The USDA guarantees no-money-down home loans for lower-income people in rural areas, but as Reuters found, billions of dollars are going to borrowers of all sorts, from Los Angeles to D.C.

A rural housing program city slickers just love

BY MICHELLE CONLIN AND JANET ROBERTS
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Dotted with swimming pools and golf courses, the thriving seaside enclave of Ewa Beach perches just down the coast from bustling Honolulu, Hawaii. The island-style homes fronting palm-fringed streets offer views of two mountain ranges and proximity to some of the best big-wave surfing in the world.

This resort community, where houses sell from around $200,000 to more than $1 million, enjoys another perk: easy access to no-money-down home mortgages, guaranteed by the U.S. Department of Agriculture. The guarantees are provided to qualified homebuyers courtesy of the farm agency’s rural housing program, created in 1949 to help lower-income Americans in rural areas who lacked access to “safe and sanitary dwellings” and couldn’t get credit any other way.

Reuters found at least 250 of the loans in the Ewa Beach area. It also found them in a lot of other places that aren’t very isolated or very rural: Los Angeles; Washington, D.C.; Austin, Texas; Seattle, Washington; and Tampa, Florida. The mortgages pop up near Silicon Valley's Sand Hill Road, the main drag for high-tech venture capital, and a short distance from the headquarters

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Durwood Canaday
Benson, North Carolina

ALLURING DEAL: Lisa and Durwood Canaday bought their home last year in Benson, North Carolina – just down the highway from Raleigh – with a USDA-backed loan. REUTERS/ELLEN OZIER. (Front) ON THE LINKS: Houses fronting the Hawaii Prince golf course in Ewa Beach, Hawaii, are eligible for the loans, too. REUTERS HUGH GENTRY
of Google, Facebook and Apple, as well as in dozens of small to midsized cities across the United States, from Salinas, California, to Spring Hill, Florida.

Durwood Canaday and his wife, Lisa, used a zero-down, USDA-backed mortgage last year to buy a 102-year-old house in Benson, North Carolina, for $84,000. “I could have bought a house another way,” says Durwood, a semi-retired advertising executive, who lives less than a 30-minute drive from his office in Raleigh. “But this allowed us to travel, and our hope in a few years is to purchase a beach property in Surf City that we can rent out now and retire in later.”

All told, from 2003 to 2011, the USDA guaranteed at least 51,600 mortgages, totaling at least $6 billion, for people who lived in areas deemed urban by the 2000 U.S. Census, according to a Reuters analysis of Census Bureau data and mortgage lenders’ regulatory filings.

“All of these areas are smack in the middle of a freeway, shopping, businesses and schools,” says Charles Vamadeva, a senior loan executive in Riverside County, California, with American Financial Network. “It’s not rural by any sense of the imagination.” AFN, based in Chino Hills, California, reported issuing more than 300 USDA-backed loans between 2009 and 2011, more than 50 of them in areas defined as urban by the Census Bureau.

The USDA disputed Reuters’ findings without providing evidence to refute them. Spokesman Justin DeJong noted that lending in some urban areas is allowed under the USDA’s own definition of rural, which differs from the Census Bureau’s and is based in part on rules established by Congress.

With banks’ lending standards persistently tight in the wake of the 2008 financial crisis, use of USDA-backed loans has ballooned, growing faster than any other type of government-backed loan. New lending under the program has risen to $16.9 billion in 2011 from $3.1 billion in 2003. More than 8 percent of that financing was for homes in urban areas.

Even with the geographic anomalies Reuters found, there is little doubt that the majority of USDA-backed loans have helped expand home ownership among the people the program was designed to serve. However, a liberal application of the term “rural” is only one of several aspects of the USDA’s Rural Housing Guaranteed Loan program that suggest it has expanded beyond its mission.

Reuters’ analysis of lenders’ regulatory filings also found more than 180 loans to borrowers making more than $500,000, including dozens of millionaires, in apparent violation of the program’s income guidelines. It found loans in Cape Cod’s Hyannisport, home to the Kennedy family compound, and Tony Healdsburg, in California’s Sonoma County wine country. There were loans for second homes, and loans to people who could have obtained conventional financing – each a breach of the program’s rules.

The findings come on top of recent audit reports from the USDA’s inspector-general faulting the program for laxity at the other end of the income scale, citing numerous instances of loans to borrowers with subpar credit scores or incomes that were too low. A February audit report said that in 2012, the program paid $496 million in loss claims, up
Seattle, Washington

Banks reported making more than $283 million in USDA-backed loans between 2003 and 2011 in Seattle and its surrounding suburbs, an area one mortgage broker calls “about as downtown as downtown can be.”

from $295 million the previous year – mirroring what’s happening on a much larger scale at the Federal Housing Administration, where defaults on billions of dollars in loans threaten the agency with insolvency.

The USDA program is minuscule compared to the FHA’s portfolio, as well as the overall multi-trillion-dollar U.S. mortgage market. But for real-estate agents, homebuilders and mortgage brokers in the know, the loans have been a handy alternative at a time when lenders require spotless credit and 20 percent down payments. And for banks, it means 90% loss coverage in case of a default.

“The USDA has taken the place of the zero-down, or 100 percent-financed products that we had out there in the past,” says Todd Niizawa, vice president of Central Pacific Home Loans, which has done nearly 200 USDA-backed loans on Oahu since 2009.

“These loans have just been a giant subsidy to the homebuilders,” adds Edward Pinto, a fellow at the American Enterprise Institute, a right-leaning think tank in Washington, D.C.

Congress faces a March 27 deadline
to reauthorize the program in its present form. The lending and building industries are pushing hard to keep the loans flowing. “We are doing everything we can” to ensure reauthorization, says Kedrin Simms Brachman, federal legislative director at the National Association of Home Builders.

Reuters filed Freedom of Information Act requests with the USDA for information on its mortgage-guarantee program in October 2011 and again on Jan. 30 this year. The department did not provide the relevant data.

For its analysis, Reuters examined data that all but the smallest lenders are required to report to the Federal Financial Institutions Examination Council under the federal Home Mortgage Disclosure Act. The information includes the census tracts of the homes and whether the loans have USDA backing.

Reuters looked for USDA-backed loans in tracts entirely within urban boundaries as drawn by the Census Bureau after the 2000 census.

The 51,600 loans that Reuters identified don’t cover all USDA-backed loans in urban areas. That’s because the analysis excluded loans in tracts that straddle urban-rural boundaries. More than 300,000 loans – totaling $38 billion – were located in these gray areas.

USDA spokesmen said some lenders probably misreported some loans when submitting their annual HMDA filings. They did not cite any examples. The HMDA data also may include some Farm Service Agency loans. A former USDA employee who worked in rural housing for decades, as well as other sources, said those numbers were probably small and would not skew the analysis.

The program’s guidelines do not cap home purchase prices. To qualify, applicants cannot have income exceeding 115 percent of the median for the area. The agency recommends credit scores of at least 620 (on the U.S. scale of 300 to 850) since anything...
below has a high risk of default. But the agency accepts applicants with subprime credit, high debt-to-income ratios and “non-traditional” credit histories – if they request a waiver. The USDA says that, on average, loan applicants make $48,000 a year and borrow $131,000.

The Reuters analysis found similar averages. However, it also found loans that do not fit any definition of rural poor. Between 2003 and 2011, there were the 180 loans to borrowers who reported making at least half a million dollars a year. Nowhere does the USDA’s upper income limit approach $500,000. The USDA also backed at least 500 loans of $500,000 or more, including more than 90 exceeding $1 million, according to lenders’ regulatory filings.

The USDA’s geographic requirements for the loans were originally based on Census Bureau definitions of urban. After the 1990 Census was released, it became apparent that many areas had grown too big to qualify for the loans.

Rather than exclude those locations, legislators crafted a grandfather clause when they reauthorized the program in 1990 that allowed those places to remain in. After the 2000 Census was released, lawmakers did the exact same thing. Today, the program covers nearly the entire U.S. land mass.

That has helped turn the program into one of the sweetest deals available, especially since other sources of home loans dried up after the housing market crashed.

Seattle-based mortgage broker Dan Keller says that since 2009, he has arranged 50 to 60 loans a year for people buying houses in the suburbs, near the corporate campuses of Boeing, Microsoft and Amazon.com. “It’s kind of funny,” Keller says. “We’re about as downtown as downtown can be.”

Top homebuilders like DR Horton, Lennar and Pulte have pushed USDA-guaranteed loans hard, plastering advertisements for them on their websites and coaching first-time buyers who can’t get conventional bank financing on how to qualify for the program.

Midsize Florida builder Southern Homes says that nearly 90 percent of its business is in USDA-backed loans, most of them for houses near freeways, shopping malls and multiplexes.

The USDA’s field offices have struggled to keep up with the surge in volume. A series of USDA inspector-general audit reports in recent years found the department’s mortgage-approval machine “vulnerable to abuse.” The reports paint a picture of an organization overwhelmed as field staffers, some of them unfamiliar with agency guidelines, scrambled to process as many as 10 loans a day.

The inspector-general found that more than 37 percent of the loans it examined were ineligible for one or more reasons, including borrowers whose incomes exceeded program limits, who didn’t meet repayment guidelines or who already owned homes and could have gotten credit without the government guarantee. At one lender alone, 46 mortgages had been made to ineligible borrowers. Of those, 33 were in default, resulting in more than $1.75 million in claims.

In response to the findings, the USDA said it disagreed with the inspector-general’s methodology and its interpretation of USDA policies. The agency said its own

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Polk County, Florida
Urban areas of Polk County, Florida, saw more than $67 million in USDA-backed lending between 2003 and 2011. Shelter Mortgage told Reuters it issued 700 loans in these areas over the last decade.

internal reviews determined that fewer than 5 percent of loans were ineligible. It also said it would improve internal controls and oversight of banks.

In a statement emailed to Reuters, USDA Housing Administrator Tammye Trevino said that when a lender submits a claim for reimbursement on a foreclosed property, the department conducts a review, and if it determines that the property was ineligible for the loan, the USDA rejects the claim.

However, the latest inspector-general audit report, released last month, found fault with the USDA’s review process. It said the department was reimbursing lenders for defaults by ineligible borrowers with high debt-to-income ratios, bankruptcies, insufficient incomes and subprime credit scores.

The program was conceived to be “subsidy neutral,” meaning it would pay for itself, with costs covered by a 2 percent fee wrapped into each loan. But with the delinquency rate on USDA-backed loans having risen to 18.7 percent in 2011 – the rate in a typical housing market is around 3 percent – Pinto of the American Enterprise Institute, among others, says it’s likely the program isn’t covering its costs and will probably require taxpayer funding.

If Congress doesn’t act by the March 27 reauthorization deadline, the 2010 Census will automatically kick in, disqualifying more than 900 communities that have been protected since the 1980s and that represent 40 percent of the program’s current loans, according to a study by the National Rural Housing Coalition.

In late February, Rep. Jeff Fortenberry, a Nebraska Republican, introduced a bill that would keep the current program alive for another 10 years. Meanwhile, the Senate’s continuing resolution to keep the government funded past March 27 contains language that would extend the program as is until at least Sept. 30.

Brian Johns has a simple solution. Last year, the product support manager for a multinational technology company got a USDA-guaranteed, no-money-down loan to buy a $290,000 house for his family of four just a five-minute walk from Baby Beach, on lush Kauai, one island over from Oahu.

The money that would have gone toward a down payment paid for a fresh coat of paint on the house, new floors and top-shelf appliances. Whether the home he bought with a USDA Rural Housing Guaranteed Loan is in a rural or urban area doesn’t matter to him.

“I think they should just change the name so folks don’t get hung up on it. Call it the USDA loan,” he says. “Thanks, USDA. Appreciate it.”

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