Direct Loans Open Doors to Rural Homeownership

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USDA's Section 502 Single Family Direct Loan Program provides subsidized housing loans to very low- and low-income rural residents who are without adequate housing and cannot obtain credit from other sources. An ERS survey of recent Section 502 borrowers finds that they are typically under 40, in families with children, and first-time homebuyers. Most of them believed that their current home and neighborhood are better than their previous ones and that, without assistance from the program, they would not have been able to afford a comparable home for at least 2 years, if ever.

Despite improvements in housing quality and a narrowing of the rural-urban gap in housing conditions over time, many rural households still face inadequate housing or high costs (Mikesell; Housing Assistance Council; Whitener, 1998). For example, in 1995, 1.6 million nonmetro households lived in housing classified as substandard, and substantial proportions of both nonmetro and metro households were burdened by high housing costs of more than 30 percent of their income (Whitener, 1999). Problems related to adequacy and affordability can occur in both growing and declining areas. In declining areas, demand for new housing may never arise and much of the existing housing stock may depreciate and become inadequate. In growing areas, demand may exceed supply, driving up housing prices and putting adequate housing outside the reach of low-income households.

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For over 50 years, USDA programs have provided home mortgages to low-income rural families, undoubtedly contributing to higher levels of homeownership in rural communities. The Rural Housing Service (RHS), formerly the Farmers Home Administration and now part of USDA's Rural Development mission area, operates a broad range of programs to promote and support affordable housing development in rural areas. Through the Section 502 Single Family Direct Loan Housing Program, RHS offers subsidized mortgage loans to low-income rural families who are without adequate housing and cannot obtain credit from other sources (see "Section 502 Single Family Direct Loan Housing Program").

At the request of the USDA's Rural Development mission area, the Economic Research Service (ERS), in cooperation with the Social and Economic Sciences Research Center at Washington State University, conducted the 1998 Survey of USDA's Single Family Direct Loan Housing Program. The survey was designed to provide detailed information on the characteristics of recent participants in the Section 502 program.

To help determine whether the program is helping specific types of rural residents and helping to improve rural housing, we defined comparison groups of rural homeowners and rural tenants from the 1995 American Housing Survey (see "Data Sources" for a definition of how "rural" is used in this article). These comparison groups allow us to assess whether recent Section 502 borrowers are similar to or better off than other rural low- to moderate-income homeowners. The renter comparison group provides insights into the characteristics and housing needs of rural low- to moderate-income renters, who are most likely to be eligible to participate in the Section 502 program. (See "Data Sources" for more information on the ERS survey, the American Housing Survey, and our comparison group selection process.)

Who Are Section 502 Borrowers?

What characterizes Section 502 program participants, and how do they benefit from participating? To address these questions, we examined the demographic characteristics and economic well-being of recent Section 502 borrowers.

Household Type. Section 502 households are predominantly (71 percent) married couples and female single parents, both with children under 18 (fig. 1). Single parents, especially those who rely on alimony for a large share of their income, may have difficulty obtaining commercial mortgages. The program appears to be helping out, with single parents comprising a third of households surveyed. Some of the single parents undoubtedly obtained their loans while married and have since been divorced, separated, or widowed. The 502 program allows mortgage payments to be adjusted as income changes.

Section 502 borrowers are twice as likely as the low- to moderate-income homeowner comparison group to be female single-parent households, while the nonprogram homeowners are much more likely to be married couples with no children (table 1). However, the largest proportion (almost 40 percent) of both homeowner groups are married couples with children.

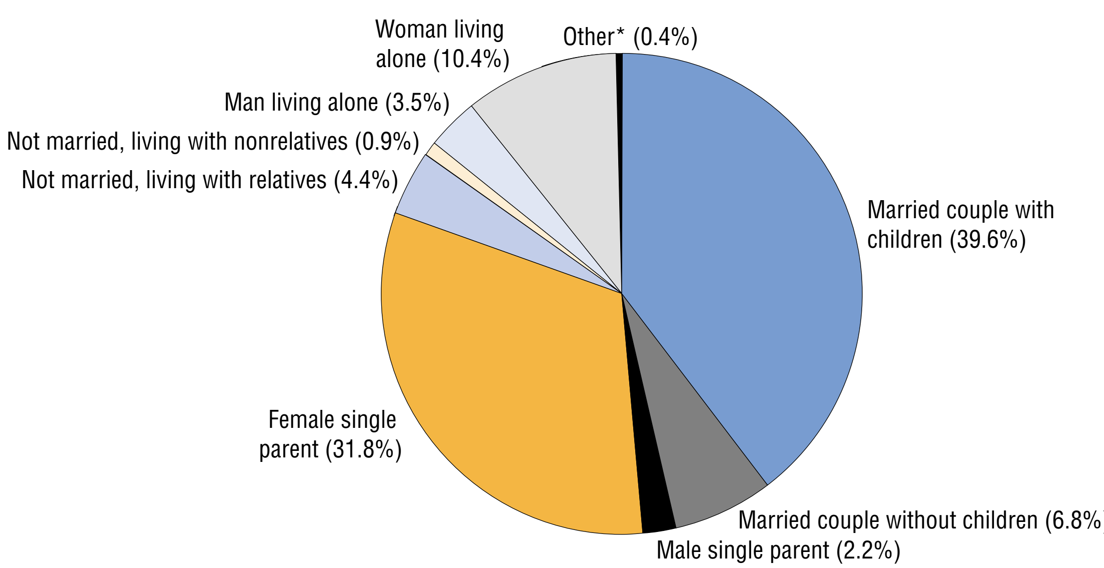
The largest proportion of low- to moderate-income renters is individuals living alone (table 1). Single parents are a slightly larger share of the renter comparison group than of the homeowner comparison group, leaving Section 502 borrowers much more likely than either comparison group to be single parents. Like the homeowner comparison group, the low- to moderate-income renters are more likely than 502 borrowers to be married couples with no children.

Respondent Age. Section 502 borrowers are predominantly under 40 years old (fig. 2). The largest share (37 percent) are 30 to 39. The share of respondents drops off at age 50, with less than 8 percent 50 to 61 and 6 percent 62 and older. A younger age distribution should be expected among recent participants in a home mortgage program of last resort. Household income tends to increase with age and work experience. Younger householders are more likely than older householders to need the 502 program in order to obtain their first house. The modest participation of elderly households in the program may be of particular concern, however, because Section 502 may offer them an affordable way out of substandard homes.

Figure 1

Section 502 borrower households by composition

Female single parents and married couples with children are the largest groups of program participants

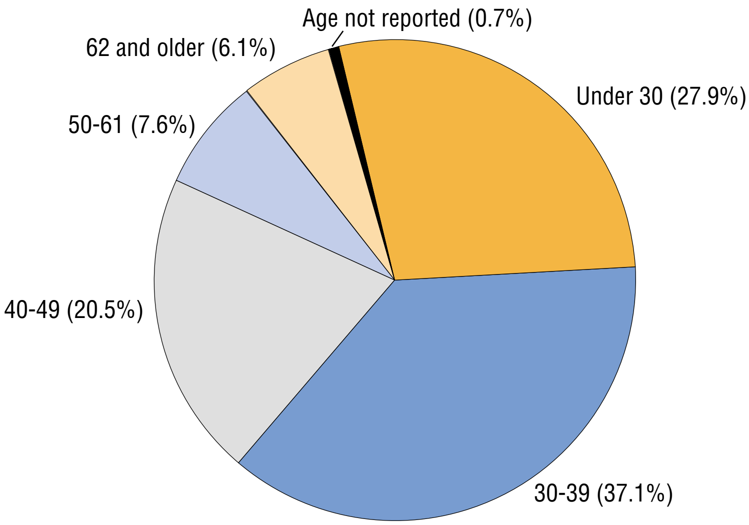


*Other includes households that did not report number of members and/or their relationships to the respondent.
Source: 1998 Survey of USDA's Single Family Direct Loan Housing Program, ERS.

Figure 2

Age of Section 502 borrowers

Young people under the age of 40 are about two-thirds of recent program participants

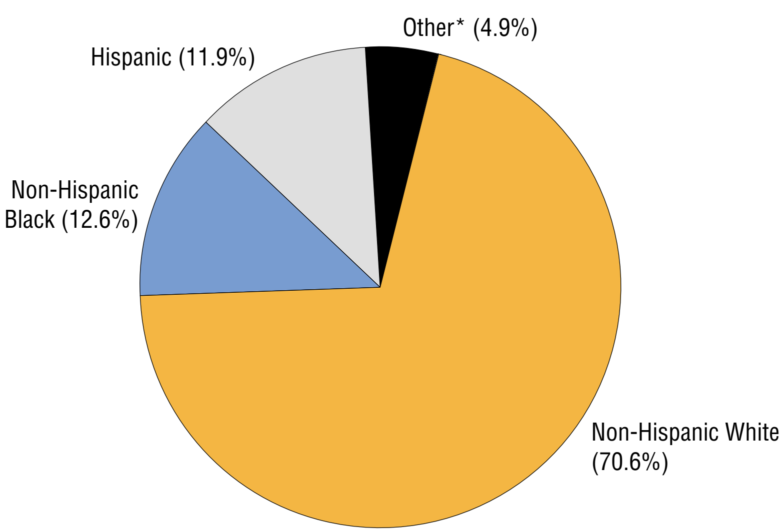


Note: Age is of the borrower who answered the survey.
Source: 1998 Survey of USDA's Single Family Direct Loan Housing Program, ERS.

Figure 3

Race and ethnicity of Section 502 borrowers

Non-Hispanic Blacks and Hispanics comprise a quarter of program participants



*Other includes Asians, Native Americans, and survey respondents who did not identify themselves by race or ethnicity.
Source: 1998 Survey of USDA's Single Family Direct Loan Housing Program, ERS.

Section 502 borrowers are more likely to be under 40 than other low- to moderate-income recent homeowners (table 1). Both Section 502 borrowers and the AHS renter group tend to be younger, with more than half of each group under 40 years of age. However, 22

Section 502 Single Family Direct Loan Housing Program

Today, most direct Federal mortgage lending to rural areas is done through USDA's Section 502 Single Family Direct Loan Program, currently run by the Rural Housing Service (RHS). Although the U.S. Department of Housing and Urban Development (HUD) provides home mortgage assistance to both urban and rural areas through its Federal Housing Administration's (FHA) single-family home mortgage insurance program, only 6 percent of the mortgages it insured in fiscal year 1997 were in nonmetro areas (Mikesell).

Section 502 direct subsidized homeownership loans are made to very low-income and low-income rural families who are without adequate housing and cannot obtain mortgage financing from other sources. Low-income families are those with adjusted incomes under HUD's applicable low-income limit, usually 80 percent of the median income of the local area; very low-income families have adjusted incomes under 50 percent. Loans can be used to build, repair, renovate, or relocate a home, or to purchase and prepare sites, including providing water and sewer facilities. Section 502 loans may also be used to refinance debts to avoid losing a home or to make necessary rehabilitation of a house affordable.

percent of the AHS tenants are 62 or older, compared with 6 percent of the Section 502 borrowers. Again, the 502 program is most likely serving young, first-time homebuyers with difficulty qualifying for conventional loans.

Race/Ethnicity. While 70 percent of Section 502 borrowers are non-Hispanic Whites, 13 percent are non-Hispanic Blacks and 12 percent are Hispanics (fig. 3). The low incomes of many minority households may restrict their access to credit, and lack of sufficient funds for a downpayment is frequently the biggest hurdle in obtaining a home mortgage. Poor credit history may also be a problem, and some may face racial discrimination or unfair practices. Some lenders may avoid the very neighborhoods in which minority households could afford to buy a home. There are too few Native Americans in the survey to report on them separately, but they face similar hurdles to homeownership.

Racial/ethnic minority households comprised a much larger share of Section 502 borrowers than of either AHS comparison group (table 1). About 30 percent of the 502 program participants are minorities, compared with 15 percent of the homeowner comparison group and 22 percent of the renter comparison group. The Section 502 direct loan program seems to be reaching minorities who would otherwise be unable to buy a home.

Table 1

Selected characteristics of Section 502 households and comparison groups

Section 502 households are more likely than other recent low- to moderate-income rural homeowners to be single parents, young, and minorities

Characteristic	Section 502 households	1995 AHS rural comparison groups: Low- to moderate-income recent owners	1995 AHS rural comparison groups: Low- to moderate-income renters
	Percent		
Household composition:			
Married, children under 18	39.6	37.9	24.2
Married, no children	6.8	21.7	11.7
Single parent	34.0	16.0	19.6
Living alone	13.9	17.0	32.8
Other[1]	5.7	7.4	11.7
Age of respondent:			
Under 40	65.0	49.3	53.8
Over 40	35.0	50.7	46.2
Race/ethnicity of respondent:			
White non-Hispanic	70.6	84.5	78.4
Black non-Hispanic	12.6	7.1	10.1
Hispanic	11.9	6.6	8.8
Other[2]	4.9	1.8	2.7
Household income:			
Under $25,000	70.6	68.0	85.3
$25,000 or more	29.4	32.0	14.7

[1]Other includes unmarried householders living with relatives or nonrelatives and, for Section 502 households, those who did not report household composition.

[2]Other includes Asians, Native Americans, and those who reported "other" race. For Section 502 households, other also includes those who did not report race or ethnicity.

Source: 1998 Survey of USDA's Single Family Direct Loan Housing Program, ERS.

Household Income and Its Sources. The vast majority of recent borrowers' household incomes are low or moderate, with median household income of recent borrowers about $20,000 in 1997. Seventy-one percent had incomes below $25,000 in 1997 (table 1), compared with 68 percent of the homeowner comparison group and 85 percent of the renter comparison group.

Over 87 percent received some wage and salary income during 1997 (table 2). With so many single parents participating, 23 percent of Section 502 borrower households reported alimony or child support. Social security, retirement, and interest and dividend income were each reported by 13 percent of borrower households. Few borrowers rely on income support from public assistance programs. When received, public assistance was most often in the form of food stamps: 18 percent of households reported someone in their household had received food stamps for at least a month during the year. Food stamps are restricted to households with income (adjusted for several factors) that is below 130 percent of the poverty threshold, indicating that nearly one-fifth of the respondent households had very low incomes for at least a month out of the previous year.

Table 2

Types of income received by Section 502 households

While wage and salary income was most common, alimony or child support was received by many households

Type of income	Households reporting income	Share of households reporting income[1]
	Number	*Percent*
Wages or salaries	2,645	87.7
Net income from a farm or other self-employed business	139	4.6
Social security and/or other retirement income	392	13.0
Interest and dividends	398	13.2
Aid to Families with Dependent Children	118	3.9
Supplemental Security Income	272	9.0
Food stamps[2]	544	18.2
Other public assistance	61	2.0
Alimony or child support	687	22.7
Workers' compensation	48	1.6
Veterans' benefits	49	1.6
Unemployment benefits	260	8.6
Disability income	121	4.0
Survivors' benefits	42	1.4
Other income	44	1.5

[1]Households could report more than one source of income, so percentages do not add to 100 percent.

[2]Food stamps are not considered cash income, but are included to show all the sources of public assistance that the respondents were asked about.

Source: 1998 Survey of USDA's Single Family Direct Loan Housing Program, ERS.

Place of Residence. Recent 502 borrowers are concentrated in the South (43 percent), compared with 25 percent in the Midwest, 21 percent in the West, and 11 percent in the Northeast. By 1990 metro-nonmetro designations, 43 percent of borrower households are within the boundaries of metro counties and 57 percent are in nonmetro counties. And, by the difficult-development status HUD has published for 1999, 47 percent of borrower households are in counties that contain difficult-development census block groups. A difficult-development area is one designated by the Secretary of HUD as an area that has high construction, land, and utility costs relative to the area's gross income. Whether the households are inside the block groups cannot be determined, but location within such counties suggests that the households may have restricted access to commercial credit.

Section 502 households are much more likely to be in the South than the AHS groups of low- to moderate-income homeowners and renters. The AHS does not provide county-level locational indicators, so we could not determine how many of the comparison group households are in counties containing difficult development areas.

In short, female single parents, young homebuyers, racial/ethnic minorities, and southern residents may be more likely to look to and qualify for the Section 502 direct loan program than rural low- to moderate-income homebuyers in general. The program is more likely to attract low- to moderate-income renters who are married couples with children and female single parents than tenants who are married couples with no children, elderly, or individuals living alone.

Section 502 Loans Have Improved Housing Conditions

When asked how their current home compared with their prior housing, most Section 502 borrowers reported improvements in housing conditions. For example:

- Over 70 percent were first-time home buyers, and homeownership is highly valued by most Americans.
- Nine of 10 borrowers indicated that the quality of their current home was better than their previous home, and 6 of 10 reported their current neighborhood was better than their previous neighborhood.
- Over half reported that their current housing costs were lower or about the same as in their last residence. The 48 percent who indicated their costs were higher mostly reported higher incomes as well.

The Single Family Direct Loan Program also appears to elevate some households from Federal rental assistance programs to homeownership. About 25 percent of program participants had received Federal rental assistance at some time prior to purchasing their home and about a fourth of those had received that assistance from Rural Development's rural rental assistance program. This suggests the rural rental assistance program is effectively steering its participants toward eventual homeownership.

Many of the comparison group homeowners and renters had serious housing disadvantages in terms of housing cost burden, structural inadequacies, and crowding (table 3). Over a quarter of these had housing costs (mortgage, taxes, insurance, repairs, and utilities for homeowners; rent, insurance, and utilities for renters) that exceeded 30 percent of household income, with 6 to 8 percent facing a severe housing cost burden—over 50 percent of income. About 10 percent of low- to moderate-income homeowners and 14 percent of renters experienced crowding (the number of household members exceeded the number of rooms). Seven percent of these recent rural homeowners (12 percent of renters) had housing classified as moderately or severely inadequate based on a HUD measure of the adequacy of plumbing, heating, and electrical facilities, maintenance items like leaking roofs and holes in walls, kitchen facilities, and condition of public hallways and common areas (see Whitener, 1999, for a more detailed definition). Overall, almost a quarter of the low- to moderate-income homeowners and a third of the renters experienced one or more of these housing disadvantages.

Although we did not collect comparable data on cost burden or most housing inadequacies from our sample of Section 502 borrowers, the Section 502 program operates to help ensure that program participants do not experience such housing disadvantages. The houses purchased under the program must meet soundness standards, and repayment schedules are adjusted annually to keep payments at or below 30 percent of household income. Although not as inclusive a measure of costs, just over 19 percent of 502 borrowers reported that their principal, interest, taxes, and home insurance costs exceeded 30 percent of their reported incomes, and might be due for a downward adjustment of payments. The one comparison we can make is on crowded housing. Only 3 percent of Section 502 borrowers—versus 10 and 14 percent of comparison group homeowners and renters—live in homes with more household members than rooms.

Section 502 program participants indicated high levels of satisfaction with their housing and neighborhood. Somewhat surprisingly, given the quarter of comparison group homeowners who had at least one housing disadvantage, about 80 percent of both Section 502 borrowers and comparison group homeowners reported high levels of satisfaction with their housing and neighborhood (table 3). The greater incidence of hous-

Table 3

Housing characteristics of Section 502 and comparison group households

Section 502 households are much less likely to be crowded than the low- to moderate-income comparison group households

Characteristic	Section 502 households	1995 AHS rural comparison groups: Low- to moderate-income recent owners	Low- to moderate-income renters
		Percent	
Housing cost burden:[1]			
Exceeds 30% of income	NA	25.1	28.6
Exceeds 50% of income	NA	7.5	5.9
Housing quality:			
Crowding[2]	3.0	10.3	13.9
Structurally inadequate[3]	NA	7.1	11.8
Housing disadvantage[4]	NA	23.9	30.3
Highly satisfied with housing[5]	80.0	77.7	59.0
Highly satisfied with neighborhood[6]	77.0	77.5	69.0

NA = Not available from the 1998 Survey of USDA's Single Family Direct Loan Housing Program.

[1]Housing costs as a percentage of household income.

[2]Number of persons in household exceeds number of rooms in housing unit, as defined by HUD.

[3]Moderate or severely inadequate based on a standard HUD measure of physical problems using 26 variables covering plumbing, heating, electricity, upkeep, hallways, and kitchens.

[4]Households meeting one of the following criteria: housing cost burden exceeds 50 percent; crowded; and moderately or severely inadequate.

[5]Scores of 8, 9, and 10 on a scale of 1-10 with 1 the worst and 10 the best based on the question, "How would you rate this home as a place to live?"

[6]Scores of 8, 9, and 10 on a scale of 1-10 with 1 the worst and 10 the best based on the question, "How would you rate this neighborhood or community as a place to live?"

Sources: 1998 Survey of USDA's Single Family Direct Loan Housing Program, ERS, and the 1995 American Housing Survey, Bureau of the Census.

Photo courtesy USDA/ERS.

ing disadvantage among the renter group may be reflected in the lower share of renters who are highly satisfied with their housing and neighborhood.

Last, 90 percent of borrowers said that, without the Section 502 program, it would have taken longer than 2 years–if ever–for them to be able to buy a comparable home.

Conclusion

The ERS survey was the first nationally representative survey of the Section 502 Direct Rural Housing Loan Program. Recent changes in Section 502 program requirements, operations, costs, and funding levels renewed interest in the characteristics of the low-income recipients and the effectiveness of the program at improving the housing and economic status of rural residents.

The survey showed that the program is reaching low- to moderate-income borrowers whose household characteristics indicate that qualifying for conventional loans may be difficult, if not impossible, for them. Compared with low-income rural residents, Section 502 borrowers are disproportionately single parents, minorities, under the age of 40, and living in the South. The Section 502 program allowed many first-time homebuyers to purchase a home they might not otherwise have been able to afford. Ninety percent of borrowers said that, without the Section 502 program, it would have taken longer than 2 years for them to be able to buy a comparable home.

More extensive findings from the 1998 Survey of USDA's Single Family Direct Loan Housing Program can be found in *Meeting the Housing Needs of Rural Residents* (Mikesell et al.). In addition to reporting on the overall characteristics of program participants, that report provides extensive information on target groups (elderly, single parent, disabled, Black, and Hispanic subsets of participant households).

For Further Reading . . .

Housing Assistance Council, *Rural Housing and Welfare Reform: HAC's 1997 Report on the State of the Nation's Rural Housing*, Washington, DC, Dec. 1997.

James J. Mikesell, "Housing Problems Differ Across Types of Rural Households," *Rural Conditions and Trends*, Vol. 9, No. 2, Feb. 1999, pp. 97-101.

James J. Mikesell, Linda M. Ghelfi, Priscilla Salant, George Wallace, and Leslie A. Whitener, *Meeting the Housing Needs of Rural Residents: Results of the 1998 Survey of USDA's Single Family Direct Loan Housing Program*, RDRR-91, USDA, ERS, Dec. 1999, <http://www.ers.usda.gov/epubs/pdf/rdrr91/rdrr91.pdf>

Leslie A. Whitener, "Rural Housing Conditions Improve but Affordability Continues To Be a Problem," *Rural Conditions and Trends*, Vol. 8, No. 2, Sept. 1998, pp. 70-87.

Leslie A. Whitener, "Measurement of Housing Poverty: An Application to Nonmetro Racial/Ethnic Minorities," Paper presented at the Rural Sociological Society annual meetings, Chicago, IL, Aug. 1999.

Data Sources

The 1998 Survey of USDA's Single Family Direct Loan Housing Program. The data are from a nationwide survey of participants in USDA's Section 502 Single Family Direct Loan Housing Program, designed to provide information on the characteristics of the low-income rural residents who benefit from this program. ERS developed the survey instrument with input from RHS, representatives of housing interest groups, and the academic research community. In 1998, ERS and the Social and Economic Sciences Research Center of Washington State University conducted a national telephone survey of 3,027 recent program participants whose loans closed between 1994 and 1998. These individuals were chosen to represent the almost 60,000 recent borrowers who participated in the program nationwide, excluding those in Guam, Puerto Rico, and the Virgin Islands. All respondents who answered the survey questions were borrowers on a current Section 502 single-family direct loan taken from Rural Development administrative records. Data reported here are based on the responses of the borrower participating in the telephone interview. No distinctions are made between a primary or secondary borrower.

The survey collected information on the demographic, educational, and employment characteristics of recent program participants and their household members; current and past housing conditions and costs; satisfaction with current residence, neighborhood, and the Rural Development financing experience; extent of participation in public assistance programs; and sources and amounts of household income. The survey response rate was 70.3 percent. Estimates have a margin of error of $\pm$ 1.7 percent at the 95-percent confidence level.

The American Housing Survey. This report also uses data from the 1995 American Housing Survey (AHS) to compare demographic, housing, and economic characteristics of Section 502 participants with other low-income rural residents. The AHS is conducted biennially by the Bureau of the Census for the U.S. Department of Housing and Urban Development. The AHS is designed to provide detailed information on housing structure, use, and plumbing characteristics; equipment and fuel use; housing and neighborhood quality; financial characteristics; and household attributes of current occupants. The national sample is based on about 55,000 units selected for interview in 1995. Data are weighted to reflect the U.S. population.

The AHS identifies seven geographic categories based on metro-nonmetro and rural-urban designations. Under the Section 502 program, eligible rural areas are defined as open country and rural places under 20,000 population or under 10,000 population in a Metropolitan Statistical Area (MSA). Thus, RHS provides housing loan assistance in rural portions of both nonmetro and metro areas. When examining AHS data, we adopt a definition of rural that comes closest to matching the definition used in the Section 502 program. This definition defines rural areas to include not only open country and towns under 2,500 people, but also larger towns, as long as they are outside densely populated areas of 50,000 population. Our definition includes households in urban and rural suburbs in both metro and nonmetro areas and households in rural nonmetro areas. Use of this definition most likely overstates the number of rural households eligible for USDA assistance since some are located in areas with populations over 20,000 but less than 50,000, which are not eligible areas. However, use of only rural or nonmetro categories would have omitted a large number of eligible households in the more rural parts of metro areas. This definition is consistent with that used by the Housing Assistance Council in their annual Reports on the State of the Nation's Rural Housing (1997).

Selection of Comparison Groups. To identify comparison groups from the 1995 American Housing Survey (AHS), we used a definition of rural that most closely matches the definition of eligibility for USDA's rural housing programs. Thus, we defined rural areas to include households outside metro central cities and urbanized areas, and outside nonmetro urbanized areas. The number of rural households according to that definition was 37.2 million in 1995. From that population, we selected those who had purchased or built a home within the last 5 years to compare with our recent program participants. From that subsample, we selected recent homeowner households with incomes between 80 and 220 percent of the poverty threshold, a range based on the distribution of our survey households' incomes relative to the poverty threshold. Household income for our survey respondents averaged 150 percent of the poverty threshold. One standard deviation above and below that 150 percent constructs the 80- to 220-percent range.

The AHS does not include data to identify rural residents who would be eligible for participation in the Section 502 Single Family Direct Loan Program. Determination of eligibility requires detailed information on amounts and sources of income, expenses, family size, and other factors and is determined by individual case. However, the AHS data can identify a target population of tenants in rural areas who have incomes similar to those of Section 502 borrowers, and who may have a strong incentive to participate in USDA's single family housing loan program to improve their housing conditions. We defined a group of renter households with low- to moderate-incomes based on the income range of 80 to 220 percent of the poverty thresholds. Most of these households had incomes high enough to make payments on a modest house, but their low incomes and inability to make substantial downpayments might render them less attractive to many commercial lenders.