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Home Buyers Turn to USDA for Mortgages

Agency Program Backs Loans to Aid Rural Development; No Money Down -- Even Now

By NICK TIMIRAOS

Tightened lending standards are leaving builders and real-estate agents scrambling for new ways to move cash-strapped buyers into homes. One increasingly popular option: an obscure home-loan program offered by the U.S. Department of Agriculture.

Created in 1991 as a way to boost homeownership in rural areas, the program is being tapped by home buyers in overbuilt exurbs who are attracted to the no-money-down terms.

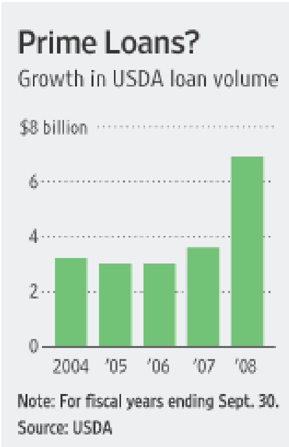
When Erick Moore first read about the USDA's Rural Development Guaranteed Loan program, he says he imagined it would be "restricted to some little farmhouse." Instead, the 33-year-old computer programmer moved last month into a four-bedroom, three-bath home in Fuquay-Varina, N.C., 17 miles outside Raleigh. The house sits on nearly one acre and features a brick facade, 10-foot ceilings and hardwood floors.

"I couldn't believe it until we closed," says Mr. Moore, who paid only $1,200 out of pocket to move into the $228,000 home. The seller contributed $5,000 in closing costs, and Mr. Moore rolled the 2% fee charged by the USDA into the loan. Mr. Moore, who owned a home in St. Louis before he relocated to the Raleigh area last year, says a 60% drop in his stock portfolio made it difficult to come up with a down payment. He directed his Realtor to show him only homes that were eligible for the USDA program.

Fueled by buyers like Mr. Moore, volume has nearly doubled for these USDA-backed loans. The department insured $7 billion in loans during the 2008 fiscal year, which ended Sept. 30, up from $3.6 billion the previous year. In October and November, the agency has already insured some $1.7 billion in loans.

That's relatively small when compared with the volume of business handled by the Federal Housing Administration -- which guaranteed $102 billion in new loans during fiscal 2008. But interest in the USDA's development lending program is growing rapidly in response to the nation's credit crunch and as most private lenders have stopped offering loans with no money down.

To be eligible for a USDA-backed loan, a borrower can't have income that exceeds 115% of the median county income, and the loans are restricted to areas with lower population density -- generally towns of no more than 25,000 residents. So while home buyers in big cities aren't eligible for the loans, residents of many of America's fastest-growing towns and exurbs do qualify. The loans that come through the program are made by private lenders, then



insured by the government and sold to Ginnie Mae, a federal agency that sells mortgages to investors.

Home builders, many of which have overbuilt properties in these areas, are eagerly promoting the program to sell excess inventory. The USDA program accounted for 40%-50% of sales in October and November for Scottsdale, Ariz.-based home builder Meritage Homes, says John Bargnesi, vice president for sales. "It's one of our main tools right now."

Builders Promote Program

Meritage is advertising a "$500 move in" program to clear inventory in new exurban developments, including the Buckeye and Queen Creek subdivisions outside Phoenix that have been hard hit by foreclosures and falling prices. "If a builder is in one of these geographical areas, they certainly are using it," says Mr. Bargnesi. "We're all in tune with it now."

D.R. Horton Inc., the nation's largest home builder by number of houses built, is promoting the program in sales pitches for a number of new developments outside Austin, Texas. One is named Parkside Condos, a development of 144 new two- and three-bedroom condos priced at $130,000 in Pflugerville. Kastera Homes LLC, a home builder based in Boise, Idaho, is offering to pay closing costs for buyers who use a USDA loan. D.R. Horton and Kastera didn't return calls seeking comment.

The success of the USDA program comes at a time when easy home financing is getting much harder to find. Private lenders have stopped offering loans that require no money down, amid worries that borrowers without equity are more likely to let their homes fall into foreclosure. In October, Congress terminated a popular program that allowed sellers to fund down-payment "gifts" for new home loans backed by the FHA. Next year, the FHA will require a minimum 3.5% down payment on all new loans, up from 3%, and private lenders often require a minimum 5% down payment.

Such restrictions do not apply to loans backed by the USDA, which is best known as the guardian of the nation's food supply. In fact, some buyers can finance 102% of the home price, factoring in a 2% USDA insurance fee meant to cover loan losses. The loans also don't require borrowers to pay for monthly mortgage insurance. That means that USDA loans typically carry lower monthly payments than FHA loans, even in cases when the size of the loan is larger.

Sue Botelho of Northstar Mortgage Group in Destin, Fla., is promoting the USDA loans as part of a "move in with a penny down" program. "The down-payment assistance has gone away. Subprime has gone away," she says. "So now mortgage lenders are pretty aggressive in terms of making people aware of this USDA program."

One of Ms. Botelho's clients, 46-year-old insurance adjustor Alan Sammons, paid nothing to move into a new $270,000 home in the Florida Panhandle in June. He had spent more than a year trying to find a reasonable loan before beginning construction on a custom four-bedroom, 3½-bathroom home in his Crestview, Fla., subdivision, which includes a community swimming pool and lighted tennis courts.

"They're still building homes in here," Mr. Sammons says.

Julie Chapman, a Brunswick, Ga., real-estate agent, says she is listing more properties eligible for the USDA loans -- including homes in the Plantation at Golden Isles, a new subdivision adjacent to a golf course. Many of the properties are selling preconstruction. "That's something you don't see anymore in this market," she says.

New housing developments built on open land that were among the first to experience the downturn could now benefit from the USDA program. "They're showing some signs of recovering," says Michael Orr, a housing analyst based in

Mesa, Ariz.

Some question the USDA's practice of allowing no-money-down purchases. "If you have to get a 102% loan, you probably shouldn't be buying a house," says U.S. Sen. Christopher Bond (R., Mo.), who adds that he supports the intent of the programs because it has traditionally been "very difficult" for rural borrowers to buy homes.

USDA officials, for their part, say that concerns about the program's 100% financing aren't warranted because the department has a strong track record and because rural areas are less prone to big increases in home prices. "We guarantee in a very controlled environment," says Philip Stetson, a USDA administrator for the lending program. Because its average loan amount is just $120,000, he says that the program is less susceptible to large-scale losses.

Income Verification

USDA- and FHA-backed loans aren't prone to some of the risks that faced subprime loans because the government-insurance programs offer only fixed loans and require income verification. "We have not seen any direct evidence at this point that 100% financing is leading to greater losses," Mr. Stetson says.

The default rate on USDA loans is slightly better than the rate for FHA-backed loans. Some 11.35% of USDA loans were delinquent in 2008, while 1.4% went into foreclosure, according to the department's statistics. Meanwhile, FHA loans had a 13.6% delinquency rate, while 2.3% went into foreclosure. That compares to a 4.3% delinquency rate and 1.6% foreclosure rate on prime loans, and a 20.0% delinquency rate and 12.9% foreclosure rate on subprime loans, according to the Mortgage Bankers Association.

Unlike the FHA, the USDA programs rely on a fixed appropriation from Congress, which totaled $4.1 billion in the 2008 fiscal year, and new loans can't be made once that allocation is exhausted. The program was able to make nearly $7 billion in loans this year because it received additional funding from other department sources.

But heavy demand for the loans has administrators asking for more money. Officials say that the program will run out of money next month, even though it has been funded through March. "Up until only two years ago, we weren't even using the full amount," says Mr. Stetson. "It has been rather incredible at how it has taken off."

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