Federal Housing Assistance Promotes Homeownership

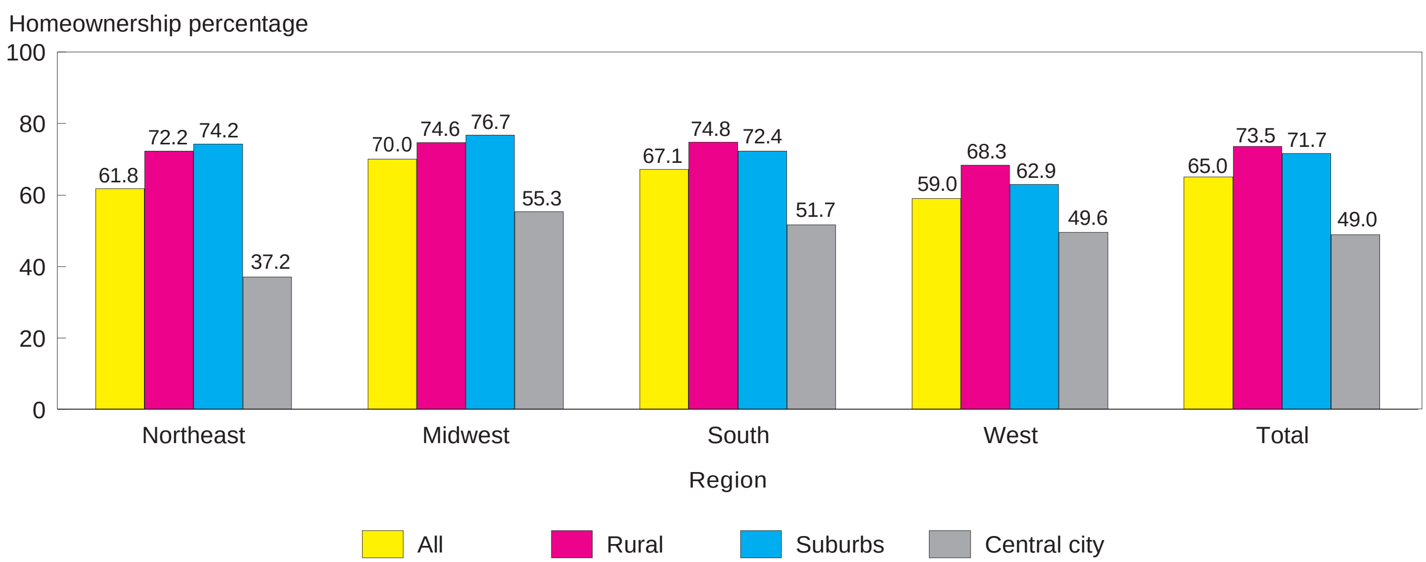
For several years, the rate of homeownership has increased, while the activities of Federal agencies have been targeted at promoting and supporting this trend. These trends are expected to continue, while major changes are proposed for public housing programs.

Most American families (65.7 percent) own their homes. Homeownership is highest in rural America, averaging 73.7 percent for 1997, compared with a similar 72.5 percent for metro suburbs and 49.9 percent in central cities. Homeownership for each of these areas is at its highest level in over a decade, with each up about 0.2 percent from 1996 levels. This is the third consecutive year for across-the-board increases in the homeownership rate. Regionally, rural homeownership rates are higher than those of suburbs in the South and West, but suburban rates were higher in the Northeast and Midwest (fig. 1). Homeownership is most typical for nonminority populations, those neither very young nor old, and families with higher incomes. As homeownership increases, the income gap between owners and renters widens, and the proportion of renters with low incomes increases. But in other ways, dissimilarities between owners and renters are narrowing. Although homeownership is less frequent among minorities, particularly Blacks and Hispanics, the rate of growth in homeowning is most rapid for these minority populations.

Federal housing programs are critical factors in advancing homeownership as the preferred housing alternative for most Americans. The long history of USDA programs that have provided home mortgages to low-income rural families may well have contributed to the particularly high level of homeownership in rural communities. In contrast, housing assistance for low-income urban families has historically relied more on rental assistance.

In both rural and urban America, as more of those who can afford homeownership leave rental housing, the already high share of renters that are low-income continues to grow. Welfare reform is beginning to affect the incomes and lives of many renters, particularly those receiving government housing assistance, including many of those in public housing. Against this background, a number of issues affect rental housing and complicate the debate about appropriate public policy. These issues include who would be assisted, the amount of that assistance, tenant requirements, appropriate local autonomy, and delivery methods (vouchers, public housing, low-income housing tax credits, low-cost construction loans, or rental subsidies).

Figure 1
Homeownership rates by region, 1995
Rural homeownership tops suburbs in South and West



Source: ERS tabulation from American Housing Survey for the United States in 1995.

The amount of direct mortgage lending by Federal agencies is now so small that annual fluctuations are unlikely to have much effect on the level of homeownership (table 1). However, such changes are still very important to the potential borrowers. Because of their low incomes they often have no other way to achieve homeownership. Most direct mortgage lending is done through USDA's section 502 program. Although lending under this program declined somewhat in 1997, higher levels are anticipated for 1998 and have been requested in the President's budget for 1999. This would interrupt a period when each year many of the more heavily subsidized Federal housing programs were reduced in size, and the subsidies provided to each program participant were often lowered. The much less costly USDA section 502 guarantee program has a clientele with relatively higher incomes and charges insurance fees that cover a substantial portion of loan losses and operating costs.

Unless restrained by regulatory ceilings, year-to-year changes in the volume of loan guarantees tend to reflect loan demand rather than the emphasis placed on such activities by the administrating agencies. USDA's section 502 guarantee program has grown each year since its inception, reaching its authorized limit each year. But both the Department of Housing and Urban Development's (HUD's) Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA) insured fewer loans in 1997 than in 1996 and, as

Table 1
Summary of largest housing programs
Projected levels of some Federal housing loan programs are up in 1998, others are down

Program	Program levels by fiscal year: 1997 actual	Program levels by fiscal year: 1998 estimate	Change	Rural areas most affected by the program
	—Billion dollars—		Percent	
USDA/RHS:				
Single family (sec. 502)—				
Direct loans	0.71	1.00	4	Large metro fringe, South and Midwest, retirement and Federal lands counties[1]
Guarantees	2.03	3.02	49	Included above[1]
Multifamily (sec. 515)	.15	.13	-16	West, totally rural, and poverty
Rental assistance	.52	.54	5	West, all but the most urbanized
VA:				
Loan guarantees	24.30	24.80	2	West, urbanized nonmetro and adjacent
HUD:				
FHA single-family mortgage insurance	75.43	82.26	9	West, urbanized nonmetro
Public and Indian	24.08	23.68	-2	West, nonadjacent and high poverty

Note: USDA/RHS = U.S. Department of Agriculture, Rural Development, Rural Housing Service. VA = U.S. Department of Veterans Affairs. HUD = U.S. Department of Housing and Urban Development. FHA = Federal Housing Administration.

[1] Information on loan distribution combines direct and guaranteed loans in a single category.

Source: ERS calculations based on the Budget and Census's Federal Funds data.

usual, were below their maximum levels. FHA and VA loan guarantees are projected to increase in 1998 because of greater anticipated demand for this assistance.

In addition, two government-sponsored enterprises (GSE's)—the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)—are major players in home mortgage financing through their secondary-mortgage market activities. They purchase home mortgages made by other lenders and in turn sell securities backed by the assets and income represented by those loans or on occasion hold mortgages as their own investments. Both GSE's have initiatives to increase their purchases of certain categories of mortgages, including those on rural properties.

Fewer Rural Home Buyers Receive Government-Assisted Mortgages

While a substantial minority of both rural and urban households benefit from Federal housing programs, these programs reach a smaller share of rural households. The 1995 American Housing Survey found that 14.6 percent of nonmetro and 24.0 percent of metro home mortgages were either from, or insured by, a Federal government agency (fig. 2).

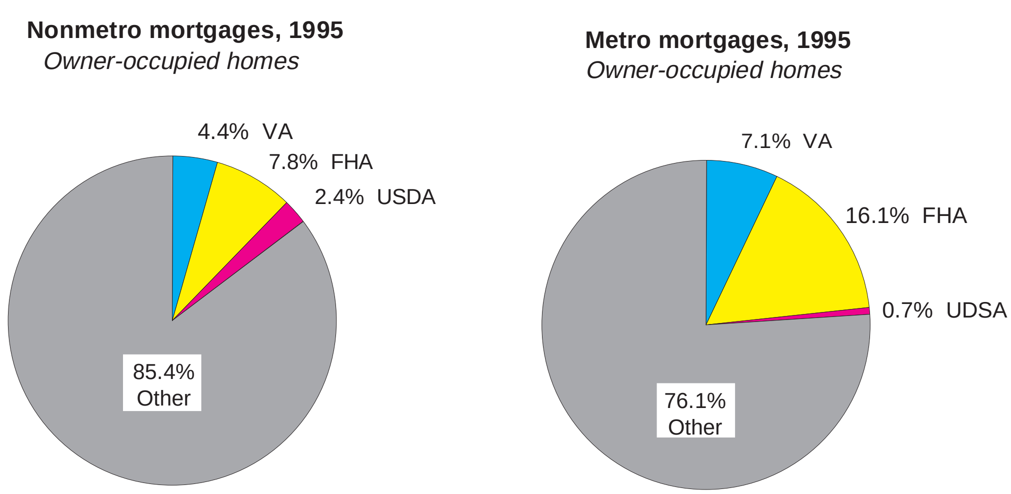
HUD is primarily responsible for housing assistance and, consequently, through the FHA, provides the largest amount of home mortgage assistance, both in urban and rural areas. However, USDA's section 502 direct and guaranteed program, administered by the Rural Housing Service (RHS), also plays an important role. In particular, the section 502 direct loan activity is the only mortgage program targeted to low-income households that otherwise could not afford to be homeowners.

Section 502 loan guarantees are increasing in importance in rural areas. Since its start in fiscal year 1992, the volume of loan guarantees has increased each year, a trend that is expected to continue in fiscal year 1998. From 1992 through 1997 the amount of section 502 direct lending has been declining. As a result, section 502 guarantees are now about three times the dollar amount of direct loans. The 1997 level of direct lending was below that anticipated when the budget was passed, because higher than expected market interest rates in turn raised the amount of subsidy associated with each direct loan. However, both direct and guaranteed lending are expected to rise in 1998.

Figure 2

Use of Federal government mortgage insurance programs, 1995

Rural mortgages are less often Government-insured



Source: ERS tabulations from American Housing Survey for the United States in 1995.

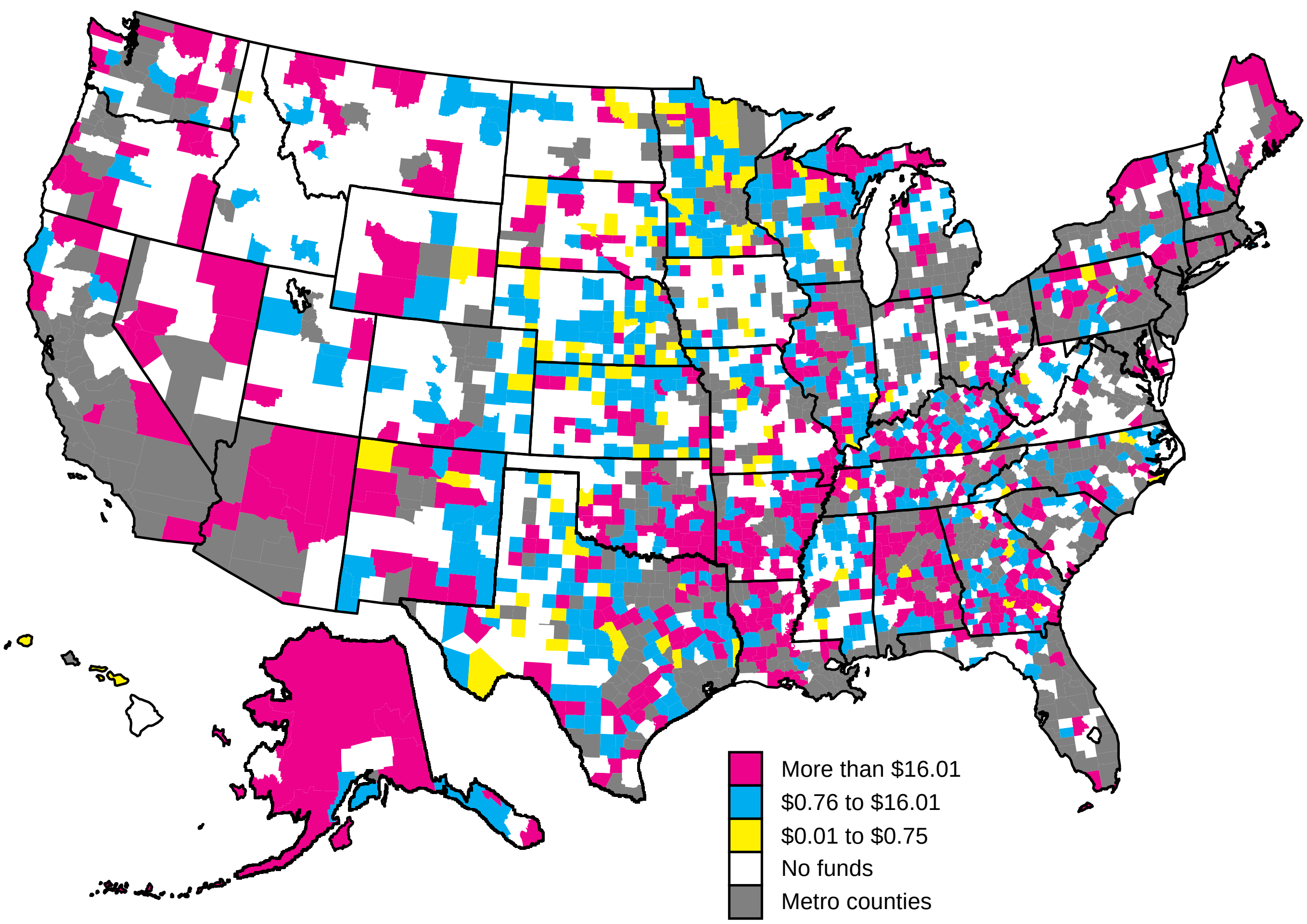
Government Rental Programs Changing

Rental housing assistance takes many forms. Low-income housing tax credits (LIHTC's) allow developers of low-income housing to borrow funds at below-market interest rates by providing an annual Federal tax credit to investors in limited partnerships that make these loans. The property owner can use the funds for purchase, construction, or rehabilitation, and in turn is obligated to rent a portion of those units to low-income tenants at below-market rates. Each State is allowed a limited number of credits each year, based on its population. The President's 1999 budget proposes an increase in the amount of these credits. Subsidized loans usually provide low-interest financing to a nonprofit, limited-profit, or governmental entity that, in exchange, agrees to certain requirements for providing low-income housing. Rental assistance payments are often used in conjunction with the previously mentioned subsidies to bridge any gap between the rent-paying ability of low-income tenants and the rent payments that are due property owners. Programs providing such assistance to rural tenants are operated by the USDA and HUD. Certificates and vouchers are issued to qualified families for use in paying for qualified housing, which is generally rental and privately owned. Vouchers are quite similar to certificates, but

Figure 3

Per capita HUD public and Indian housing assistance, fiscal year 1996

Higher amounts are in the South and counties with Indian reservations



Source: Calculated by ERS using Federal Funds data from the Bureau of the Census.

allow recipients to choose from a wider selection of housing units, potentially at a higher tenant cost. Many feel that vouchers' greater flexibility in location will be important for assisting many welfare recipients in their transition to employment. This part of HUD's section 8 program has recently become one of the major rental subsidy activities. Public housing provides 1.3 million publicly owned housing units operated by public housing authorities. While little, if any, new public housing is being built, except to replace demolished units, considerable funding is needed to operate and maintain this housing for those least able to pay rent.

While urban areas receive more Federal funds for rental housing than do rural areas, the difference is much less than that for homeowner programs. In fiscal year 1996, the largest programs for rental housing provided about $95 per capita nationally and $70 per capita in rural areas. Higher rural levels seemed to be in parts of the South, the Appalachian region, and Indian reservations (fig. 3). By comparison, the major homeownership programs provided per capita amounts of $273 nationally and $106 in rural areas.

Owner programs have a clientele base that includes many moderate-income families.Renter programs are almost exclusively focused on the low-income population. Renter programs operate either by subsidizing rents for those unable to afford adequate housing or by promoting an increased supply of low-cost rental housing. Both approaches can be found in a single program, such as the RHS section 515 program where financing costs are subsidized in return for an agreement that units be rented to program participants at reduced rates. HUD's rental assistance is shifting away from such long-term subsidies tied to particular rental units and into more flexible tenant assistance, which gives greater attention to housing vouchers, local control, and homeownership options.

The future direction of Federal government rental assistance is far from clear, though there have been a number of recent changes and more are quite likely. Since the 1970's, the poorest families have been given priority for public housing and tenant rent could not exceed 30 percent of adjusted income (which was often zero). Beginning in 1995, public housing authorities have had more flexibility to set their own rules, including charging a minimum rent (up to $50) and selecting tenants on a basis other than lowest income. But many housing authorities have been hesitant to make changes because this authority must be renewed each year. Various proposals for more permanent changes have been in the legislative process for over a year, and there is some optimism that an agreement will be reached soon. Points of contention include the degree of autonomy given local housing authorities (or governments), minimum and maximum rents, and the allowable income mix of tenants.

More permanent change has come to one segment of public housing, that for American Indians and Alaska Native tribes. New rules, established by 1996 legislation, will give tribal housing authorities more authority, providing $600 million of public housing funds as block grants. While there are still guidelines for the use of these funds, local authorities have much more flexibility than in the past.

Rental Assistance Is USDA's Major Expenditure on Housing Programs

USDA's housing programs, administered by the Rural Housing Service (RHS), provide assistance in rural portions of both nonmetro and metro counties. The section 502 single-family housing program comprised over three-fourths of the agency's total housing loan and grant activity. Most of this amount was related mortgage lending, not the government cost of providing that assistance. In contrast, expenditures for rental subsidies consumed the bulk of RHS's budget.

As discussed earlier, over the last 4 years, the direct lending share of the section 502 program fell, while the number and amount of guarantees grew rapidly. In turn, per borrower program costs have fallen, since only direct loans carry a significant subsidy. Subsidy expenses on new loans were also lowered by changes in program regulations that increased the effective interest rate on most direct loans. Subsidies on direct loans also rise and fall in tandem with movements in market interest rates. This is because the effective interest rates on most new direct loans are determined by borrower income, without consideration of market interest rates. A major change implemented in fiscal year 1998 provides further cost savings to the Government, mostly through lowering administrative expenses.

RHS is using loan leveraging to reach more low-income borrowers with its limited funds for direct lending. In conjunction with the primary loan from another lender, the RHS makes a reduced-interest loan for the remainder of the total financed amount. RHS has an agreement with Fannie Mae and Freddie Mac that they will purchase the non-RHS portion of such loans. RHS often makes loan-sharing agreements directly with various public, private, and nonprofit entities. Although this increases the number of people that can be assisted, unless the companion loan also carries a greatly reduced interest rate, this program cannot reach RHS's lowest income clientele. In addition, because RHS takes essentially all of the risk exposure for the combined loan, RHS's future loss rate may be higher than if RHS were the sole lender, because it is involved in more loans.

The RHS administers other housing programs for the same rural areas eligible for the section 502 program. The largest of these activities in fiscal year 1996 provided rental assistance for low-income tenants in RHS-financed rental housing. The $520 million in estimated fiscal year 1998 budget authority for rental assistance is two-thirds of the total for all RHS loan and grant programs, exclusive of costs for salaries and expenses. Additionally, RHS's section 515 multifamily housing program provides financing for the construction, purchase, rehabilitation, or repair of low-income rental housing. Over two-thirds of such RHS rental housing assistance, both loan and grant, went to nonmetro areas. Additional RHS programs include such activities as very-low-income home repair, self-help housing, and farm-labor housing. After doubling to $26 million in fiscal year 1997, funding for mutual self-help grants is expected to remain steady in 1998.

FHA Insurance Expands Dominant Role in HUD Housing Programs

HUD's main housing activity is FHA's single-family home mortgage insurance program, which provided over $75 billion of mortgage insurance in fiscal year 1997 and is projected to exceed $82 billion in 1998. Only 6 percent of the amount insured in fiscal year 1996 was in nonmetro areas. These nonmetro loans were concentrated in the West and in counties that were more urbanized. The nonmetro aid distribution of FHA and RHS programs were quite different, with the RHS section 502 program varying little by rurality level and FHA assistance considerably lower in the more rural counties. Totally rural counties not adjacent to a metro area had only $25.29 of FHA loans per capita compared with $98.58 for the most urbanized adjacent counties and the metro average of $263.54.

HUD's multifamily programs receive the bulk of all housing grant funds. In fiscal year 1996, expenditures on the major public housing programs were about $6.2 billion, which was $23.22 per capita nationally and $18.95 in rural areas. On a per capita basis, rural counties with higher funding levels were more often in the West, were isolated from metro centers, or contained Indian reservations.

Major changes have already been made in HUD programs, and others are in the works. HUD programs seem destined to be far fewer in number and much more flexible in how they are used. State and local governments and housing authorities will have greater control over the use of Federal housing assistance. And many program recipients will have a choice in how that assistance is used, including where they will live, and even whether they will rent or purchase a home. Commitment is strong to expand the opportunity for homeownership to a wider audience, reduce the role of large-scale housing projects for the low-income, and respond to changing needs, such as those introduced by welfare reform. As an agency, the future HUD will also be quite different. The total number of HUD employees will drop over 20 percent, with many of these in a few locations with specialized functions, and far fewer assigned to local offices. Many HUD activities will be consolidated or modified in other ways. While the dust has not yet settled, changes at HUD are underway, significant, and happening quickly.

VA Mortgage Insurance Concentrates in Urban Areas

VA housing loans are expected to total about $25 billion in fiscal year 1998, a nominal increase from 1997. In fiscal year 1996, about 11 percent of VA's housing program activity was in nonmetro areas. Nearly all of that is in the form of guaranteed loans. Rural areas received over $21 per capita of such VA loans, slightly more than half of that received by urban areas. VA nonmetro loan levels were highest in the most urban and adjacent counties ($33.93) and lowest in the most rural and nonadjacent counties ($10.09). By region, nonmetro lending was highest in the West ($36.28) and lowest in the Midwest ($15.24)

Most VA borrowers pay a loan guarantee fee that is a percentage of the loan amount. Fees are higher for certain loans, including those with smaller downpayments. Some special borrowers can receive the loan guarantee at no cost. The only direct loans that VA makes are a very few to finance specially adapted housing for a few disabled veterans. Still outstanding are a number of direct loans made by VA when they also targeted "rural areas where availability of private mortgage funds was limited." *[Jim Mikesell, 202-694-5432, mikesell@econ.ag.gov]*