

**DOCUMENT RESUME**

07428 - [C2787905]

[Implementation of Revised Section 235 Homeownership Program].  
CED-78-16; B-171630. November 23, 1977. 5 pp.

Report to Secretary, Department of Housing and Urban  
Development; by Henry Eschwege, Director, Community and Economic  
Development Div.

Issue Area: Domestic Housing and Community Development: Housing  
for Low and Moderate Income Families (2101).

Contact: Community and Economic Development Div.

Budget Function: Income Security: Public Assistance and Other  
Income Supplements (604); Community and Regional  
Development: Community Development (451).

Organization Concerned: Department of Housing and Urban  
Development.

Congressional Relevance: House Committee on Banking, Finance and  
Urban Affairs; Senate Committee on Banking, Housing and  
Urban Affairs.

An inquiry was conducted into the Department of Housing  
and Urban Development's (HUD's) implementation of the revised  
section 235 homeownership program. Since its inception in  
January 1976, the program has helped only 9,459 homebuyers, and  
only \$21.3 million of the total \$264.1 million in contract  
authority has been reserved or obligated. The Department's  
initial goal was to spend the \$264.1 million over a 2- and  
3-year period to assist 250,000 to 300,000 homebuyers. There has  
been little activity in many major metropolitan areas although  
these areas have received relatively large portions of the  
program's allocated funds. Although many persons interviewed  
agreed that the concept of the program is good and that it fills  
a need for persons who want to be homeowners but cannot afford a  
home through conventional means, mortgagees were the only group  
which indicated some satisfaction with the current program  
requirements. The following actions to increase program  
participation should be considered: lowering the downpayment,  
increasing the interest subsidy, extending the life of the  
mortgage, making existing housing eligible under the program,  
relaxing the rigid 40% limitation on the number of section 235  
homes in a subdivision, and increasing the mortgage limits.

(RRS)

7905



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

IN REPLY  
REFER TO:

COMMUNITY AND ECONOMIC  
DEVELOPMENT DIVISION

NOV 23 1977

B-171630

The Honorable  
The Secretary of Housing  
and Urban Development

Dear Mrs. Harris:

The General Accounting Office has been inquiring into the Department of Housing and Urban Development's implementation of the revised section 235 homeownership program. Because we understand that the Department is currently looking into possible changes that might be made, we are providing you with the results of our inquiries at this time.

As you know, there has been little activity in this program since its inception in January 1976. After 21 months, the program has helped only 9,459 homebuyers and only \$21.3 million of the total \$264.1 million in contract authority has been reserved or obligated. These results compare with the Department's initial goal of spending the \$264.1 million over a 2- to 3-year period in assisting 250,000 to 300,000 homebuyers, and its April 1976 stated goal of providing 110,000 section 235 homes by September 30, 1977. We have also noted that there has been little activity in many major metropolitan areas such as New York City, Chicago, Philadelphia, and Northern New Jersey even though these areas have received relatively large portions of the program's allocated funds and units.

Our inquiries were made in the New York City, Newark, Philadelphia, Miami, Denver, Phoenix, and Salt Lake City areas. In these areas, we discussed the program with Department officials, builders, mortgagees, realtors, and section 235 participants. We elicited comments on what were considered the good and bad points of the program and specifically what was impeding the program's implementation on a larger scale.

Those interviewed agreed that the concept of the program is good and that it fills a need for those individuals who want to be homeowners but cannot afford a home through conventional means. Most, however, believed that adjustments to the program requirements will have to be made if any significant

program activity is to be achieved. Mortgagees were the only group we talked to which indicated some satisfaction with the current program requirements. They believed that liberalizing the program would cost them money by increasing the servicing required on program mortgages.

#### NEED FOR PROGRAM REVISIONS

While not all those interviewed agreed as to the extent that the program requirements should be liberalized, most agreed that the following actions would increase program participation and should be considered:

- Lowering the downpayment.
- Increasing the interest subsidy.
- Extending the life of the mortgage.
- Making existing housing eligible under the program.
- Relaxing the rigid 40-percent limitation on the number of section 235 homes in a subdivision.
- Increasing the mortgage limits.

The first three of these actions address the need to make it easier financially for prospective section 235 homebuyers to participate in the program while the last three deal with increasing the supply of available section 235 housing.

#### Increasing the demand

The downpayment currently required under the revised section 235 program is the same or higher than that required of a nonsubsidized purchaser under the regular Federal Housing Administration section 203 program. Although the downpayment computation is the same under both programs (3 percent of the first \$25,000 plus 5 percent of the amount over \$25,000), the fact that the section 235 program has lower mortgage limits than section 203 (\$38,000 or \$44,000 vs. \$60,000) causes the section 235 homebuyer to pay a greater downpayment for certain homes costing more than the mortgage limits for section 235, than would a section 203 homebuyer purchasing the same or similar priced home.

Most Department field office officials, builders, mortgagees, and realtors we interviewed believed that the homebuyers should have enough equity in their homes to feel financially obligated to become successful homeowners. The amount considered adequate generally ranged from a flat \$1,000 investment to a straight 2 or 3 percent downpayment.

The interest subsidy under the revised program may be too low to allow many people to participate. The fact that program participants must pay at least a 5 percent interest rate on their mortgages seems to limit the program to persons residing in areas where income is relatively high and housing costs are relatively low. A homebuyer must meet the Department's underwriting criteria which limits his mortgage payment to 35 percent of income and all fixed debts to 50 percent of income. With the higher mortgage limits of the recently enacted Housing and Community Development Act of 1977, increasing building costs, and the builders' natural inclination to build the most expensive houses the market will bear, the population of those families eligible and financially capable of participating in the program will become even smaller in some areas and probably nonexistent in others.

Two likely solutions to this problem are to increase the interest subsidy and/or extend the life of the mortgage. Most of those we talked to favored a program interest rate 2 to 4 percent lower than it is now. Some also favored extending the repayment period for the mortgage from 30 to 35 or 40 years. Either or both of these changes would make more people eligible for the program by lowering their monthly mortgage payments.

### Increasing the supply

Existing housing represents a potential supply of housing for the section 235 program. In recent years, 4 to 5 existing homes have been sold for every new one. Also, the median price of existing sales has been about \$4,000 less than for new homes. The inclusion of existing homes in the section 235 program, however, poses some problems for the Department, especially in the area of administrative control. Given the experiences of the original section 235 program, homes would probably have to be inspected (not just appraised), the activities of realtors and repair contractors suspected of less than adequate performance would have to be carefully monitored, and the Department would have to closely supervise its own employees to insure the integrity of the program.

Department officials in the field offices we visited agree that many of the problems of the existing housing portion of the original program were the fault of administrative failure and not the fault of the program participants. Most, however, believe their offices are now ready and able to do a good job administering existing housing for section 235 if the Department chooses to return this source of homes to the program.

The 40-percent limitation on the number of section 235 homes in a subdivision is an irritant to builders. Their principal complaint is with the rigidity of the 40-percent limitation. Given a hypothetical situation where a builder sells 40 homes through section 235 and 40 homes by other means in a 100 home subdivision, the builders say it is unfair for them to have to turn away a section 235 buyer who wants one of the remaining homes. They believe that a mix of income groups could be achieved in a subdivision without rigid limits and without the prospects of penalties being imposed on builders. We recognize that the 40-percent limitation is now law, but believe that the Department should study further its merits and necessity in accomplishing intended objectives.

Mortgage limits that are too low impact negatively on the supply of housing produced under a program. In the areas we visited where there has been little program activity, one of the overriding reasons was that the program's low mortgage limits were inconsistent with the overall cost of housing in those areas. Builders very simply could not afford to build houses with selling prices approximating the program's limits. We believe that the increased section 235 mortgage limits in the Housing and Community Development Act of 1977 will, except in the highest cost areas, increase the number of builders willing and able to participate in the program and thereby help to increase the supply of housing available under the program.

- - - - -

To get the revised section 235 program moving at a rate consistent with Department stated goals, it appears to us that additional changes will have to be made to some of the program's requirements. The program must be attractive to builders and mortgagees who have influence over the supply of housing produced under the program. On the other hand, it must be attainable by a targetable population which needs the program's

assistance and is financially capable of participating. Changes to the supply or demand side of the program alone will do little to stimulate program activity. A combination of well thought out changes to both sides of the picture should help to produce a much more viable home-ownership assistance program than what exists today.

It should be recognized that these are the views we obtained as a result of our inquiries, and that these views are presented for your consideration now because of the pending decisions to be made on the future of the section 235 program. We would be pleased to discuss these matters further with you or your staff.

Copies of this letter are being sent to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Banking, Finance and Urban Affairs. We are also sending copies to your Assistant Secretary for Housing-Federal Housing Commissioner and Inspector General.

Sincerely yours,

A handwritten signature in cursive script that reads "Henry Eschwege".

Henry Eschwege  
Director