



USDA Rural Housing Programs: An Overview

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Summary

Title V of the Housing Act of 1949 authorized the Department of Agriculture (USDA) to make loans to farmers to enable them to construct, improve, repair, or replace dwellings and other farm buildings to provide decent, safe, and sanitary living conditions for themselves or their tenants, lessees, sharecroppers, and laborers. USDA was also authorized to make grants or combinations of loans and grants to those farmers who could not qualify to repay the full amount of a loan, but who needed the funds to make the dwellings sanitary or to remove health hazards to the occupants or the community.

While the act was initially targeted toward farmers, over time the act has been amended to enable USDA to make housing loans and grants to rural residents in general. Currently, the USDA housing programs are administered by the Rural Housing Service (RHS). The housing programs are generally referred to by the section number under which they are authorized in the Housing Act of 1949, as amended.

The rural housing programs include loans for the purchase, repair, or construction of single-family housing; loans and grants to remove health and safety hazards in owner-occupied homes; loans and grants for the construction and purchase of rental housing for farmworkers; loans for the purchase and construction of rental and cooperative housing for the elderly and for rural residents in general; rental assistance payments to make rental housing more affordable; interest subsidies to make homeownership loans more affordable and to enable production of rental housing that is affordable for the target population; and loans for developing building sites upon which rural housing is to be constructed.

The collapse of the mortgage market in 2007 has resulted in an increased demand for home loans that are insured or guaranteed by the federal government, including the USDA Section 502 guaranteed home loans. By May 2010, the FY2010 funding for the USDA guaranteed loan program was exhausted.

As enacted on July 29, 2010, the 2010 Supplemental Appropriations Act, P.L. 111-212, authorized additional appropriations for Section 502 guaranteed loans for the remainder of FY2010. The act also permits USDA to charge lenders a guarantee fee of up to 3.5% of the mortgage amount. In addition, lenders may be charged an annual fee of 0.5% of the mortgage balance for the life of the loan. These changes in the guarantee fees are intended to enable the Section 502 guaranteed home loan program to operate with little or no need for positive credit subsidies in FY2011 and beyond.

Since no appropriations legislation was enacted before the beginning of FY2011, the 111th Congress enacted a series of continuing resolutions (CR) to continue funding at the FY2010 level for most accounts in the federal budget (including all of the accounts in USDA's budget). The latest CR (P.L. 111-322) is slated to expire at the earlier of March 4, 2011, or enactment of FY2011 appropriations legislation.

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Introduction

Title V of the Housing Act of 1949 authorized the Department of Agriculture (USDA) to make loans to farmers to enable them to construct, improve, repair, or replace dwellings and other farm buildings to provide decent, safe, and sanitary living conditions for themselves or their tenants, lessees, sharecroppers, and laborers.¹ USDA was also authorized to make grants or combinations of loans and grants to those farmers who could not qualify to repay the full amount of a loan, but who needed the funds to make the dwellings sanitary or to remove health hazards to the occupants or the community.

While the act was initially targeted toward farmers, over time it has been amended to enable USDA to make housing loans and grants to owners of real estate in rural areas in general.² Currently, the USDA housing programs are administered by the Rural Housing Service (RHS). The housing programs are generally referred to by the section number under which they are authorized in the Housing Act of 1949, as amended.

Descriptions of the rural housing programs are presented below in the order of the sections under which they are authorized in the Housing Act of 1949. Note that most of the programs involve direct loans from USDA, while others involve USDA-insured loans from private lenders. USDA is one of the few government agencies that makes direct loans to borrowers. The report concludes with a discussion of funding problems for the guaranteed home loan program. At the end of the report, tables are presented that show funding for various rural housing programs since FY1980.

Single-Family Housing Loans (Section 502)

Section 502 of the Housing Act of 1949 gave USDA authority to make housing loans to farm owners to construct or repair farm dwellings and other buildings, for themselves or their tenants, sharecroppers, and laborers.

The Housing Act of 1949 was amended in 1961 to make nonfarm properties eligible for the Section 502 loans.³ Amendments by the Housing and Urban Development Act of 1965 authorized the loans to be used for the purchase and repair of previously-occupied dwellings as well as the purchase of building sites.⁴ Amendments in 1968 enabled borrowers to receive interest credits to reduce the interest rate to as low as 1%.⁵ The Housing and Urban Development Act of 1970 enabled Section 502 loans to be made for homes on leased land as long as the remaining term of the lease extends beyond the repayment period of the loan.⁶

¹ P.L. 81-171, October 25, 1949, 42 U.S.C. 1471, et. seq.

² As amended, Section 520 of the Housing Act of 1949 (42 U.S.C. 1490) defines rural to include any open country, place, town, village, or city (1) with a population of up to 10,000; (2) with a population of up to 20,000 that is not part of a standard statistical area, and that has a serious lack of mortgage credit for lower- and moderate-income families as determined by USDA; and (3) with a population of up to 25,000 that was classified as rural based on a previous decennial census, and that has a serious lack of mortgage credit for lower- and moderate-income families.

³ Section 803 of P.L. 87-70 (June 30, 1961).

⁴ Section 1001 of P.L. 89-117 (August 10, 1965).

⁵ Section 1001 of P.L. 90-448 (August 1, 1968).

⁶ Section 802 of P.L. 91-609 (December 31, 1970).

As amended, today's Section 502 program enables borrowers to obtain loans for the purchase or repair of new or existing single-family housing in rural areas. The loans can also be used to purchase new manufactured homes. In effect, there are now two Section 502 home loan programs—one in which borrowers receive direct home loans from USDA, and one in which borrowers receive USDA-guaranteed home loans from private lenders.

Section 502 Direct Loan Program

Borrowers with income levels at or below 80% of the area median may be eligible for direct loans from USDA. The loans can be used to build, repair, renovate, or relocate homes, or to purchase and prepare building sites, including providing water and sewage facilities. Section 502 loans may also be used to refinance debts when necessary to avoid losing a home through foreclosure or when a loan of \$5,000 or more is necessary for repairs to correct major deficiencies and make the dwelling safe and sanitary.

In a given fiscal year, at least 40% of the funds for this program must be made available only to families or individuals with incomes below 50% of the area median. Borrowers must have the means to repay the loans but be unable to secure reasonable credit terms elsewhere. There is no downpayment requirement. In general, the loans are repayable over a 33-year period. The loan term may be extended to 38 years for borrowers with incomes below 60% of the area median, and who cannot afford the property based on the 33-year payments. The loan term is limited to 30 years on manufactured homes.

Applicants must apply for and obtain Certificates of Eligibility from USDA, which indicate the USDA underwriting process has determined that they qualify for and can afford to repay Section 502 mortgages. The borrower's monthly contribution for principal, interest, property taxes, and insurance (PITI) is set at the higher of (1) 24% of the borrower's adjusted annual income; or (2) principal and interest calculated at 1% on the Section 502 loan plus property taxes and insurance. The borrower's income is verified annually, and the borrower's required payments may be increased or reduced based on changes in income.

Housing financed under the Section 502 program must be modest in size, design, and cost. Each USDA Rural Development State Office can choose between two ways of setting a cost limit to define modest housing in its state: (1) a State Office can adopt the limit established by its state housing agency; or (2) a State Office can adopt a limit calculated according to USDA's regulations that takes cost and market value into account.

Section 502 Guaranteed Loan Program

The Housing and Community Development Act of 1987 directed USDA to carry out a three-year demonstration program under which moderate income borrowers could obtain loans from private lenders for the purchase of single-family homes in rural areas and the loans would be guaranteed by USDA under Section 502 (42 U.S.C. 1472).⁷ A permanent guaranteed loan program was authorized in 1990 by the Cranston-Gonzalez National Affordable Housing Act.⁸

⁷ Section 304 of P.L. 100-242 (February 5, 1988).

⁸ Section 706 of P.L. 101-625 (November 28, 1990).

Borrowers with income of up to 115% of the area median may purchase homes in rural areas with USDA-guaranteed loans from private lenders. Priority is given to first-time homebuyers, and USDA may require that borrowers complete a homeownership counseling program. USDA uses two formulas to determine a family's ability to undertake the responsibility of a mortgage: (1) the PITI must be 29% or less of gross monthly income; and (2) the total of all monthly debts (including the mortgage payment) must be 41% or less of gross monthly income.

Section 502 guaranteed loans must be from lending institutions that have been approved by USDA. Loans have 30-year terms and fixed market-level interest rates. Loans may be for up to 100% of the home's appraised value or the sales price, whichever is less. The maximum loan amount is what the homeowner can afford based on the above criteria. Loans may include closing costs, legal fees, title services, the cost of establishing an escrow account, and other prepaid items as long as the appraised value is higher than the sales price.

The American Homeownership and Economic Opportunity Act of 2000 authorized USDA to guarantee loans made to refinance existing Section 502 home loans.⁹ The interest rate on the new loan must be fixed and the rate may not exceed the interest rate on the loan being refinanced. The property being refinanced must be owned and occupied by the borrower as the principal residence, and the new loan may not exceed the remaining balance of the refinanced loan plus any authorized closing costs.

The USDA charges the lender a one-time guarantee fee of 2% of the loan amount, and the lender may choose to pass this charge along to the borrower by adding it to the mortgage.¹⁰ The guarantee fee for refinance transactions is 0.5% of the loan amount. USDA guarantees the loan at 100% of the loss for the first 35% of the original loan, and the remaining 65% of the loan is guaranteed at 85% of loss. The maximum loss payable by USDA cannot exceed 90% of the original loan amount. No private mortgage insurance is required of the borrower.

There are no restrictions on the size or design of homes financed with Section 502 guaranteed loans. Typical amenities, such as garages, central air conditioning, basements, and extra bathrooms, are allowed. In-ground swimming pools are permitted as long as loan funds are not used to finance the contributory value of the pool. In other words, the loan amount may not include the value that the pool adds to the appraised value of the property.¹¹ Manufactured homes must be new and permanently installed.

Summary of Differences Between the Programs

The major differences between the Section 502 direct loan and guaranteed loan programs are as follows:

- The lender and servicer for the direct program is USDA. The lender for Section 502 guaranteed loans is a private lender that also handles all the loan servicing.

⁹ Section 701 of P.L. 106-569.

¹⁰ The fee was raised to 2% by Section 739 of P.L. 106-387 but that change is not codified at 42 U.S.C. 1472(h)(7).

¹¹ James C. Alsop, *In-Ground Swimming Pools, Single Family Housing Guaranteed Loan Program*, U.S. Department of Agriculture, Rural Development Administrative Notice No. 4442 (1980-D), Washington, DC, May 28, 2009.

- Income levels for participants in the direct program must not exceed 80% of the median income for the area. Income levels for participants in the Section 502 guaranteed program may not exceed 115% of the area median income.
- Borrowers in the direct loan program may receive subsidies to bring the interest rate as low as 1%. No interest rate subsidy is available to borrowers in the guaranteed loan program, so loans are at market interest rates.
- The size of homes may be restricted under the direct loan program, while there is no size restriction under the guaranteed loan program.
- Borrowers under the direct loan program must be unable to secure reasonable credit terms elsewhere, while there is no “credit elsewhere” test for borrowers under the guaranteed loan program.

Modernizing Rural Homes (Section 504)

For farmers without sufficient income to qualify for a Section 502 loan, Section 504 of the Housing Act of 1949 (42 U.S.C. 1474) authorized loans, grants, or combinations of loans and grants to make farm dwellings safe and sanitary or to remove health hazards.¹² Low-income nonfarm homeowners became eligible for the program in 1961.¹³ Eligibility was extended to leasehold property in 1970.¹⁴ The 1983 Housing Act made the program available to very low-income homeowners only.¹⁵ The act also eliminated congressionally mandated loan and grant limits for individual homeowners and gave USDA the authority to set those limits.

Under current regulations, rural homeowners with incomes of 50% or less of the area median may qualify for USDA direct loans to repair their homes. Loans are limited to \$20,000, and have a 20-year term at a 1% interest rate. Owners who are aged 62 or more may qualify for grants of up to \$7,500 to pay for needed home repairs. To qualify for the grants, the elderly homeowners must lack the ability to repay the full cost of the repairs. Depending on the cost of the repairs and the income of the elderly homeowner, the owner may be eligible for a grant for the full cost of the repairs, or for some combination of a loan and a grant that covers the repair costs. The combination loan and grant may total no more than \$20,000.

¹² 42 U.S.C. 1474.

¹³ P.L. 87-70, Section 801, June 30, 1961, 42 U.S.C. 1474.

¹⁴ P.L. 91-609, Section 802, December 31, 1970, 42 U.S.C. 1474.

¹⁵ P.L. 98-181, Section 504, November 30, 1983, 42 U.S.C. 1474.

Construction Defects/Underserved Areas (Section 509)

Construction Defects

Section 504 of the Housing and Community Development Act of 1977 added Section 509(c) to the Housing Act of 1949 (42 U.S.C. 1479).¹⁶ Under Section 509(c), USDA is authorized to receive and resolve complaints concerning construction of Section 502 housing by contractors. If a contractor refuses or is unable to honor a warranty, the borrower may be eligible for a grant for the cost of correcting the defects. The borrower must begin the process within 18 months of the completion of the home. Related costs, such as temporary living expenses, may be included in the grant.

Underserved Areas

The Cranston-Gonzalez National Affordable Housing Act amended Section 509 by adding subsection (f) which mandates set asides of some USDA lending authority.¹⁷ In each fiscal year, USDA is required to designate 100 counties and communities as “targeted underserved areas” that have severe unmet housing needs. The USDA must set aside 5% of each fiscal year’s lending authority under Sections 502, 504, 515, and 524, and reserve it for assistance in targeted underserved areas. Colonias, however, are given priority for assistance with the reserved funds.¹⁸ The USDA must also set aside sufficient Section 521 rental assistance that may be used with the Section 514 and Section 515 programs. (See “Rental Assistance and Interest Subsidy (Section 521),” below.)

Subsection (f) also created the Housing Application Packaging Grant (HAPG) program under which nonprofit organizations, community development organizations, state or local governments, or their agencies may receive grants from USDA to help low-income families and individuals prepare applications for USDA housing loans in targeted underserved areas and colonias.

Housing for Farm Laborers (Sections 514 and 516)

The Housing Act of 1961 added Section 514 to the Housing Act of 1949 (42 U.S.C. 1484).¹⁹ Under Section 514, loans are made to farm owners, associations of farm owners, or nonprofit

¹⁶ P.L. 95-128, October 12, 1977, 42 U.S.C. 1479.

¹⁷ P.L. 101-625, Section 709(b), November 28, 1990, 42 U.S.C. 1479.

¹⁸ Colonias are defined as any identifiable community that (1) is in the state of Arizona, California, New Mexico, or Texas; (2) is within 150 miles of the border between the United States and Mexico (except for metropolitan areas with populations exceeding 1 million); (3) is designated as a colonia by the state or county in which it is located; (4) is determined to be a colonia on the basis of objective criteria such as a lack of a potable water supply, inadequate sewage systems, and a shortage of decent, safe and sanitary housing; and (5) was in existence and recognized as a colonia prior to November 28, 1990.

¹⁹ P.L. 87-70, Section 804, June 30, 1961, 42 U.S.C. 1484.

organizations to provide “modest” living quarters, basic household furnishings, and related facilities for domestic farm laborers. The loans are repayable in 33 years and bear an interest rate of 1%. To be eligible for Section 514 loans, applicants must be unable to obtain financing from other sources that would enable the housing to be affordable by the target population.

Individual farm owners, associations of farmers, nonprofit organizations, federally recognized Indian tribes, and agencies or political subdivisions of local or state governments may be eligible for loans from USDA to provide housing and related facilities for domestic farm labor. Applicants who own farms or who represent farm owners must show that the farming operations have a demonstrated need for farm labor housing, and the applicants must agree to own and operate the property on a nonprofit basis. Except for state and local public agencies or political subdivisions, the applicants must be unable to provide the housing from their own resources and unable to obtain the credit from other sources on terms and conditions that they could reasonably be expected to fulfill. The applicants must be unable to obtain credit on terms that would enable them to provide housing to farm workers at rental rates that would be affordable to the workers. The USDA state director may make exceptions to the “credit elsewhere” test when (1) there is a need in the area for housing for *migrant* farm workers and the applicant will provide such housing, and (2) there is no state or local body or nonprofit organization that, within a reasonable period of time, is willing and able to provide the housing.

Applicants must have sufficient capital to pay the initial operating expenses. It must be demonstrated that, after the loan is made, income will be sufficient to pay operating expenses, make capital improvements, make payments on the loan, and accumulate reserves.

In 1964, the 1949 Housing Act was amended to add Section 516 (42 U.S.C. 1486).²⁰ The Section 516 program permitted qualified nonprofit organizations, Indian tribes, and public bodies to obtain grants for up to two-thirds of the development cost of farm labor housing. Applicants must demonstrate that there is a need for such housing, and that there is reasonable doubt that the housing would be built without USDA assistance. Grants may be used simultaneously with Section 514 loans if the necessary housing cannot be provided by financial assistance from other sources. The section was amended in 1970 to permit grants of up to 90% of the development cost of the housing.²¹ The 1983 Housing Act provides that in decisions on approving applications under these two sections, USDA shall consider only the needs of farm laborers and make the determination without regard to the extent or nature of other housing needs in the area.²² The act also requires that, in a given fiscal year, up to 10% of the funds available under Section 516 shall be made available to assist eligible nonprofit agencies in providing housing for domestic and migrant farm workers.²³

Nonprofit organizations, Indian tribes, and local or state agencies or subdivisions may qualify for Section 516 grants to provide low-rent housing for farm labor. The organizations must be unable to provide the housing from their own resources, and be unable to secure credit (including Section 514 loans) on terms and conditions that the applicant could reasonably be expected to fulfill. Applicants must contribute at least 10% of the total development costs from their own resources or from other sources, including Section 514 loans. The housing and related facilities must fulfill

²⁰ P.L. 88-560, Section 503, September 2, 1964, 42 U.S.C. 1486.

²¹ P.L. 91-609, Section 801(d)(4), December 31, 1970.

²² P.L. 98-181, Section 510, November 30, 1983.

²³ P.L. 98-181, Section 513, November 30, 1983.

a “pressing need” in the area, and there must be reasonable doubt that the housing can be provided without the grant.

The Housing and Community Development Act of 1987 redefined “domestic farm labor” to include persons (and the family of such persons) who receive a substantial portion of their income from the production or handling of agricultural or aquacultural products.²⁴ They must be United States citizens or legally admitted for permanent residence in the United States. The term includes retired or disabled persons who were domestic farm labor at the time of retiring or becoming disabled. In selecting occupants for vacant farm labor housing, USDA is directed to use the following order of priority: (1) active farm laborers, (2) retired or disabled farm laborers who were active at the time of retiring or becoming disabled, and (3) other retired or disabled farm laborers.

Farm labor housing loans and grants to qualified applicants may be used to buy, build, or improve housing and related facilities for farm workers, and to purchase and improve the land upon which the housing will be located. The funds may be used to install streets, water supply and waste disposal systems, parking areas, and driveways, as well as for the purchase and installation of appliances such as ranges, refrigerators, and clothes washers and dryers. Related facilities may include a maintenance workshop, recreation center, small infirmary, laundry room, day care center, and office and living quarters for a resident manager.

Section 514 loans are available at 1% interest for up to 33 years. Section 516 grants may not exceed the lesser of (1) 90% of the total development cost of the project, or (2) the difference between the development costs and the sum of (a) the amount the applicant can provide from its own resources, and (b) the maximum loan the applicant can repay given the maximum rent that is affordable to the target tenants.

Rural Rental Housing (Section 515)

The Senior Citizens Housing Act of 1962 amended the Housing Act of 1949 by adding Section 515 (42 U.S.C. 1485).²⁵ The law authorized USDA to make loans to provide rental housing for low- and moderate-income elderly families in rural areas. Amendments in 1966 removed the age restrictions and made low- and moderate-income families, in general, eligible for tenancy in Section 515 rental housing.²⁶ Amendments in 1977 authorized Section 515 loans to be used for congregate housing for the elderly and handicapped.²⁷

Loans under Section 515 are made to individuals, corporations, associations, trusts, partnerships, and public agencies. The loans are made at a 1% interest rate and are repayable in 50 years. Except for public agencies, all borrowers must demonstrate that financial assistance from other sources will not enable the borrower to provide the housing at terms that are affordable to low- and moderate-income borrowers. There are restrictions on the amount of rent borrowers may charge to occupants. Subject to USDA approval, borrowers set project rents based on the debt service for the loans and reasonable operating and maintenance expenses.

²⁴ P.L. 100-242, Section 305, February 5, 1988.

²⁵ P.L. 87-723, Section 4(b), September 28, 1962, 42 U.S.C. 1485.

²⁶ P.L. 89-754, Section 804, November 3, 1966.

²⁷ P.L. 95-128, Section 508, October 12, 1977.

The Housing and Community Development Act of 1987 amended the Housing Act of 1949 to state that occupancy of Section 515 housing, which has been allocated low-income housing tax credits (LIHTC),²⁸ may be restricted to those families whose incomes are within the limits established for the tax credits.²⁹ If, however, USDA finds that some of the units have been vacant for at least six months and that their continued vacancy will threaten the financial viability of the project, then higher-income tenants will be authorized to occupy the units.

Rental Assistance and Interest Subsidy (Section 521)

In 1968, Section 521 was added to the Housing Act of 1949 (42 U.S.C. 1490a).³⁰ Section 521 established an interest subsidy program under which eligible low- and moderate-income purchasers of single-family homes (under Section 502) and nonprofit developers of rental housing (under Section 515) may obtain loans with interest rates subsidized to as low as 1%.³¹

Section 521 was amended in 1974 to authorize USDA to make rental assistance payments to owners of USDA-financed rental housing (Sections 515 or 514) on behalf of tenants unable to pay the USDA-approved rent with 25% of their income.³² Amendments in the 1983 Housing Act provide that rent payments by eligible families would equal the greater of (1) 30% of monthly adjusted family income, (2) 10% of monthly income, or (3) for welfare recipients, the portion of the family's welfare payment that is designated for housing costs.

The rental assistance payments, which are made directly to the borrowers, make up the difference between the tenants' payments and the USDA-approved rent for the units. Borrowers must agree to operate the property on a limited profit or nonprofit basis. The term of the rental assistance agreement is 20 years for new construction projects and five years for existing projects. Agreements may be renewed for up to five years. An eligible borrower who does not participate in the program may be petitioned to participate by 20% or more of the tenants eligible for rental assistance.

Self-Help Housing (Section 523)

The Housing and Urban Development Act of 1968 added Section 523 to the Housing Act of 1949 (41 U.S.C. 1490c).³³ Under Section 523, nonprofit organizations may obtain two-year loans to purchase and develop land that is to be subdivided into building sites for housing to be built by the mutual self-help method (groups of low-income families who are building their own homes).

²⁸ For background on the LIHTC, see CRS Report RS22389, *An Introduction to the Design of the Low-Income Housing Tax Credit*, by (name redacted).

²⁹ P.L. 100-242, Section 306, February 5, 1988. LIHTC provides a 10-year reduction in tax liability for owners of low-income rental housing based on the development costs of low-income apartments. In general, apartments financed using LIHTC cannot be rented to anyone whose income exceeds 60% of area median gross income.

³⁰ P.L. 90-448, Section 1001, August 1, 1968.

³¹ Eligible borrowers under the single-family program are those who are unable to afford the mortgage payment at the current interest rate with 24% of their adjusted income. Eligible borrowers under the multi-family program are those who are unable to pay the indebtedness on the housing at the current interest rate.

³² P.L. 93-383, Section 514, August 22, 1974.

³³ P.L. 90-448, Section 1005, August 1, 1968.

The interest rate is 3% for these loans. Applicants must demonstrate a need for the proposed building sites in the locality.

Nonprofit sponsors may also obtain technical assistance (TA) grants to pay for all or part of the cost of developing, administering, and coordinating programs of technical and supervisory assistance to the families who are building their own homes. Each family is expected to contribute at least 700 hours of labor in building homes for each other. Participating families generally have low income and are unable to pay for homes built by the contract method.

Applicants must demonstrate that (1) there is a need for self-help housing in the area, (2) the applicant has or can hire qualified people to carry out its responsibilities under the program, and (3) funds for the proposed TA project are not available from other sources.

The program is generally limited to very low- and low-income families. Moderate-income families may be eligible to participate, provided they are unable to pay for homes built by contractors.

TA funds may not be used to hire construction workers or to buy real estate or building materials. Private or public nonprofit corporations, however, may be eligible for two-year site loans under Section 523. The loans may be used to purchase and develop land in rural areas. The land is subdivided into building sites and sold on a nonprofit basis to low- and moderate-income families. Generally, a loan will not be made if it will not result in at least 10 sites. The sites need not be contiguous.

Sites financed through Section 523 may only be sold to families who are building homes by the mutual self-help method. The homes are usually financed through the Section 502 program.

Developing Building Sites (Section 524)

In 1979, Section 524 was added to the Housing Act of 1949 (42 U.S.C. 1490d).³⁴ Under Section 524, nonprofit organizations and Indian tribes may obtain direct loans from USDA to purchase and develop land that is to be subdivided into building sites for housing low- and moderate-income families. The loans are made for a two-year period.

Sites financed through Section 524 have no restrictions on the methods by which the homes are financed or constructed. The interest rate on Section 524 site loans is the Treasury cost of funds.

Housing Preservation Grants (Section 533)

The Rural Housing Amendments of 1983 amended the Housing Act of 1949 by adding Section 533 (12 U.S.C. 1490m).³⁵ This section authorizes USDA to make grants to organizations for (1) rehabilitating single-family housing in rural areas that is owned by low- and very low-income families, (2) rehabilitating rural rental properties, and (3) rehabilitating rural cooperative housing

³⁴ P.L. 91-152, Section 413(f)(1), December 24, 1969.

³⁵ P.L. 98-181, Section 522, November 30, 1983.

that is structured to enable the cooperatives to remain affordable to low- and very low-income occupants.

Applicants must have a staff or governing body with either (1) the proven ability to perform responsibly in the field of low-income rural housing development, repair, and rehabilitation; or (2) the management or administrative experience that indicates the ability to operate a program providing financial assistance for housing repair and rehabilitation.

The homes must be located in rural areas and be in need of housing preservation assistance. Assisted families must meet the income restrictions (income of 80% or less of the median income for the area), and must have occupied the property for at least one year prior to receiving assistance. Occupants of leased homes may be eligible for assistance if (1) the unexpired portion of the lease extends for five years or more, and (2) the lease permits the occupant to make modifications to the structure and precludes the owner from increasing the rent because of the modifications.

USDA is authorized to provide grants to eligible public and private organizations. The grantees may in turn assist homeowners in repairing or rehabilitating their homes by providing the homeowners with direct loans, grants, or interest rate reductions on loans from private lenders. A broad range of housing preservation activities are authorized: (1) the installation and/or repair of sanitary water and waste disposal systems to meet local health department requirements; (2) the installation of energy conservation materials such as insulation and storm windows and doors; (3) the repair or replacement of heating systems; (4) the repair of electrical wiring systems; (5) the repair of structural supports and foundations; (6) the repair or replacement of the roof; (7) the repair of deteriorated siding, porches, or stoops; (8) the alteration of a home's interior to provide greater accessibility for any handicapped member of the family; and (9) the additions to the property that are necessary to alleviate overcrowding or to remove health hazards to the occupants. Repairs to manufactured homes or mobile homes are authorized if (1) the recipient owns the home and site, and has occupied the home on that site for at least one year, and (2) the home is on a permanent foundation or will be put on a permanent foundation with the funds to be received through the program. Up to 25% of the funding to any particular dwelling may be used for improvements that do not contribute to the health, safety, or well-being of the occupants; or materially contribute to the long-term preservation of the unit. These improvements may include painting, paneling, carpeting, air conditioning, landscaping, and improving closets and kitchen cabinets.

USDA is also authorized to make Section 533 grants to organizations that will rehabilitate rental and cooperative housing.

Guaranteed Loans for Rental Housing (Section 538)

The Section 538 program was added in 1996 (42 U.S.C. 1490p-2).³⁶ Under this program, borrowers may obtain loans from private lenders to finance multi-family housing, and USDA guarantees to pay for losses in case of borrower default. Section 538 guaranteed that loans may be used for the development costs of housing and related facilities that (1) consist of five or more adequate dwelling units, (2) are available for occupancy only by renters whose income at time of

³⁶ P.L. 104-120, March 28, 1996.

occupancy does not exceed 115% of the median income of the area, (3) would remain available to such persons for the period of the loan, and (4) are located in a rural area.

Eligible lenders include the following: (1) any lender approved by the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), or the Federal Housing Administration (FHA), and currently active in their multi-family housing guaranteed lending programs; (2) state or local housing finance agencies; (3) members of the Federal Home Loan Bank System; and (4) other lenders that demonstrate to USDA that they have knowledge and experience with multi-family lending. In any case, the lenders must apply to USDA for permission to participate in the program. Eligibility must be verified every year.

Eligible borrowers include public agencies, Indian tribes, individuals, general partnerships (if formed for a term at least equal to the loan term), limited partnerships, for-profit corporations, nonprofit corporations, limited liability companies, and trusts. In addition, borrowers must meet the following requirements: (1) be a creditworthy single-asset entity³⁷ or have received prior written approval from USDA; (2) not be in default under any other agency housing program, or have performed well for six months in an approved workout plan; (3) be able to and intend to operate and maintain the project in accordance with program requirements; (4) be in legal and regulatory compliance with respect to any federal debt; (5) be a U.S. citizen or legal resident, a U.S.-owned corporation, or a limited liability corporation (LLC) or a partnership where the principals are U.S. citizens or permanent legal residents. Borrowers must contribute initial operating capital equal to at least 2% of the loan amount.

The eligible uses of loan proceeds include new construction; moderate or substantial rehabilitation and acquisition when related to the rehabilitation; acquisition of existing buildings for special needs; acquisition and improvement of land; development of essential on- and off-site improvements; development of related facilities; on-site management and maintenance offices; appliances; parking development and landscaping; limited commercial space costs; professional and application fees; technical assistance and packaging fees to and by nonprofit entities; board of director education fees for cooperatives; interest on construction loans; relocation assistance when applicable; developers fees; and refinancing applicant debt when authorized in advance to pay for eligible purposes prior to loan closing and approved by RHS. The program may not be used for transient or migrant housing, health care facilities, or student housing. Unless granted an exception by USDA, refinancing is not an authorized use of funds.

The interest rates on Section 538 loans must be fixed. The maximum allowable interest rate is as specified in each year's Notification of Funding Availability (NOFA). In order to help the Section 538 program serve low- and moderate-income tenants, however, at least 20% of Section 538 loans made each year must receive interest credit subsidy sufficient to reduce the effective interest rate to the Applicable Federal Rate (AFR) defined in Section 42(I)(2)(D) of the Internal Revenue Code.³⁸

³⁷ A single-asset entity is one that owns no assets other than the proposed project.

³⁸ The AFR is available at <http://ftp.fedworld.gov/pub/irs-utl%20afrs.pdf>, or in the *Wall Street Journal* on the third Wednesday of each month, labeled the "Long Term Monthly Rate."

Rural Housing Voucher Program (Section 542)

The Housing and Community Development Act of 1992 added Section 542 (42 U.S.C. 1490r) to the Housing Act of 1949.³⁹ Owners of complexes financed through the USDA Section 515 program receive subsidized loans, and agree to rent only to low-income residents. The rental rates are controlled. When the mortgage is paid off, the owner has the right to raise rents to what the local economy can bear. Rural Housing Vouchers are made available to residents to cover the difference between the tenant's rent contribution and the new rental rate.⁴⁰ Tenants may use the voucher at their current property or any other rental unit that passes Housing and Urban Development (HUD) housing quality standards, and where USDA vouchers are accepted. Use of the vouchers is prohibited at HUD Section 8 or other federally assisted public housing projects.

Recent Funding Issues

Multi-family Housing Preservation and Revitalization Program (MPR)

In November 2004, USDA released a report on the Section 515 program.⁴¹ The purpose of the report was to assess the status of the Section 515 portfolio in terms of prepayment options and long-term rehabilitation needs. While few health and safety issues were found, the report found that no properties had adequate reserves or sufficient cash flow to do needed repairs and for adequate maintenance over time. The report concluded that the USDA portfolio of Section 515 projects represented a federal investment of nearly \$12 billion; that the projects serve some of the poorest and most underserved families in rural communities; and that the location, physical condition, and tenant profile of the properties suggest that the public interest is best served by revitalizing most of the housing for long-term use by low- and moderate-income tenants. The report recommended a revitalization program for USDA multi-family housing.

In response to the report, the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2006, P.L. 109-97, included a provision that created a demonstration program for the preservation and revitalization of multi-family rental housing properties. The program is referred to as the Multi-Family Housing Preservation and Revitalization (MPR) program. The purpose of the MPR program is to preserve Section 515 and Section 514/516 projects in order to provide safe and affordable housing for low-income residents. Expectations are that properties selected to participate will be able to be revitalized and extend affordable use without displacing or impacting tenants because of increased rents.

³⁹ P.L. 102-550.

⁴⁰ The tenant's rent contribution equals the greater of (1) 30% of monthly adjusted family income, (2) 10% of monthly income, or (3) for welfare recipients, the portion of the family's welfare payment that is designated for housing costs.

⁴¹ Kevin S. Blake, Thomas W. White, and Richard F. Simpson, et al., *Rural Rental Housing—Comprehensive Property Assessment and Portfolio Analysis, Final Study Report*, ICF Consulting Team, prepared for U.S. Department of Agriculture, Rural Development, November 2004.

Under MPR, the USDA has authority to use funds to restructure existing loans using such tools as reducing or eliminating interest; deferring loan payments; subordinating, reducing, or re-amortizing loan debt; and making loan advances.

In its FY2011 Budget for USDA, the Administration proposed no funding for the MPR program. The Administration argues that the program has been operating since 2006, that the most cost-effective and justified repairs have been achieved, and that continued funding could be seen as over-subsidizing multi-family property owners. Instead, the Administration proposed an increase in funding for the Section 515 program to \$95 million instead of the \$70 million approved for FY2010.⁴²

Title VIII of the Housing Preservation and Tenant Protection Act of 2010, H.R. 4868, would authorize continuing funding for the MPR program. The bill was passed by the House Financial Services Committee but has not been considered in the full House. No companion bill was introduced in the Senate.

Since no appropriations legislation was enacted before the beginning of FY2011, the 111th Congress enacted a series of continuing resolutions (CR) to continue funding at the FY2010 level for most accounts in the federal budget (including all of the accounts in USDA's budget). The latest CR (P.L. 111-322) is slated to expire at the earlier of March 4, 2011, or enactment of FY2011 appropriations legislation.

Funding for Section 502 Guaranteed Home Loans

Since the collapse of the mortgage market in 2007, prospective homebuyers have found that lenders typically require either a 20% downpayment or a 10% downpayment and the purchase of private mortgage insurance. This has resulted in an increased demand for loans insured or guaranteed by the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), and the USDA, since these programs require smaller downpayments, and in the case of VA and USDA, no downpayments.

The use of the Section 502 guaranteed loan program increased from 32,481 loans in FY2007 to 56,745 loans in FY2008, an increase of nearly 75%. In FY2009, there were 119,826 Section 502 guaranteed loans issued, an increase of more than 111%.⁴³ The high demand for the program has continued, and on March 9, 2010, USDA sent a notice to USDA State Directors noting that the FY2010 funding for the Section 502 guaranteed loan program was expected to be exhausted by the end of April.⁴⁴ This is not the first time that the USDA would have exhausted its loan authority prior to the end of the fiscal year. However, this year was the first time that the agency would be exhausting its funds with so much of the fiscal year remaining.

⁴² U.S. Department of Agriculture, *2011 Budget, Explanatory Notes for Committee on Appropriations, Volume 2*, 2010, pp. 27-59.

⁴³ U.S. Department of Agriculture, *2011 Budget, Explanatory Notes for Committee on Appropriations, Volume 2*, Washington, DC, 2010, pp. 27-105.

⁴⁴ Tammye Trevino, *USDA Rural Development, Single Family Housing Guaranteed Loan Program, Program Funds*, U.S. Department of Agriculture, To: All State Directors, Washington, DC, April 9, 2010.

On May 11, 2010, USDA provided guidance to lenders on how to proceed with loans when FY2010 funds for the Section 502 loan guarantee program were exhausted.⁴⁵ In the guidance, USDA estimated that funds would be exhausted on May 12, 2010, or soon thereafter. Lenders could resume making Section 502 guaranteed loans but the USDA guarantee on the loans would be “subject to the availability of funds and Congressional authority to charge a 3.5% guarantee fee for purchase loans and a 2.25% guarantee fee for refinance loans.” Lenders would assume all loss default risk for the loans until funds are available for USDA to obligate and USDA issues the Loan Note Guarantees to lenders.

As enacted on July 29, 2010, the 2010 Supplemental Appropriations Act, P.L. 111-212, provided additional appropriations for Section 502 guaranteed loans for the remainder of FY2010. The act also permits USDA to charge lenders a guarantee fee of up to 3.5% of the mortgage amount. In addition, lenders may be charged an annual fee of 0.5% of the mortgage balance for the life of the loan. These changes in the guarantee fees are intended to enable the Section 502 guaranteed home loan program to operate with little or no need for positive credit subsidies in FY2011 and beyond.

The latest continuing resolution, P.L. 111-322, funds the program at the FY2010 level until the earlier of March 4, 2011, or enactment of FY2011 appropriations legislation for USDA.

⁴⁵ Tammye Trevino, *Section 502 Single Family Housing Guaranteed Loan Program, Delivery of Guaranteed Purchase and Refinance Loans*, U.S. Department of Agriculture, To: All Approved Lenders, Washington, DC, May 11, 2010.

Table I. Funding for Selected Rural Housing Programs, FY1980-FY2010

(\$ millions of loan or grant obligations)

Fiscal Year	Section 502 Direct	Section 502 Guaranteed	Section 504 Loans	Section 504 Grants	Section 514	Section 516
1980	2,806	18.9	21.9	24.0	24.6	22.3
1981	2,578	5.8	17.9	22.7	18.5	10.5
1982	2,476	na	10.0	13.6	1.9	14.9
1983	2,137	na	7.1	12.5	4.0	7.5
1984	1,845	na	7.2	12.5	5.5	9.8
1985	1,790	na	7.9	12.5	17.6	11.2
1986	1,157	na	7.0	13.9	10.4	10.8
1987	1,144	na	5.9	12.5	10.7	7.1
1988	1,271	na	7.6	12.5	11.4	11.2
1989	1,267	na	11.3	12.5	11.4	9.4
1990	1,311	na	11.6	12.6	11.3	10.8
1991	1,269	38	11.2	12.8	13.8	10.4
1992	1,254	214	11.3	12.8	15.9	13.5
1993	1,291	540	11.8	14.3	16.3	15.9
1994	1,657	726	25.2	27.5	15.7	40.6
1995	931	1,049	29.5	27.8	15.1	11.0
1996	1,016	1,700	35.1	25.7	15.0	10.0
1997	706	2,000	30.9	17.6	15.0	8.4
1998	1,008	2,823	30.3	25.7	14.6	10.0
1999	923	2,977	25.5	21.3	20.0	13.1
2000	1,141	2,151	27.4	30.4	28.8	19.3
2001	1,074	2,342	30.8	33.7	33.2	9.9
2002	1,081	2,419	32.0	31.2	47.3	14.5
2003	1,038	3,087	32.1	33.7	55.9	7.0

Fiscal Year	Section 502 Direct	Section 502 Guaranteed	Section 504 Loans	Section 504 Grants	Section 514	Section 516
2004	1,352	3,233	33.6	32.4	24.1	6.8
2005	1,141	3,050	34.7	31.6	32.9	33.4
2006	1,129	3,075	32.9	30.7	31.9	14.0
2007	1,208	3,664	31.2	27.7	30.4	12.7
2008	1,139	6,756	29.9	37.1	30.6	11.4
2009 ^a	1,489	14,713	26.8	32.1	34.5	15.0
2010 ^a	2,417	13,618	34.4	32.0	29.3	9.8

Source: U.S. Department of Agriculture.

Note: na = program was not authorized in the years shown.

a. USDA estimate based on amount appropriated.

Table 2. Funding for Selected Rural Housing Programs, FY1980-FY2010

(\$ millions of loan or grant obligations)

Fiscal Year	Section 515	Section 521	Section 523 Self-Help Housing Grants	Section 524 Site Loans	Section 533	Section 538
1980	881.3	393.0	6.2	0.8	na	na
1981	864.8	423.0	13.1	0.5	na	na
1982	953.7	403.0	4.7	0	na	na
1983	802.0	398.0	10.2	0.3	na	na
1984	919.0	123.7	5.0	0.2	na	na
1985	903.0	111.0	9.4	0	na	na
1986	652.3	168.3	5.1	0	19.1	na
1987	554.9	275.3	7.6	0.2	19.1	na
1988	554.9	275.3	5.7	0	19.1	na
1989	554.9	275.4	8.3	0.4	19.1	na

Fiscal Year	Section 515	Section 521	Section 523 Self-Help Housing Grants	Section 524 Site Loans	Section 533	Section 538
1990	571.0	296.4	5.3	0.1	19.1	na
1991	576.3	311.1	12.0	0.6	23.0	na
1992	573.9	319.8	7.8	0.4	23.0	na
1993	573.9	404.0	16.9	0.6	23.0	na
1994	512.4	446.7	11.9	0.1	23.0	na
1995	183.3	523.0	12.9	0	22.0	na
1996	151.0	540.5	12.9	0.6	11.0	23.7
1997	152.5	520.2	26.2	0.1	7.6	51.8
1998	149.4	541.4	26.7	0.4	11.1	78.7
1999	114.4	583.4	26.2	3.1	7.2	74.8
2000	113.8	639.6	28.0	0.6	5.5	99.7
2001	114.1	685.7	17.6	3.7	7.4	101.8
2002	118.4	701.0	26.5	0.5	8.6	99.4
2003	115.0	723.7	40.0	1.2	10.3	102.0
2004	115.9	580.6	35.3	3.2	9.3	99.4
2005	99.2	592.0	42.1	0.4	8.8	97.2
2006	99.2	638.5	34.0	3.0	10.8	98.4
2007	98.9	615.8	35.5	1.9	9.5	97.2
2008	131.7	478.7	37.9	1.7	9.7	90.4
2009 ^a	67.7	902.2	31.0	0.6	10.4	120.9
2010 ^a	69.5	980.3	56.4	5.0	10.1	141.5

Source: U.S. Department of Agriculture.

Notes: na = program was not authorized in the years shown.

a. USDA estimate based on amount appropriated.

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