United States General Accounting Office

GAO

Report to Congressional Requesters

June 1995

FOREIGN HOUSING GUARANTY PROGRAM

Financial Condition Is Poor and Goals Are Not Achieved

GAO/NSIAD-95-108

GAO

United States
General Accounting Office
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National Security and
International Affairs Division

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The Honorable Toby Roth
Chairman
The Honorable Sam Gejdenson
Ranking Minority Member
Subcommittee on International
Economic Policy and Trade
The Honorable Doug Bereuter
Chairman, Subcommittee on Asia and
the Pacific
Committee on International Relations
House of Representatives

As you requested, we reviewed the U.S. Agency for International Development's (USAID) use of Housing Guaranty Program funds. Specifically, our review focused on the program's (1) evolution, (2) financial condition, and (3) impact. This report suggests that the Congress may wish to terminate the program. If the Congress does not terminate the program, the report also contains recommendations to the USAID Administrator intended to strengthen the financial condition of the program and improve its management.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 15 days from its issue date. At that time, we will send copies to other appropriate congressional committees, the Administrator of the U.S. Agency for International Development, and the Director of the Office of Management and Budget. Copies will also be made available to others upon request.

This report was prepared under the direction of Joseph E. Kelley, Director-in-Charge, International Affairs Issues. If you have any questions concerning this report, please call him at (202) 512-4128. Other major contributors to this report are listed in appendix III.

Henry L. Hinton, Jr.

Henry L. Hinton, Jr.
Assistant Comptroller General

Executive Summary

Purpose

The Foreign Assistance Act of 1961, as amended (22 U.S.C. 2151 et. seq.), authorizes the U.S. Agency for International Development (USAID) to guaranty loans made by U.S. investors to borrowers in developing countries for shelter-related projects. With this authority, USAID operates the Housing Guaranty Program. A long-run goal of this program is to increase shelter for low-income families in developing countries by stimulating local credit institutions to provide the necessary investment capital and other resources. Since 1961, USAID has guarantied over $2.7 billion in loans (valued at $5 billion in 1995 dollars) in 44 countries for home construction, mortgages, home improvements, urban infrastructure, and other shelter-related projects.

Members of the House Committee on International Relations have become concerned about the use of Housing Guaranty Program funds and the program's true cost to the U.S. government. At their request, GAO reviewed the program's (1) evolution, (2) financial condition, and (3) impact.

Background

USAID's Office of Environment and Urban Programs is responsible for managing the Housing Guaranty Program and related technical assistance programs, while USAID's regional bureaus are responsible for authorizing them. Overseas, the programs are implemented primarily by USAID's Regional Housing and Urban Development Offices.

Results in Brief

Over the past 34 years, the focus and geographic scope of the Housing Guaranty Program have changed significantly. Program focus has expanded beyond home construction and mortgage financing to include urban infrastructure financing and governmental policy reform. Due to changes in international economic conditions and U.S. foreign and budget policies, more creditworthy and advanced developing countries are now the most likely recipients of loan guaranties. In addition to loan guaranties, USAID relies on technical assistance to implement the program.

The Housing Guaranty Program is in serious financial condition because program fees have not been sufficient to cover the cost of this program. In 1995 dollars,[1] program losses due to loan defaults have already cost the U.S. government over $540 million,[2] and GAO estimates that the cost of future defaults is likely to be an additional $600 million. Although USAID program officials believe that almost all defaulted borrowers will

[1]Unless otherwise noted, all figures are presented in 1995 dollars.

[2]$383 million in then-year dollars.

ultimately repay their debts, GAO estimates that USAID is likely to recover only about $200 million. As a result, the total U.S. government cost associated with the program's existing portfolio is likely to be about $1 billion.[3] This amount does not include several hundred million dollars in technical assistance that USAID has provided to implement the program but has not reported as a Housing Guaranty Program cost. The legislated ceiling on guaranties[4] did not effectively limit the U.S. government's overall investment in the program because defaulted loans, once repaid by USAID, are not counted against the ceiling.

Although the Housing Guaranty Program has contributed to shelter sector reforms in many participating countries, it has not stimulated increased private investment in low-income shelter, one of the program's long-run objectives. Further, in nearly every country visited for this review, GAO observed program-financed shelter projects that were outside the reach of the poorer families that the program is supposed to target. USAID documents also reflected this problem. For example, in India a USAID study indicated that 36 percent of program-financed home loans went to families with above-median incomes, and in Tunisia one sampling showed that 17 percent of eligible beneficiaries had incomes above the median. USAID's performance indicators do not adequately measure progress in achieving these objectives.

Since fiscal year 1992, the Congress has authorized new loan guaranties under this program and, as required by the Credit Reform Act, appropriated about $50 million to cover probable loan default costs associated with them. However, the Congress has done so without full knowledge of the U.S. government's liabilities from earlier guaranties and the other problems GAO has outlined in this report.

Principal Findings

Housing Guaranty Program Has Changed Significantly

Since the Housing Guaranty Program was introduced in the early 1960s, it has changed significantly in terms of the (1) profile of participating countries, (2) type of projects funded, and (3) implementation strategy. Historically, assistance under this program went primarily to countries in Latin America. Foreign policy considerations, U.S. credit reform, and the

[3]GAO's cost projections are rough and may vary over time depending upon market expectations for USAID's guaranty portfolio.

[4]This $2.6 billion ceiling applies only to loan guaranties authorized before fiscal year 1992.

1980s debt crisis have led to a program shift toward more creditworthy and advanced countries in other regions of the world. Some program activities, such as those in Israel and Portugal, were mandated by the Congress for specific foreign policy reasons. Due to the Federal Credit Reform Act of 1990, which requires appropriated funds to be set aside to cover probable loan defaults, USAID has been unable to maintain its historical volume of loan guaranties to higher risk borrowers with its existing budget authority. Recent programs have focused on countries such as Indonesia, India, Tunisia, and Thailand, which have relatively favorable credit ratings and, therefore, require smaller reserves for probable default.

With respect to the types of projects this program has funded, the program's loans were initially limited to financing housing built by U.S. contractors and local firms. Now, program loans are used to finance a wide variety of shelter-related projects that affect the urban environment in developing countries. Such projects have included urban renewal projects, sewage systems, water treatment facilities, and other infrastructure projects.

USAID's initial implementation strategy was to demonstrate the feasibility of building low-cost housing projects that could be replicated by local entrepreneurs and institutions. However, more recently, the goal has been policy reform in the recipient country. USAID has offered loan guaranties as incentives for governments to adopt more effective laws and policies on shelter and urban development. USAID also provides technical assistance as part of its efforts to achieve desired policy reform and institutional development objectives. The cost of this closely-linked assistance, totaling \$471 million[5] for USAID's ongoing projects, has been funded through USAID's regional bureaus.

Housing Guaranty Program Loses Millions Annually

Although the Congress specifically authorized USAID to charge fees to cover the cost of its Housing Guaranty Program, the program has been losing millions of dollars annually. Fee revenues have been adequate to cover administrative costs but not loan default costs. As a result, the total net cost of the program to the U.S. government is likely to be about \$1 billion. Based on audited financial statements and other financial information, GAO determined that since 1970 the program has received \$417 million[6] in appropriations and has borrowed \$125 million from the

[5]Amount is not adjusted for inflation.

[6]\$258 million in then-year dollars.

U.S. Treasury to finance losses due to loan defaults. The cost to the U.S. government of future loan defaults on USAID's portfolio is likely to be an additional $600 million. USAID has only enough reserves to cover about $50 million in defaults for loans authorized since fiscal year 1992.[7] Although program officials expect to recover nearly the full amount of all loan defaults, GAO estimates that USAID will ultimately recover only about $200 million.

In addition to these costs, USAID has committed several hundred million dollars in technical assistance to program participants. The cost of this assistance, although not reflected in the program's budget or financial statements, should be considered a cost of the program.

To date, USAID has been unable to collect much of the debts owed by defaulted borrowers and has continued to extend loan guaranties to countries in spite of repeated debt rescheduling. According to the program's financial statements, uncollected debt has more than doubled from $171 million in 1989 to $409 million in 1994.[8] Deferring repayment through multiple rescheduling of uncollected debts is common, and some debts have been rescheduled up to 10 times. By the end of fiscal year 1994, USAID had recovered only 5 percent of all rescheduled debt.

The $2.6 billion legislated ceiling on pre-fiscal year 1992 loan guaranties did not effectively limit the cost of this program to the U.S. government. The ceiling limited only the amount of guaranties outstanding at any one time. Thus, if a borrower defaulted on a guarantied loan and USAID made a principal payment to the lender, the outstanding guaranty was reduced. This allowed USAID to issue new guaranties under the ceiling, even though the borrower had not repaid (and may never repay) USAID for its default costs. Thus, USAID continued guarantying loans while over $400 million in uncollected debt accumulated, and the total amount of the U.S. government resources committed grew beyond the $2.6 billion ceiling. As of March 1995, USAID planned to guaranty $193 million more in loans that were authorized under this ceiling and are likely to result in over $50 million in default costs.

[7]Under the Credit Reform Act, USAID and the Congress must budget up-front for the estimated cost of probable defaults for guarantied loans authorized since fiscal year 1992. Therefore, the Congress has appropriated funds for the probable defaults of new loan guaranties under this program.

[8]This total does not include debts that USAID has written off as uncollectible. Amounts are not adjusted for inflation.

Impact on Low-Income Shelter Investment Is Not Evident

Although the Housing Guaranty Program has contributed to shelter sector reform in developing countries, it has not achieved one of its fundamental, long-run objectives. The program has not led to an increase in the availability of domestic capital to finance shelter projects benefiting poor families, particularly from private sources. The Foreign Assistance Act states that the program should demonstrate to local entrepreneurs and institutions the feasibility of investing in low-income shelter projects, thereby stimulating them to provide increased investment capital and other resources. USAID-sponsored projects have contributed to increased private managerial and technical involvement in the construction of state-financed shelter projects. However, USAID documents indicate that private credit institutions have not invested their own capital in similar projects as a result of this program. Instead, financing has come from the limited government resources of these countries.

In addition, the Foreign Assistance Act requires that at least 90 percent of the guaranties be issued for housing suitable for families with below-median incomes. However, USAID does not routinely ensure that the projects it finances actually benefit such families. In many cases, USAID relies on unvalidated reports from the borrowers to monitor the use of loan funds. In the countries visited for this review, GAO readily found instances where housing financed by the program did not appear to be benefiting low-income families. For example, GAO's review of the program in India revealed that some home improvement loans went to the above-median income employees of a participating bank. In some cases, USAID documents GAO reviewed confirmed that a significant portion of eligible program beneficiaries probably had above-median incomes. In other cases in the countries GAO visited, USAID studies acknowledged the potential for this problem.

USAID has not designed its performance indicators to measure the Housing Guaranty Program's progress in achieving the goals of stimulating private investments and providing shelter to below-median income families. Instead, USAID generally measures a variety of large-scale shelter sector changes that are not directly attributable to the program.

Matters for Congressional Consideration

The Congress may wish to deauthorize guaranties for undisbursed loans, where feasible, and terminate the Housing Guaranty Program because (1) the program is now primarily benefiting borrowers in more creditworthy and advanced developing countries that have access to comparable loans from other international lenders; (2) the program annually costs millions of dollars more than anticipated; (3) loans previously guarantied under the pre-1992 legislated ceiling continue to be disbursed, even though USAID has not collected over $400 million in defaulted debt; and (4) there is no evidence that the program has measurably increased the availability of private domestic capital for low-income shelter.

Other actions are warranted if the Congress believes that the goals of (1) stimulating domestic investment in the recipient countries (particularly private investment) and (2) targeting shelter assistance to below-median income families are possible to achieve and are of sufficient priority. Before authorizing additional loan guaranties, the Congress may wish to require USAID to submit a comprehensive plan to the appropriate congressional committees on how it plans to achieve the stated program goals, reduce losses, and return the program to a viable financial condition.

Recommendations

If the Congress does not terminate the Housing Guaranty Program, GAO recommends that the USAID Administrator take the following actions to (1) minimize the financial impact of the Housing Guaranty Program on the foreign assistance budget and the U.S. government budget deficit and (2) bring the program in line with the objectives of the Foreign Assistance Act:

- Withhold future loan disbursements and related technical assistance from borrowers that have repeatedly rescheduled debt repayments to USAID.
- Increase program revenues by adopting a fee structure designed to offset a larger portion of the program's costs.
- Ensure that performance indicators measure the extent to which (1) local investors replicate the program's low-income shelter projects using private sources of long-term financing and (2) project benefits accrue to the below-median income target population.

Agency Comments and GAO's Evaluation

In commenting on a draft of this report, USAID strongly disagreed with GAO's findings, arguing that the Housing Guaranty Program was a cost-effective method for pursuing development assistance and that the program had achieved the goals established by the Congress. USAID criticized the report for failing to adequately consider alternative program goals and congressional directions. USAID also asserted that the report was based on a flawed financial analysis and a distorted portrayal of program costs because of the use of 1995 dollars. Furthermore, USAID maintained that GAO did not adequately consider evidence that the program had successfully stimulated private investment and reached below-median income target populations. USAID suggested that termination of this program and deauthorization of guaranties might interfere with legally binding agreements and congressionally supported activities. USAID did not address the report's specific recommendations, since it contended that they were based upon incorrect information and a flawed analysis.

As a result of these comments, GAO modified its matters for congressional consideration and recommendations to (1) recognize that it may not be feasible to deauthorize all loan guaranties and (2) indicate that USAID should increase its guaranty fees to cover more of its costs. However, GAO's evaluation of these comments revealed that USAID had not credibly supported any of its broad and strongly worded criticisms. USAID did not identify any specific legislated program goals that GAO overlooked or any legal provisions that contradict the goals GAO focused on. USAID's criticism of GAO's financial analysis is unfounded and even disregarded its own most recent audited financial statements regarding probable losses from loan defaults. GAO's use of 1995 dollars reflects the true cost of the program more accurately than the use of then-year dollars, especially for costs incurred over many years. GAO denominated figures in both 1995 and then-year dollars, except in cases, such as the discussion of legislated ceilings, where it was not meaningful or possible to use 1995 figures. Furthermore, none of the additional data USAID provided (most of which GAO had already reviewed) undermined GAO's conclusions.

Contents

Abbreviations

OMB	Office of Management and Budget
RHUDO	Regional Housing and Urban Development Office
USAID	U.S. Agency for International Development

Chapter 1

Introduction

The Foreign Assistance Act of 1961, as amended, provides the framework for the Housing Guaranty Program (originally called the Housing Investment Guaranty Program). Since 1961, the Agency for International Development's (USAID) Office of Environment and Urban Programs, which is responsible for administering the program, has guarantied $2.7 billion in loans (valued at $5 billion in 1995 dollars) to 44 developing countries. The projects funded by the loans were intended to develop the countries' construction capabilities and encourage the countries' credit institutions to make domestic capital and other resources available for low-cost shelter programs.

Legal Framework

The U.S. government has provided a 100-percent guaranty on long-term loans from U.S. lenders to borrowers in developing countries to finance housing and shelter-related projects. If a borrower defaults on a loan payment, the U.S. government pays any principal, interest, and fees due to the lender. USAID then attempts to collect these funds from the defaulted borrower.

The Foreign Assistance Act places certain restrictions on the amount and use of these guaranties. For example, the face value of guaranties issued may not exceed $25 million per fiscal year in any country, and the average face value of all guaranties issued in a fiscal year may not exceed $15 million. Also, at least 90 percent of the loan funds must be used for projects suitable for the below-median income population. The Foreign Assistance Act also includes provisions regarding allowable interest rates, assessment of fees, coordination with other U.S. foreign assistance, and other administrative matters.

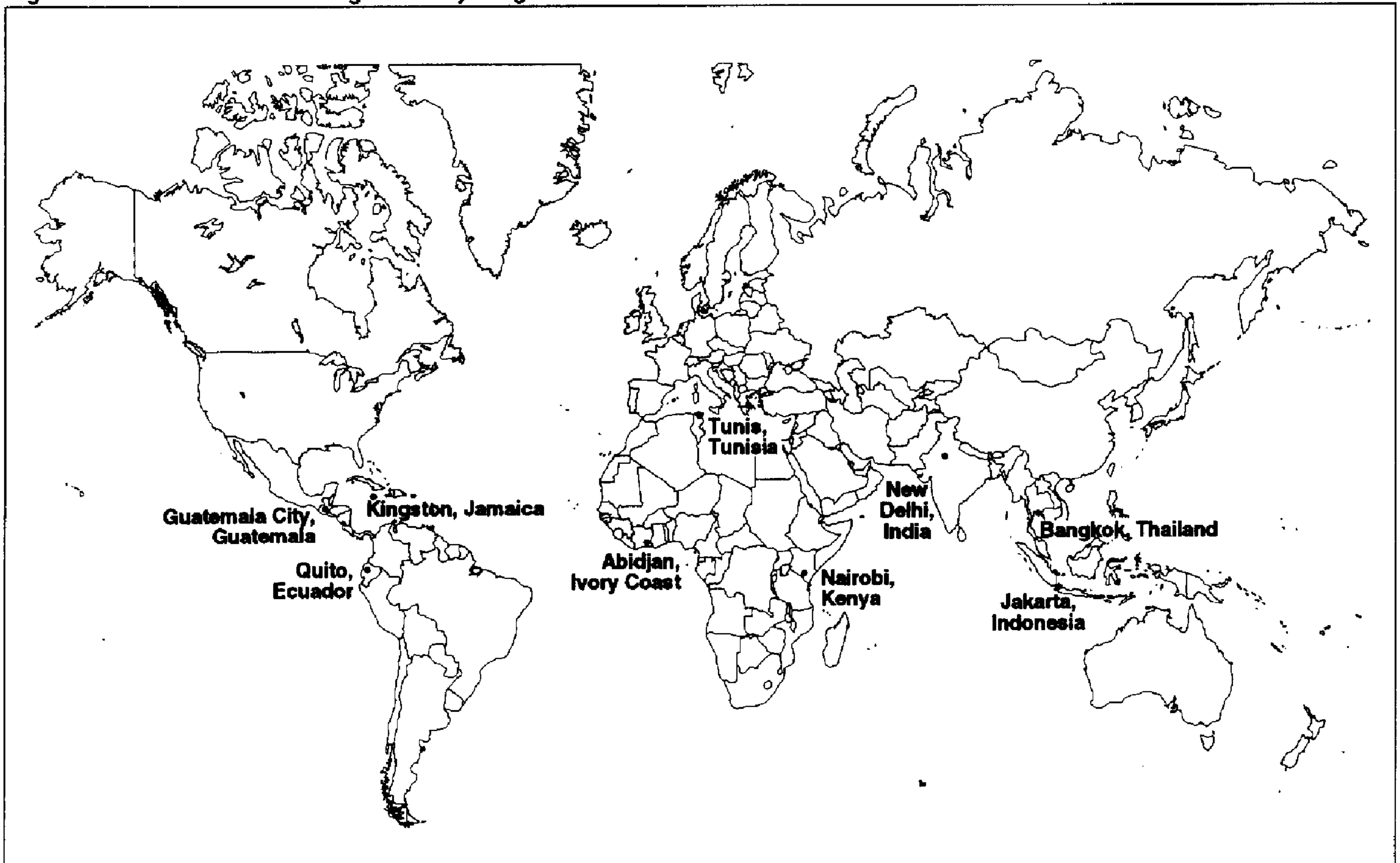
Loan Guaranty Process

USAID works in cooperation with host country officials to determine which activities will be financed through the Housing Guaranty Program. Borrowers have included government ministries, central banks, national housing banks, housing development corporations, and private financial institutions, such as cooperatives or savings and loan associations. U.S. lenders have included banks, insurance companies, and other financial institutions and investors. Because of the U.S. government guaranty, lenders bear virtually no risk—similar to investing in U.S. Treasury bonds. Lenders base loan interest rates, which can be either fixed or variable, on prevailing commercial rates plus a premium. The borrower and the lender negotiate the terms of the financing, subject to approval by USAID. Typically, Housing Guaranty Program loans are extended for 30 years, with a 10-year grace period on the repayment of the loan principal. Loans to governmental borrowers have a host country guaranty of repayment to USAID. Loans to private borrowers are backed by equivalent collateral but are not always guarantied by the host government. To pay for program operations, USAID charges borrowers an initial disbursement fee of 1 percent of the loan principal, an annual fee of 0.5 percent of the outstanding principal, and a fee for each day that a payment is late.

Organizations With Responsibility for Shelter Programs

USAID's Office of Environment and Urban Programs is responsible for administering the Housing Guaranty Program, including managing the loan portfolio and associated technical assistance. USAID's regional bureaus are responsible for authorizing both the loans and the technical assistance programs. Overseas, individual programs are implemented by USAID's seven Regional Housing and Urban Development Offices (RHUDO), located throughout the developing world with assistance, when necessary, from USAID's Regional Economic Development Support Offices and USAID missions. Figure 1.1 shows the locations of the major offices that administer the Housing Guaranty Program worldwide.

Figure 1.1: Locations of Housing Guaranty Program Offices Worldwide



Source: USAID.

The Office of Environment and Urban Programs and the RHUDOs employ about 60 direct-hire staff members and 70 contractors to implement this program.

Objectives, Scope, and Methodology

At the request of Representatives Toby Roth, Doug Bereuter, and Sam Gejdenson, members of the House Committee on International Relations, we conducted a comprehensive review of the Housing Guaranty Program's (1) evolution, (2) financial condition, and (3) impact. We performed our work at USAID offices in Washington, D.C., Chile, Ecuador, India, Indonesia, Morocco, Poland, and Tunisia. Programs in these countries reflected a wide variety of shelter-related projects and program objectives. We interviewed officials in USAID's Office of Environment and Urban Programs of the Bureau for Global Programs, Field Support, and Research; USAID Regional Bureaus; and other organizations with responsibilities related to the Housing Guaranty Program. We also met with representatives of private voluntary organizations and other USAID contractors involved in USAID's shelter programs in the United States and overseas. We also interviewed representatives of three multilateral organizations—the World Bank, the United Nations Development Program, and the United Nations Center for Human Settlement (commonly known as Habitat). We reviewed the legislative history of the Foreign Assistance Act and examined USAID records, including program documentation and evaluations.

To evaluate the program's financial condition, we reviewed the program's financial records, including audited financial statements for fiscal years 1989 through 1993, examined budget documents for fiscal years 1961 through 1994, and reviewed prior reports on the Housing Guaranty Program prepared by USAID's Office of the Inspector General and our office. We also interviewed officials of the USAID Office of Inspector General; Riggs National Bank in Washington, D.C. (which acts as the program's transfer agent); the accounting firm that conducted the most recent financial audit of the Housing Guaranty Program; and the Office of Management and Budget (OMB).

To estimate the U.S. government's probable costs due to nonpayment of USAID's existing loan guaranty portfolio, we applied an updated version of our method for estimating the cost of country risk associated with loan guaranties outstanding.[1] We developed our country risk ratings by statistically averaging two contemporaneous, professionally-accepted ratings—Euromoney and the Institutional Investor—and then transformed those ratings into a country risk cost using econometric estimates based on data from the secondary market. Cost estimates for USAID's loan guaranty portfolio using this method (as well as comparable methods) will change over time depending upon market expectations for this particular group of guaranties. Our method involves three issues that could qualify our cost estimates. Those issues are whether (1) our sample size of debt traded on the emerging market was large enough to capture the market's real behavior; (2) the price relationship we estimated for these traded instruments could be extended to proxy the prices of similar debt

[1]This method is presented in detail in Credit Reform: U.S. Needs Better Method for Estimating Cost of Foreign Loans and Guarantees (GAO/NSIAD/GGD-95-31, Dec. 19, 1994).

instruments held by the private sector but not traded; and (3) debt owed the private sector—from which our country risk cost estimates were derived—is as likely to be repaid in the long run as sovereign debt owed the U.S. government.

USAID's records did not allow us to categorize the use of guarantied loan funds by project type. Also, due to the unique nature of the Housing Guaranty Program in Israel, we specifically excluded it from the scope of our assessment of USAID's program management.

We performed our work from January 1994 through February 1995 in accordance with generally accepted government auditing standards.

Housing Guaranty Program Has Changed Significantly

The Housing Guaranty Program has changed considerably in scope and content since its inception in 1961. Though initially concentrated in Latin American countries, the program now operates in developing countries in Africa, Asia, and the Middle East and increasingly in more creditworthy and advanced developing countries. Similarly, the program's focus has expanded from basic housing construction to a variety of projects that address the broader needs of the urban environment. The program's strategy has shifted from simply demonstrating the feasibility of constructing low-income housing to reforming shelter sector policy in borrowing countries. In addition, the provision of technical assistance has become a fundamental part of the program.

Advanced Developing Countries Are Likely Loan Recipients

The debt crisis of the 1980s, U.S. credit reform, and foreign policy considerations have influenced USAID to change the type of countries likely to participate in the Housing Guaranty Program. The result has been an increase in guarantied loans authorized for more creditworthy and advanced developing countries and for countries specified by the Congress.

Due in part to the worldwide recession of the mid-1980s and the resulting debt crisis, many borrowing countries in Latin America and Africa began to default on payments on their large portfolio of international debt and became high credit risks.

In 1990, the Congress passed the Credit Reform Act, which required each government department or agency to recognize its potential financial liability for each loan authorized and disbursed after fiscal year 1991. Prior to the act, USAID, like other agencies, treated a guaranty as having no cost unless and until the borrower defaulted. Under the Credit Reform Act, USAID must set aside a reserve to cover the estimated future cost of loans guarantied, including default costs. The amount of the reserve is based on an OMB-approved assessment of the borrower's creditworthiness, which reflects the probability that the borrower will default: the greater the credit risk, the higher the subsidy required. Disbursement of loans is restricted by the extent to which appropriations are available for the reserve.[1] In response, USAID has ceased to authorize new loan guaranties to many of the less creditworthy countries of Latin America and Africa that had historically benefited from the program. Although the Credit Reform Act has changed the financing for this program and influenced USAID's

[1]USAID has obtained over $50 million in appropriations since fiscal year 1992 to set up such reserves for new loan guaranties.

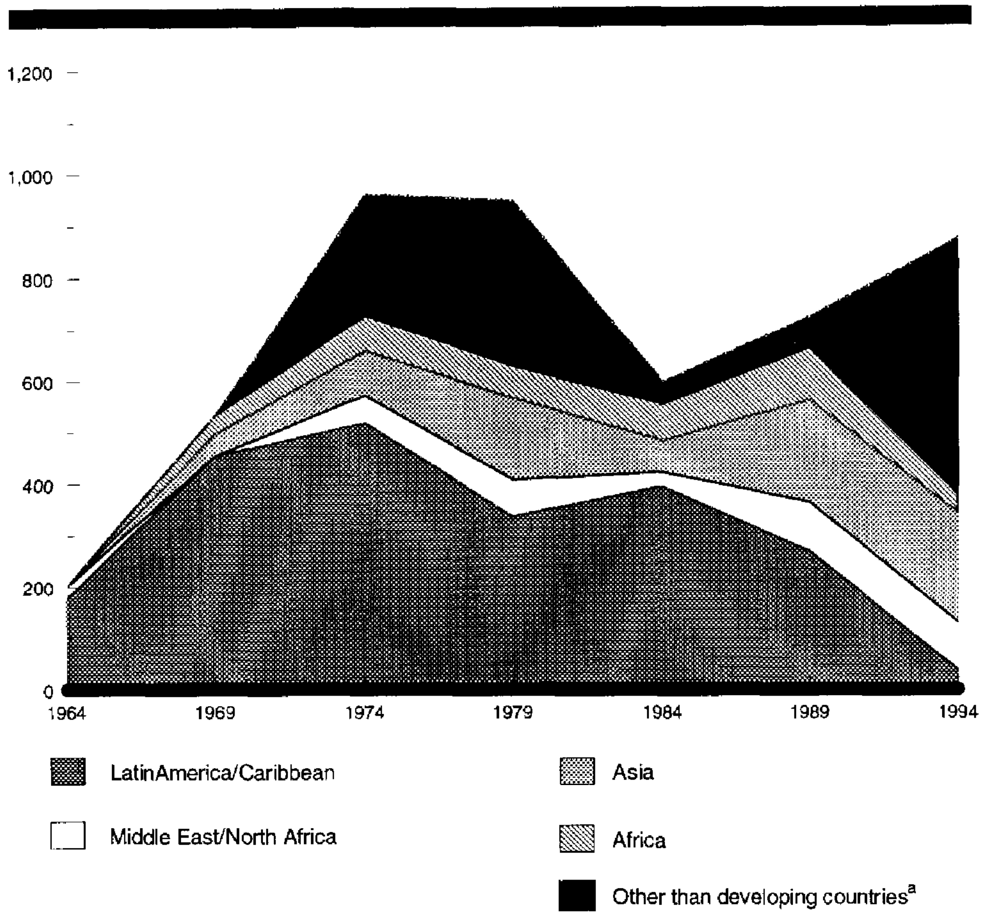
selection of borrowers, the program has continued to operate under the same authorizing legislation and guidelines.

To cope with the budgetary constraints imposed by this legislation, USAID has begun to concentrate its new loan programs in more creditworthy countries, for which smaller reserves are required. Since Credit Reform measures were enacted, USAID has authorized new guaranties for countries such as India, Indonesia, Tunisia, and Thailand, which have relatively favorable credit ratings. Because of their relatively low credit risk, such countries have ready access to capital from international credit markets.

Foreign policy considerations have also caused USAID to devote a large portion of its guarantied loans to several more developed countries. For example, a program in Portugal was mandated by the Congress in the 1980s as part of an economic support package in exchange for maintaining U.S. military base rights in the Azores. In 1990, $400 million in guaranties were authorized for Israel in response to its request for help in coping with the housing needs of Soviet immigrants. More recently, loan guaranties for Poland, the Czech Republic, and Hungary have been authorized as part of a larger U.S. effort to encourage democracy and promote free market systems in countries of Eastern Europe and the former Soviet Union.

Figures 2.1 and 2.2 and table 2.1 show the geographic breakdown of borrowing, by region and by country, in terms of dollars lent since the Housing Guaranty Program's inception.

Figure 2.1: Regional Distribution of Housing Guaranty Program Loans
(Fiscal Years 1964-94) (in Millions of 1995 Dollars)



[a]Israel, Portugal, and Poland.

Note: Shaded areas reflect total volume of guarantied loans contracted in respective regions during 5-year intervals. No loans were contracted prior to fiscal year 1964.

Source: Our analysis of USAID data.

Table 2.1: Value of Loans Guaranteed by USAID Under Housing Guaranty Program by Country (as of Sept. 30, 1994)

Dollars in millions

Country/regional bank	Face value of loans guarantied	Value of loans guarantied in 1995 dollars
Belize	$2.0	$2.9
Mauritius	4.0	5.4
Ethiopia	1.5	5.5
Guyana	1.6	6.7
Paraguay	4.0	9.3
Poland	10.0	10.2
Interamerican Savings and Loan Bank	6.0	11.9
Barbados	10.0	14.9
Botswana	9.9	15.9
Senegal	5.0	20.5
Republic of China	4.8	21.2
Iran	7.5	23.6
Pakistan	25.0	26.2
Zaire	10.0	33.5
Philippines	35.0	36.9
Thailand	15.0	37.0
Guatemala	17.7	45.1
Lebanon	30.0	45.5
Morocco	43.5	48.8
Mexico	10.8	50.2
Bolivia	28.4	59.4
Nicaragua	16.0	60.0
Dominican Republic	17.0	66.1
Jordan	55.9	66.3
El Salvador	25.9	71.0
Costa Rica	40.0	71.5
Sri Lanka	60.0	83.4
Zimbabwe	65.0	88.6
Kenya	50.0	90.7
Ecuador	63.2	105.0
Colombia	26.9	118.8
Honduras	68.1	119.4
Cote d'Ivoire	70.9	125.1
Indonesia	120.0	133.5
Argentina	39.7	154.9

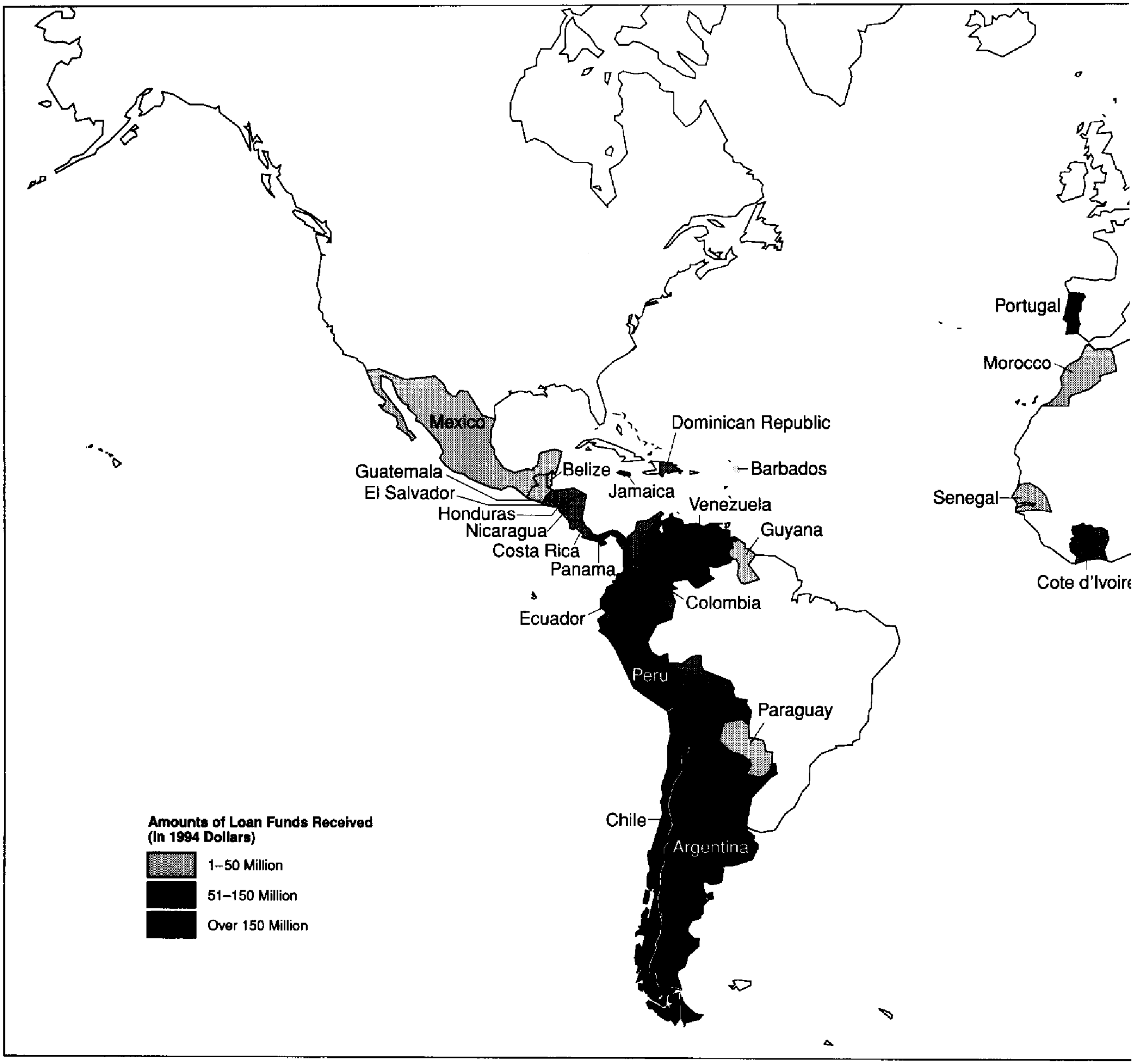
(continued)

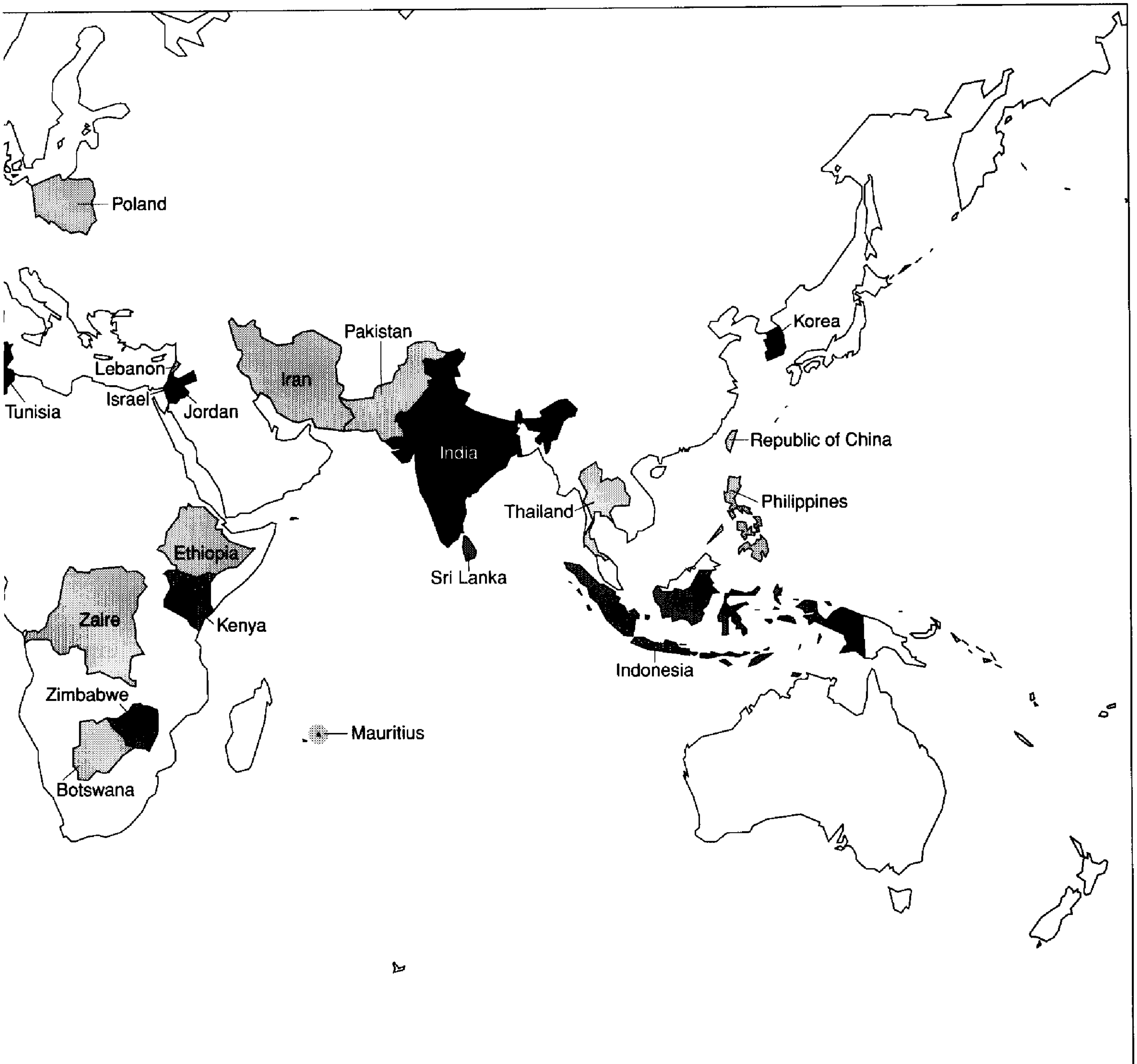
Dollars in millions

Country/regional bank	Face value of loans guarantied	Value of loans guarantied in 1995 dollars
Chile	79.7	173.0
Panama	87.3	177.0
Tunisia	108.0	183.5
India	155.0	189.5
Venezuela	51.4	199.7
Portugal	140.0	215.5
Jamaica	123.3	223.3
Peru	103.7	226.0
Korea	95.0	251.9
Central American Bank for Economic Integration	139.9	267.1
Israel	600.0	959.5
Total	**$2,683.6**	**$4,950.9**

Source: Our analysis of Housing Guaranty Program Financial Summaries.

Figure 2.2: Countries That Have Received Housing Guaranty Program Loan Funds





(Figure notes on next page)

Note: Does not include loans to two regional banks serving multiple Central American countries.

Source: Our analysis of USAID data.

Scope of Program Has Extended Beyond Housing Projects

The Housing Guaranty Program originally provided financing for U.S. construction firms to build housing projects in Latin America to demonstrate advanced methods of construction and finance that could be replicated in the borrowing country. In 1965, the Congress reoriented the program toward "institution building"—financing demonstration projects developed by local institutions so that they could gain direct experience and continue to build low-cost homes.

In 1975, the Congress changed the authorizing legislation to require that at least 90 percent of future guaranties be issued for housing suitable for families with incomes below the median income of the borrowing country.[2] The Congress also directed that the Housing Guaranty Program complement other development assistance programs and that housing projects demonstrate the "feasibility and suitability of particular kinds of housing or financial or other institutional arrangements." As a result of these legislative changes, the focus was on financing low-cost, minimum standard housing projects designed to be affordable to the poor.

In 1985, the word "housing" was replaced with the word "shelter" in the Foreign Assistance Act, and the scope of the program was expanded to include "essential urban development services." USAID interprets the broader language of the legislation as including any shelter-related project that affects the greater urban environment, including infrastructure projects.

USAID currently guaranties loans in developing countries for the following categories of projects:

- finance projects for housing and infrastructure development, such as potable water, sewerage, electricity, and roads, designed to be affordable to below-median income families;
- institution-building projects to develop or enhance housing finance systems, such as mortgage banking networks;
- urban environment projects designed to manage urban growth and improve municipal administration; and
- projects that enhance local governance and municipal management to foster broad-based participation in the governance of urban communities.

[2]The International Development and Food Assistance Act of 1975.

The following are examples of the wide variety of uses of guarantied loan funds we observed in the countries we visited.

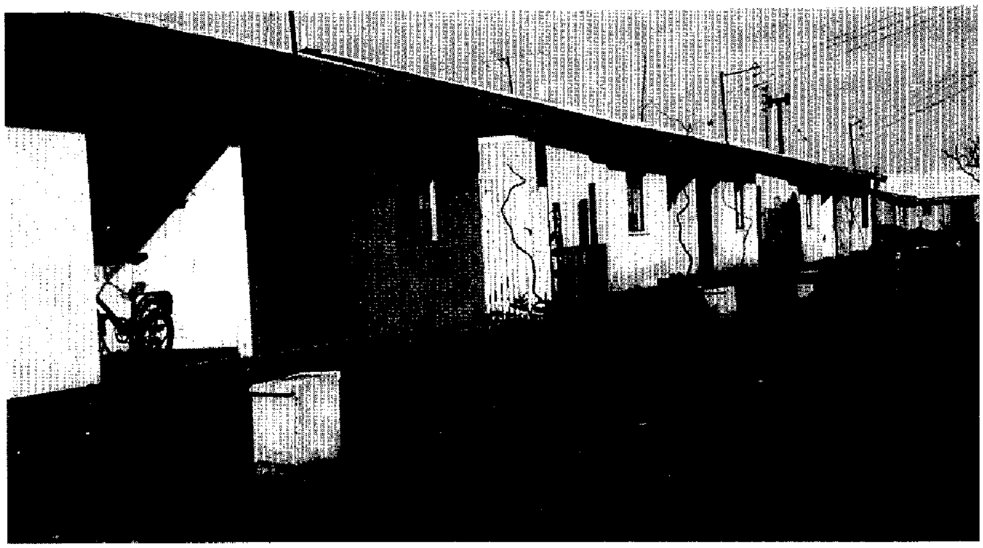
- In Ecuador and India, loans financed mortgages and home improvement loans, aimed at involving private financial institutions in long-term shelter financing.
- In Indonesia, loans financed the construction of drainage ditches, public toilets, roads and walkways, and water supply and treatment facilities, aimed at promoting the development and management of environmental infrastructure by local governments.
- In Tunisia, loans financed serviced housing sites and sewer extensions to slum dwellers, aimed at stimulating the production of more affordable sanitary shelter.

Figures 2.3 through 2.8 are pictures of some projects financed through the Housing Guaranty Program in the countries we visited.

Figure 2.3: New Housing With Mortgages Financed by Housing Guaranty Program in Carapungo, Ecuador

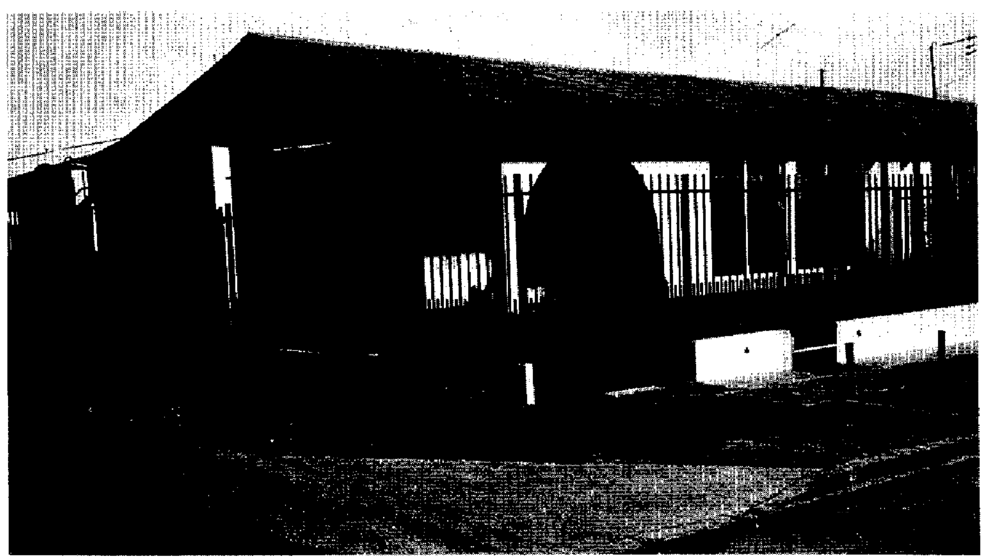
Source: Ecuadorian Housing Bank.

Figure 2.4: Housing With Construction Financed by Housing Guaranty Program in Parral, Chile



Source: GAO.

Figure 2.5: Owner-Improved Housing With Original Construction Financed by Housing Guaranty Program in Parral, Chile



Source: GAO.

Figure 2.6: Housing and Infrastructure Financed by Housing Guaranty Program in El Mourouj, Tunisia

Source: GAO.

Figure 2.7: Housing Built on Sites With Infrastructure Financed by Housing Guaranty Program in Larache, Morocco

Source: GAO.

Figure 2.8: Footpath and Drainage Ditch Financed by Housing Guaranty Program in Kecamatan, Indonesia

Source: GAO.

Current Strategy Focuses on Policy Reform and Technical Assistance

For many years, USAID used the Housing Guaranty Program primarily to develop demonstration projects that USAID hoped would be replicated by local entrepreneurs and institutions. However, USAID has begun to use the program primarily to leverage policy reforms that are intended to have positive long-term effects on the borrowing countries' shelter sectors. According to USAID officials, the loan guaranties have served as incentives for recipient countries to enact USAID-recommended reforms. In some cases, specific reforms are preconditions for receiving loans. In addition, according to RHUDO officials we spoke to, the loans afford USAID day-to-day influence on policymakers in the host country: the loans "buy USAID a seat at the table" where shelter policy is made.

Policy reform objectives associated with the Housing Guaranty Program have included

- in Chile, enacting laws to establish a mortgage-backed securities market intended to facilitate investment in low-income mortgages by pension funds and other private investors;
- in Ecuador, adopting an accounting unit for housing finance indexed to inflation (called the constant value unit), intended to facilitate private investment in housing in a climate of high inflation;
- in Indonesia, strengthening local governments' ability to develop urban infrastructure by allowing the governments to retain 100 percent of property tax revenues collected and by reducing the central government's direct involvement; and
- in Tunisia, converting a central government agency from a direct producer of individual housing lots to a wholesaler of land to private developers.

Technical Assistance Is Integral to Program

Consistent with its policy reform strategy, USAID has increasingly relied on technical assistance to implement the Housing Guaranty Program.[3] USAID is providing technical assistance, through contracts, for all of its ongoing projects at a cost of $471 million.[4] According to program officials, USAID's regional bureaus provide the funding for this technical assistance from the Development Assistance, Economic Support Fund, and other program accounts.

In the countries we visited, technical assistance was provided as part of USAID's efforts to achieve desired policy reform and institutional development objectives.

- In Indonesia, USAID-funded technical advisors in four government agencies helped implement decentralization policies intended to lead to more efficient development of urban infrastructure projects by local governments.
- In India, a USAID-funded seminar resulted in the development of a government action plan to introduce fundamental urban policy changes intended to facilitate private sector participation in infrastructure development.

[3]Technical assistance consists of consultants, training, equipment, facilities, and other assistance provided to the borrower and other institutions participating in the program.

[4]Amount is not adjusted for inflation.

- In Poland, USAID-funded seminars and consulting services, including a program to train employees of nine banks in mortgage underwriting, enabled local financial institutions to originate sound mortgages.
- In Ecuador, USAID-funded technical assistance helped the city of Quito's Municipal Water Company find ways to reduce its construction costs and improve water service to the city's marginal neighborhoods.
- In Morocco, extensive technical assistance, including funding for consultants, computer equipment, and vehicles, was provided to the city of Tetouan to help it improve municipal management of urban infrastructure, including project planning, construction, and cost recovery.

Housing Guaranty Program Is in Serious Financial Condition

The Housing Guaranty Program is not self-sustaining. Although the Congress specifically authorized USAID to charge borrowers fees to cover costs, the cost to the U.S. government of the existing loan guaranty portfolio is likely to total about $1 billion (in 1995 dollars).[1] The Housing Guaranty Program has already received $542 million in appropriations and U.S. Treasury borrowings to finance earlier losses resulting from loan defaults. In addition, we estimate the cost of future loan defaults to be about $600 million more. Projected program revenues are not adequate to cover administrative and default costs. Although program officials expect to recover most of the losses from defaulted borrowers, we estimate USAID will ultimately recover only about $200 million. These costs do not include several hundred million dollars in technical assistance that USAID has provided to implement the program but has not reported as a program cost. Moreover, the legislated ceiling on loan guaranties was not effective at limiting the U.S. government's financial investment in this program, since it allowed USAID to issue new guaranties even though defaulted borrowers had not repaid their outstanding debts.

Program Has Already Incurred Significant Costs for Loan Defaults

The President's annual budgets for fiscal years 1971 through 1975 indicate that the Housing Guaranty Program was originally intended to be self-sustaining. The documents stated that "consistent with the intent of the Congress that the housing programs be totally self-supporting, the costs of administration, program evaluation and development, and claims investigations are paid from fee income." However, fee income has not been adequate to cover all program costs, and USAID has required $542 million in inflation-adjusted appropriations and U.S. Treasury loans. Although historical financial information for this program is incomplete, we determined, based on a review of audited financial statements and budgetary documents, that from fiscal years 1970 to 1994, the program had experienced at least $542 million in losses due to loan defaults. USAID financed these losses with $258 million in appropriations ($417 million in 1995 dollars) and $125 million in loans from the U.S. Treasury.[2]

[1]Unless otherwise noted, all figures are presented in 1995 dollars.

[2]A more precise accounting of total losses was not available because financial records prior to fiscal year 1989 are incomplete and unreliable. Prior to 1968, an undisclosed amount of administrative expenses were paid from USAID's general appropriation instead of from program revenues. In fiscal year 1970, the Congress provided the program a reserve fund of $50 million and another $40 million in 1985 to cover expenses associated with borrower defaults. Having expended these reserves, from fiscal years 1987 to 1992 the program borrowed, but has not yet repaid, $125 million from the U.S. Treasury, and from fiscal years 1992 through 1994, USAID received $168 million in appropriations to fund the program's annual shortfalls. Adjusted for inflation, these figures represent a total of $542 million that USAID required to finance program losses.

USAID's reported program costs do not include several hundred million dollars that it has committed for technical assistance to implement this program, as described in chapter 2. USAID does not report the cost of this assistance as a Housing Guaranty Program expense in its budget or financial statements, because the cost is funded from other USAID program accounts. However, we believe that much of this assistance amounts to closely-linked cross subsidies to program participants, and including them in reports on the cost of the program is reasonable.[3] Although USAID's ongoing technical assistance is currently estimated to cost $471 million,[4] historical cost information was not available. Therefore, the total cost of technical assistance associated with this program is unknown, though it is probably much higher than this amount.

Projected Future Default Costs Total About $600 Million

Our analysis of the program's outstanding loan guaranty portfolio and the risk profile of current borrowers indicates that over the remaining life of the portfolio USAID will likely have to make principal and interest payments now valued at $600 million on behalf of borrowers that do not fully repay their loans.[5] These cost projections are rough and will vary over time depending upon market expectations for the portfolio. According to the program's fiscal year 1993 audited financial statements, USAID estimates this liability at over $700 million.

USAID has no reserves to fund this liability, except for about $50 million in appropriations it obtained to finance projected default costs associated with loan guaranties authorized after the Credit Reform Act took effect. The remaining default costs will be financed with budget authority established for such unfunded liabilities under the Credit Reform Act.[6]

[3] We developed two criteria for defining a closely-linked cross subsidy program. They are that (1) the appropriation for the cross subsidy program directs assistance to the credit program participants and (2) the government's commitment of the two programs is obligated concurrently. For a more detailed discussion of closely-linked cross subsidies, see Credit Reform: Case-by-Case Assessment Advisable in Evaluating Coverage and Compliance (GAO/AIMD-94-57, July 28,1994).

[4] Amount is not adjusted for inflation.

[5] To determine the probable default costs associated with USAID's pre-Credit Reform loan portfolio, we applied an updated version of our method for estimating the cost of country risk associated with loan guaranties outstanding. Our country risk ratings were developed by statistically averaging two contemporaneous, professionally accepted ratings—Euromoney and the Institutional Investor. Our method transformed country risk ratings into country risk cost using econometric estimates on data derived from the secondary market.

[6] The Credit Reform Act requires that loans disbursed before fiscal year 1992 be budgeted and accounted for on a cash basis. The act provides permanent, indefinite budget authority to fund defaults from such loans to the extent that the defaults are not covered by funds available in the credit liquidating account from prior year surpluses.

USAID's unfunded liability includes costs associated with $193 million in loan guaranties it authorized before the Credit Reform Act took effect but had not contracted or disbursed as of March 1995. Some of these loans are to countries with relatively poor credit risk ratings, such as Ecuador and Jamaica. If USAID deauthorizes these loan guaranties instead of disbursing the loans as currently planned, future default costs could be reduced by over $50 million.

Future Fee Revenue Will Be Inadequate to Cover Costs

Based on our analysis of the Housing Guaranty Program portfolio, projected revenues will continue to be inadequate to cover future defaults and other program costs. Presented in present value terms, we estimate that from fiscal years 1995 through 2024, USAID's program expenses for the current portfolio are likely to total about $800 million: about $600 million in default costs, about $80 million in administrative costs,[7] and $125 million to repay funds it still owes to the U.S. Treasury to cover earlier program losses. However, USAID is likely to collect less than $100 million in fees during this period.[8]

The Foreign Assistance Act authorizes USAID to charge borrowers fees to cover the cost of this program. However, despite the significant losses incurred and anticipated for this program, USAID has not taken any steps to increase fee revenues. The program's existing fee structure has remained virtually unchanged since fiscal year 1972. Specifically, on new loans borrowers are assessed a 1-percent initiation fee and an annual fee of 0.5 percent of the outstanding loan balance, regardless of credit risk.

In its audit report on the program's fiscal year 1991 financial statements, USAID's Inspector General recommended that USAID managers consider implementing a risk-based fee structure, and USAID has funded two consultant studies to examine this issue. One study showed that an increase in annual fees to 1.5 percent of the outstanding loan principal for fiscal years 1971 through 1990 would have eliminated the need for $165 million (nearly $200 million in 1995 dollars) in appropriations and U.S. Treasury borrowing during that period. Another study indicated that

[7]Administrative costs were assumed to be a constant percentage of the probable outstanding loan balance for the next 10 years and were estimated based on fiscal year 1994 appropriations figures. We further assumed that after 10 years, the administrative costs associated with the existing portfolio would be negligible.

[8]Fee income includes initiation fees, annual fees, and USAID late fees. Late fees (charged at the loans contracted rate of interest) were assumed to be a constant percentage of the outstanding loan balance and were estimated based on actual fiscal year 1993 figures. This estimate assumes the same probable default rate for annual fees as we used for principal and interest payments.

the program's fees are in the middle range of similar fees charged by other international lenders. Both studies stated that an increase in fees could negatively affect the willingness of countries to participate in the program, although few other lenders offer the attractive 30-year repayment terms that the Housing Guaranty Program does. According to one study, charging higher fees for certain borrowers could be politically embarrassing for USAID.

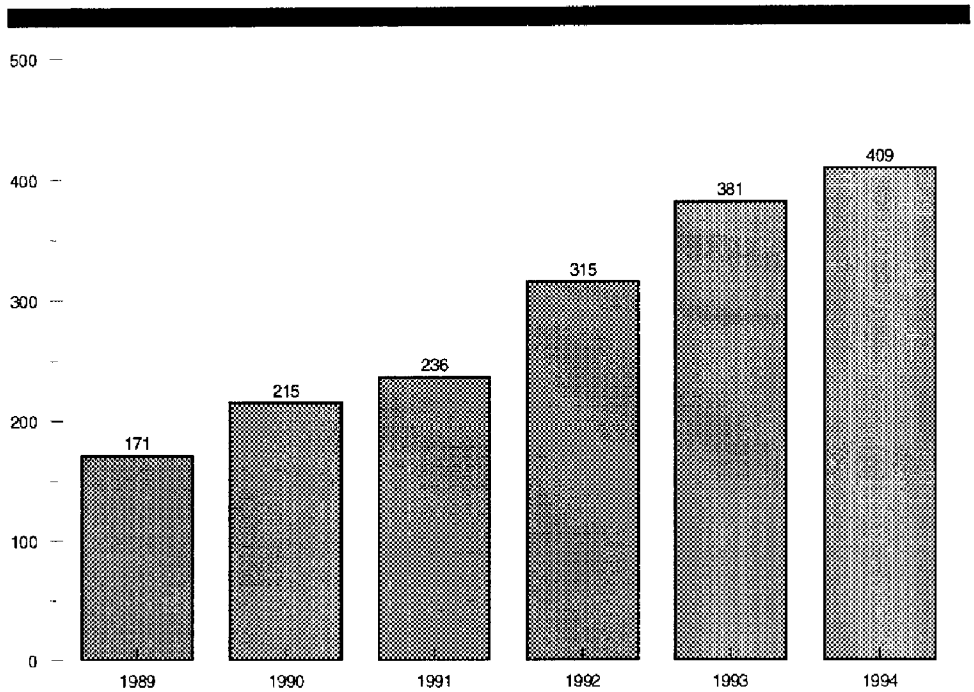
Our assessment of the program's financial condition indicates a necessity to raise fees in order to make the program as self-sustaining as possible. Even with higher fees, USAID-guarantied loans would likely remain attractive to many developing countries because of their low interest rates, lengthy repayment terms, foreign exchange value, accompanying technical assistance, and the increased financial credibility associated with receiving U.S. government credit. Also, as one of USAID's consultant studies indicates, USAID could raise its fees and still remain competitive with other international lenders.

USAID Is Unlikely to Recover a Growing Amount of Defaulted Debt

Our review of USAID's financial records indicates that the amount of debt that defaulted borrowers owe USAID has been escalating in recent years. Figure 3.1 shows that, not adjusted for inflation, uncollected debt more than doubled, from $171 million in fiscal year 1989 to $409 million in fiscal year 1994. This debt consists of defaulted principal, interest, and fees. Based on our analysis of USAID's portfolio of rescheduled debt, we estimate that USAID can ultimately expect to recover only about one-half of this debt, or about $200 million. According to the program's fiscal year 1993 audited financial statements, the most recent available, USAID is likely to collect only about $30 million of this debt (see table 3.1 for a comparison of USAID's and our analyses of program cost). In addition to this defaulted debt, USAID has incurred over $100 million in other unrecoverable program costs over the life of the program.[9]

[9]Unrecoverable costs include default costs USAID has "written off" ($39 million in then-year dollars), including default costs for a loan to the Imperial Government of Iran and 31 pre-1973 loans to nonsovereign borrowers with no host government guaranty of repayment. USAID has been making principal and interest payments on these loans for many years but has recovered virtually none of its costs and does not expect to recover them. A precise accounting of all unrecoverable costs was not possible, because financial records provided to us for periods prior to fiscal year 1989 are incomplete and unreliable.

Figure 3.1: Cumulative Uncollected Housing Guaranty Program Debt Owed to USAID (Fiscal Years 1989-94) (Dollars in Millions)



Note: Amounts are not adjusted for inflation.

Source: USAID Office of the Inspector General Audit Reports and our analysis of Housing Guaranty Program Financial Summaries.

Table 3.1: Comparison of USAID and GAO Analyses of Program Cost to the U.S. Government

Dollars in millions

Program funding	Fiscal year(s)	Cost: USAID financial records	Cost: GAO analysis (1995 dollars)
Appropriation for reserve	1970	$50	$185
Appropriation for reserve	1985	40	55
Net U.S. Treasury borrowings	1987-91	125	125
Appropriations for administrative and default costs on pre-Credit Reform guaranties	1992-94	168	177
Appropriations for future default costs of post-Credit Reform guaranties	1992-94	49	50
Appropriations for default costs of pre-Credit Reform guaranties, net of recoveries	1995-2025	707	575
Estimated recoveries from about $400 million of defaulted loans outstanding as of September 30, 1994	1995-2025	(29)	(200)
Total		**$1,110**	**$967**

Housing Guaranty Program officials believe that USAID is likely to recover nearly all of this debt. This belief is based on their observation that over the past 4 years many of the defaulted borrowers in Latin America have undergone fundamental economic changes, resulting in increasing creditworthiness. This economic improvement, they believe, is unlikely to be reversed, and the long-term trend for these countries is positive. The officials did not provide any specific estimates of probable defaults. Our review indicates that USAID's forecast is unreasonably optimistic; it is essentially based on intuition rather than sound analysis. In our December 1994 report on credit reform, we showed that the probability of default for most of the Latin American countries with the greatest Housing Guaranty Program debt, despite recent economic improvements, still exceeded 50 percent.

Instead of immediately repaying defaulted debt to USAID, borrowing countries have increasingly rescheduled their debts to the United States through bilateral agreements under the Paris Club.[10] The borrowing countries agree to repay this debt along with other debt they owe to the

[10]When foreign countries are unable to meet their external debt obligations owed to governments, the Paris Club is the mechanism the United States and other official creditors use to reschedule the debt. Paris Club meetings are organized by the French Finance Ministry. The Department of State represents the U.S. government in Paris Club negotiations.

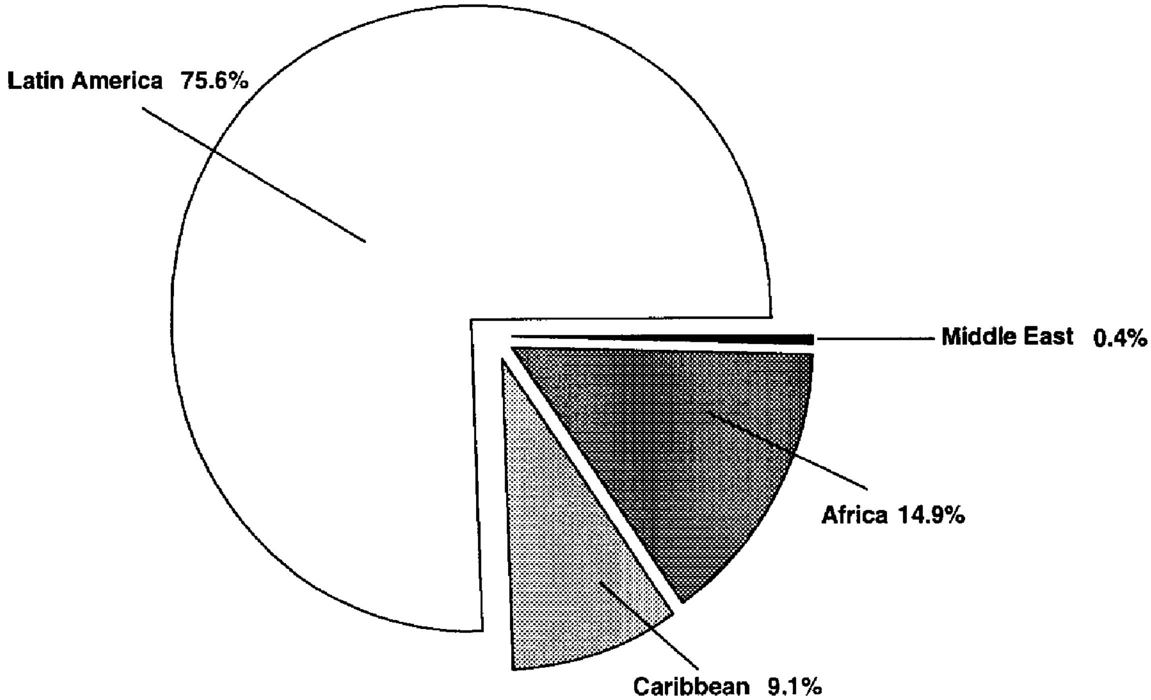
U.S. government, with interest, over an extended period of time. The rescheduled debt includes all outstanding debt payments a country has defaulted on or is in imminent default on. Multiple rescheduling of rescheduled debt to defer repayment is common; in fact, one borrower has rescheduled its debt 10 times. As a result, by September 30, 1994, USAID had collected only about 5 percent of all rescheduled debt.

USAID has, in effect, provided additional benefits to borrowers that rescheduled their debts instead of paying them immediately. For example, we identified 12 cases since 1985 in which USAID authorized new disbursements of Housing Guaranty Program loans to countries that had recently rescheduled (or were in the process of rescheduling) debt to USAID.[11] USAID provided new guarantied loans for four countries (Ecuador, Jamaica, Jordan, and Panama) despite repeated rescheduling of old debt. According to USAID officials, USAID waives initiation and annual fees on rescheduled loans to encourage repayment of the original loan amount. This has amounted to a waiver of over $11 million ($10.6 million in then-year dollars) in fees for fiscal years 1987 through 1994.

Figure 3.2 shows the distribution of uncollected debt by geographic region (see app. I for outstanding guarantied loan balances and unpaid debts by country).

[11]This occurred for Bolivia, Costa Rica, Chile, Ecuador, Jamaica, Jordan, and Panama.

Figure 3.2: Geographic Distribution of Uncollected Debt Owed to USAID (as of Sept. 30, 1994)



Source: Our analysis of Housing Guaranty Program Financial Summaries.

Legislated Ceiling Did Not Limit Financial Commitment

The legislated ceiling on loan guaranties has not been effective at limiting the U.S. government's financial commitment under this program. The Foreign Assistance Act authorized USAID to issue guaranties for up to about $2.6 billion in loans before fiscal year 1992.[12] When loan principal was repaid, USAID reduced the liability it recorded under the ceiling, allowing it to issue a corresponding amount of new loan guaranties. This occurred even when USAID was required, as guarantor, to make a payment on behalf of a borrower. These amounts paid by USAID are no longer guarantied loans but a program asset due from a borrower and are therefore no longer

[12]Beginning in fiscal year 1992, new loan guaranties were not subject to this authorized ceiling, but were required to be authorized individually in accordance with the provisions of the Credit Reform Act.

counted against the loan guaranty ceiling. Thus, USAID continued to issue new loan guaranties while the total amount of uncollected debt grew. As a result, by fiscal year 1995, the total amount of U.S. government resources committed by USAID had grown to $2.8 billion,[13] despite the authorized ceiling of $2.6 billion. If USAID had been required to include uncollected debt under the ceiling, it would have been unable to issue $200 million in loan guaranties, reducing the probable cost of loan defaults by about $50 million.

[13]This figure reflects the face value (not the 1995 value) of all guarantied loans outstanding and uncollected debt. It does not include $355 million in loan guaranties authorized since September 30, 1992, which are subject to the provisions of the Credit Reform Act and do not fall under the Foreign Assistance Act ceiling.

Program's Impact on Low-Income Shelter Investment Is Not Evident

The Housing Guaranty Program and related technical assistance have contributed to many improvements in the shelter sectors of participating countries. However, USAID has not achieved a major long-run objective of the program as envisioned in the Foreign Assistance Act: to increase private investment in shelter for poor families. The program has not convinced local entrepreneurs and private institutions that investing their capital in lower income shelter is financially viable. In addition, USAID's implementation of the program has not ensured that at least 90 percent of guarantied loan funds were spent on projects directly benefiting families below the median income level, the program's target population. Finally, USAID has not designed its performance indicators to measure progress toward the program's objectives.

Program Has Not Stimulated Investment

Despite over 30 years in operation, the Housing Guaranty Program has not increased private investment in low-income shelter. According to the Foreign Assistance Act, the program was intended "to increase the availability of domestic financing for low cost shelter by demonstrating to local entrepreneurs and institutions that providing this shelter is financially viable." In the seven participating countries we visited, the program has helped bring about some improvements in these countries' shelter markets. However, the program has not stimulated local credit institutions to make private investment capital available for low-income shelter projects.

The program can be credited with helping countries increase participation by private institutions in state-financed shelter production. However, these institutions have not increased their own investment in the low-income shelter sector. The following examples illustrate the limited involvement of private sector investment in the Housing Guaranty Program.

- In India, the Housing Guaranty Program was aimed at increasing private sector financing of low-income housing. To this end, the program has helped India's National Housing Bank finance low-cost mortgages and home improvement loans through private housing finance corporations. However, the housing finance corporations have not invested their own capital in these types of projects. Thus, a 1994 evaluation of the India program, conducted by a USAID contractor, indicated that USAID had not met the goal of increasing the availability of private housing finance for low income households, but rather established another conduit for distributing public resources.

- In Ecuador, the government dominates the formal development of low-income housing. The most recent Housing Guaranty Program effort in that country was aimed at involving commercial banks, credit unions, and savings and loans in low-cost housing development by providing below market rate investment capital through the state-run Ecuadorian Housing Bank. Officials of several of these institutions told us that although their involvement in the USAID program was financially satisfactory, they did not plan to invest their own capital in similar projects.
- In Chile, the government provides families with direct subsidies and loans to purchase homes, but the demand for affordable housing has exceeded the supply, and many families cannot take advantage of the government financing. Two of USAID's recent programs in Chile provided short-term construction financing to three cooperatives to encourage them to satisfy some of this housing demand. In addition to Housing Guaranty Program financing, the cooperatives have been able to obtain additional short-term, market rate construction loans from commercial banks. However, when the homes were completed, the government of Chile reimbursed the cooperatives most of the development costs through subsidies to the home buyers. Thus, while this program has helped enhance the availability of housing, the long-term financing for the housing is still provided by the government, not the private sector.
- In Tunisia, a recent Housing Guaranty Program provided a loan for the country's Housing Bank to increase private production of affordable housing and developable land. The loan was contingent upon a series of policy and institutional reforms. USAID has indicated that the program's initial $15 million investment led to millions of dollars of additional lending by the Housing Bank for low-income mortgages. However, the capital for this lending was not raised from private credit institutions, rather from a 1-percent tax on salaries and from previous loan repayments. According to a 1993 evaluation of this program, conducted by a USAID contractor, the low return on investments in this area makes it impossible to raise financing capital from alternative sources. According to USAID, the Housing Bank raised about $75 million in short-term financing from private sources to fund initial project construction. However, the long-term financing of these projects was provided through the government-sponsored mortgage program.

- In Indonesia, infrastructure projects had been the domain of the central government, which planned, financed, and constructed them. Since 1988, in part with the encouragement and assistance provided by USAID through the Housing Guaranty Program, the government of Indonesia has pursued decentralization, allowing municipalities to raise funds locally and develop infrastructure projects. With seed money from the program, the government of Indonesia established a Regional Development Account to lend funds to local governments for slum improvements and other shelter-related infrastructure projects. However, this program has not increased the availability of private financing for low-cost shelter because the investment capital for these projects was provided by the government of Indonesia at below-market rates and not from private credit markets. Evaluations of the Housing Guaranty Program in Indonesia, conducted by USAID contractors in 1992 and 1993, indicated that more attention was needed on providing local governments access to private sector financing.

By failing to stimulate private investment and instead relying on host government financing and subsidies, the program's impact is limited. Given the financial constraints on developing country governments, they have been unable to provide adequate resources to finance the shelter their poor populations need. As the Director of USAID's Office of Environment and Urban Programs has acknowledged, "most existing housing subsidies . . . do not result in programs of sufficient order of magnitude to really have an impact on the shelter sector."

Even though it has not been able to convince local entrepreneurs to invest in low-income shelter, USAID has repeatedly guarantied loans in the same countries. As table 4.1 shows, in some of the countries we visited, USAID has been providing guarantied loans for over 25 years.

Table 4.1: Loan Guaranty History in Selected Countries

In millions of 1995 dollars

Country	Year of first loan	Number of loans	Total value of loans guarantied
Chile	1968	8	$173.0
Ecuador	1968	7	105.0
India	1983	10	189.5
Indonesia	1989	5	133.5
Morocco	1985	5	48.8
Poland	1994	1	10.2
Tunisia	1964	12	183.5

Source: Our analysis of Housing Guaranty Program Financial Summaries.

According to USAID officials, the Housing Guaranty Program and related technical assistance have contributed to innovations and greater efficiency of the host governments in providing shelter. They cite as an example a demonstration project through which USAID convinced the government of Morocco of the efficacy of rehabilitating slums rather than bulldozing them. They told us that the program has also helped countries establish more reasonable building codes and land tenure policies intended to facilitate the construction and upgrading of low-income dwellings. However, USAID has not demonstrated to what extent these innovations have led to greater long-term investment by the private sector in low-income shelter developments.

USAID hopes to make progress in marshalling private investment resources in the future. For example, projects being initiated in Chile and Ecuador, if successful, could allow financial institutions to raise capital for shelter projects by selling mortgage-backed bonds to private investors, such as pension funds and insurance companies. Also, efforts are underway in India to enable housing institutions to access private credit markets for long-term financing. However, our review indicated that these programs were in their preliminary stages, and USAID has not yet demonstrated whether this is a viable option for financing low-income shelter projects, which are traditionally considered higher risk investments.

USAID Does Not Always Ensure Access to Projects by Lower Income Group

The Foreign Assistance Act requires that at least 90 percent of the guaranties issued under the Housing Guaranty Program be used to finance shelter suitable for families with incomes below the country's median income. However, our review indicated that USAID does not always ensure that its projects are fully accessible by the below-median income target population.

USAID contends that as long as the projects funded by the program are priced to be affordable to below-median income families, they are considered suitable, regardless of whether those families actually benefit from the projects. Many of our project site visits and extensive review of USAID documents in the countries we visited, including a review of USAID consultant studies, showed that factors other than price have sometimes adversely affected below-median income families' access to program loan funds.

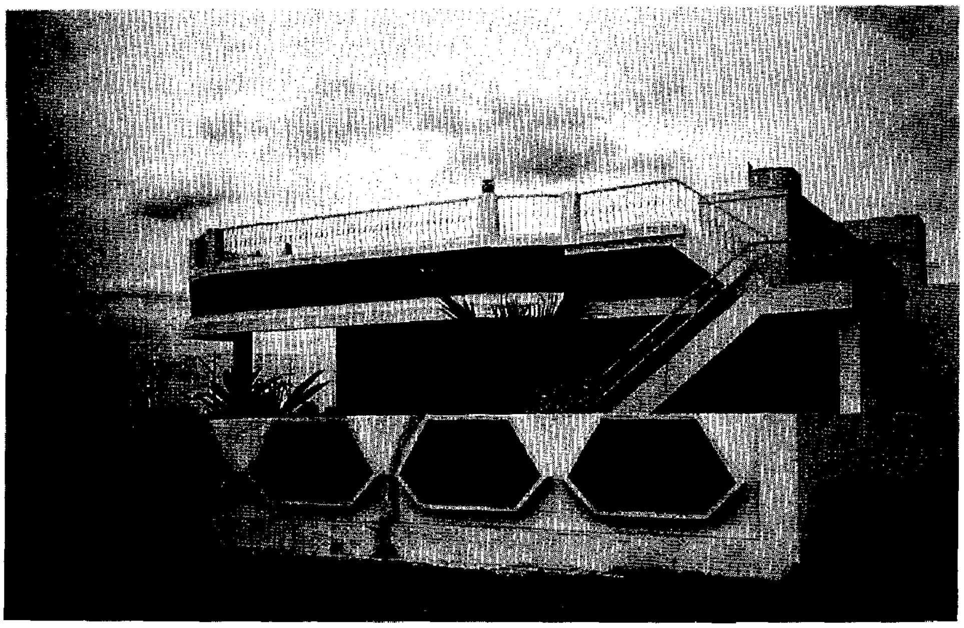
- In India, we found that at least one bank participating in the program extended loans to its own employees, who had above-median incomes. One such employee we visited obtained a home improvement loan to build an addition, where an extended family member conducted aerobics classes. A RHUDO-sponsored survey of beneficiaries indicated that about 36 percent of the loans financed through the Housing Guaranty Program went to families with above-median incomes.[1]
- In Ecuador, a nonprofit agency told us that many higher income people had purchased and upgraded housing financed through the Housing Guaranty Program. A 1989 USAID-sponsored evaluation of the Ecuador program also expressed this concern.
- In Indonesia, several program-financed projects we visited appeared to be serving people above the country's median income. This included a pay toilet in Bali that served tourists (shown in fig. 4.2) and small-scale infrastructure projects in higher income neighborhoods. In a 1992 evaluation of the Indonesia program, a USAID consultant noted that USAID had not taken adequate measures to ensure that at least 90 percent of the beneficiaries were below the median income, leading to "conflicting speculation as to whether these investments are reaching the poor."
- In Morocco, program-financed housing built for lower income families to relocate from slums (shown in fig. 4.3) had not been sold to those families. Instead, at the time of our visit, the municipality that built them was holding some of them vacant and intended to sell them to other buyers at a profit to raise funds for other municipal projects.
- In Tunisia, a RHUDO-sponsored survey of beneficiaries indicated that about 17 percent of one sampling of families that USAID deemed eligible to benefit from the program had above-median incomes.[2]

Figures 4.1 through 4.3 show examples of program-financed projects we visited that did not benefit below-median income families.

[1]According to USAID officials in India, these were acceptable results because participating institutions made additional loans to families with below-median incomes for which they did not receive Housing Guaranty Program financing. However, such loans were larger than USAID determined would be affordable to a family below the median income.

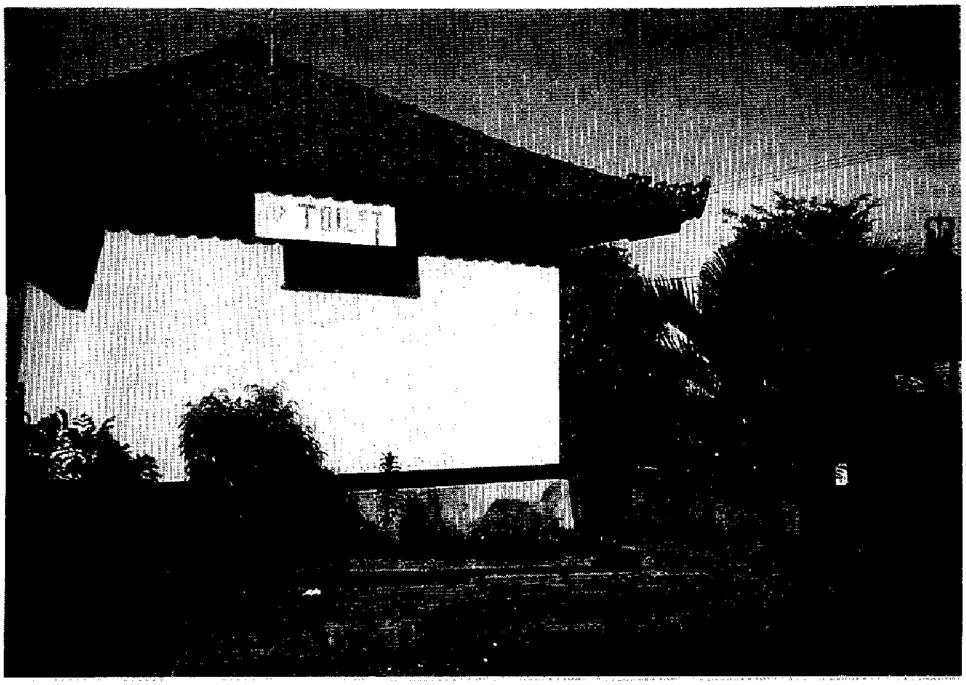
[2]According to RHUDO officials in Tunisia, these results were acceptable because the government of Tunisia finances other loans to families below the median income.

Figure 4.1: House Partially Financed by the Housing Guaranty Program for Above-Median Income Family in Bangalore, India



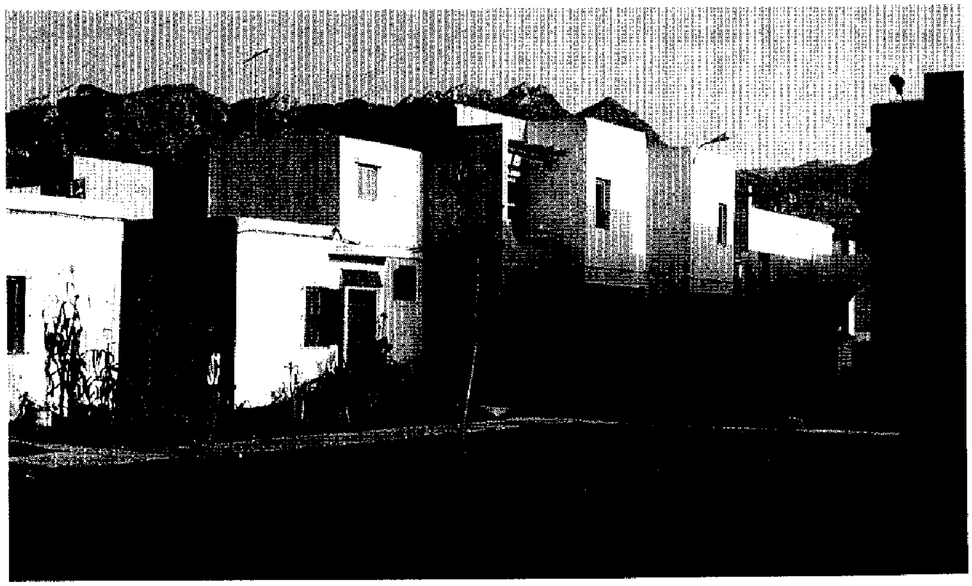
Source: GAO.

Figure 4.2: Pay Toilet for Tourists Financed by the Housing Guaranty Program in Bali, Indonesia



Source: GAO.

Figure 4.3: Partially Unoccupied Housing Financed by Housing Guaranty Program in Tetouan, Morocco



Source: GAO.

We determined that, in several countries we visited, RHUDO and USAID missions did not routinely visit projects or review case files to monitor beneficiary selection and ensure that programs benefited below-median income groups. Instead, they often relied on reports from borrowers, such as certifications attesting that mortgages or home improvement loans were affordable to the below-median income target groups.

If USAID is to ensure that host country institutions follow its lead and develop shelter projects that benefit below-median income families, USAID must first ensure that its demonstration projects reach that target population.

Performance Indicators Do Not Measure Progress Toward Program Objectives

Since 1991, USAID has been developing performance indicators to measure the Housing Guaranty Program's impacts on the shelter sectors of developing countries. However, these indicators do not focus on the effectiveness of the program in persuading local investors to finance low-income shelter projects. Nor do they measure the extent to which the program is serving its low-income target population. Instead, they measure broad changes in the shelter sector, such as in infrastructure expenditures per capita and the house price to income ratio, and associate them with USAID's programs.

Given the many factors outside of USAID's control that affect the overall shelter sector in a country, direct correlations between individual Housing Guaranty Program efforts and broad sector changes are unreliable. Domestic conditions, such as the level of social, economic, and political stability, are significant factors affecting a country's shelter sector that could be reflected in USAID's indicators. Also, the effects on the overall shelter sector of parallel initiatives are difficult to independently monitor. USAID's assistance may be relatively minor in relation to a country's own investments and the assistance provided by other bilateral or multilateral donors. For example, in 1993 USAID-guarantied loans represented only 7 percent of the capital in Indonesia's Regional Development Account for shelter-related infrastructure investment. In Poland, USAID's $25 million loan guaranty program is part of a $400 million housing finance program with the World Bank and the European Bank for Reconstruction and Development. USAID officials have also observed that the performance indicators are of limited use in measuring the direct results of its program.

USAID can develop ways to measure progress toward its objectives on a smaller, more realistic scale. For example, through surveys and other evaluation methodologies, USAID can measure the direct impact of its demonstration projects and policy reform on the investment patterns of a sampling of private sector institutions.

Conclusions, Matters for Congressional Consideration, and Recommendations

Throughout the Housing Guaranty Program's 30-year history, the Congress and USAID have modified the program to try to improve its effectiveness. After initially focusing primarily on Latin American countries, USAID shifted to other regions of the world and then to more creditworthy and advanced countries. USAID has also altered its strategy by increasingly incorporating policy reform objectives and providing several hundred million dollars in technical assistance to complement the guarantied loans. However, despite these modifications, the Housing Guaranty Program has not met congressional expectations, as established in the Foreign Assistance Act.

Although the Congress authorized USAID to assess borrowers fees to cover program expenses, the program's total cost to the U.S. government is likely to be about $1 billion (in 1995 dollars). Loan defaults (especially in Latin America, where the program had been concentrated) have been high, and program costs have escalated. The program has incurred at least $542 million in default costs. Future default costs are likely to total about $600 million. To limit the U.S. government's liability under the program, the Congress established a $2.6 billion ceiling on loan guaranties; however, loan guaranties and debts to USAID resulting from this program have totaled about $2.8 billion.

While the Housing Guaranty Program has sponsored demonstration projects and helped persuade recipient countries to adopt policy reforms, it has not succeeded in convincing local entrepreneurs and institutions to increase private investments in lower income housing projects. Thus, the program's anticipated long-term impact on the availability of capital for lower income shelter is not evident. Furthermore, USAID has not ensured that the actual shelter projects financed by this program necessarily benefit below-median income families. USAID has not designed its indicators to measure the direct impact of this program on private sector investment and on below-median income families.

Matters for Congressional Consideration

The Congress may wish to deauthorize guaranties for undisbursed loans, where feasible, and terminate the Housing Guaranty Program because (1) the program is now primarily benefiting borrowers in more creditworthy and advanced developing countries that have access to comparable loans from other international lenders; (2) the program annually costs millions of dollars more than anticipated; (3) loans previously guarantied under the pre-1992 legislated ceiling continue to be disbursed, even though USAID has not collected over $400 million in defaulted debt; and (4) there is no evidence that the program has measurably increased the availability of private domestic capital for low-income shelter.

Other actions are warranted if the Congress believes that the goals of (1) stimulating domestic investment in the recipient countries (particularly private investment) and (2) targeting shelter assistance to below-median income families are possible to achieve and are of sufficient priority. Before authorizing additional loan guaranties, the Congress may wish to require USAID to submit a comprehensive plan to the appropriate congressional committees on how it plans to achieve the stated program goals, reduce losses, and return the program to a viable financial condition.

Recommendations

If the Congress does not terminate the Housing Guaranty Program, we recommend that the USAID Administrator take the following actions to (1) minimize the financial impact of the Housing Guaranty Program on the foreign assistance budget and the U.S. government budget deficit and (2) bring the program in line with the objectives of the Foreign Assistance Act:

- Withhold future loan disbursements and related technical assistance from borrowers that have repeatedly rescheduled debt repayments to USAID.
- Increase program revenues by adopting a fee structure designed to offset a larger portion of the program's costs.
- Ensure that performance indicators measure the extent to which (1) local investors replicate the program's low-income shelter projects using private sources of long-term financing and (2) project benefits accrue to the below-median income target population.

Agency Comments and Our Evaluation

The report has been revised, where appropriate, to reflect USAID's concerns. The comments and our evaluation of them appear in appendix II.

In commenting on a draft of this report, USAID strongly disagreed with our findings, arguing that the Housing Guaranty Program was a cost-effective method for pursuing development assistance and that the program had achieved the goals established by the Congress. USAID criticized the report for failing to adequately consider alternative program goals and congressional directions. USAID also asserted that the report was based on a flawed financial analysis and a distorted portrayal of program costs because of the use of 1995 dollars. Furthermore, USAID maintained that we did not adequately consider evidence that the program had successfully stimulated private investment and reached below-median income target populations. USAID suggested that termination of this program and deauthorization of guaranties might interfere with legally binding agreements and congressionally supported activities. USAID did not address the report's specific recommendations, since it contended that they were based upon incorrect information and a flawed analysis.

As a result of these comments, we modified our matters for congressional consideration and recommendations to (1) recognize that it may not be feasible to deauthorize all loan guaranties and (2) indicate that USAID should increase its guaranty fees to cover more of its costs. However, our evaluation of these comments revealed that USAID had not credibly supported any of its broad and strongly worded criticisms. USAID did not identify any specific legislated program goals that we overlooked or any legal provisions that contradict the goals we focused on. USAID's criticism of our financial analysis is unfounded and even disregards its own most recent audited financial statements regarding probable losses from loan defaults. Our use of 1995 dollars reflects the true cost of the program more accurately than the use of then-year dollars, especially for costs incurred over many years. We denominated figures in both 1995 and then-year dollars, except in cases, such as the discussion of legislated ceilings, where it was not meaningful or possible to use 1995 figures. Furthermore, the additional data USAID provided (most of which we had already reviewed) were misleading and did not undermine our conclusions.

Housing Guaranty Program Debts as of September 30, 1994

This appendix lists the countries and regional banks with outstanding guarantied loan balances and debts to the U.S. Agency for International Development (USAID) under the Housing Guaranty Program as of September 30, 1994.

Country/regional bank	Loan balance	Debt to USAID
Botswana	$9,565,714	$134,169
Ethiopia	0	1,878,010
Cote d'Ivoire	50,319,092	31,853,835
Kenya	43,206,224	3,996,380
Senegal	0	4,718,552
Mauritius	4,000,000	0
Zaire	2,384,974	18,392,795
Zimbabwe	65,000,000	0
Subtotal	**174,476,004**	**60,973,741**
India	144,000,000	0
Indonesia	120,000,000	0
Korea	53,321,406	0
Pakistan	25,000,000	0
Philippines	35,000,000	0
Sri Lanka	56,010,000	0
Thailand	9,750,000	0
Subtotal	**443,081,406**	**0**
Poland	10,000,000	0
Subtotal	**10,000,000**	**0**
Israel	520,500,536	0
Jordan	55,858,833	1,827,825
Lebanon	28,428,904	0
Morocco	43,459,684	0
Portugal	100,000,000	0
Tunisia	93,728,115	0
Subtotal	**841,976,072**	**1,827,825**
Argentina	4,148,611	42,451,775
Barbados	7,600,000	0
Belize	1,950,000	0

(continued)

Country/regional bank	Loan balance	Debt to USAID
Bolivia	17,445,882	19,272,776
Central American Bank for Economic Integration	109,062,899	153
Colombia	0	10,914
Chile	62,821,782	437,036
Costa Rica	30,983,229	4,295,015
Dominican Republic	737,257	6,241,941
Ecuador	54,438,827	12,619,483
El Salvador	13,770,659	3,478,405
Guatemala	10,000,000	0
Guyana	0	1,303,527
Honduras	58,793,468	21,749,898
Interamerican Savings and Loan Bank	5,365,967	0
Jamaica	100,327,044	29,564,332
Nicaragua	2,620,496	22,284,013
Panama	69,322,973	27,520,864
Paraguay	3,036,032	0
Peru	72,060,131	154,888,134
Venezuela	2,388,688	140,784
Subtotal	**626,873,945**	**346,259,050**
Total	**$2,096,407,428**	**$409,060,616**

Note: Totals may not add due to rounding.

Source: Housing Guaranty Program Financial Summary

Comments From the U.S. Agency for International Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

USAID

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

MAY - 8 1995

Mr. Henry L. Hinton, Jr.
Assistant Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Hinton:

We have received your letter of March 31, 1995, and the accompanying draft report entitled "Foreign Housing Guaranty Program: Financial Condition Poor and Goals Not Achieved" (GAO Code 711059).

The U.S. Agency for International Development (USAID) strongly disagrees with the report's findings. We believe that the Housing Guaranty (HG) program is a cost-effective method for pursuing development assistance and that the program has achieved the goals established by Congress.

See pp. 7-8 and 53-54.

We have several fundamental disagreements with the team's findings:

- The conclusion that the HG program goals have not been achieved reflects the team's failure to consider the entire legislative history of the program. The finding is based exclusively on Section 221 of the Foreign Assistance Act although Section 222(b) provides direct and explicit requirements for the program. A detailed discussion of the legislative history is provided in Enclosure 1.

- GAO's assertion that the HG program is in serious financial condition does not consider the program in its totality and is based on flawed financial calculations. The team completely disregarded the distinction between the pre and post-Credit Reform programs. Congress addressed many of the financial shortcomings of the old program with the Credit Reform Act. The post-Credit Reform program is financially sound -- a fact that GAO representatives acknowledged in an April 27th meeting with USAID officials and Congressional staff aides. A conclusion of this relevance should certainly be included in the report.

See comment 1.

Additionally, the use of "1995 dollars" to calculate the cost of the pre-Credit Reform portfolio is inconsistent and distorts the program costs. During 30 years of operations,

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See pp. 7-8 and 53-54.

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the cost to the U.S. taxpayers for write-offs is one and one-half cents on each dollar loaned. The total cost for claims paid to investors under the pre-Credit Reform program is 15 cents for each dollar loaned, of which a significant portion is likely to be recovered. Enclosure 2 provides further discussion of the program's financial condition.

- The report indicates that the program has shifted toward participation by more advanced developing countries and that USAID does not ensure that the program targets the below-median income populations. Although USAID has sought to minimize the risk by operating the program in some credit-worthy countries, the program is meeting the Congressional intent and has benefitted millions of low income people. It has accomplished significant, sustainable policy and systemic reforms, which have increased the access of poor families to shelter and basic urban environmental services. Enclosure 3 provides numerous examples to demonstrate that the targeted beneficiaries are indeed the low income populations.

We agree with GAO's finding that the program's worldwide indicators can be improved. We have already commenced an assessment of the performance measurement system. Enclosure 4 includes a more extensive discussion of performance monitoring.

Your report invites Congress to consider deauthorizing undisbursed loan guaranties. Deauthorization would result in the cancellation of $215 million in existing guaranty obligations and agreements authorized under credit reform between 1992 and 1994. These obligations are in the form of valid and legally binding agreements. In addition, the report asks Congress to consider termination of the program. Termination would halt multi-year activities in a number of countries, including those specifically supported by Congress.

We have not addressed the report's specific recommendations since they are based upon incorrect information and flawed analysis. We suggest that GAO consider a more thorough review of the HG program before issuing a final report. We ask that this letter and its enclosures be reprinted in their entirety within your final report.

Sincerely,

Larry E. Byrne
Assistant Administrator
Bureau for Management

Enclosures: a/s

ENCLOSURE 1 - STATUTORY GOALS/LEGISLATIVE HISTORY

1. Statutory Goals

See comment 2.

The draft GAO report concludes that the Housing Guaranty (HG) goals have not been achieved. The "goals" GAO relies on are long term goals mentioned in the last sentence of Sec 221, Foreign Assistance Act of 1961, as amended (FAA):

> "The Congress declares that the long run goal of all such programs should be to develop domestic construction capabilities and to stimulate local credit institutions to make available domestic capital and other management and technological resources required for effective low-cost shelter programs and policies."

The report on four separate occasions (pp. 3, 6, 8, 42-47) refers to the unwillingness of local credit institutions to make their capital available for low income housing. Thus, GAO asserts: "[t]he program has not stimulated local credit institutions to make private investment capital available for low income shelter projects."

HG program goals have changed substantially over the life of the program. The trend has followed that applicable to other USAID programs: to serve the poor majority. Less than one fourth of the HG activities in the last decade involve formal credit institutions mentioned in Section 221. This results from the fact that the lowest income groups in less developed countries (LDCs) are too poor to become entrants in formal credit markets within time frames implicit in the GAO Report. The remaining three quarters of HG activity, as specifically mandated by Section 222(b), have emphasized housing-related and infra-structure activities that directly benefit very low income families, but bear only an indirect relationship to the second goal of Section 221 -- the stimulation of local credit institutions to make private investment capital available for low income shelter projects. Accordingly, both the long term goals expressed in Section 221 and the specific kinds of HG activities required to be "emphasized" by Section 222(b) should be taken into account in evaluating the impact of the HG program. GAO has erred by not adjusting its interpretation of Section 221's applicability so as to give reasonable consideration to the direct and explicit requirements of Section 222(b).

2. Legislative History

See comment 2.

Sections 221-223 have been amended numerous times since the program was established in the late 1960s. The original purpose of the statute was to promote the export of U.S. building technologies to LDCs. Subsequently, with the active intervention of the U.S. savings and loan (S&L) industry, the HG program goals were directed to the establishment of financial intermediaries in

LDCs along the lines of the U.S. S&L industry model. Early versions of Section 221 with a focus on "credit institutions" were enacted during this period of time.

In 1978, much of the FAA, and the HG sections in particular, (Sections 221-223) were amended in a manner that is reflected in much of the HG activity today. The 1978 amendments, in general, were intended to "carry forward the New Directions" concepts affecting the "poor majority".[1] In this overall context, the 1978 amendments to Section 222(b) recognized that formal credit institutions could not meet the shelter needs of the poorest of the poor and that other forms of intervention were needed. Section 222(b) was intended to "update and clarify the purpose of the housing guaranty program." It reads:

> "(b) Activities carried out under this section shall emphasize-
>
> (1) projects which provide improved home sites to poor families on which to build shelter, and related services;
>
> 2) projects comprised on expandable core shelter units on serviced sites;
>
> (3) slum upgrading projects designed to preserve and improve existing shelter;
>
> (4) shelter projects for low income people designed for demonstration or institution building purposes; and
>
> (5) community facilities and services in support of projects authorized under this section to improve shelter occupied by the poor."

Current activities responding to Section 222(b), therefore, are intended to meet the needs of the poorest of the poor. It was understood at the time Section 222(b) was drafted, and more so now, that the basic shelter needs of the LDC poor, defined as slum dwellers and squatters in informal settlements, could not be met by formal credit institutions. S&L style banking institutions (which had been successfully promoted by USAID in the early days), at best, could serve only regularly employed poor - which were not the "poorest of the poor" target group envisioned by the Congress in the "New Directions" amendments. In concert with the new directions legislation affecting USAID, therefore, the HG Statute was amended to direct and "emphasize" the use of program resources toward the basic infrastructure needs of slum dwellers. The amendments were accomplished by new wording in Section 222(b) quoted above, and later by substitution

[1]See H.R. 95-1087, 1978 U.S.C.C.A.N. at 2352, 2355.

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of the word "shelter" for housing in Section 221.[2] USAID has implemented the Section 222(b) amendments with activities directly responding to the amendments' provisions, such as slum upgrading (versus slum eradication) and shelter-related infrastructure (e.g., potable water, drainage, sewerage, electricity, and land tenure).

The statutory history noted above explains why the Section 222(b) amendments were enacted. We cannot determine why the last sentence of Section 221 regarding credit institutions was inserted in the statute. Indirectly, and over a time period well beyond that considered by the GAO Report, Section 222(b) activities can be expected to result in some squatters and slum dwellers having land tenure in bankable assets and this, in turn, will give them the ability to enter the formal banking system in a sustainable manner. Beyond this indirect and long term connection, Section 221 references to credit institutions simply are not compatible with Section 222(b). Stated another way, if Congress wanted the HG Program to focus exclusively on the financing of low income shelter by credit institutions, it could not reasonably have enacted Section 222(b). The legislative history of Section 222(b) amendments <u>per se</u> is totally silent on the issue of credit institutions. The weight of technical opinion within USAID is that pursuit of Section 222(b) activities will not, within the time periods considered by GAO, sufficiently impact the credit institution goals appearing in the last sentence of Section 221.

While Section 222(b) directs the HG activities away from formal credit institutions, Section 221 refers (in part) to credit institutions, and has not been changed or eliminated. Further, Section 222 begins: "(a) To carry out the policy of Section 221, the President is authorized to...[emphasize the Section 222(b) activities]". The legislative history accompanying the 1978 Section 221 and 222(b) amendments states the "new policy statement does not represent a change in focus of the program..." (page 2378). This, on its face, suggests there is a disconnect between the last sentence of Section 221 and Section 222 that should have been taken into account by GAO.

Under general rules of statutory construction, where there is an apparent conflict between two provisions, we are required to interpret the statutes to give maximum reasonable effect to both. Since Section 222(b) is explicit in the activities mandated, we believe Section 221 must be interpreted in a manner that permits USAID to carry out the intent of Section 222(b). This reasoning

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[2]See Foreign Assistance Appropriations Act, 1985, Sec. 541(a), as contained in the Continuing Appropriations Act, 1985 (P.L. 98-473; 98 Stat. 1903).

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would make all of the general language of Section 221 about the importance of shelter, etc., fully valid. However, the last sentence of Section 221 referring to the long term goal of the HG program has to be read as envisioning a time period that fits the infrastructure activities being "emphasized". We believe such a time period to be well beyond that used in the GAO report. This reading is necessary in order to give maximum effect to both statutes. We believe, further, that Section 221, taken as a whole, is compatible with the overall intent of the HG legislation, including Section 222(b).

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ENCLOSURE 2 - FINANCIAL CONDITION OF PROGRAM

1. Pre and Post-Credit Reform Programs

See comment 3.

GAO's conclusion that the Housing Guaranty Program is in serious financial condition reflects a total disregard for the fundamental changes in the program resulting from the 1990 Federal Credit Reform Act. The report does not distinguish between two separate and distinct Housing Guaranty (HG) programs. The pre-credit reform program operated using financial practices existing from 1964 to 1991. Congress addressed many of the financial shortcomings of this program with the passage of the 1990 Federal Credit Reform Act. The current portfolio is an on-budget activity that is financially sound.

a. Post-Credit Reform Program

The current Housing Guaranty program receives annual appropriations projected by the Inter-Agency Country Credit Risk Assessment System to be sufficient to cover future costs. The program has sustained no write-offs or investors' claims. In addition, it has a fully funded reserve to cover the estimated risk of future claims which represents about 15 cents for each dollar guarantied.

In an April 27th meeting to discuss the draft report with senior GAO officials and aides to the House International Relations Committee, the GAO indicated that the post-Credit Reform portfolio, taken as a whole, is financially sound. We question why a GAO conclusion of this relevance is not included in the report.

b. Pre-Credit Reform Program

See comments 1 and 4.

The pre-credit reform program was structured as an off-budget activity without annual appropriations for reserves. We disagree with GAO's estimates of the cost of the old portfolio. The estimates are based upon a worst case scenario under which 17 countries default on their debts. In addition, GAO's use of "1995 dollars" in calculating estimates is inconsistent and distorts program costs. Amounts written off, claims, and rescheduled loans have been valued in 1995 dollars whereas references to legislative ceilings and the total amount of loans guarantied have not been consistently valued to 1995 dollars.

(1) Program Costs

See comment 4.

The pre-Credit Reform program has written off $39.3 million - about one and one-half cents per dollar guarantied. Over the past 30 years, USAID has paid $408.9 million in claims to investors on pre-credit reform guaranties - about 15 cents for each dollar guarantied. Using a methodology rejected by both OMB and CBO, GAO contends that about $925 million in loan guaranties may ultimately be uncollected - about 19 cents per dollar guarantied.

The "Audit of Fiscal Year 1993 Annual Financial Statement for USAID's Housing Guaranty Program Under the CFO Act" contains an estimate of the potential future liability for pre-Credit Reform loan guaranties through 1994 of about $702 million. As indicated in the report, USAID management viewed the figure as conservative, in other words, also a "worst case" scenario. The FY 1994 financial statement audit is currently underway, and preliminary indications are that this number may be lower.

USAID believes that even with the most rigorous analytic protocols, future costs are at best speculative. The pre-Credit Reform program's potential costs are most accurately described as *somewhere between* the current write-offs of $39.3 million and the report's hypothetical $925 million - between one and one-half cents and nineteen cents per dollar.

(2) Ceiling Levels

See comment 5.

GAO indicates that USAID has exceeded its $2.6 billion ceiling on pre-credit reform guaranties. The legislated ceiling has been modified annually through the appropriations process. The 1995 Appropriations Act, for instance, provides that commitments to guaranty loans may be entered into, notwithstanding the legislated ceiling.

(3) Debt Rescheduling

See comment 6 and p. 40.

GAO claims that "due in part to the worldwide recession of the mid-1980s and the resulting debt crisis, many borrowing countries...began to default on payments". While this assertion is correct, it is also misleading as there is no reference to the larger macroeconomic context within which HG reschedulings took place. The pre-credit reform program's rescheduled loans did not result from individual loan defaults. Rather, due to macroeconomic conditions under which countries sought public debt relief, HG loans were subsumed within a country's rescheduling of all public debt. This debt rescheduling phenomenon is not unique to the HG program; actually, the pre-credit reform program's loans make up only a small part of a debt rescheduling concern faced by all U.S. Government international public lending agencies. The HG program's portion is about two percent of the total.

See comment 7.

GAO also claims that only 6% of rescheduled debt has been collected over recent years. Most rescheduling agreements allow for initial grace periods when only payments for interest are due. Actually, USAID has collected 95.6% of principal, interest and fees due from rescheduled borrowers.

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See comment 8.

In addition, the report indicates that USAID has failed to ensure that rescheduled borrowers do not continue to receive loan guaranties. Of the 12 cases noted, guaranty commitments were consciously made in three rescheduled countries, based upon sound political and developmental reasoning. The other nine represented a decision to honor guaranty commitments approved prior to rescheduling. At any rate, these cases represent about one percent of all guarantied loans.

(4) Reserve Funds

See comment 9.

GAO asserts that the program is in "serious financial condition, because program fees are not sufficient" to satisfy investors' claims. The pre-credit reform program's fee income was not intended to cover the entire cost of lender claims. GAO uses a 25-year old Presidential budget message to maintain that the program was intended to be self-sustaining. The April 1984 GAO report entitled "AID's Management of the Housing Guaranty Program" states that "a reserve fund, originally of $50 million, was established to...satisfy lender claims for missed payments on guarantied loans". Since then, USAID has funded investors' claims through a number of Congressionally-approved mechanisms, including retained interest earnings on reserves, budget appropriations, and treasury borrowings. Through 1994, budget appropriations are $196.7 million. When added to $125.2 million in Treasury borrowings, the total government contribution required to meet investors' claims is $321.9 million. Against this, USAID is owed and intends to collect $408.9 million - 27% more than the government's contributions.

2. Future Fee Revenue

See comment 10 and pp. 7 and 53.

GAO recommends that USAID increase program revenues by adopting a fee structure designed to offset both administrative costs and probable defaults. The Credit Reform Act currently prohibits the recovery of program administration costs through fees. USAID is considering an increase in fees which would help to offset, but not fully, probable future default costs. Using the post-credit reform program's average cost of 15 cents per dollar, the interest rate margin to be added to the investors' rate for full cost recovery would be about 3%. An increase of this magnitude will make the program unaffordable to most lower-income countries.

3. Technical Assistance Funds

See comment 11.

GAO claims that the program's financial reporting "does not include several hundred million dollars in technical assistance". USAID's position regarding this matter is that aggregating funds used for technical assistance with costs for program administration and claims distorts the true cost of credit programs. GAO supports its position by stating that they "believe that much of

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this assistance amounts to closely-linked subsidies to program participants". The report cites criteria developed by GAO for assessing U.S. credit institutions, concluding that income tax credits and rental vouchers in the U.S. context, are the same as grant-funded technical support. Tax credits and rental vouchers are mechanisms used to improve the affordability of a housing product. Technical assistance, on the other hand, is systemically applied throughout most USAID programs worldwide, to help USAID counterparts achieve policy reforms and undertake activities such as institution building.

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ENCLOSURE 3 - CURRENT FOCUS AND IMPACT OF THE PROGRAM

The detailed analysis of the statutory goals and legislative history (Enclosure 1) clearly illustrates that the legislation has driven the significant changes in the scope and focus of this program over the years. Although it is true that the focus has changed, GAO's assertion that the program's impact on low income shelter investment is not evident and that benefits have not accrued to low income households is completely inaccurate. The program has generated a considerable amount of private investment and it overwhelmingly benefits low income populations.

1. Profile of Participating Countries

See comment 12 and p. 19.

GAO concludes that the Credit Reform Act and the 1980's debt crisis have led to a shift toward program participation by "more advanced developing countries". The report acknowledges that program activities in some countries occur for specific foreign policy reasons, as mandated by Congress. While USAID could argue, using the more rigorously defined World Bank Criteria for country rankings, that the program operates overwhelmingly in lower-income countries, it is clear that some of the countries are more advanced, particularly those graduating from the foreign assistance program. However, it can be demonstrated that program benefits continue to reach the poor population, even in more creditworthy countries.

The post-credit reform program currently operates in India, Indonesia, Sri Lanka, Thailand, Tunisia, Morocco, Zimbabwe, Honduras, Guatemala, and El Salvador. The GAO report clearly explains the benefit and desirability of allowing creditworthy countries to participate in the HG program: lower risk borrowers and smaller required reserves. In addition, the current focus of the program, the financing of a wide variety of shelter and infrastructure projects in urban areas of developing countries, targets poor, inner-city residents.

2. Program Beneficiaries

See comments 12 and 13.

GAO has concluded that USAID does not always ensure access to projects by the below-median income target population. USAID rigorously pursues verification of eligible expenditures for each HG loan. Verification mechanisms include program evaluations, expert assessments, field visits, sample surveys, review of counterpart documents and records, and borrower certifications. These processes have verified that no less than 90% of all HG eligible expenditures are suitable for below-median income families, and below median-income beneficiaries make up the overwhelming majority of program recipients. GAO's 1978 report, "AID's Housing Guaranty Program," indicated that USAID made dramatic changes in the kinds of housing financed to serve the poor in developing countries, and helped to effect important changes in host-countries' housing policies and delivery systems. Its 1984 report, "AID's Management of the Housing Guaranty

Program", found that the program made substantial progress in achieving affordable shelter for the poor. This report also indicated that USAID used the program since the mid-1970s to promote self-sustaining shelter delivery systems for below median income families by lowering standards, promoting self-financing, and encouraging continuous private sector participation. Recent GAO findings on the Russia Housing Sector Reform Project, a program structured upon HG principles and guidelines, indicate that it has been fully successful in meeting its objectives, contributing to sustainable systemic reform, and engendering broad-based counterpart participation.

See comments 14 and 15.

In India, housing finance companies have loaned about $294 million with terms and conditions suitable for the program's targeted beneficiaries. A sample survey found that 78% - or $229 million - actually did go to households with incomes below the median. This exceeded the $150 million contributed by the HG program to India's housing finance companies, by 1.6 times.

See comments 14 and 15.

Since expenditures in Indonesia are for large scale urban infrastructure improvements, program disbursements represent only 40% of the full cost of undertakings. The program's share of funding has been reduced to ensure that the below median-income population is served. The GAO's example of the public toilet in Bali does not reveal that the public toilet provides facilities for lower-income workers serving the tourist industry.

See comment 12.

In Ecuador, expenditures are based on reimbursements and the incomes of beneficiaries are certified by three institutions: the retail financial institution, the Ecuadorian Housing Bank, and USAID. USAID, the Cooperative Housing Foundation, the Peace Corps, and the Ecuadorian Housing Bank all work with local financial institutions to ensure that families meet the below median income requirements through periodic site visits and through a permanent Peace Corps presence in many credit unions. In a recent reimbursement, USAID did not refinance about 5% of loans after finding ineligible borrowers.

See comment 15.

In Chile, the direct housing subsidy system, which provides about 25% of the value of the house, sets the parameters for who can receive housing loans under the program. The families who receive subsidies are below the median and the criteria for receiving a subsidy are very strict and must be documented. Because the system is established in a manner that sets strict standards and backs them up with proof and documentation, the houses financed under the HG programs in Chile must go to below median income families. Even though HG 010 was a special Congressional authorization that did not require the below median income requirement, to date, 100% of the beneficiaries in the program have been below median income.

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See comment 14.

In Tunisia, the Housing Bank presented lists of "potential" eligible expenditures totalling $64 million for a $15 million HG guaranty. USAID's sample survey determined that 83%, or $53 million - about 3.5 times the $15 million guaranty - were directly attributable to below median income households. This was well in excess of the requirements for this guaranty.

The program also has a broader impact on the urban poor beyond the direct assistance received by beneficiaries. Not only has the Morocco Urban Environmental program brought potable water to 90,000 people, it has also indirectly benefitted around 200,000 urban poor through higher income and an improved health environment.

When USAID identifies shortfalls, it works diligently with the program's implementors to improve beneficiary targeting. For instance, in India, when the sample survey indicated that only 78% of suitable loans were actually reaching the targeted beneficiaries, USAID worked with its counterparts to develop a demonstration program focused on increasing the access of informally employed lower-income borrowers, to formal housing finance resources. In Indonesia, when a 1992 evaluation indicated a need for additional efforts, a follow-on assessment was used to make significant changes to improve beneficiary targeting.

3. Private Investment

See comment 16.

GAO contends that private credit institutions have not invested their own capital as a result of this program. In Indonesia, the program has supported private sector investment in urban environmental infrastructure and services totalling $590 million. In India, $1.4 billion, two-thirds of the available funds for loans through housing finance companies supported by the program, comes from private sources: owners' equity, banks, depositors, and capital markets.

See comment 17 and p. 44.

In Tunisia, a system of providing private developers with access to raw land and construction financing was put in place to ensure replication. Only mortgage loans to low-income families to purchase this privately produced housing continues to benefit from government subsidy. The $75 million construction financing - far in excess of the $15 million HG guaranty - was provided to private developers at prevailing market interest rates from resources mobilized by the Housing Bank from deposits and equity raised in the stock market.

See comment 16.

In Ecuador, the HG program has facilitated the establishment of a secondary mortgage bank, with written agreements by 21 private sector financial institutions to provide an initial capitalization of over $4 million. In 1994, credit unions and S&Ls financed $25 million worth of housing loans with their own resources. In addition, every transaction under the current

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program is financed by the private sector; USAID only refinances up to 75%. This means that at least 25% of any HG-financed transaction is funded by the private sector.

See comment 16.

In Chile, HG programs have produced over 4,400 homes for low-income families through the private sector. $10 million in HG funds has produced over $45 million worth of low-income housing through private sector housing cooperatives. Additionally, the Government of Chile has established conditions that enable the private sector to participate massively in the provision of housing solutions for low income families. The private sector has been producing approximately $800 million worth of low income housing per year, building an average of 88,000 units.

See comment 18.

In Morocco, the HG program has brought potable water and sewerage services to 15,000 lots purchased by the urban poor, as well as to 10,000 low-income households in existing neighborhoods. According to a 1992 program evaluation, the purchasers of those 15,000 lots experienced a 20-40% increase in household income. Also, program investment in land-site and service improvements has generated a 10-fold increase in private economic activity, ultimately raising income levels of the urban poor.

See comment 18.

The report fails to take into account that a considerable amount of private activity comes from individual household investment. At one surveyed site, program evaluators found that 70% of households have invested in home improvements, and 75% had purchased electricity connections before the upgrades were completed.

See comment 18.

In Indonesia, $39 million in program-financed housing upgrades has led to additional homeowner investments of $78 million to further improve their dwellings. Borrowers participating in India's housing finance system have contributed no less than $351 million in the form of downpayments and homeowners' equity. In Tunisia, a typical low-income family purchasing a serviced site invests four times the value of the plot financed by the HG program to complete their home.

See comment 18.

In Ecuador, most families invest directly in their housing, independently of any financing they may receive. Recent estimates show that 70% of all housing is built informally in Ecuador without formal sector loans. The HG program finances both home improvements and mortgage loans for home construction or purchasing. In the home improvement area, families receive loans for an amount they can afford to repay and then they provide labor and materials to build as much of the home as is possible. In the case of mortgage loans, a family provides between 10% and 20% of the value of the home as a downpayment. In Morocco, individual homeowners invest about five times the amount provided by the program for serviced plots and community upgrading.

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In Chile, low income families are required to save for a downpayment on their home. In the last four years, low income families have saved more than $1 billion per year to be used as downpayments. This savings has energized the economy in Chile, providing resources for sustaining high levels of economic growth.

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ENCLOSURE 4 - PERFORMANCE MONITORING

1. Performance Indicators

See comment 19.

GAO indicates that "USAID generally measures a variety of large-scale shelter sector changes that are not directly attributable to the program." USAID measures a minimum of two sets of indicators: indicators for each project which measure purpose and output level achievements, and worldwide indicators which attempt to measure accomplishments between countries and across regions.

In its analysis, GAO focused on the worldwide indicators and did not consider project level indicators. Their conclusions overlooked the purpose and output level indicators which do provide specific measures of changes attributable to the individual projects. Examples of project level indicators include number of loans to households below the median income, the value of private investment in urban environmental infrastructure, loan volume of private housing finance institutions, and measurable progress in issuing regulations.

GAO's finding that the program's worldwide indicators can be improved to cumulatively measure program impacts is valid. Despite a significant effort, there remains much to do to develop worldwide indicators which aggregate individual country level indicators into an overall worldwide program performance measurement system. A formal reassessment of the performance measurement system commenced in June 1994. Because the reassessment and collection of base-line data will not be complete until FY96, an interim process was adopted for FY95, which relies on the purpose and output level indicators that provide specific measures of changes attributable to the individual projects.

2. Program Monitoring

See comment 19.

GAO relates that "in several countries...RHUDO and USAID missions did not routinely visit projects or review case files...they relied on reports from borrowers such as certifications...". Documentation regarding routine field visits and program file reviews is maintained in USAID's regional and field mission files. Often, outside consultants are utilized to audit borrower records. For example, the Tunisia and India programs relied on experts contracted to provide evaluations and sample surveys. In Ecuador, eligible expenditures are verified by three different institutions. Unfortunately, more than one of our field offices reported that the GAO teams did not review all of the files made available to them.

The following are GAO's comments on USAID's letter dated May 8, 1995.

GAO Comments

1. In nearly every case, the report shows monetary amounts in both nominal and 1995 dollars. We did not convert amounts to 1995 dollars in cases where it was not meaningful to do so or where doing so would distort the presentation of the financial situation; this includes our discussion of the legislated ceiling. USAID's claim that it may ultimately collect 27 percent more than the program has cost (see p. 66, section 1(b)(4) of USAID's letter) reveals the flaws associated with using nominal instead of 1995 dollars. USAID's calculation does not take into account over $150 million in interest that the U.S. government has foregone by using its funds to pay default costs for this program—a real cost that has impacted the federal deficit. Furthermore, portraying costs in only nominal dollars would inflate our projection of future default costs to nearly $1.2 billion, which would be misleading because it would not reflect the decreased purchasing power of the dollar over time.

2. Section 221 of the Foreign Assistance Act sets forth the policy statement for the Housing Guaranty Program. It declares that the long-run goal of the program "should be to develop domestic construction capabilities and to stimulate local credit institutions to make available domestic capital and other management and technological resources required for effective low-cost shelter programs and policies." (See 22 U.S.C. 2181.) In 1978, the Congress amended sections 221 and 222 of the act to rewrite the policy statement to consolidate separate housing guaranty programs into one program. The legislative history indicates that "[t]he new policy statement does not represent a change in focus of the program, but merely updates and clarifies the purposes of the program . . . that the focus of the program should be on improving the shelter facilities of the poor." (See H. Rpt. No. 1087, 95th Cong., 2d Sess. 28 (1978).) The Committee included language in the report reiterating that the long-run goal of the program as set forth in section 221 remained unchanged. (See H. Rpt. No. 1087 at 29.)

USAID suggests that there is a "disconnect" between the long-run goal in section 221 and the activities emphasized in section 222. According to USAID, the new activities shifted the focus away from formal credit institutions and toward basic infrastructure needs.

However, the language of the Foreign Assistance Act, along with the legislative history accompanying the changes made to sections 221 and 222 in 1978, indicates that, at the time, the Congress saw no inherent contradiction between these two sections of the act. Section 222 of the act sets forth the means "[t]o carry out the policy of section 221." (See 22 U.S.C. 2182(a).) It identifies the types of activities that the Congress intended to be emphasized in the program, including slum upgrading, community facilities and services, and institution building. These activities are not, in and of themselves, the "long-run goals" of the program but simply the types of activities the Congress intended to be emphasized to achieve the program's goals. As noted above, the legislative history shows that in prescribing the activities the Congress intended to retain the long-run focus reflected in section 221.

USAID believes that the activities in section 222 will not, within the time periods we considered, achieve the long-run goals of section 221. Nevertheless, some more positive indicators of progress should be expected after 30 years (and 17 years since the enactment of section 222(b)). We believe that USAID is accountable for either meeting the long-run goals of the program or, alternatively, reporting to the Congress within a reasonable period of time its inability to meet them.

3. USAID's reference to two "separate and distinct" Housing Guaranty Programs—pre- and post-Credit Reform—is an artificial distinction, which obscures the program's overall financial condition and the total U.S. government liability. While the financing of the program has changed because of Credit Reform budgeting rules for new loan guaranties beginning in fiscal year 1992, the operation of the program has continued under the same authorizing legislation and guidelines. In fact, as we point out, USAID continues to authorize disbursement of pre-Credit Reform guarantied loans without any reserve for defaults. While it is true that the post-Credit Reform portion of the portfolio has experienced no defaults or write-offs, the loans in this category represent a very small portion of the program's portfolio and are currently in a grace period in which no principal is due.

4. Contrary to USAID's assertion, neither the Office of Management and Budget (OMB) nor the Congressional Budget Office have ever challenged the validity of the method upon which we based our projection of default costs. In fact, OMB and other executive agencies recognized the validity of increasing the use of market price to derive better assessments of default costs when assessing sovereign risk—a key component of our methodology. However, OMB indicated that estimating default costs for 167 countries using this method would be overly burdensome. Moreover, our

calculations are comparable to those presented in USAID's most recent audited fiscal year 1993 financial statements; both sets of calculations indicate that the cost of the program is about $1 billion. USAID mischaracterizes our projection of default costs and the one contained in its own financial statements as "worst case scenarios." In fact, both projections represent likely costs, based on two independent assessments of country credit risks.

5. USAID dismisses our observations about the legislated ceiling, indicating that this ceiling is no longer applicable to the program. However, this ceiling does still apply to those loan guaranties authorized prior to fiscal year 1992.

6. We recognize that, as USAID indicates, defaults and debt rescheduling under this program occur within the larger macroeconomic context of debt rescheduling that USAID describes. We continue to believe that the program's poor financial condition has been aggravated by (1) repeated rescheduling by program borrowers, (2) USAID's provision of additional loan guaranties to rescheduled borrowers, and (3) the waiver of administrative fees on rescheduled debts. However, we have revised the language in our report relating to USAID's influence on a country's decision to reschedule its debts.

7. USAID asserts that it has collected 95.6 percent of payments due from rescheduled borrowers. However, this is not because these borrowers have been repaying their debt to USAID. In fact, most of these borrowers have rescheduled their payments on uncollected debt, an average of five times each so far, repeatedly deferring repayment. Thus, only about 5 percent of the debt has technically come due and has been repaid.

8. Although, as USAID indicates, loans to previously rescheduled borrowers amount to about 1 percent of all guarantied loans, the rescheduled borrowers involved in these cases now collectively owe USAID about $96 million, or 23 percent of all uncollected debt.

9. USAID claims that the program was never intended to be self-sustaining. We do not assert that the program was intended to be self-sustaining. However, as we indicated in our report, on a number of occasions, presidential budget documents represented the program to the Congress as being totally self-sustaining "consistent with the intent of the Congress." Such representations were made even up to 5 years after USAID first received a substantial reserve account to cover missed loan

payments. Furthermore, USAID's assertion that it is owed and intends to collect 27 percent more than the government's contribution seriously underestimates the cost of this program to the U.S. government. It does not consider the foregone interest on U.S. funds as we have done by converting dollar amounts to 1995 dollars where appropriate (see comment 1).

10. The Credit Reform Act does not prohibit the recovery of administrative costs through fees. Rather, it allows fees to be applied against probable default costs, thereby reducing the necessary subsidy appropriation and administrative costs to be funded separately through appropriations. Thus, the act does not negate USAID's authorization under the Foreign Assistance Act to collect fees to cover program expenses. We acknowledge that it may be difficult to recover all program costs and still charge affordable fees, although, as our report indicates, USAID could raise its fees and still be competitive with other international donors. We have revised our report to recommend that program fees be increased to cover a greater portion of program costs.

11. We defined a closely-linked cross subsidy as cash or assistance provided to participants of a subsidized credit program that decreases the likelihood that borrowers will default by either increasing the likelihood of income for the borrowers or decreasing the borrowers' costs. In the countries we visited, USAID's technical assistance, assuming it achieved its objectives, clearly met this definition. The World Bank recognizes the financial value of technical assistance and often includes the cost in the principal amount of its loans to developing countries.

12. USAID contends that its program overwhelmingly reaches the targeted poor population in those countries where it operates. However, USAID does not provide credible evidence to support its contention. As we indicate in chapter 4, after analyzing USAID's documentation, including that described in USAID's comments, we found that the mechanisms USAID employed did not ensure and in some cases were not intended to ensure that 90 percent of the program funds are used to finance projects that benefit below-median income families.

13. USAID cites our earlier reports to support its position that it has reached the target population. While we have in the past, as we have in this report, acknowledged some of USAID's successes under this program, we have also pointed out serious shortcomings, including the potential inadequacy of the program's reserves and difficulties reaching the target

population. None of our earlier findings contradict our current conclusions. Interestingly, USAID also points to recent favorable statements we made on USAID's housing sector reform project in Russia. While, as we reported, the program achieved its reform objectives, it did so without the use of a Housing Guaranty Program loan.

14. We believe the fact that host governments have invested in projects intended to benefit below-median income families does not relieve USAID from its responsibility for ensuring that the projects it finances benefit the target population.

15. In several cases, USAID presented inaccurate and misleading information to support its criticism of our report. For example, with regard to the pay toilet for tourists in Indonesia, our interviews with local workers at this site revealed that they did not use this facility, despite USAID's claims to the contrary. USAID also inaccurately indicates that only below-median income families are eligible for Chile's subsidy program, when, in fact, there are no income restrictions. We were unable to verify USAID's claim that 100 percent of the beneficiaries in the most recent program in Chile had incomes below the median, because these funds were disbursed after our field work in Chile was completed. At the time of our visit, however, USAID officials indicated that they did not intend to check family income for this program.

16. USAID provides statistics and other information contending that its programs have stimulated private investment we did not consider. We had already reviewed virtually all of the data USAID provided and found that it is not germane to the conclusions of our report. For example, USAID cites statistics on investments in India, Indonesia, and Ecuador which benefit essentially upper-income not low-income families. USAID also describes a $10 million Housing Guaranty Program investment in Chile that has produced over $45 million worth of housing. As we explain in our report, this does not represent an increase in long-term private investment for housing but rather private construction of housing largely financed by the government of Chile. In addition, USAID refers to shelter sector developments that cannot be directly attributed to Housing Guaranty Program activities. For example, increased private shelter construction in Chile is driven by that country's government-funded housing subsidy program, for which USAID cannot take credit.

17. We revised our report to reflect information provided on short-term construction financing raised from private sources in Tunisia.

18. USAID criticizes our review for overlooking private investment by homeowners. We acknowledge that formal investment in shelter can have a multiplier effect on homeowner consumption and the economy in general, as USAID's data illustrate. In fact, the program is predicated on this fact. However, we focused on investment from credit institutions and entrepreneurs, as this is the type of investment the program was specifically intended to stimulate, according to the Foreign Assistance Act. Such investment would sustain and expand the multiplier effect USAID describes. Also, since USAID has not ensured that 90 percent of the program beneficiaries have below-median incomes, it likewise cannot ensure that all of the homeowner investments it cites benefit the target population.

19. USAID generally acknowledges that improvements are needed in its performance measurement system but criticizes our review for having overlooked pertinent information on project level indicators and monitoring activities. Our review was specifically aimed at reviewing all of USAID's monitoring and evaluation activities, and, accordingly, we conducted an exhaustive review of the agency's records on this subject. In addition, despite our extensive file review, we specifically requested the program staff to provide any pertinent documents we may have missed. We found that the data USAID provided generally did not demonstrate achievement of the program's private investment goal or the assurance that projects suitable for below-median income families actually benefited those families.

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