Statement of

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Before the

Subcommittee on Rural Housing and Development
Committee on Banking, Housing and Urban Affairs
United States Senate

March 23, 1983

The Farmers Home Administration (FmHA) within the Department of Agriculture is a major source of housing credit for rural residents--having provided more than $3 billion in mortgage lending during each of the last six years alone. Although the commitment to rural housing has been large, the budget treatment of these programs seriously obscures their costs, making informed funding and program decisions difficult. The Administration is proposing to modify the budget treatment of rural housing programs and to substitute a block grant to states for most new lending beginning in 1984.

At the Committee's request, I will discuss present budget practices for the rural housing programs, and program costs, in order to provide a context for considering alternative approaches. My remarks will cover three topics:

- First, an overview of rural housing loan programs and their budget treatment;
- Second, a more detailed examination of current budget practices and of options for making near-term program expenditures more apparent; and
- Third, an examination of long-term program costs and of options for making them both more evident and more comparable to those of other programs.

RURAL HOUSING PROGRAMS AND THEIR BUDGET TREATMENT

Current rural housing programs provide credit for several purposes. The vast majority of aid is provided through two programs: the Section 502 homeownership loan program, which provides mortgages at effective interest rates as low as 1 percent to allow low- and moderateincome persons to purchase homes; and the Section 515 program, which provides 1 percent mortgages to finance the construction or rehabilitation of rental housing projects. Smaller programs include home repair loans, as well as lending to finance housing for farm laborers, to develop housing sites, and for weatherization. At the end of fiscal year 1982, $25 billion in loans was outstanding under these programs. In 1983, $3.3 billion in loans is expected to be made, assisting 54,000 additional homebuyers, and subsidizing 28,000 additional rental units (see Table 1).

The budget treatment of loan programs is necessarily complex, and their budget impacts are therefore often difficult to assess. Rural housing loans, like many other federal loans, are financed through revolving funds. The largest of these--the Rural Housing Insurance Fund (RHIF)--borrows money at the federal government's cost of funds and lends the money at much lower interest rates. The difference between the cost of funds to the RHIF and the interest rates paid by borrowers represents the primary cost of the programs to the federal government. Smaller costs include losses due to defaults and foreclosures, as well as administrative expenses.

Each year the Congress authorizes some amount of additional lending for rural housing. The budgetary consequences of these new loans are of two types:

TABLE 1. RURAL HOUSING LOANS OUTSTANDING IN 1982, ESTIMATED 1983 LENDING, AND PROJECTED 1984 LENDING ACTIVITY (By fiscal years, in billions of dollars)

Program	Loans Outstanding, End of 1982	Lending Authorized for 1983	1984 Lending: Current Policy a/	1984 Lending: Admin. Proposal
Section 502 Homeownership Loans	20.6	2.3	2.5	0.3
Section 515 Rental Housing Loans	4.4	0.9	1.0	c/
Other Programs b/	0.2	c/	c/	c/
Total	25.2	3.3	3.5	0.3

NOTES: Includes only programs financed through the Rural Housing Insurance Fund. Components may not sum to totals due to rounding.

a. Represents estimated loan volume necessary to assist the same number of additional households in 1984 as are expected to be aided in 1983.

b. Includes home repair, farm labor housing, housing site development, and weatherization loans.

c. Less than $50 million.

- First, each year's new lending adds to federal expenditures as loan funds are distributed to borrowers, although most of these funds are eventually repaid.
- Second, each year's new lending contributes to interest-subsidy costs for many years to come.

As I will discuss next, current budget practices obscure both of these effects on the budget.

CURRENT BUDGET PRACTICES

Under current budget practices, the FmHA can transfer out of the unified budget the expenditures associated with initiating loans for rural housing, agricultural credit, and rural development. This occurs because, once the agency makes loans, it may sell securities called Certificates of Beneficial Ownership (CBOs) to the Federal Financing Bank (FFB)--an office within the Department of the Treasury that borrows funds on behalf of federal agencies. 1/ Because the FFB's expenditures to purchase CBOs from the FmHA are not included in unified budget totals, these transactions effectively transfer off budget the outlays associated with making loans. The result is to understate total federal outlays, and thus federal borrowing needs, in the unified budget for the year in which the loans are made.

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1. The Rural Electrification Administration (REA) may also finance lending through the sale of CBOs to the FFB. In the case of the REA, however, the agency's loan fund is already off budget. Consequently, the effect of CBO sales by the REA is to transfer outlays from one off-budget entity to another.

Although transactions between the RHIF and the FFB are treated as asset sales, they should more appropriately be viewed as borrowing by the RHIF from the FFB. The FmHA continues to maintain possession of the mortgages securing the CBO and to service them. It also guarantees the timely payment of interest on the securities, and the repayment of principal at maturity. Thus, the FFB does not purchase a pool of mortgages; rather, it lends to the FmHA based on the agency's guarantee. If these transactions were defined as borrowing, no offsetting income from a CBO "sale" would appear in the FmHA's accounts. Consequently, federal expenditures associated with making loans would appear as on-budget outlays attributable to the RHIF, rather than as off-budget outlays of the FFB. In this way, the unified budget would present a more complete picture of total federal activity and, thus, borrowing needs.

Under current budget practices, the outlays associated with more than $8 billion in loan commitments expected to be made by the FmHA in 1983 for rural housing and other purposes could eventually be transferred off budget.

<u>Options for Making Near-Term Expenditures More Apparent</u>

The most comprehensive approach to problems with the current budget practices--one that is endorsed by the Congressional Budget Office--would be to include all FFB activities in the unified budget, and to allocate outlays of the FFB to the accounts of the agencies originating the loans. The Truth in Budgeting Act, S. 711, proposed by Senators Proxmire and Gorton, would change the treatment of the FFB in this manner. 2/

The Administration has proposed a more limited approach that would alter only the treatment of transactions between the RHIF and the FFB. Under the Administration's proposal, all past and future transactions between the RHIF and the FFB would be treated as borrowing. This would involve reclassifying outstanding CBOs as debt instruments and, therefore, recomputing past on- and off-budget outlays. In addition, the proposal would include in the unified budget the outlays associated with any new rural housing lending. If this change were adopted, and if the number of additional households assisted annually were maintained at the 1983 level, on-budget outlays associated with new lending could total between $3 billion and $4 billion annually during each of the next five years. Total on- and off-budget outlays in any year, however, would not be affected by this change in budget treatment.

PROGRAM COSTS

Because most loans are eventually repaid, the actual costs of rural housing programs to the federal government are the interest subsidy, plus any default and foreclosure expenses, less the effects of certain provisions

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2. For a more complete discussion of issues surrounding the budget treatment of the FFB, see Congressional Budget Office, The Federal Financing Bank and the Budgetary Treatment of Federal Credit Activities (January 1982).

to recapture part of the subsidy. These costs can be viewed in two ways: the cost in any one year of all outstanding loans, or the cost of each year's new lending over the expected term of the loans. Currently, budget documents include information on annual program costs. Estimates of the long-term cost of each year's new lending are not now available, but would be useful to the Congress in comparing the costs of loans with those of grants.

The annual cost of rural housing loans outstanding in 1982 totaled $1.5 billion. This represents a five-fold increase since 1978, primarily reflecting growth in the volume of loans outstanding and the high interest rates paid by the government. The Congressional Budget Office estimates that, if the number of additional households assisted each year were maintained at the 1983 level, the annual cost of outstanding loans would rise to $2.6 billion by 1988.

The long-term cost of each year's new loans equals the total interest-subsidy, default, and foreclosure expenses incurred over the term of the loans, less any recaptured subsidies. For example, new Section 502 borrowers must eventually repay some of the subsidy they received if they subsequently sell their homes at a profit. Similarly, Section 515 rental housing costs are partially offset by the higher rents that better-off tenants pay. Estimating long-run costs is difficult, however, because it requires forecasting over a lengthy period, and because information on the likely effects of several key program provisions is sketchy.

Moreover, because the costs of rural housing loans are incurred over a number of years, they cannot easily be compared with the costs of other programs whose funds are appropriated in one year, spent shortly thereafter, and not repaid. Merely summing the interest-subsidy and default costs over the term of the loans neglects the fact that future dollars are worth less than current ones. One way to express the long-term costs of loan programs in a manner more comparable with those of other programs would be to convert the future costs into "present-value" terms. 3/ The present-value of long-term costs would provide the Congress with a measure more nearly equivalent to appropriations for grant programs, but the uncertainties inherent in estimating long-term loan costs mean that such comparisons could never be precise.

Applying a range of assumptions regarding the factors that would affect long-term costs, the Congressional Budget Office estimates that the present value of the cost of any Section 502 homeownership loans authorized for 1984 would range from about $5,000 to almost $8,000 per

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3. A present-value calculation is a means of "discounting" the value of future dollars relative to dollars available today. The calculation takes into account anticipated future inflation as well as the real (after-inflation) return that one could earn on funds available now rather than in the future.

household assisted, or from $13 million to $20 million per $100 million lent (see Table 2). Any Section 515 rental housing loans authorized in 1984 are estimated to cost between $16,000 and $23,000 per household assisted, or between $45 million and $65 million per $100 million lent. If the same number of additional households were aided in 1984 as are expected to be assisted in 1983, the present value of the long-term costs from new loans made in 1984 would range from $800 million to $1.1 billion. These estimates are, however, dependent on the amounts of subsidies assumed to be recaptured. To the extent that these offsetting receipts did not materialize, the eventual costs of rural housing loans made in 1984 would be larger than the net cost figures reported here.

Options for Making Long-Term Costs More Apparent

In order to provide the Congress with cost information more nearly comparable to programs whose funds are appropriated in one year and spent shortly thereafter, the FmHA could be required to submit estimates each year of the present value of the long-run cost of proposed lending. Such estimates (similar to the ones presented here) could be provided both for total costs and for anticipated net costs--that is, total costs less the expected recapture of subsidies from beneficiaries. 4/

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4. Currently, the Office of Management and Budget includes present-value estimates of interest-subsidy costs in its annual special analysis of federal credit programs. The estimates for rural housing programs, however, do not take into account differences in the terms of the loans, anticipated loan prepayments, variations in the interest rates paid by borrowers over the lives of the loans, or the offsetting effect of recapturing part of the subsidies.

TABLE 2. ESTIMATED PRESENT VALUE OF LONG-TERM COSTS FOR NEW RURAL HOUSING LENDING IN 1984 (In dollars)

Program	Cost Per Household Assisted	Cost Per $100 Million in Loans
Section 502 Homeownership Loans		
(A) Interest-subsidy cost a/	7,600 to 10,500	19 million to 26 million
(B) Offsetting collections from subsidy recapture	2,500 to 2,700	6 million to 6.5 million
Net cost = (A) - (B)	5,100 to 7,800	13 million to 19.5 million
Section 515 Rental Housing Loans		
(A) Interest-subsidy cost a/	21,200 to 24,600	60.5 million to 70 million
(B) Offsetting collections from rent payments above the minimum	5,400 to 2,000	15.5 million to 5.5 million
Net cost = (A) - (B)	15,800 to 22,600	45 million to 64.5 million

NOTE: Estimates are prepared under a range of assumptions, including a range of discount rates. Factors considered in estimating Section 502 costs include: the interest rate paid by the FmHA on CBOs issued to finance the loans; the initial interest rates paid by homebuyers; changes over time in borrower incomes and therefore in interest rates paid; the extent and timing of loan prepayments; the rate of appreciation of homes purchased and, thus, the amount of subsidy recaptured when the homes are sold; and the extent of borrower defaults. Factors considered in estimating Section 515 costs include: the interest rate paid by the FmHA on CBOs issued to finance the loans; the initial incomes of project tenants; and the rate at which tenant incomes change over time. Because the FmHA has little information on incomes of Section 515 tenants, estimates of offsetting collections from better-off tenants are subject to especially great uncertainty.

a. Includes default and foreclosure expenses.

A second means of considering long-term program costs would be to appropriate enough funds at the time that rural housing loan commitments are made to cover their potential long-term costs. Several programs operated by the Department of Housing and Urban Development (HUD) are treated in this manner, but important differences between FmHA and HUD programs could make this approach less appropriate for rural housing loans. Under most HUD programs, the federal government signs long-term contracts to subsidize the housing expenses of low-income households. Because HUD does not have authority to borrow from the Treasury--whereas the FmHA does--the Congress provides HUD with sufficient budget authority to cover the total cost of its assistance commitments over future years. Although the Congress could provide upfront funding for rural housing programs, such funding is not necessary because the FmHA already has permanent authority to borrow from the Treasury. Further, because forward funding of long-term program costs is, of necessity, simply the sum of costs in the future when dollars are expected to be less valuable, it would be inappropriate to compare such sums with amounts appropriated for most grants, in which funds are generally spent shortly after they are made available.

CONCLUSION

In conclusion, rural housing loan programs involve both near-term expenditures and long-term costs that are not apparent in the budget at the time that loan commitments are made. The absence of this information makes it difficult for the Congress to reach informed judgments regarding the appropriate volume of annual lending, or the desirability of alternative approaches to providing rural housing assistance. As the Congress considers 1984 funding decisions and program alternatives, it may therefore wish to alter present budget practices to provide more complete information.