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FOREIGN HOUSING GUARANTY PROGRAM

Goals Are Not Achieved and Financial Condition Is Poor

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our recent report on the U.S. Agency for International Development's (USAID) Housing Guaranty Program, entitled Foreign Housing Guaranty Program: Financial Condition is Poor and Goals Are Not Achieved.[1] A fundamental long-term goal of this program is to increase shelter for low-income families in developing countries by stimulating local institutions to provide the necessary investment capital and other resources. The Foreign Assistance Act and subsequent amendments have authorized the use of different strategies and tools to achieve this goal. Since 1961, USAID has guarantied over $2.7 billion in loans in 44 countries under this program for home construction, mortgages, home improvements, urban infrastructure, and other shelter-related projects.

We examined this program at the request of members of this subcommittee, who had long-standing concerns about the program's evolution, financial condition, and impact in the developing world. We performed our work at USAID headquarters and in seven countries in South America, Asia, North Africa, and Eastern Europe. Our fieldwork included visits to project sites and discussions with local government and private financial institution officials. We also conducted a thorough review of the program's audited financial statements and related records.

SUMMARY

Our work has led us to conclude that the Congress should consider terminating this program.

Over the past 34 years, the Housing Guaranty Program has evolved from financing homes constructed by U.S. firms in Latin America to financing an assortment of shelter-related activities in many parts of the world. Increasingly, assistance has gone to advanced and creditworthy developing countries--countries that have ready access to international financing.

The program has not had the intended impact of stimulating local private sector investment in low-income shelter. Instead, in the countries we visited, the program has basically provided supplementary funds for host government low-income housing and related infrastructure financing. Further, USAID does not always know whether the program is benefiting the poor target population. We found numerous instances in our fieldwork in which this program was benefiting higher-income families.

Many borrowers have defaulted on loan payments, forcing USAID, as guarantor, to make these payments for them. The fees that USAID charges borrowers do not generate

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[1]GAO/NSIAD-95-108, dated June 2, 1995.

enough income to cover these costs. As a result, the total cost to the U.S. government for this program due to loan defaults is likely to be about $1 billion in constant 1995 dollars. This does not include several hundred million dollars in technical assistance that USAID has provided borrowers to help implement the projects that are financed.

PROGRAM EVOLUTION

The program has evolved in three respects: its approach, the type of projects funded, and its geographical scope. While these changes appear reasonable, we believe the change in the profile of borrowers raises questions about the need for this program.

The program's approach has evolved from conducting demonstration projects using U.S. firms to involving and supporting local institutions. More recently, the emphasis has shifted toward policy reform as an explicit recognition of the limited impact of demonstration projects alone in countries whose policies discourage efficient development of shelter for the poor. This shift and the provision of technical assistance to help program borrowers use their loan funds effectively were reasonable management decisions.

Beginning in the 1970s, the program shifted from financing U.S.-style housing projects to financing more basic, minimum standard housing. More recently, the scope of projects financed has expanded from housing to urban services, such as sewers and water treatment plants, electricity, and roads, to support housing construction and upgrading. This change was consistent with the program's intent to make housing more affordable to the poor.

However, USAID has increasingly provided assistance in more advanced and creditworthy developing countries. Given the risk of loan defaults and U.S. budgetary constraints, this choice of borrowers may seem to be more appropriate; however, these borrowers may have less need for this type of assistance than other countries. We recognize that some of the loan guaranties under this program were approved for foreign policy considerations. However, a key factor in the overall shift in borrowers is the implementation of the Federal Credit Reform Act of 1990. This act requires appropriated funds to be set aside to cover probable loan defaults. As a result of this requirement, USAID has scaled back its loan guaranties in countries that are higher-risk and lower-income, which require larger reserves for probable defaults. Recent programs have focused on countries that currently have ready access to comparable loans from other international lenders. These countries include USAID graduating countries, such as Tunisia and Thailand, and more creditworthy countries, such as India and Indonesia.

IMPACT ON LOW-INCOME SHELTER INVESTMENT

After 34 years of existence, there is still little evidence of progress toward the Housing Guaranty Program's fundamental, long-term objectives. As I pointed out earlier, the program is intended to finance demonstration projects that would stimulate local private sector investment in low-cost shelter projects. While the program has included the local private sector in the delivery of housing and infrastructure financed by the developing country governments, USAID documents and our fieldwork showed that the program has not convinced local private investors to risk their own capital in similar projects. Instead, in the countries we visited, the formal low-income shelter markets are still heavily dependent on government-furnished subsidies and financing.

For example, in Tunisia, long-term financing for low-income housing is generated through a payroll tax instead of from private sources. A USAID-sponsored study indicated that rates of return on mortgages are too low for private financial institutions to offer their own capital. In Ecuador, private bankers we visited told us that they could not afford to offer low-income mortgages without subsidies from the government. In India, also, private lenders rely on government financing at subsidized rates to make home loans available to low-income customers. A USAID consultant in India concluded that instead of leading to increased low-income shelter investment, the USAID program in that country had simply created another conduit for distributing government resources. In Indonesia, USAID consultants reported little progress in replacing government financing of infrastructure projects with private financing.

The Foreign Assistance Act requires that at least 90 percent of the guaranties issued under the program be used to finance shelter suitable for families with incomes below the country's median income. However, our review showed that USAID does not always ensure that the projects it finances are benefiting the program's poor target population. In the countries we visited for this review, we found instances where housing financed by the program was not or appeared not to be benefitting low-income families. For example, our review of the program in India revealed that a participating bank was lending program funds to its own upper-income employees for home improvements. In Indonesia, the program financed infrastructure projects we visited in higher-income neighborhoods.

In several cases, USAID documents confirmed our observations that a significant portion of beneficiaries probably had above-median incomes. For example, according to a USAID consultant study, about 36 percent of Housing Guaranty Program funds in India were benefitting upper-income families. A similar study in Tunisia showed that 17 percent of a sampling of eligible beneficiaries had above-median incomes. In other countries we visited, USAID consultants noted the potential for this problem but did not attempt to document its extent. For example, a consultant study in Indonesia reported "conflicting speculation" about whether infrastructure projects were benefitting the poor. In Ecuador, representatives of a nonprofit agency working with USAID on one major housing project reported to us and to a USAID consultant that many beneficiaries appeared to be upper-income families.

Additionally, it is important to point out that USAID has not designed its performance indicators to measure the program's progress in stimulating private investment and providing shelter to the target population. Instead, USAID measures a variety of large-scale shelter sector changes that cannot be directly attributed to the program, such as infrastructure expenditures per capita and house price-to-income ratios.

FINANCIAL CONDITION

The U.S. government's total net cost for the existing portfolio of loans is likely to be about $1 billion. This is because many borrowers have defaulted on loan payments and we project they will default in the future. USAID, as guarantor, must make the payments for them. The fees USAID charges have not generated enough revenues to cover the costs USAID incurs when borrowers default .

Since 1970, the program has required $417 million (in 1995 dollars) in appropriations and $125 million in loans from the U.S. Treasury to cover loan defaults. We estimate that the cost to the U.S. government of future loan defaults from the existing portfolio of loans is likely to be an additional $600 million. Since fiscal year 1992, the Credit Reform Act has required USAID to set aside a reserve fund with appropriations to cover the estimated future cost of defaults on its newly guarantied loans. However, because this was only a recent requirement, USAID has only enough reserves ($50 million) to cover defaults on loans authorized after fiscal year 1992.

The potential cost to the U.S. government could be reduced by deauthorizing, where feasible, the nearly $193 million in guaranties that were issued before 1992 on loans that have not yet been disbursed.

USAID Housing Guaranty Program officials disagree with our $1 billion cost projection, because they feel they will eventually recover nearly all default costs from the defaulted borrowers. However, the results of USAID's efforts to date are not encouraging. USAID has recovered only about 5 percent of the debt it has assumed under the program, and the outstanding balance of uncollected debt owed to USAID grows each year. Based on our estimates of probable default, we project that USAID will ultimately recover only about $200 million of the $542 million the program has cost so far. Many defaulted borrowers have avoided repayment by repeatedly rescheduling the debt--one country has rescheduled its debt to USAID 10 times. Nonetheless, in several cases, USAID continued to guaranty new loans for countries that were in arrears and repeatedly rescheduled their debts--increasing the U.S. government's exposure.

It is important to note that while our projection of future default costs is about $600 million, USAID's own auditors estimate these costs at over $700 million in their fiscal year 1993 audited financial statements, which were the most recent available at the time of our review. Our projection reflects more current country risk data than USAID's and is derived from the secondary market's expectations of default.

It should be pointed out that in addition to the costs already discussed, USAID has provided several hundred million dollars in technical assistance to program participants; $471 million is programmed for ongoing projects alone. These costs are not reflected in the program's budget or financial statements and is not considered by USAID to be a cost of the program.

One other issue needs to be mentioned with regard to the financial condition of the program--the $2.6 billion ceiling in the Foreign Assistance Act on outstanding loan guaranties issued prior to 1992. This ceiling has not been effective at limiting the government's financial exposure from this program. Every time some amount of loan principal was paid off, USAID was allowed, under the legislated ceiling, to issue a new guaranty for a corresponding amount. However, as we have pointed out in our report, in many cases USAID itself made principal payments on behalf of defaulted borrowers. Thus, USAID was able to issue new guaranties even when the borrower itself did not repay the principal that was due. If USAID had been required to include overdue amounts owed by borrowers under the legislated ceiling, it would have issued $200 million less in loan guaranties. This would have reduced USAID's probable default costs by an estimated $50 million.

As you know, our recent report suggested that the Congress consider terminating the Housing Guaranty Program because

-- the program is increasingly benefiting more creditworthy and advanced developing countries that have access to comparable loans from other international lenders;

-- the program has not stimulated local private sector investment in low-income shelter as intended; and

-- the program annually costs the U.S. government millions of dollars more than anticipated.

MATTERS FOR CONGRESSIONAL CONSIDERATION

You and the Members of the House of Representatives have already initiated action to terminate this program when you passed H.R. 1561. Section 3251 of that bill repeals housing guaranty authority and denies aid to any country that is in arrears on a loan guarantied under this program.

In the event the program is not terminated, we believe that the Congress should consider requiring USAID to develop a comprehensive plan for reforming the program to achieve its legislated goals and reduce its cost to the U.S. government. Our report also contains several recommendations to USAID to improve the management of the program.

This concludes our statement, Mr. Chairman. I would be glad to take your questions now.

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