

RURAL HOUSING SERVICE

Statement of Russell T. Davis, Administrator of the Rural Housing Service, submitted to the Financial Services Subcommittee on Housing and Community Opportunity.

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to present the President's Fiscal Year (FY) 2006 budget for the USDA Rural Development rural housing programs.

As an integral part of Rural Development, the rural housing program assists rural communities in many fundamental ways. We provide a variety of both single and multi-family housing options to residents of rural communities. We also help to fund medical facilities, local government buildings, childcare centers, and other essential community facilities. Rural Development programs are delivered through a network of 47 State offices and approximately 800 local offices.

The proposed budget for the rural housing program in FY 2006 supports a program level of approximately \$6.49 billion in loans, loan guarantees, grants, and technical assistance. It also maintains the Administration's strong commitment to economic growth, opportunity, and homeownership for rural Americans. We believe that our efforts, combined with the best of both the non-profit and private sectors, will ensure

that this budget makes a tremendous difference in rural communities. The FY 2006 Budget also includes a major initiative to revitalize the rural rental housing programs.

Let me share with you how we plan to continue improving the lives of rural residents under the President's FY 2006 budget proposal for our rural housing programs.

Multi-Family Housing Programs

The Multi-Family Housing (MFH) budget preserves Rural Development's commitment to maintaining the availability of affordable housing for the many rural Americans who rent their homes. Our existing portfolio provides decent, safe, sanitary, and affordable residences for about 470,000 tenant households.

The total program level request is \$1.07 billion. This represents an increase of 30 percent from last year's request. \$650 million will be used for rental assistance (RA) for contract renewals, farm labor housing, and preservation. These funds will renew more than 46,000 4-year RA contracts. We estimate using \$27 million for MFH direct loans to meet our preservation responsibilities including prepayment prevention incentives.

Revitalization Initiative

In November 2004, we released a report titled the "Multi-Family Housing Comprehensive Property Assessment and Portfolio Analysis." This report analyzed the issues associated with the preservation of the portfolio and provided recommendations

for changes to the MFH program. The FY 2006 budget addresses the immediate need to provide assistance for tenants of projects that prepay and leave the program. Included is \$214 million for the initial stage of the multi-family housing Revitalization Initiative that establishes a tenant protection program. Later this year, the Administration will propose legislation to ensure that projects remain in the program and that they are properly maintained. The authority to make rural housing vouchers is contained in the Housing Act of 1949. Regulations will need to be developed in order to use this authority.

The report recommended three primary strategies to revitalize our aging portfolio, which continue to play a critical role in delivering affordable rental housing to rural communities across the nation:

(1) Allowing prepayment while protecting tenants

While a significant segment of the portfolio has the legal right to prepay, the report concluded that prepayment is economically viable for only about 10 percent of owners. Recent court decisions require that owners of projects that are eligible to prepay under the terms of their loans, be allowed to do so. This would leave the tenants of these projects at risk of significant rent increase and potential loss of their housing. Therefore, we are proposing that all tenants of these projects be adequately protected through the use of housing vouchers.

(2) Creating an equitable new agreement with project owners electing to stay with the program

The report recommended that new agreements be reached with project owners to keep their projects in the program and, thus, be used for housing low income families. This new agreement would allow owners and project managers to exercise their entrepreneurial planning and management skills. Performance expectations and performance-based incentives would be provided so that high-performing owners and project managers are rewarded. Conversely, owners and property managers performing poorly would be subject to sanctions.

(3) Using debt relief as the primary tool to stabilize projects at risk of physical deterioration

The report also recommended that a majority of the existing MFH portfolio is in need of additional financial assistance to achieve long-term viability. The report recommended our using debt restructuring as the primary tool. Additional financial assistance would be provided in exchange for the owner's commitment to providing long-term affordable housing.

The Administration continues to evaluate the costs and benefits of various options to address items (2) and (3). We expect to complete this evaluation and to propose legislation later this year. However, for FY 2006 the Budget includes \$27 million for direct loans that is to be used to meet immediate revitalization needs.

We anticipate our revitalization efforts will span the next several years and have initiated a demonstration program to test the viability of the revitalization concepts. In addition, we will be initiating a demonstration program for making loans through the use of revolving funds for preservation purposes, as provided for in the 2005 Appropriations Act.

Section 538 Guaranteed Rural Rental Housing Program

The FY 2006 budget request will fund \$200 million in Section 538 guaranteed loans, funds that may be used for new construction. The Section 538 guaranteed program continues to experience ever-increasing demand, brisk growth, and is rapidly becoming recognized within the multi-family housing finance, development, and construction industry, as a viable conduit to facilitate the financing of housing projects. In fact, Rural Development received an overwhelming response to the latest Notice of Funding Availability with over 150 applications received.

In FY 2004, we distributed more than \$99 million in guarantees to fund housing projects with over \$243 million in total development costs. The risk exposure to the government continues to be very low, as loan guarantees to total development costs are well under 50 percent. We also have a very low delinquency rate of zero. A 'notice to proceed' was given to 44 applicants with an average loan guarantee request of \$2.2 million and an average total development cost of \$5.5 million. Thirty-five out of the 44

applications given the approval to proceed included the use of Low-Income Housing Tax Credits from the various state governments where the projects will be located.

Since inception of the program, the Section 538 guaranteed program has closed 71 guarantees totaling over \$171 million. The program also has an additional 89 loans in process and not yet closed, totaling over \$352 million. The 71 closed guarantees will provide over 4,200 rural rental units at an average rent per unit of approximately \$500 per month.

The rural housing program recently published a final rule to address program concerns from our secondary market partners and make the program easier to use and understand. We look forward to administering the FY 2006 proposed budget of \$200 million, which will enable Rural Development to fund a significant number of additional guaranteed loan requests.

The FY 2006 budget also request funds \$42 million in loans and \$14 million in grants for the Section 514/516 Farm Labor Housing program, \$2 million in loans for MFH credit sales, and \$10 million for housing preservation grants.

Single Family Housing Programs

The Single Family Housing (SFH) programs provide several opportunities for rural Americans with very low- to moderate-incomes to purchase homes. Of the \$4.7 billion in program level requested for the SFH programs in FY 2006, \$3.7 billion will be available as loan guarantees of private sector loans, including \$207 million for refinancing more affordable loans for rural families. Also, with \$1 billion available for direct loans, our commitment to serving those most in need in rural areas remains strong. This level of funding will provide homeownership opportunities for 40,400 rural families.

Effective outreach and an excellent guarantee, coupled with historically low interest rates have increased the demand for the Section 502 guaranteed program.

Approximately 2,000 lenders participate in the guaranteed SFH program. The competitive low-interest rate environment has enabled the rural housing program to serve low-income families that would typically receive a Section 502 direct loan with a guaranteed loan instead. In FY 2004, approximately 32 percent of guaranteed loans were made to low-income families.

Section 523 Mutual and Self-Help Housing

The President's FY 2006 budget requests \$34 million is for the mutual and self-help housing technical assistance program.

FY 2004 ended with over \$35 million awarded for contracts and two-year grants. There were 39 "pre-development" grants awarded in FY 2004, including many first-time sponsors, several faith-based groups, and groups in States with no self-help housing programs. Pre-development funds may be used for market analysis, determining feasibility of potential sites and applicants, and as seed money to develop a full-fledged application. Groups in the pre-development phase typically need 6 to 12 months before they are ready to apply for full funding.

The FY 2006 proposed budget also includes \$36 million in program level for home repair loan funds and \$30 million for grants to assist elderly homeowners. It also includes \$5 million in loan level for each of two site loan programs, \$10 million in loan level for sales of acquired properties, and \$1 million for supervisory and technical assistance grants.

Community Programs

The Community facilities budget request will provide essential community facilities, such as educational facilities, fire, rescue, and public safety facilities, health care facilities, and child care centers in rural areas. The total requested program level of \$527 million includes \$300 million for direct loans, \$210 million for loan guarantees, and \$17 million for grants.

In partnership with local governments, State governments, and Federally recognized Indian tribes, the FY 2006 budget will support more than 240 new or improved public safety facilities, 105 new and improved health care facilities, and approximately 80 new and improved educational facilities to serve rural Americans.

In FY 2004, we invested over \$130 million in 113 educational and cultural facilities serving a population totaling over 3.3 million rural residents, over \$97 million in 338 public safety facilities serving a population totaling over 1.7 million rural residents, and over \$304 million in 141 health care facilities serving a population totaling over 3.2 million rural residents. Funding for these types of facilities totaled \$531 million. The remaining balance was used for other essential community facilities such as: food banks, community centers, early storm warning systems, child care centers, and homeless shelters.

Program Highlights

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

Rental Assistance

We have continued to improve the internal controls in the Rental Assistance (RA) program and plan to implement a number of new initiatives in this regard with the recent publication of a comprehensive revision of our regulations. The new initiatives include

an increased emphasis on verification methods and procedures for certifying income reported by tenants and improving management of tenants with no reported income. We are currently in discussions with the Department of Health and Human Services concerning USDA receiving access to the National Directory of New Hires database. This will enable us to match the data in the national directory against the information provided by the tenant, and therefore reduce fraud and abuse within the program. Additional training of borrowers and property managers will also be key to reducing errors when certifying tenants for residency in MFH properties.

The automated RA forecasting tool is now in place and operational. The forecasting tool was used to develop the FY 2006 RA budget and is able to forecast when RA contracts will either exhaust funds or reach their 4-year term limit. The forecasting tool can also develop the cost of new contracts based on an actual RA usage rate or a selected inflation rate. For the FY 2006 RA budget, an inflation rate of 2.4 percent was used, as recommended by the General Accounting Office. We will continue to provide State offices with additional guidance on the transfer of RA units and will centralize the redistribution of unused RA.

Automation Initiatives

Last year, we reported that the rural housing program was developing a data warehouse for MFH and SFH loans to improve our reporting capabilities. I am pleased to report that we are currently utilizing our data warehouses, making needed improvements, and training staff on how to expand their reporting capabilities. Our Multi-Family

Information System (MFIS) database is now in Phase 5 of development, following a very successful completion of Phase 4, which integrated electronic debiting and crediting of borrowers accounts and eliminated funds handling in area offices. We now have a website available to the public to locate all MFH properties, with property and contact information. Also implemented is the Management Agent Interactive Network Connection (MAINC), which allows property managers to transmit tenant and property data electronically to MFH via the Internet. This data goes directly into the MFIS database and the data warehouse.

Last year, we also reported that an Automated Underwriting System (AUS) was being developed that would allow lenders to input SFH customer application data, pull credit, and determine immediately whether the rural housing program would issue a commitment. The AUS should be fully operational by next winter.

In December 2004 our Centralized Servicing Center (CSC) in St. Louis, Missouri began the centralization of loss claims submitted by lenders under our SFH guaranteed program. As of September 30, 2004, CSC provided loss mitigation for approximately 110,000 guaranteed loans. CSC is also supporting the rollout of the Lender Interactive Network Connection (LINC), which is an Internet-based alternative for lenders to submit loss claims electronically. Centralization will improve efficiency, consistency, customer service to lenders, and provide better management data to program officials.

USDA's Five Star Commitment to Increase Minority Homeownership

The rural homeownership rate continues to outpace the national rate. In 2004, it stood at 76.1 percent compared to the national rate of 69.2 percent. But, while rural America has the highest percentage of homeownership, we are committed to do more, particularly to assist more minority families in living the American Dream.

For USDA's part, we developed a Five-Star Commitment to increase minority homeownership opportunities.

1. Reducing barriers to minority homeownership

Origination fees can now be incorporated into the loan amount. Through reduction of such barriers the program guaranteed a total of \$3.18 billion in loans in fiscal year 2004, a record for the program.

2. Doubling the number of Self-Help participants by 2010

Over 54 percent of the families who participate in this program are minorities. In FY 2004, we helped over 1,100 families build their own home.

3. Increasing participation by minority lenders through outreach

Rural Development offices across the country have developed a marketing outreach plan to increase participation in the guaranteed loan program by lenders serving rural minorities.

4. Promoting credit counseling and homeownership education – critical to successful homeownership

Since the signing of an agreement with the Federal Deposit Insurance Corporation to promote and utilize their "Money Smart" training program, nearly 700 Rural Development field staff received training and will deliver the training to others. Over a third of our State offices have already made the Money Smart Program available to non-English speaking groups.

5. Monitoring lending activities to ensure a 10 percent increase in minority homeownership

USDA has jointly developed with the Departments of Housing and Urban Development (HUD) and Veteran Affairs (VA) an internal tracking system to measure the success of each of the 53 States and territories we serve. Overall, the number of loans to minorities has increased by more than 1,000 per year - an increase of more than 12 percent.

Improving Successful Homeownership

We are also pleased to report our achievement in helping our customers remain successful homeowners. Rural Development has lowered its direct loan housing program gross delinquency rate by 35.6 percent and new loan delinquency rate by 61.8 percent over the past five years. As of today, our gross delinquency rate is 12.85 percent and the new loan delinquency rate is 1.92 percent. Our portfolio recently outperformed the delinquency rate for sub-prime mortgage loans as tabulated by the Mortgage Bankers Association's National Delinquency Survey.

To ensure that we were also providing a high level of customer service, a satisfaction survey was recently completed. This was our first independent homeowner survey and established a benchmark for customer satisfaction. The survey was conducted by an outside contractor and showed an average homeowner satisfaction rate of 8.6 on a scale of 1 to 10. The study used the J. D. Power 2004 home mortgage study to compare these results to the results of other organizations providing financial services. The J. D. Power survey includes such well known and respected major lending institutions as Bank of America, Wells Fargo, and Chase. The average satisfaction level for the organizations included in the survey is 7.2 with the highest rating going to USAA (a private mortgage corporation) at 8.6. USDA Rural Development is at the top of the list for customer satisfaction at 8.6.

Rural Partners

In FY 2006, we will continue to stretch the rural housing program's resources and its ability to serve the housing needs of rural America through increased cooperation with HUD and other partners. We are committed to working with these partners to leverage resources for rural communities. For example, we are working with HUD and expect to adopt their "TOTAL" scorecard, modified for SFH guaranteed loans. This cooperation between USDA and HUD will save time and money in system development. Additionally, Rural Development information technology staff and the CSC worked with HUD and VA to develop a one-stop web portal, www.homesales.gov, to market government homes for sale.

In our MFH program, HUD has been extremely helpful in sharing data for development of our Comprehensive Property Assessment and in providing knowledgeable, professional staff from their Office of Affordable Housing Preservation to consult with before making determinations on our rural portfolio. This eliminates duplicative work and ensures better consistency.

Conclusion

Through our budget, and the continued commitment of President Bush, rural Americans will have the tools and opportunities they can put to work improving both their lives and their communities. We recognize that we cannot do this alone and will continue to identify and work with partners who have joined with the President to improve the lives of rural residents.

I would like to thank each of you for your support of the rural housing program's efforts. I look forward to working with you in moving the FY 2006 rural housing program budget forward, and welcome your guidance as we continue our work together.