Communities with populations between 10,000 and 20,000 that are outside standard metropolitan statistical areas may also be eligible if the USDA and HUD secretaries find there is a serious lack of mortgage credit. The principal purpose of Section 502 is to provide subsidized loans to low-income families to acquire, rehabilitate, or construct single family homes.

Section 502 Single Family Direct Loan Program: RHS's homeownership loans are made and serviced by USDA staff.[25] To qualify for the direct loan program, borrowers must have very low or low incomes but be able to afford the mortgage payments, including taxes and insurance.[26] Also, applicants must be unable to obtain credit elsewhere, yet have reasonable credit histories. Priority is given, in the following order, to applicants who: 1) already have a Section 502 loan but need to correct health and safety hazards; 2) want a loan to transfer or assume a property from another Section 502 borrower; 3) live in deficient housing;[27] and/or 4) are participating in a mutual self-help housing project.[28]

Section 502 borrowers are predominately married couples or female single parents, in both cases with children under 18 years old.[29] In a survey undertaken by ERS in 1998, these households accounted for 71 percent of the families using the direct loan program. Ten percent of the borrowers were women living alone and 7 percent were married couples without young children.[30] According to RHS staff, the average adjusted household income for FY 1999 of a Section 502 household is $18,459. About 9 percent of households have annual incomes less than $10,000.[31]

The direct loan program has seen a sharp decrease in its funding over the past 25 years. In the mid-to-late 1970s to the early 1980s, the program's appropriations ranged from over $2.8 billion (1976) to almost $2.1 billion (1983). But, beginning in 1995, Congress began to cut severely its appropriations to less than $950 million, going as low as $706 million in 1997. In 2000, the Congress appropriated $1.1 billion for direct loans, 60 percent less than the 1976 appropriation. The number of homeownership units

funded by the direct loan program has dropped significantly in the past 25 years. In 1976, more than 132,000 units were funded with direct loan funds; in 2000, the number has dropped 89 percent to less than 15,600 units.

Not only have the Administration and Congress cut lending levels for Section 502, but the amount of subsidy available has also been reduced. In October 1995, RHS changed the subsidy mechanism for Section 502 from an interest credit system to payment assistance. Under interest credit, eligible households could receive a mortgage interest rate as low as 1 percent. To save money, RHS moved to payment assistance, with the amount of the subsidy based on annual income and expenses. Eligible very low-income families could still receive one percent loans, but other eligible households would be required to pay 2 to 6.5 percent, depending on their income as a percent of area median income. If the loan is not leveraged, these households pay 22, 24, or 26 percent of their adjusted income, depending on their income level.[32]

The result of reducing subsidy and lending levels of Section 502 is a far less costly program for the federal government. About one-third of the reduction in Section 502 spending is a result of reduced subsidies. The rest is a result of lower lending levels.

The average income of families assisted under Section 502 direct loans has increased. For FY 1995, the last year of interest credit, the average income of the households assisted was $16,967. At the end of FY 1999, the average income was $18,459. This is an increase of nine percent. There is anecdotal evidence that this change has fallen the hardest on low-income borrowers — those with incomes 50.1 to 80 percent of area median income (AMI). Very low-income borrowers continue to receive one percent loans, but low-income borrowers with only slightly higher incomes are provided far less subsidy. Several participants in the symposium indicated that low-income families with any sort of debt — such as car payments and health care expenses — are unlikely candidates for Section 502 loans because of the limited available subsidy.

"RHS has had to reach into new markets and create partnerships across the nation to serve more people as our federal dollars and resources have diminished."

— Betsy Fletcher, RHS Branch Chief of Loan Origination

Declining federal resources have brought about a change in RHS's approach to homeownership and the direct loan program. In the past, RHS typically provided 100 percent of the funding necessary to purchase a home. Betsy Fletcher, RHS Branch Chief of Loan Origination, told symposium participants how decreasing appropriations have forced the agency to break out of its "traditional modus operandi." Due to fewer resources, RHS has sought out other financing sources to be used in conjunction with the Section 502 program. In 1995 to 1996, RHS re-engineered Section 502 by first centralizing its loan servicing process. Then the agency began looking for ways to make the program more flexible, encouraging its field offices to develop partnerships at the local level and giving priority to applications that leveraged additional resources.

More flexibility meant that RHS could develop new mortgage products with different terms. It also encouraged field offices to develop partnerships with state housing finance agencies, banks, non-profits, and mortgage lenders. Leveraged loans are Section 502 loans made in conjunction with other public and private sources of financing. The purpose of the leveraged loan program is to stretch Section 502 funds. As part of a vigorous outreach program, RHS officials spoke at conferences across the country and participated in the President's national task force on homeownership. The agency also set aside funds in the

national office for partnerships with the Community Development Financial Institutions (CDFI) Fund and the Rural Home Loan Partnership (RHLP) program.

As these partnerships have evolved, low-income rural households are getting better services than they could with the current level of 502 direct loan appropriations. Loans are being designed to meet each household's financial needs, and more rural families have access to housing counseling and post-purchase counseling programs. As more private-sector lenders learn about RHS, more resources are being leveraged and home buyers can get loans with better terms. However, few lenders or community development organizations are able to provide loans with interest rates comparable to Section 502. Consequently, the families being served have incomes higher than those served under the direct loan program except in situations where additional funds are being leveraged to help lower mortgages. According to RHS, the average adjusted income of leveraged loan borrowers for 1999 was $21,961.

"In the Rural Home Loan Partnership program the non-profits are money players. The banks, RHS, and the non-profits bring money to the table. There are no guests at the table."

— Hal Wilson, Local Initiatives Support Corporation, DC

Rural Home Loan Partnership: An example of the leveraged loan program is the Rural Home Loan Partnership (RHLP) sponsored by the Local Initiatives Support Corporation (LISC) through its Center for Home Ownership. LISC is a national intermediary and RHS's partner in this initiative.

RHS and LISC established RHLP in 1996. Under this program, RHS provides a set-aside of Section 502 funds (75 percent from the national reserve and 25 percent from state allocations) which are distributed to local partnerships. Local partnerships typically consist of a non-profit community development or housing organization, local financial institutions, and the state and local RHS offices. The availability of Section 502 funds fosters local partnerships and facilitates the participation of the private sector.

The partners develop projects, including new construction and rehabilitation, identify and counsel potential borrowers, package mortgage loans, and secure additional funding. Banks make first mortgages using long-term, fixed-rate products, and RHS provides long-term, fixed low-interest-rate mortgages.

The national partners offer training and technical assistance, and the commitment to resolve administration and regulatory issues which can make the homeownership process unduly burdensome. The program's goal is to provide homeownership opportunities to families with incomes below 80 percent of AMI. In 1999, 54 percent of the households served were very low-income, and 46 percent were low-income.At the outset, there were four national partners: RHS, LISC, the Federal Housing Finance Board, and the Federal Home Loan Bank System. Over the years, new national partners have joined RHLP including the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the Neighborhood Reinvestment Corporation and the Rural National Alliance of Community Builders. Intermediaries such as the Housing Assistance Council, the Federation of Appalachia Housing Enterprises and LISC provide training, technical assistance, and pre-development capital.

During the Symposium, Hal Wilson of LISC described the Partnership's growth since it was established in 1996. In its first year, the program involved nine community development corporations in nine states, developing and financing 37 homes. As of March 2000, RHLP had partnered with 177 non-

profits and had developed and financed almost 1,350 homes. In just four years, the program's non-profit partners had grown 20-fold and the number of homes developed and financed 36-fold. Over $84.5 million has been invested through the Partnership: $56.7 million in RHS funds; $23.3 million in private mortgages; and $4.6 million in other funds provided through non-profit groups.

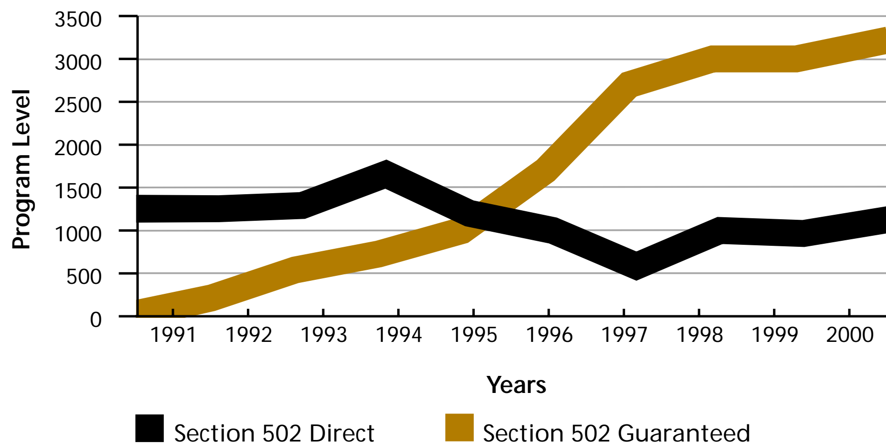
For FY 2000, RHS has set aside about $50.5 million at the national level and $12.6 million in state office allocations. RHLP expects to leverage an additional $25.3 million from other private and public sources, and the non-profit partners are expected to invest over $5.5 million.

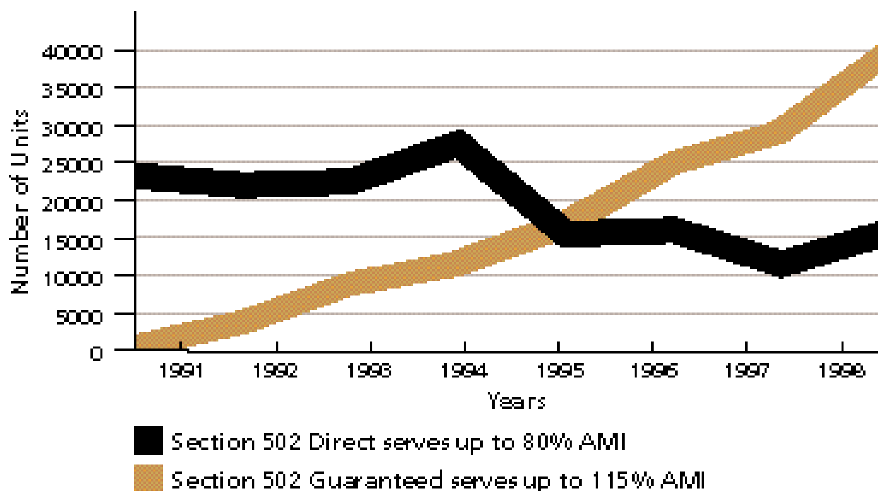
> "RHLP's goal is simple: providing homes to low-income families through local partnerships. One significant advantage is the set-aside in every state which gives non-profits access to Section 502 funds without having to confront the program's waiting lists. This gives the partners an incentive, and allows them time to work through other barriers."
>
> — Bill French, Rural Community Assistance Corporation, CA

Section 502 Guaranteed Program: In the Section 502 guaranteed loan program, RHS guarantees unsubsidized loans to low- and moderate-income households made by commercial lenders. The program's participants are households with steady incomes and stable credit histories, but those that are unable to qualify for conventional mortgage credit. The government backing of these loans is an incentive to commercial lenders who may not otherwise lend to lower income families. Applicants must have an income no greater than 115 percent of AMI. RHS uses two formulas to determine a mortgage: the burden of principal, interest, taxes, and insurance (PITI) divided by gross monthly income must be 29 percent or less; and the total of monthly debts divided by gross monthly income must be 41 percent or less. The loan must also be from an RHS-approved lending institution.

Figures 3 and 4 illustrate the decline of the direct loan program and the rise of the guaranteed program in the number of units that have been built. For example, in 1979, the direct loan program funded 93,400 units and the guaranteed program, 374; in 1998, the direct loan program funded 15,563 units and the guaranteed program, 39,144.[33] Federal policy has clearly moved in the direction of guaranteed loans, which has resulted in the predominance of moderate-income borrowers. FY 1999 data show that the guaranteed program serves primarily moderate-income families, although one-quarter of the families served are low-income. Of the 38,555 guaranteed loans that

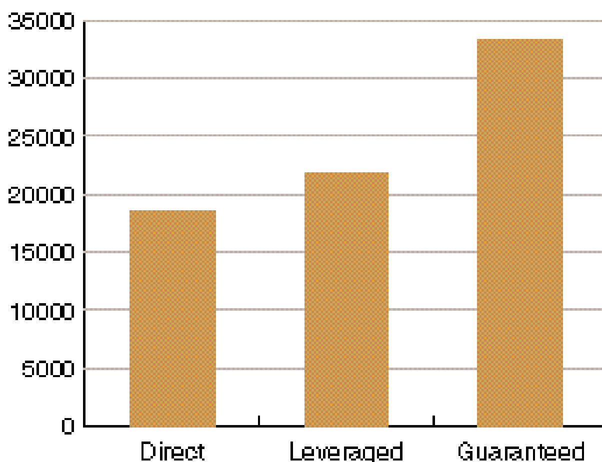
Figure 3
Section 502 Direct vs. Guaranteed – Program Level





RHS made in 1999, 68 percent went to moderate-income households, 26 percent to low-income and 3 percent to very low-income. The average income of families served was $33,318. (See Figure 5 for a comparison of the average income of families served by Section 502.)

Mutual and Self-Help Housing: One way in which Section 502 assists very low-income borrowers is through the Mutual Self-Help Housing program. With the assistance of local housing agencies, families eligible for Section 502 loans perform approximately 65 percent of the construction labor on each other's homes under qualified supervision. The sweat-equity savings on labor costs allow otherwise non-qualifying families to own their homes. Home buyers who use the self-help program save, on average, $7,000 on their mortgages.[34]



The amount of the self-help allocation is determined each year and is based on the state RHS offices' estimated need for such loans. In FY 1998, the agency allocated $106 million; in FY 1999, $108 million; and in FY 2000, $110 million in Section 502 direct loan funds. The national office then uses these funds to pay 75 percent of every self-help loan made by the agency; state offices make up the remaining 25 percent from their Section 502 state allocations.

RHS FY 1998 statistics show that 68 percent of self-help loans were made to minorities, compared to 31 percent of Section 502 loans overall. Self-help housing has also been a viable option for farmworker families.[35] In a study by Self-Help Enterprises of California, measuring its program from 1965 to 1996, farmworker families represented some of the lowest-income participants — but also had the lowest foreclosure rates and the longest residency rates.[36]

The key to self-help housing is the organizational framework provided by non-profit sponsors. This is illustrated by the growth of the self-help program after 1971, when RHS's Mutual Self-Help Technical Assistance Grant (Section 523) program began funding grants to non-profit housing organizations.[37] From 1961 to 1971, Section 502 self-help funds financed some 2,300 homes, but during the following 28 years RHS financed approximately 27,000 self-help homes.

While the number of units funded each year varies, the average number for the past three fiscal years has been around 1,500 homes a year — more than six times the average annual rate during the 1961-1971 period.

Using Section 523, the sponsors train the participants in construction supervision, project coordination, bookkeeping, and the many technical skills necessary for any successful housing development effort. The non-profit also helps the borrower apply for a Section 502 direct loan from RHS which mortgages the home once it is built. In the past few years, Section 523 has grown, and in FY 1997 received a major boost from the Administration and Congress when $26 million was appropriated — double the appropriation for FY 1996. As a result, the program has increased production and expanded into a number of previously unserved areas. Currently, there are about 100 organizations that are self-help technical assistance providers helping rural families build their own homes.

According to Peter Carey, Executive Director of Self-Help Enterprises (SHE) and a participant in the Homeownership Symposium, the mutual self-help process is something much bigger than building a home. It helps create interdependence between neighbors, a sense of community, and the long-term stability that low- and very low-income families achieve through homeownership. To Carey, the "mutual" in Mutual Self-help is a critical piece of its success. SHE has helped build 4,700 homes since its inception in 1965 — 3,400 of those homes with Section 523 funds.

> "Section 502 and Section 523 are two key programs that provide the perfect match for a self-help project. They are still the best vehicles to permanent homeownership for the low- and very-low-income, and should be expanded."
>
> — Peter Carey, Self-Help Enterprises, CA

> "What really makes our program unique is the post-purchase counseling. We have committed to our lenders and to RHS that we will be there for the long haul. We do post-purchase visits and phone calls for at least five years with our families, even if there are no problems."
>
> — Marsha Bursey, Community Connections, IN

Carey notes that over the years there has been a significant change in how SHE approaches its projects. In addition to using funds from RHS's programs, SHE now reaches out to various state, local, and national programs to leverage additional funding. Programs like HOME, CDBG, AHP and those offered by state and local agencies, banks, and charitable foundations have all provided funds for its projects.[38] Last year, SHE and Fannie Mae embarked on an initiative new to both entities. They became partners in a creative program that allows private lenders to make construction loans and then to convert the loan into the borrower's mortgage, the procedure already used by RHS. Carey believes this initiative takes a key piece of the Section 502 Mutual Self-help concept and makes it available to the private market.

Sections 502 and 523, when used together, become a model of sweat-equity housing that is replicable in many parts of rural America.

Homeownership Counseling: Counseling, both before and after buying a home, is crucial to successful homeownership. Pre-purchase counseling helps prepare home buyers for the financial, physical, and emotional challenges of homeownership.

Post-purchase counseling helps families keep their homes by attending to fiscal responsibilities and proper maintenance. In addition, rural renters can be prepared for homeownership if they are counseled on its advantages and disadvantages and carefully guided through the home buying process.

Some non-profit organizations provide counseling as part of their services. An example is Community Connections of Indiana whose staff have counseled 300 families and brought 100 into homeownership. The organization has worked in conjunction with local collection agencies, medical providers, and banks to write off up to 40 percent of the clients' credit blemishes. This has encouraged the families to take part in the education component of the program, which includes budgeting, self-esteem exercises, and warnings about predatory lenders. Community Connections, one of the most successful in the nation with no defaulted loans, is able to cover only 25 percent of its counseling costs — through grants, the state's housing finance authority, and loan packaging.

"At Homes in Partnership, a community-based organization, we use Section 523 funds to build homes — but we must always leverage outside funds in order to make homeownership an option for very low-income families."

— H. Lewis Kellom, Homes in Partnership, FL

Although homeownership counseling is considered to be a relatively expensive undertaking, it is a more efficient alternative when compared to the cost of delinquent payments, defaulted loans, and long-term damage to credit histories. Government lenders are only beginning to recognize the importance of counseling. Section 523 self-help housing grantees provide pre- and post-purchase counseling as a part of the self-help process. The entire self-help construction process typically builds a strong bond between the organization and the families involved. However, there is not a reliable or regular source of funding for other rural organizations providing homeownership assistance. USDA has no housing counseling program despite having the lowest income homeowners in the federal government. HUD's counseling appropriation only totals $17 million.

B. HUD Programs

States are increasingly important players in rural housing efforts. One of the important ways that states participate in rural housing is through HUD block grant programs.

HUD provides two main sources of funding to support low-income homeownership efforts: Community Development Block Grants (CDBG) and HOME Investment Partnership (HOME). These programs provide formula allocations to states and localities, with a focus on entitlement communities and participating jurisdictions, respectively.

In CDBG, non-metro communities receive funding through the States and Small Cities Block Grant program. In HOME, smaller communities are eligible for those funds allocated to states. In recent years, HUD has turned over more policymaking on these block grants to the states. While federal laws and regulations set eligibility, terms, and conditions for assistance, HUD has increasingly allowed states the discretion to set priorities and policies.

Symposium participants voiced support for CDBG and HOME as important tools for rural homeownership; however, the most important drawback of both programs is that they are not dependable sources of funding as rural communities must apply to states for funding.

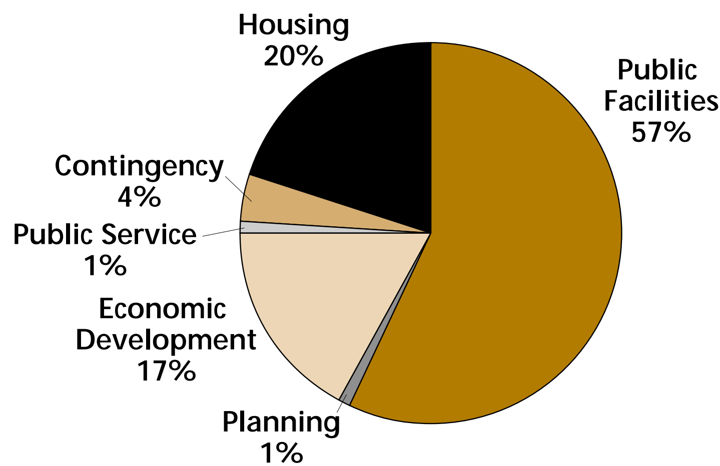
Community Development Block Grants: HUD provides Community Development Block Grant (CDBG) funding through the State and Small Cities Block Grant program to local governments that do not receive direct CDBG allocations (i.e., to "non-entitlement communities"). Under the allocation rules, 70 percent of the CDBG funding of approximately $4.4 billion is allocated to CDBG entitlement communities, which include metropolitan cities (population of 50,000 or more) and urban counties. The remaining 30 percent (about $1.25 billion in FY 2000) is allocated to the states for non-metropolitan areas through the State and Small Cities program.

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), a 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.

Most states award CDBG funds to local communities through a competitive process. Private and non-profit 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.

The CDBG program is used to promote a range of housing rehabilitation and community development activities. The grants serve low- and moderate-income households. Between 1994 and 1999, an estimated 14 to 17 million households benefited from the CDBG program and almost 115,000 jobs were created through its economic development activities. Currently, about 20 percent of CDBG funds go towards housing rehabilitation activities. Figure 6 displays the distribution of CDBG funds for FY 1997. These percentages change dramatically when examined on a state-by-state basis however. Housing rehab activities as a percentage of state programs ranged from zero percent to 46.9 percent in FY 1999 according to the Council of State Community Development Agencies.

Figure 6
CDBG State and Small Cities Program Percent of Funds Obligated by Activity for FY 1997



Source: *Building Communities and New Markets for the New Century 1998 Consolidated Report.* U.S. Department of Housing and Urban Development. p.17.)

For housing interests, beyond the limitation to housing rehab, the main drawback for CDBG is the competition for funds. CDBG funds may be used for a host of other activities in low- and moderate- income areas including infrastructure development, economic development and community services. Participants noted that competition for CDBG funds is keen and housing interests do not always fare well.

HOME Investment Partnership: The HOME Investment Partnership Program was

authorized by the National Affordable Housing Act of 1990 and is the largest federal block grant to state and local governments specifically designed to create affordable housing for low-income households. Annual appropriations average $1.5 billion. These funds are allocated by the Department of Housing and Urban Development (HUD) to states and to hundreds of localities or participating jurisdictions nationwide. The program's flexibility allows states and local governments to use the funds for a variety of housing activities including acquisition of existing properties, rehabilitation, and new construction.[39]

HOME does not include a set aside for non-metro areas. Instead, the state allocations (40 percent of the appropriation or about $640 million in FY2000) may be used for a range of housing activities. The law requires that state allocations take into account the incidence of housing problems in non-metropolitan areas. The National Council of State Housing Agencies reports that member agencies administering HOME funds in 1998 spent 25 percent of those funds in rural and non-metropolitan areas for both homeownership and rental programs.

Unlike CDBG funds, HOME dollars must be matched by 25 cents in non-federal funds or in-kind contributions from the participating jurisdiction. Also, 15 percent of HOME funds are set aside for Community Housing Development Organizations (CHDOs). HOME funds are frequently leveraged with private, foundation, and other public resources. Since the program's inception, nearly $8.2 billion in HOME funds have leveraged an estimated $19.6 billion, or $2.40 of other resources for each HOME dollar.[40]

Over the years, more than 132,000 home buyers have used HOME funds to help purchase a home, and 104,000 homeowners have used such funds for home rehabilitation. Nearly one in three home buyers and seven in ten homeowners (almost half of them elderly) who receive HOME assistance earn 50 percent or less of area median income. Funds have been increasingly used for homeownership assistance, with 27.1 percent of HOME used in FY 1994, compared to 32 percent in FY 1995 and 44 percent in FY 1997.[41]

HOME appears to be a focal point for non-profits in the field. There are several reasons for this. First, the funds are exclusively for housing. Second, many rural non-profit housing organizations are CHDOs and therefore qualify for the 15 percent of HOME funds are set aside for such organizations. Finally, the leveraging requirement has necessitated housing organizations to become more entrepreneurial in their funding and has dovetailed with the recent changes in Section 502's encouraging leveraged loans. The following two examples from the symposium demonstrate how HUD block grant funds can be used by rural non-profits to promote low-income homeownership.

Home and CDBG in the Field: Working with local organizations that are members of the Federation of Appalachian Housing Enterprises, Kentucky Housing Corporation has helped assemble financing packages to serve households with annual incomes of $5,000 to $8,000. While each package is different, there are common elements, including financing provided through HOME. These funds are usually provided to the family through a deeply subsidized loan — carrying zero to 3 percent interest and allowing some of the loan to be forgiven — or a grant. Other funding sources include CDBG, Section 502 mortgages (usually at one percent), volunteer labor, AHP funds from the Federal Home Loan Bank System, Self-Help Opportunity Program (SHOP) funds from the Housing Assistance Council, grants from the

> **"KHC has said to its partners — the cities, counties, non-profits and CHDOs — 'Design what works in your community.'"**
>
> — Tom Carew, Kentucky Housing Corporation

Appalachian Regional Commission, and other sources of state and local funds.

The sheer number of funding sources and the complexity of the packages makes the job harder. But in the search to find adequate subsidies to house very low-income households, KHC has successfully used HOME as one of its principal tools, and CDBG as a secondary one.

In two rural California communities, Self Help Enterprises used HOME funds in conjunction with other sources to finance two self-help housing projects. SHE used Section 523 funds to plan development and conduct the projects. SHE also used loans from the California Housing Finance Agency as first mortgages with 5 percent loans for 30 years. HOME funds were used as "soft seconds" with a sliding scale based on income, and zero-percent interest rate deferred loans from the city redevelopment funds were included. In addition, HOME grant funds were used to offset the cost of environmental remediation. The result was the financing of 13 homes for low and very low-income families in the community of Lemoore. The average mortgage cost was $60,000, and families contributed some $10,000 each in labor.

In the community of Newman, SHE employed Section 502 funds with "soft seconds" from HOME and deferral of county fees as a third financing source. The average loan amount for the project was $75,750, with 10 very low-income families contributing $12,000 each in labor.

***Frontier Housing, Inc.* uses creative combinations and strategies to maximize funding for affordable housing in Kentucky.**

- Its home loan fund has been central to its success in leveraging other private, federal and state dollars, including HOME, RHS, ARC FAHE, SHOP, KHC and CDBG.
- More than 400 pre-applications have been received to date.
- Two-thirds of its projects in 2000 serve very low-income families, and the remaining third low-income. Average family income is $12,000.

Homeownership Symposium participants discussed the possibility of using HOME funds to create revolving loan funds for non-profits. Because rural areas are not entitlement communities or participating jurisdictions (PJs), they cannot depend on annual funding from either program. Most states make annual funding decisions; there is seldom a multi-year commitment for funding.

Currently, when most states distribute their HOME funds to the CHDOs, they require that the funds be re-paid to the state. When the use of the funds has been completed or in cases where the HOME funds have been loaned out by the CHDO, the principal is returned to the state after it has been paid to the non-profit.

According to participants, this policy deprives the community of an ongoing housing resource. Such a policy is particularly hard on rural areas that cannot count on regular funding for housing. Symposium participants agreed that if non-profits were allowed to keep the funds that borrowers repaid to them, the funds could be used to set up and replenish revolving loan programs, which in turn could be loaned again to other home buyers. The loan funds would grow as HOME funds are repaid and, over time, grantees would build up a reserve to carry them through budget-cutting times.

C. State Housing Finance Programs: Mortgage Revenue Bonds[42]

State and local governments issue Mortgage Revenue Bonds (MRBs) to help lower-income home

buyers, such as teachers, fire fighters, police, industrial, service and agriculture workers, buy their first home with low-interest loans from the proceeds of private investment in bonds. MRB investors accept lower interest on those bonds because the interest is tax-free. The states pass the savings in interest on to the home buyer through mortgages with below-market interest rates, significantly lowering the home buyer's costs.

Congress requires targeting under the MRB program, stipulating that funds are to be used for first-time home buyers who earn less than the statewide median income or the area median income, whichever is greater. (Families of three or more can earn up to 115 percent.) The cost of an MRB-financed home cannot exceed 90 percent of the average home price in its area. Borrower income and home purchase price limits are higher in strictly defined "targeted areas," which are predominately low-income and/or chronically economically distressed and in need of affordable housing.

The demand for MRBs is in the billions of dollars. In 1997, the national dollar volume for MRBs was over $9.3 billion; more than 104,000 loans were made. Although the dollar volume was slightly lower in 1998, it was still almost $9 billion, which helped purchase more than 97,000 homes. Approximately 81,000 (84 percent) of the 1998 loans were for existing homes and the rest were for new construction. According to the National Council of State Housing Agencies, 17 percent of the MRB loans issued in 1998 financed homes in rural areas, and RHS insured about 8 percent.[43]

The biggest disadvantage of MRBs is that they are lumped with many other types of tax-exempt bonds under the "private activity bond" volume cap. The volume cap limits the amount of all the private activity bonds that states can issue each year, severely hindering many state agencies in their efforts to meet demand for such bonds. In 29 states and Puerto Rico, the volume cap is based on the state's population, with each state allocated $50 per person. The other 21 states, plus the District of Columbia and the Virgin Islands, are allotted $150 million each in bond activity, since relying on their population numbers alone would result in a lower allocation.

MRBs play an important role in homeownership programs developed by state housing finance agencies across the nation. At the Homeownership Symposium, Dee Taylor of the Washington State Housing Finance Commission (WSHFC) discussed the state's federal tax-exempt mortgage bond and taxable bond programs. Precluded from making loans directly, WSHFC works through a statewide network of private lenders who make loans directly to home buyers. Through its collaborative partnerships, the agency targets low-income, first-time home buyers. Taylor reports that WSHFC, like other state housing finance agencies, has to struggle to stay within the volume cap, since other bond programs such as the state's student loan program are also in high demand and push against the cap.

According to Taylor, the volume cap has become even more restrictive because of inflation, which has cut the MRBs' purchasing power almost in half since the program was set by Congress in 1986. To help relieve the pressure on states, Congress enacted a phased-in increase of the bond cap in 1998. Starting in 2003, each state's cap will increase in equal annual increments, until it reaches the greater of $75 per capita or $225 million in 2007.

WSHFC has designed two programs — the House Key and the Community Reinvestment Act (CRA) Qualified Rural Investment Program — which are targeted to the state's low-income households. The House Key program targets households earning up to 115 percent of the statewide or area median income but can go, according to IRS guidelines, as high as 140 percent. The borrower must occupy the home for the life of the loan or pay a recapture tax if the home is sold or otherwise disposed of during the first nine years of ownership, if the borrower's income increases each year by 5 percent above the maximum federal income limit at the time of purchase, and if he borrower realizes a gain upon the sale of the home. Since

all of these events must occur to trigger a tax payment, it is unlikely that most borrowers will pay a recapture tax. Should that occur, the tax will be only a portion of the borrower's gain on the sale of the home. The law states that the maximum recapture tax is either 50 percent of the gain on the sale or 6.25 percent of the original loan amount, whichever is less.

In April 2000, the House Key program's interest rate was 7.55 percent and 75 basis points below the state average. From July 1, 1999 through June 30, 2000, WSHFC made 1,587 loans under the program, of which 26 percent were to households living in rural areas. The average rural household income was $35,841 and the average home purchased cost $106,280.[44]

"In Washington state we have done a lot of outreach with community banks. We focus on rural areas, assuring that funds get to them faster than they would otherwise."

— Dee Taylor, Washington State Housing Finance Commission

The CRA Qualified Rural Investment Program, the first such program in the nation, was developed in collaboration with the state's lending institutions. Lenders invest in WSHFC's loan products and get CRA credit for their investment. WSHFC offers the program at 25 basis points below the tax-exempt rate, making it more attractive to borrowers. Loans are targeted to home buyers earning below 80 percent below AMI. As of May 2000, 61 loans had been made to low-income families living in rural Washington, 18 percent of whom were minorities. The average family income was $28,788 and the average house cost about $67,000. Thirteen banks have used the program, loaning approximately $10,650,000.

MRBs are part of the solution to the low-income homeownership problem, and WSHFC has made a good effort to tailor programs for rural needs. By using private investment dollars, state housing finance agencies have designed programs which allow housing providers the flexibility to develop projects that lower costs to home buyers. With federal resources declining, the private sector is playing a greater role in meeting affordable housing needs. MRBs are one way for the private sector to help make up for the federal funding shortfall. Affordable housing advocates and experts are considering other ways in which the private sector can play an increased role. The following section describes how the secondary mortgage market has become another option for rural homeowners.

D. Secondary Mortgage Market: Rural Programs

The Federal National Mortgage Association (Fannie Mae) was created by Congress in 1938 to expand the flow of mortgage money. When Congress established Fannie Mae, it authorized the organization to buy Federal Housing Administration (FHA) insured mortgages, which would thereby replenish the supply of lendable money.[45] Following up on Fannie Mae's success, Congress chartered two other secondary mortgage market organizations: the Government National Mortgage Association (Ginnie Mae) was created in 1968 and the Federal Home Loan Mortgage Corporation (Freddie Mac) in 1970. (Fannie Mae and Freddie Mac are now private, stockholder-owned corporations and are considered Government Sponsored Entities, or GSEs.) These three entities promote efficiencies in the flow of credit to housing markets by making mortgage loans more liquid investments. According to a 1995 study, they increase mortgage credit availability by accessing capital markets, and by helping standardize the finance industry.[46]

These entities purchase or securitize loans originated by others. They do not originate loans or offer subsidies or grants, but use mortgage-backed securities (MBS) to sell their loans to investors. Because MBSs

are comparable to securities regularly traded on the financial markets, investors are more likely to buy the mortgages.

Federal National Mortgage Association (Fannie Mae): When Fannie Mae became a private corporation in 1968, its responsibility to purchase government-subsidized mortgages was transferred to the newly created Ginnie Mae. Fannie Mae remains a major market for government insured or guaranteed loans, but today the overwhelming majority of its total business is in conventional mortgages.[47]

In 1994, Fannie Mae began to market its products aggressively in rural areas; by 1999, it had financed over 1.3 million rural homes for over $110 billion.[48] As part of its rural initiative, Fannie Mae has established statewide rural housing programs with rural housing team leaders in 26 of its local offices. Fannie Mae partners with the RHS Section 502 Guaranteed program and its Rural Direct Leveraging Loan Product.

In addition to products for rural areas, Fannie Mae is implementing an initiative targeted to Native Americans. It has developed instruments that allows its products to be used on tribal trust or restricted Native American lands and in Native Hawaiian Home Lands. It is also participating in HUD's Native American Section 184 Guaranteed Program, the FHA Native American Section 248 Insured Program, the FHA Section 247 Hawaiian Home Lands Mortgage Insurance program, and the RHS Section 502 Rural Housing Native American Pilot.[49]

Federal Home Loan Mortgage Corporation (Freddie Mac): Freddie Mac is a stockholder-owned corporation that purchases and sells conventional residential mortgages made by the Federal Home Loan Bank Board member institutions, primarily the federally insured savings and loan associations. Freddie Mac now also serves the same conventional mortgage markets as Fannie Mae, although the two differ in the strategies they use.[50]

Since 1970, Freddie Mac has financed homes for over 20 million families.[51] About 42 percent of the 2.7 million homes financed by Freddie Mac in 1998 were affordable to low- and moderate-income families and families in underserved communities.[52]

"No deal is too small. We realize that in some rural areas it is difficult to obtain products. We are willing to create smaller securities for rural banks."

— John Urquijo, Fannie Mae

Freddie Mac has designed an array of programs aimed at increasing homeownership. Its Community Development Lending program is specifically targeted to low- and moderate-income and minority families, underserved communities and economically depressed neighborhoods. The program works through public-private collaborations and partnerships.

While rural areas have access to all of Freddie Mac's programs, the corporation has also developed three national programs available only in rural areas: Section 502 Rural Leveraged Second Loan Program; Guaranteed Rural Housing Program; and HUD Section 184 Indian Housing Loan Guaranteed Program. The organization has also entered into several local partnerships including a partnership with Rural Opportunities, Inc., in which borrowers receive pre-and post-counseling services. Freddie Mac is also partnering with Native American tribes in Oklahoma, Texas, Arizona, Alaska, New Mexico, Washington, and Oregon under its Native American Housing Initiatives program, building on housing opportunities made possible through the 1996 Native America Housing Assistance and Self-Determination Act.[53]

Government National Mortgage Association (Ginnie Mae): Ginnie Mae was

established in 1968 as a HUD agency to support federal housing initiatives by providing liquidity to the secondary mortgage market and by attracting capital from the nation's capital markets into residential mortgage markets. Ginnie Mae guarantees the timely payment of principal and interest on securities issued by private institutions and backed by pools of mortgage loans insured by FHA or VA or guaranteed by RHS. Each year Ginnie Mae-guaranteed securities provide the financing for approximately 97 percent of all loans backed by FHA and VA.

As of December 31, 1999, Ginnie Mae had securitized 79,129 RHS Section 502 Guaranteed loans. The average loan size for all guaranteed loans that Ginnie Mae has securitized is $71,737.[54]

Center for Community Self-Help, a private community development credit union, created its Home Loan Secondary Market Program in 1994 to help North Carolina's banks "recycle" their Community Reinvestment Act loans into new lending capital. Aimed at low-income borrowers with jobs, stable but limited income, and creditworthiness, CCSH worked with banks to help them see the value of making loans to help build stable communities as well as fulfill their CRA obligations.

"There is a huge untapped market out there. We have demonstrated that this market can be served safely and through traditional channels."

— Janneke Ratcliffe, Center for Community Self-Help, NC

The program was so successful that within four years, it had purchased over $100 million in affordable housing loans from North Carolina's major commercial banks, helping an additional 1,800 low-income families achieve homeownership.[55] Based on the program's success, CCSH launched a major new initiative in 1998 called Community Advantage,™ which expands the secondary market concept to banks across the country. Community Advantage serves households earning 80 percent of AMI. Households in low-income and minority census tracts and earning up to 115 percent of AMI are eligible for the program.

To get the program started, the organization entered into partnerships with the Ford Foundation, Fannie Mae, and a number of banks. The Ford Foundation gave CCSH a $50 million grant for equity to help cover default risk on the loans it purchases, and Fannie Mae committed to buy and/or securitize $2 billion over five years in loans that CCSH will acquire. This means that about 35,000 minority and low-income home buyer loans will be acquired nationwide.

To date, the program has purchased $400 million in loans for more than 6,000 low- and moderate-income families, with an average household income of 68 percent of AMI. Forty-one percent of the households are minority and 43 percent are female-headed. Nine institutions have sold non-conforming loan portfolios in 24 states through the Community Advantage program, and CCSH has custom-designed a number of new "flow" programs with lenders. The new flow programs are enabling lenders to create unique loan products with an assured investor after loan origination.

Through both portfolio and flow deals, lenders can offer innovative loan products that meet particular market needs. Since CCSH absorbs the default risk on the loans, Fannie Mae is able to approve loan parameters that are more aggressive than those it would normally be able to accept. This allows the market to drive the type of loan product that is made available in any given area.

Affordable Housing Program (AHP) of the Federal Home Loan Bank System

AHP was established by Congress in 1989 as a tool to assist local organizations in creating and preserving affordable housing. Each year, the 12 Federal Home Loan Banks contribute 10 percent of their net income or $100 million, whichever is greater, to the program. Member financial institutions work with locally based developers to apply for AHP grants and subsidies, which are awarded through a competitive scoring process.

Since the program's inception, the Federal Home Loan Banks have provided more than $900 million to help build or rehabilitate over 200,000 affordable housing units. In New England, the Federal Home Loan Bank of Boston has contributed more than $107 million to fund more than 15,300 units of affordable housing.

— Carmen Gutierrez-Seales of the Federal Home Loan Bank of Boston presented this information at the NRHC symposium.

Self-Help Opportunity Program (SHOP) of the Housing Assistance Council

SHOP supports non-profit homeownership programs that use the self-help sweat equity model.

The Housing Assistance Council (HAC) began SHOP in 1997 with funds from HUD. HAC competes for these funds annually, which it then distributes as loans to qualified non-profits.

Funds may be used for land and infrastructure to house very low- and low-income families. Every $10,000 of SHOP funds must help produce one completed unit of housing. Once the unit is completed, 75 percent of the loan becomes a grant, and the remaining 25 percent becomes a loan at zero percent interest.

The funds that are repaid to HAC are used in a revolving loan fund to be re-lent to other non-profits. The revolving fund has allowed HAC to use the $18.3 million it received over three years to loan out $28 million.

— Moises Loza of the Housing Assistance Council presented this information at the NRHC symposium.

IV. Key Findings and Recommendations

The two key findings of the Rural Homeownership Symposium were:

- RHS Section 502 is essential to the success of non-profit housing strategies for homeownership;
- In the face of reduced subsidy levels and overall lending in Section 502, an important non-profit delivery system has evolved to coordinate financing for affordable rural housing.

The participants recognized Section 502 as an invaluable resource for promoting homeownership among low-income rural households. There was also widespread acknowledgment that reduced levels of subsidy and lending have greatly diminished the scope of the program. These changes to the Section 502 program make it necessary for non-profits to seek out other, complementary funding sources and to act as the delivery system for homeownership finance.

In light of these key findings, the symposium participants made the following recommendations, which focus on reinvigorating Section 502 and providing for increased capacity-building for non-profit organizations.

A. Increase Subsidies and Assistance to Low-Income Households by Reinvigorating Section 502

1. *Increase subsidies in Section 502 for low-income home buyers.*

In 1993, RHS changed from an interest subsidy to payment assistance. Since very low-income borrowers can get a subsidy to make interest rates as low as one percent, they are less affected by the change than low-income borrowers. The subsidy structure of payment assistance has been less effective in serving low-income households (50 to 80 percent of median). As a result of the reduced subsidy available, average incomes for borrowers have increased.

One alternative is to revise payment assistance to provide more gradations and more subsidy to low-income borrowers. Many at the symposium indicated a preference for returning to the interest credit program in effect prior to FY 1996.

It is important to note that the overall low cost of Section 502 makes increasing the subsidy to low-income families possible. In recent years the cost to the government of financing a Section 502 unit has been as low as $7500, and the projected cost for 2001 is less than $10,000 per unit. (The cost to the government is a calculation based on interest subsidies and potential for losses.)

Increasing the subsidy is important, but so is increasing the lending level for Section 502. It is clear that rural areas do not receive a fair share of housing assistance. For many rural households, assistance available through RHS is the only option for improving housing conditions. While Congress has in recent years provided limited increases, the demand for assistance is great. At the start of each fiscal year RHS has more than twice as many applications for assistance as it can fund. With millions of rural households in need of improved housing, the current federal response falls far short of meeting the need.

2. *Identify ways to improve the Section 502 Guaranteed Loan program.*

The guaranteed program is playing a bigger role in rural homeownership, helping more very low-income households become homeowners. Symposium participants, however, took the view that the program

could be improved if it were made it more efficient and effective by (1) providing an interest subsidy to the program and thereby making it more accessible to low-income families; and (2) developing incentives for non-profit developers to use the guaranteed program.

3. *Recapture RHS Section 502 repayment funds.*

Since 1977, USDA has recaptured interest subsidy funds from the sale of Section 502 properties. The proceeds from the sales are returned to the federal treasury and reallocated for purposes other than housing. Over the history of the program, approximately $1.46 billion has been returned to the government; in FY 1999, more than $112.5 million was returned. Symposium participants recommend that recaptured funds be used to help fund homeownership education and counseling programs rather than being withdrawn from the housing sector. These funds can return important dividends by helping homeowners to acquire a more in-depth understanding of the challenges and rewards of the home buying process.

4. *Expand the housing counseling program.*

Counseling both before and after buying a home is a key to successful homeownership. RHS's Section 502 self-help program, which includes funds for housing counseling, is highly successful, in part because the counseling is so effective. Despite the proven value of counseling, however, non-profit organizations generally lack access to resources to help defray its costs. RHS should incorporate housing counseling into its programs and allow its rural rental program managers to refer renters to organizations that provide homeownership counseling.

5. *Create a Section 502 direct loan fee/grant program for non-profits.*

A program similar to the RHS Section 523 technical assistance grant program for self-help organizations is needed to help non-profits package and monitor processing of Section 502 loans. The Section 523 grant pays for such items as office supplies, specialty tools, and staff salaries. Currently, RHS pays a per-loan packaging fee which is cumbersome and inefficient when packaging several loans in a project. Symposium participants believe that the process would be more efficient if the non-profit were given a grant that would cover expenses and allow the organization to package many Section 502 applications over a specified period of time.

6. *Institutionalize Section 502 allocation to non-profits and self-help groups.*

The two set-asides discussed in this report — the Mutual Self-Help Set-Aside and the Rural Home Loan Partnership Set-Aside — are practical ways to target federal funds toward rural homeownership. With this in mind, symposium participants believe RHS should formally institutionalize both programs. This recommendation is based on the participants' belief that the programs are efficient and effective tools for increasing rural homeownership.

B. Build Non-Profit Organization Capacity

1. *Recapture HOME funds.*

HOME is currently the most flexible form of housing assistance provided directly to states and local governments. The program also strongly emphasizes the role of community-based non-profit housing development organizations (CHDOs) in the housing delivery system. HOME funds may be used to support a range of activities necessary to produce decent, affordable rental and homeownership housing.

Some states require the CHDOs to return the funds to the state when the CHDO has loaned the funds and they have been repaid. In order to create a long-term, self-sustaining non-profit rural homeownership program, states should be encouraged to allow the CHDOs to keep the repaid funds. In this scenario, the HOME funds are actually "passed-through" to the CHDOs, which then use the funds to set up revolving loan fund programs. The revolving loan funds are a

way to institute a "recycling" of federal funds, thereby creating a system that will, in the long run, help CHDOs become more self-sustaining.

2. Modify the Rural Community Development Initiative (RCDI) program.

This new RHS program provides funds to national intermediaries to provide technical and financial assistance to rural non-profit, community-based organizations, helping them build their capacity to implement housing, community and economic development projects. RCDI requires the national intermediaries to match the federally funded dollars from private and philanthropic resources. Symposium participants, however, believe that homeownership programs could be strengthened if non-profit developers had adequately capitalized revolving home loan funds. The RCDI program is a resource that could be used to help capitalize such funds.

3. Support the Affordable Homeownership Tax Credit Initiative.

Participants expressed support for a Homeownership Tax Credit. In January 2000, the National Association of Home Builders (NAHB) launched an Affordable Homeownership Tax Credit initiative. This tax credit, structured like the Low Income Housing Tax Credit (LIHTC), is designed to (1) increase investment in the rehabilitation and new construction of affordable single-family housing stock; (2) encourage homeownership in distressed communities; and (3) increase homeownership by low- and moderate-income individuals.

The proposed credit could be used in conjunction with other public subsidies including the HOME program to increase the affordability of any federal grant made to the seller or the investor, regardless of whether such grant is included in the recipient's gross income. The parties involved in a project could allocate the credits among themselves in order to make it economically efficient. There would be no requirement that a party claiming the credit's tax benefit must have a direct economic interest in the project's residences when they are sold. Consequently, it is possible that a taxpayer receiving a credit allocation could assign the credits to a third party.

The above recommendations have a common theme: to reinforce the government's role while giving non-profits more effective tools and resources. Building on state-of-the-art programs that have long since demonstrated their value, these recommendations if implemented will make homeownership a reality for many more low-income rural Americans.

Appendix: Homeownership Symposium Panelists

Betsy Fletcher
Branch Chief of Loan Origination
USDA, Rural Housing Service
Washington, D.C. 20250-0701

Carmen Gutierrez-Seales
Representative
Housing Community and Investment
Federal Home Loan Bank Board-Boston
One Finance Center
Boston, Massachusetts 02111

Dee Taylor
Washington State Housing Finance Commission
1000 Second Avenue, Suite 2700
Seattle, Washington 98104-1046

Tom Carew
Kentucky Housing Corporation
340 N. Wilson
Morehead, Kentucky 40351

H. Lewis Kellom
Homes In Partnership
P.O. Box 761
Apopka, Florida 32704

John Urquijo
Senior Business Manager
Fannie Mae Corporation
Washington, D.C.

Janneke Ratcliff
Center for Community Self-Help
301 West Main Street
Durham, North Carolina 27701

Hal Wilson
Local Initiatives Support Corporation
1825 K Street, NW, Suite 1100
Washington, D.C. 20006

Moises Loza
Executive Director
Housing Assistance Council
1025 Vermont Avenue, NW, Suite 606
Washington, D.C. 20005

Peter Carey
Executive Director
Self Help Enterprises
P.O. Box 351
Visalia, California 93279-0351

Marsha Bursey
Director
Pathfinder Services/Community Connections
P.O. Box 1001
Huntington, Indiana 46750

Endnotes

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2. U.S. Department of Housing and Urban Development, "Now is the Time: Places Left Behind in the New Economy." April, 1999. p. 6.
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6. Lance, George. *Housing Assistance Council.* Physical Adequacy Cross tabulation Chart using 1995 AHS data. February, 2000.
7. Economic Research Service. *Rural Conditions and Trends*, 1999, Vol. 9, No. 2. p. 81.
8. Economic Research Service website. www.ers.usda.gov. *Understanding Rural America – County Types.*
9. Understanding rural homelessness requires a more flexible definition of homelessness. There are far fewer shelters in rural areas; therefore, people experiencing homelessness are less likely to live on the street or in a shelter, and more likely to live in a car or camper, or with relatives in overcrowded or substandard housing. Restricting definitions of homelessness to include only those who are literally homeless — that is, on the streets or in shelters — does not fit well with the rural reality. *National Coalition for the Homeless*, Rural Homelessness NCH Fact Sheet #13. March, 1999.
10. Ibid
11. U.S. Bureau of the Census, 1994. The South exceeds all other regions of the country in mobile homeownership, accounting for 52 percent of the nation's total. In fact, South Carolina ranks first in the growth of mobile homes, with a 92 percent increase during the last decade. Porter Young, Kate. p.27.
12. Ibid.
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26. Very low income is defined as below 50 percent of the area median income and statewide non-metro median income; low income is between 50 and 80 percent of AMI.
27. Deficient housing is defined as a dwelling that lacks complete plumbing, lacks adequate heating, is dilapidated or structurally unsound, has an overcrowding situation that will be corrected with loan funds, or is otherwise uninhabitable, unsafe, or poses a health or environmental threat to the occupant or others.
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31. Ibid.
32. The loan payment may never exceed that of the promissory note.
33. Housing Assistance Council. "RHS Programs Which Construct, Purchase or Repair Rural Housing." Chart "Direct Section 502 Home Ownership Loans" and "Guaranteed Section 502 Home Ownership Loans." Provided to NRHC on March 3, 2000.
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36. *The Mutual Self-Help Homeownership Experience 1965-1996.* Self-Help Enterprises. Visalia, 1998.
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38. HOME Investment Partnership Program (HOME), Community Development Block Grant program (CDBG), and Affordable Housing Program (AHP) of the Federal Home Loan Bank System.
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