UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

CIVIL DIVISION

MAR 17 1972

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Dear Mr. Hyde:

Our survey of rehabilitation loan activities carried out under section 312 of the Housing Act of 1964, as amended, has shown that the Department of Housing and Urban Development (HUD) generally makes such loans for the maximum 20-year period allowable to borrowers who apparently could repay their loans over considerably shorter periods. We believe that there is a need for HUD to establish guidelines providing for shorter loan repayment periods than the statutorily authorized 20-year maximum where the borrowers are financially able to repay the loans in less time.

Our survey was made at the HUD Central Office, the Chicago Regional Office, and the Los Angeles Area Office. At the Chicago and Los Angeles offices, we reviewed 65 loans to individuals in projects administered by 18 local public agencies.

The section 312 rehabilitation loan program was established to help property owners finance repairs and improvements to their properties. A rehabilitation loan may be made to an owner of property located in an area which is receiving Federal financial assistance under programs such as urban renewal, neighborhood development, and code enforcement. A loan made to an owner-occupant of a structure containing one to four dwelling units may include an amount necessary to refinance existing indebtedness secured by the structure if 20 percent of the owner-occupant's average monthly income would not be sufficient to make monthly payments on both the (1) rehabilitation loan needed to rehabilitate the property and (2) other indebtedness secured by the property.

A loan may be made in an amount up to $12,000 per dwelling unit--$17,400 in high-cost areas. The loan shall bear interest at a rate not to exceed 3 percent per annum. The term of a loan may not exceed 20 years or three fourths of the remaining economic life of the structure after rehabilitation, whichever is less.

Neither the legislation nor HUD regulations provide guidance as to whether, or under what conditions, HUD officials should consider making loans with repayment periods of less than 20 years. Consequently,

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loans generally are made for 20 years unless a borrower specifically requests a shorter repayment period.

While some loan recipients may need 2^ years to repay their loans, many borrowers apparently could pay off their loans over considerably shorter periods of time. Also, Federal legislation authorizing certain other housing assistance programs require program participants to use about 20 to 25 percent of their incomes for monthly housing payments.

Fifty of the 65 loans that we reviewed were made for the maximum period of 20 years, although all but 9 of the 50 borrowers could have repaid their loans over considerably shorter periods without using more than 20 percent of their incomes for loan payments. The remaining 15 borrowers, whose loan repayment periods were less than 20 years, could have similarly repaid their loans in shorter periods without using more than 20 percent of their incomes.

As indicated above, only 9 of the 65 borrowers included in our survey were using 20 percent or more of their incomes for monthly loan payments. Nineteen of the 65 borrowers were making monthly loan payments of between 10 and 15 percent of their incomes; 23 borrowers were paying between 5 and 10 percent of their incomes: and 7 were paying less than 5 percent of their incomes.

By paying 20 percent of their incomes for monthly payments, the repayment periods of the 65 loans would have been reduced from an average of 17.4 years to an average of 7 years, as shown below.

			Average number of years for repayment	
Category of loan	Number of loans	Loan amounts	Actual	Based on 20% of income
Rehabilitation only	44	$128,000	16.2	3.8
Rehabilitation and refinancing	21	268,000	20.0	13.0
	65	$396,000	17.4	7.0

For example, a borrower with annual income of $15,168 received a 3 percent loan of $3,450 to be paid off over 20 years. After the loan, the borrower's total monthly payments, including any payments on other indebtedness secured by the property being rehabilitated, was $78, or about 6.2 percent of his monthly income. With payments equal to 20 percent of his monthly income, or $252 monthly, he could have repaid the loan in 19 months.

A borrower with annual income of $10,440 received a 3 percent loan of $14,200, including $8,737 to refinance existing indebtedness, to be paid off over 20 years. After the loan, the borrower's total monthly payments, including any payments on other indebtedness secured by the property being rehabilitated, was $73, or about 8.4 percent of his monthly income. With monthly payments equal to 20 percent of his income, or $174 monthly, he could have repaid the loan in less than 8 years.

A borrower with annual income of $11,352 received a 3 percent interest loan of $4,400 to be paid off over 20 years. After the loan, the borrower's total monthly payments, including any payments on other indebtedness secured by the property being rehabilitated, was $24.42, or only about 2.6 percent of his monthly income. With monthly payments equal to 20 percent of his income, or $189 monthly, he could have repaid the loan in 25 months.

The relatively high incomes of some of the other borrowers further indicate that they could repay their loans over shorter repayment periods than were provided. One borrower had an annual income of about $50,000, and 3 other borrowers each had annual incomes of about $24,000.

Shorter loan repayment periods would enable a more rapid return of funds to HUD. In this connection, annual loan approvals have increased at a rapid rate from less than $1 million in fiscal year 1966 to an estimated $50 million in 1972. However, only a small part of the funds being used for new loans are being provided through loan repayments--in fiscal year 1971 loan repayments were $6.4 million. Further, from time to time there have been insufficient funds to meet the demands for new loans. In January 1972, HUD estimated that an additional $30 to $35 million would be needed to meet the demands for loans during fiscal year 1972. In February 1972, HUD reported that at least 7 of the 10 regional offices would use all of their fiscal year 1972 rehabilitation loan funds by the end of the month.

HUD estimates that $45 million in loans for residential properties during fiscal year 1972 will enable the rehabilitation of 10,375 dwelling units. Although the precise effect of establishing loan repayment periods on the basis of a borrower's ability to repay is not known, it seems obvious that many additional dwelling units could be rehabilitated without increasing the current level of appropriated funds.

There appears to be ample support for the proposition that borrowers generally can and should use a designated percentage of their incomes for housing. Real estate brokers frequently consider--as a "rule-of-thumb" guide--that individuals can pay about 20 to 25 percent of their incomes for mortgage payments. Also, the Congress has made it rather clear that the amounts of Federal funds to be provided under housing assistance programs generally should be related to the incomes of the program participants. For example, to qualify for an interest subsidy under section 235 of the National Housing Act a participant must make monthly mortgage payments of at least 20 percent of his adjusted monthly income. Under section 236 of the National Housing Act, a program participant must pay at least 25 percent of his adjusted monthly income for rental charges. Also, rent supplements are available under title I of the Housing and Urban Development Act of 1965 only to renters whose rents exceed 25 percent of their incomes. Finally, to qualify for a rehabilitation grant under section 115 of the Housing Act of 1949, an applicant whose income exceeds $3,000 a year must make monthly housing expense payments of at least 25 percent of his income. A common characteristic of all of these programs is that renters and homeowners must pay at least a stated percentage of their incomes for housing.

In view of the above, we believe that each rehabilitation loan repayment period should be commensurate with the individual borrower's financial ability to repay. For example, borrowers could be required to pay at least 15 or 20 percent of their average monthly incomes for loan payments. Accordingly, we recommend that you prepare and issue guidelines which require that each loan repayment period be commensurate with the individual borrower's financial ability to repay--within the authorized 20-year period.

If you or members of your staff wish to discuss the above matters or require any additional information, please let us know.

A copy of this letter report has been sent to the Inspector General, Department of Housing and Urban Development.

Sincerely yours,

B. E. Birkle

B. E. Birkle
Assistant Director

The Honorable Floyd H. Hyde
Assistant Secretary for Community
Development
Department of Housing and Urban
Development