026184

3.04.14
73-0034
21
32

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114873

LM096184

JAN 30 1973

Dear Mr. Chairman:

In accordance with your request of January 27, 1972, and subsequent discussions with our representatives, we reviewed certain aspects of the administration of the rural rental housing program of the Farmers Home Administration (FHA), Department of Agriculture, in Iowa and Missouri.

Under the rural rental housing program, FHA makes loans to provide moderate cost rental housing for elderly persons and other persons of low and moderate incomes in rural areas. Although loans are repayable with interest at rates determined by the Secretary of Agriculture which are stated in the borrowers' promissory note, FHA can provide financial assistance in the form of interest subsidies to reduce the interest payable on the promissory notes and therefore achieve reductions in the rental rates.

As agreed, the results of our review are summarized in this report as they relate to certain statements made in a November 1971 report by the Rural Housing Alliance, Washington, D.C., on studies of the program in Iowa, Missouri, and Wisconsin. In its report, a copy of which was enclosed with your request, the Alliance stated that:

--FHA regulations governing the program were confusing, misleading, and unnecessarily restrictive.

--The program was developing slowly and was centered in a few States.

--Wide variations existed in the manner in which the program was administered.

Our review was made at FHA headquarters in Washington, D.C.; FHA's National Finance Office, St. Louis, Missouri; and FHA State offices and selected FHA county offices primarily in Iowa and Missouri. We reviewed FHA's policies, procedures, practices, and program statistics relative to the rural rental housing program. We interviewed FHA headquarters, State, and county office employees. Our findings are summarized below.

~~701407~~ 096184

## PROGRAM REGULATIONS

With respect to the statement that FHA regulations were confusing, misleading, and unnecessarily restrictive, FHA revised its regulations on September 15, 1972, to reduce restrictions on builders and investors by providing additional incentives for them to participate in the program. The revised regulations are discussed on page 3.

## PROGRAM DEVELOPMENT

As reported by the Alliance, FHA's rural rental housing program has developed slowly and has been centered in a few States. FHA, however, has made certain changes in its program to encourage program development.

From inception of the program in 1962 through calendar year 1971, FHA made loans totaling $109.8 million to 1,676 borrowers. Some borrowers had received more than one loan. The following table shows the number of borrowers and the amount of loans made each calendar year since inception of the program.

| Calendar year | Number of borrowers | Amount loaned (millions) |
|---|---|---|
| 1962, 1963 | 5 | $ 0.2 |
| 1964 | 19 | 1.4 |
| 1965 | 38 | 1.8 |
| 1966 | 88 | 4.6 |
| 1967 | 134 | 5.9 |
| 1968 | 282 | 14.2 |
| 1969 | 355 | 21.8 |
| 1970 | 408 | 29.6 |
| 1971 | 347 | 30.3 |
| Total | 1,676 | $109.8 |

Although FHA made loans in 48 States and Puerto Rico, there were relatively high numbers of loans in some States and very limited numbers in others. For example, about

40 percent of the loan activity was concentrated in five States--Alabama, Iowa, Missouri, North Dakota, and Wisconsin. Fewer than 10 loans each had been made in 14 States and Puerto Rico.

Iowa had the largest number of borrowers. As of January 1, 1972, FHA had made loans totaling $12.8 million to 246 borrowers in Iowa. An FHA official in Iowa told us that the program started in the southwestern part of the State about 8 years ago and spread as a result of community support.

Missouri was second to Iowa in the number of borrowers but was the largest in terms of dollars. As of January 1, 1972, FHA had made loans totaling $13.1 million to 131 borrowers in Missouri. An FHA official in Missouri told us that the program started in Missouri about 6 years ago and expanded without much FHA emphasis as a result of community support.

FHA's Assistant Administrator (Rural Housing) told us that concentration of the program in certain areas was partly due to greater promotion of the program by FHA officials in certain States. He stated that FHA was revising its regulations to encourage greater program development and that the program could not help very low income persons obtain housing because the rental rates which must be charged for projects, even for those receiving the maximum interest subsidy authorized by law, were too high for the very poor.

Effective September 15, 1972, subsequent to our discussion with the Assistant Administrator, FHA revised some of the program's regulations to reduce restrictions on private builders and investors by providing additional incentives for them to participate in the program. These added incentives are:

1. Interest subsidies are available to individuals and private corporations that agree to operate on a limited-profit basis (6-percent return on initial investment.) Previously, only nonprofit corporations and consumer cooperatives qualified for interest subsidies.

2. Removal of the requirement that individual members of profit or limited-profit corporations be personally liable for loan repayment.

3. Elimination of the requirement that an applicant be a resident of the community in which the project is to be located. Under the revised regulations, a loan applicant who will not reside near the proposed project must retain a managing agent who is located in close proximity to the project and who has full authority to act for, and on behalf of, the applicant.

The Department of Agriculture announced in September 1972 that FHA's budget allocated $70 million for rural rental housing, double the amount it was a year ago.

Rural rental housing units may now be made available to very low income families through arrangements between FHA and the Department of Housing and Urban Development (HUD) under HUD's leasing program, section 23. Pursuant to these arrangements, an FHA borrower can lease rental units at a rate approved by FHA to a local public housing authority which manages the property. HUD, in turn, pays the housing authority the difference between the rent the family can reasonably afford and the rental rate provided in the lease agreement between the FHA borrower and the public housing authority.

## PROGRAM ADMINISTRATION

As to variations in the manner in which FHA administered the program, the Alliance report stated that, in Missouri, FHA encouraged maximum use of interest subsidies and thus was able, in effect, to bring the interest rates stated in the promissory note down to as low as 1 percent in many cases, whereas in Iowa interest subsidies were used to bring interest rates down to 3 percent. In addition, the report stated that Iowa and Missouri were headed in different directions with respect to the size of projects, because Iowa favored four-unit projects and Missouri favored 20-unit projects.

Although the use of interest subsidies and the sizes of the projects differed in the two States, the practices in both States were within the parameters of the enabling legislation and administrative regulations.

Interest subsidies

Section 521 of the Housing Act of 1949, as amended (42 U.S.C. 1490a), provides that the interest rate to borrowers providing rental or cooperative housing for eligible occupants may be reduced to as low as 1 percent a year. To implement this section, FHA has established two plans for computing the amount of the interest subsidies that will be provided to eligible borrowers and passed on to the occupants in the form of lower rents.

To obtain interest subsidies, eligible FHA borrowers must choose either plan I or plan II. Plan I provides an interest subsidy without requiring monthly computations. Plan II provides a larger subsidy but requires more analysis of project costs and occupants' incomes by the sponsor.

Under plan I the effective interest rate is 3 percent a year. All occupants in a project pay the same rent regardless of income. The borrower must agree to limit occupancy of the housing to low-income nonsenior citizens and low- and moderate-income senior citizens. The borrower must certify annually as to the eligibility of the families occupying the housing.

Under plan II the effective interest rate ranges from a low of 1 percent a year to the higher interest rate on the borrower's promissory note. Both the interest subsidy and the rates for the units in a project vary, depending on the incomes of the occupants. Occupants pay 25 percent of their incomes or the basic rental, whichever is greater; the rental rates, however, cannot exceed the fair market rental rates which would be charged if no Federal assistance were involved. Basic rentals are computed on the basis of an assumed 1 percent loan and project operating costs. Market rental rates are computed on the basis of the interest rate stated in the promissory note and project operating costs.

Under plan II, the borrower must agree to limit occupancy to low- and moderate-income nonelderly persons and to senior citizens of any income. The borrower is required to advise FHA monthly of any changes in occupancy so that the interest subsidy can be recomputed if necessary.

Computing interest subsidies under plan I is relatively simple and does not require revision when occupancy changes. Computing interest subsidies under plan II requires an analysis of operating costs and occupants' incomes, and the analysis must be redone each time there is a change in occupancy.

Plan I was used exclusively by eligible borrowers in Iowa. According to FHA officials in Iowa, Iowa borrowers preferred plan I because it required less paperwork than plan II. Eligible borrowers in Missouri were using both plan I and plan II.

## Project size

FHA regulations state that, as a general rule, a rural rental housing project should consist of multiunit housing with two or more family units. An FHA official in Iowa said that most projects in Iowa contained four or five units and that, although projects were not limited to four or five units, projects of this size were more popular in the small communities in Iowa.

An FHA official in Missouri said that the average project in that State had 20 units and that the range was four to 42 units. He said also that the FHA State office in Missouri generally discouraged projects smaller than 12 units because broad-based community support was easier to obtain for larger projects.

- - - -

We did not obtain written comments on the matters discussed in this report from FHA; however, we obtained the information from FHA and discussed it with FHA officials.