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**U.S. DEPARTMENT OF  
AGRICULTURE**

**Centralized Servicing for  
FmHA Single-Family Housing  
Loans**

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Resources, Community, and Economic  
Development Division



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Mr. Chairman and Members of the Subcommittee:

We are pleased to participate in this hearing on a proposal to centralize servicing for the Farmers Home Administration's (FmHA) single-family housing loans. Our testimony is based on our September 1993 report on the advantages to be gained from centralizing such servicing activities as loan collections, escrow accounting for taxes and insurance, and delinquency management.<sup>1</sup>

In summary, the possibility of centralizing FmHA's service activities presents an opportunity to demonstrate how reengineering government processes in more businesslike ways can improve service while cutting costs. FmHA's efforts over the past 5-1/2 years to centralize servicing operations for direct housing loans have not been fruitful, the budgetary and efficiency benefits of centralization outweigh the disadvantages, and options for moving forward with centralization would be consistent with USDA's efforts to reinvent itself.

Centralizing loan servicing activities is also consistent with positions we took in testimony before this subcommittee in April 1993<sup>2</sup>. In that testimony, we said that the U.S. Department of Agriculture (USDA) needs to be fundamentally restructured--reinvented, if you will--in the context of the newer management concepts that guide private sector corporations, state governments, and governments in other countries. These concepts emphasize, among other things, competition, flattened hierarchies, and the achievement of results.

After providing some brief background, the remainder of our testimony will focus on FmHA's past efforts, the benefits and disadvantages of centralization, and options for moving forward.

#### BACKGROUND

FmHA makes housing and farm loans to rural Americans who cannot otherwise obtain them on reasonable terms. FmHA has a large single-family housing portfolio. As of December 31, 1993, the outstanding principal due on single-family housing loans was \$18.6 billion (compared to about \$13.7 billion for farm loans), and the ratio of direct single-family housing borrowers to farm program borrowers was 3 to 1. Moreover, since the program was first authorized in the Housing Act of 1949, FmHA has made over 2 million single-family housing loans for over \$45 billion.

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<sup>1</sup>U.S. Department of Agriculture: Centralized Servicing for FmHA Single-Family Housing Loans (GAO/RCED-93-231BR, Sept. 23, 1993).

<sup>2</sup>Revitalizing USDA--A Challenge for the 21st Century (GAO/T-RCED-93-32; April 22, 1993).

FmHA services about 675,000 single-family housing borrowers from about 1,700 offices. Servicing these single-family housing loans accounts for about 35 percent of the work load in FmHA's county offices. An additional 90,000 loans are administered by a loan servicing company from a central location. These loans were sold in 1987 as part of the Omnibus Budget Reconciliation Act of 1986.

The private sector has used centralized servicing of housing loans for many years. Under centralized servicing, an individual who wishes to buy a home obtains a loan from a lending institution. After the loan is closed, the lending institution often sells the servicing rights to another organization. It is this centralized servicing organization that collects monthly payments, establishes escrows for property taxes and insurance, manages delinquencies, and provides credit counseling. The borrower communicates with the servicing organization over the telephone or through the mail.

FmHA's in-house centralized servicing for FmHA borrowers would work in much the same way as private sector servicing. Borrowers could obtain their loans from FmHA's local offices, regional offices, or a central location, but all loan servicing would be performed at a separate, central location. The borrower would receive the same services provided by the private sector loan servicing industry as well as services unique to FmHA, such as periodic review of interest credit agreements, application of moratoriums, and appeals.

#### Although Many Studies Support Centralized Servicing, No Action Has Been Taken

Although FmHA has pursued the centralized servicing concept since 1988 as a means to improve program management and streamline its field office operations, it has yet to take action. Over the past 5-1/2 years, FmHA has spent more than \$1.6 million for one external and two internal studies, three plans for implementing centralized loan servicing, and an unsuccessful pilot project to establish federally mandated escrow accounting. The pilot project did not succeed because the contractor was not able to integrate its automation system with FmHA's loan accounting system.

The most recent of the three plans was FmHA's June 1992 Strategic Business Plan, which stated that the agency would implement centralized servicing and escrow accounting by fiscal year 1994. That plan was not carried forward by the new administration because it did not want to deal with a business plan developed by the prior administration.

A new FmHA task force was formed in January 1994 to once again study centralized servicing options.

## Benefits Outweigh the Disadvantages of Centralization

FmHA's studies and our analysis show that the benefits of centralized servicing outweigh the disadvantages. For example, a contracted USDA study estimated operating cost savings of \$106 million annually. Moreover, we identified about 700 FmHA county offices that have more than 75 percent of their loans in single-family housing. With centralized servicing, these offices could be studied for possible consolidation or closure. Other benefits of centralized servicing--which are currently experienced by the private company that centrally services the former FmHA single-family housing loans--are an appreciably lower delinquency rate (9.2 percent on December 31, 1993, vs. 16 percent for FmHA) and reduced loan losses. The private company credits this increased efficiency (as compared to FmHA's servicing) to its (1) computer system that flags delinquent borrowers and allows the company to question early on why payments were missed, (2) escrow accounting system that helps borrowers budget for taxes and insurance, and (3) high degree of specialization among staff members who service loans.

The potential disadvantages of centralized servicing are (1) the loss of face-to-face contact between borrower and loan servicer and (2) the costs that would be incurred to redesign automated systems, if centralized servicing were to be carried out by FmHA rather than by a private company already using centralized servicing. At private servicing companies, the loss of face-to-face contact has not proved to be a major detriment to customer service, and on numerous occasions we have reported on the need to improve FmHA's automated systems.

## Options for Moving Forward With Centralization

Three basic options for moving forward with centralization include in-house loan servicing by FmHA, private sector contracting, or a combination of the two that allows the public and private sectors to compete for the loan servicing. At least to some extent, the option selected depends on one's view of the role of the government and whether it can carry out and should be carrying out functions the private sector can do.

Although this is an age-old debate, recent literature and efforts by the administration's National Performance Review team have emphasized the benefits of private sector and public/private competition. For example, the National Performance Review states that

"reinventing government is not just about trimming programs; it's about fundamentally changing the way government does business. Forcing public agencies to compete...will create a permanent pressure to streamline programs, abandon the obsolete, and improve what's left."

Allowing the public and private sectors to compete for centralized servicing of the 675,000 borrowers currently serviced at the local level will fundamentally change the way FmHA does business. It also could mean reaping the benefits of the competitive marketplace--greater efficiency, increased focus on customer needs, increased innovation, and improved morale.

For example, while FmHA has unsuccessfully attempted to develop an escrow accounting system for the loans it services, a private company has established escrow accounts for each of its 90,000 loans. If forced to compete, FmHA will have to develop escrow accounts and a computer system that meets the needs of the loan holders and FmHA employees. Without a system comparable to the one developed by private industry, FmHA would not be competitive. Yet the literature states that once forced to compete, government employees enjoy the challenge of competition if job security is not at stake.

Any of the three options could be implemented over a period of years. This measured pace would allow USDA to rely on attrition and retirements to minimize reductions in the work force that would result from office consolidations.

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That concludes my statement. I would be happy to respond to any question you may have.

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