

**GUARANTEED RURAL RENTAL HOUSING PROGRAM
ORIGINATION AND SERVICING HANDBOOK**

**U.S. DEPARTMENT OF AGRICULTURE
RURAL HOUSING SERVICE
1400 INDEPENDENCE AVENUE, S.W.
WASHINGTON, D.C. 20410**

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GLOSSARY

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APPENDIX 2: LIST OF FORMS

CHAPTER 1: OVERVIEW OF GUARANTEED RURAL RENTAL HOUSING PROGRAM ORIGINATION AND SERVICING HANDBOOK

1.1 INTRODUCTION

This chapter provides an overview of the Guaranteed Rural Rental Housing Program (GRRHP) handbook and key program features. It includes the following sections:

Key Topics in this Chapter

- The Handbook
- The Rural Housing Service (RHS)
- Program Overview
- Federal Requirements

SECTION 1: THE HANDBOOK

1.2 PURPOSE

This handbook provides lenders and Rural Housing Service (Agency) staff with guidance on the origination and servicing of GRRHP loans and the approval of qualified lenders. Lenders will use this handbook as a guide for carrying out the activities and procedures required by the regulation. Agency staff will use the handbook as a reference to monitor and evaluate a lender's performance in the program.





These instructions are intended to be consistent with all applicable laws, Executive Orders, and USDA regulations. Nothing in this handbook should be construed to supersede, rescind, or otherwise amend such laws, Executive Orders, and regulations.

Any additions or revisions to this handbook will be distributed to approved lenders and made available to other interested parties upon request.

1.3 USING THE HANDBOOK

The handbook has been organized for ease in looking up information. Several graphic tools and conventions have been used to make information easier to find and understand.

A. Handbook Symbols

- **References.** The book symbol directs the reader to additional information sources, such as laws, regulations, or instructions. 
- **Civil rights.** A modified fair housing logotype highlights processing procedures with significant fair housing or civil rights implications. 
- **Deadlines.** Time frames for completing required actions are highlighted by a small clock to make them easier to locate. Deadlines are also underlined in the text. Deadlines are generally expressed in terms of calendar days unless otherwise noted. 
- **Helpful hints.** Helpful hints, cautions, or important facts are included in text boxes throughout the text. 

B. Citations and Text Boxes

- **Regulatory citations.** The text of the GRRHP regulation [*7 CFR Part 3565*] is provided in Appendix 1. All references to this regulation appear in italicized brackets. Other regulations or Rural Development (RD) Instructions may also be found on the USDA website <http://www.usda.gov/>.
- **Form references.** Agency forms, guides, and system letters are shown in italics. Appendix 2 lists all forms used in this handbook.

The Code of Federal Regulations

What is the CFR? It is the Code of Federal Regulations (CFR). This code is published in volumes and is numbered according to the Agency or subject. The part pertaining to the U.S. Department of Agriculture can be found in Title 7 of the CFR.

Where do I find Federal regulations? Some sources for the CFR are:

- Purchase it from the U.S. Government Printing Office, Superintendent of Documents, Washington, DC 20402-9328.
- See if it is available on the Internet at: <http://www.access.gpo.gov/nara/cfr/index.html>.

- **Examples and exhibits.** Text boxes labeled as examples or exhibits provide a specific illustration of a concept described in the text or provide additional detailed information. Exhibits are numbered in sequence, using the chapter number. For example, Exhibit 2-1 is the first exhibit in Chapter 2.

C. Attachments and Appendices

- **Attachments.** Attachments at the end of each chapter contain technical information that is specific to the topics covered in the chapter. Attachments are referenced in sequence, using the chapter number and a letter; for example, Attachment 4-A is the first attachment in Chapter 4.
- **Glossary and acronyms lists.** Key words and terms are defined in the glossary. The glossary and list of acronyms can be found directly before Appendix 1.
- **Appendices.** Appendices at the end of the handbook include forms and other reference materials that relate to multiple chapters.

SECTION 2: THE RURAL HOUSING SERVICE (RHS)

1.4 RHS ORGANIZATION

The Rural Housing Service (RHS) is a credit agency within the United States Department of Agriculture for rural housing and community development. The Agency's purpose is to increase the availability of affordable housing and community facilities for rural residents.

The GRRHP will be administered jointly by the RHS National Office and State Offices. The National Office will allocate guarantee authority to the States. National Office staff will also approve lenders and allocate interest credit.

For Fiscal Year 1998, the approval authority for all loan guarantee applications will reside with the National Office. All applications will be sent to the National Office for funding. The National Office may involve the State Office in processing the application and in future years may delegate approval authority to State Offices.

SECTION 3: OVERVIEW OF THE GUARANTEED RURAL RENTAL HOUSING PROGRAM

1.5 PROGRAM GOALS

The GRRHP was established to:

- Increase the supply of moderately-priced housing in rural areas;
- Ensure that housing is affordable to low- and moderate-income rural residents whose incomes are 115 percent of area median income (AMI) or less;
- Provide housing that is decent, safe, sanitary, and competitive in the market; and
- Foster risk-sharing partnerships with public and private lenders.

Under the program, the Agency will provide credit enhancements to encourage private and public lenders to make new loans for affordable rental properties that meet program standards. Lenders will be expected to underwrite and service the loans. The Agency will approve qualified lenders to participate and will monitor lender performance to ensure that program requirements are met.

1.6 ELIGIBLE RURAL AREA

Loans under this program may only be made in an eligible rural area. An eligible rural area is:

- Open country which is not a part of or associated with an urban area.
- Any town, village, city, or place, including the immediate, adjacent, densely-settled area, which is not part of, or associated with, an urban area and which has:
 - ◇ An area with a population of 10,000, or less if it is rural in character, or
 - ◇ An area with a population in excess of 10,000 but not in excess of 20,000, that is not contained within a Metropolitan Statistical Area, and has a serious lack of mortgage credit for low and moderate income households, as determined by the Secretary of Agriculture and the Secretary of the Department of Housing and Urban Development (HUD), or
 - ◇ An area classified as a rural area prior to October 1, 1990, (even if within a Metropolitan Statistical Area), with a population exceeding 10,000, but not in excess of 25,000, which is rural in character and has a serious lack of mortgage credit for low and moderate income families. (This definition is effective through the receipt of census data for the year 2000.)

1.7 PROGRAM FEATURES

Key features of the program include:

A. Risk Sharing With Lenders

The Agency will provide a guarantee in the event of loss of up to 90 percent of the loan amount; lenders will retain the remaining 10 percent of any loss. The Agency and lender risk sharing percentages will be applied equally to every dollar of the Agency-approved loss amount. While this type of lending presents additional risks to lenders, the Agency believes that lender performance will be improved if lenders have a financial interest in preventing losses.

B. Affordability Features

The program restricts both tenant income and unit rents. The program is designed to provide housing for low- or moderate-income families or individuals whose incomes at initial occupancy do not exceed 115 percent of the area median income (AMI) adjusted for family size. Monthly rent for a unit may not exceed 30 percent of 115 percent of adjusted AMI. Average project rent may not exceed 30 percent of 100 percent of AMI.

C. Combination Construction and Permanent Financing

The program will provide credit enhancement for construction lending as part of a combination construction and permanent loan. This feature is intended to encourage greater construction lending in rural areas and make it easier for lenders to make one loan to finance a project.

D. Lender Origination, Servicing, and Disposition

Participating lenders must be experienced in loan origination and servicing. Lenders will be responsible for underwriting the loan in a prudent manner and for servicing the loan to ensure repayment and preservation of value. In the event of default by the borrower, lenders must dispose of properties prior to submitting a claim to the Agency.

When a borrower defaults on a loan, the lender must submit a liquidation plan for the Agency's approval. When the property is liquidated, the lender will be able to submit a claim and receive payment for the Agency's share of any loss if the lender has complied with all program requirements.

E. The NOFA Process

The availability of GRRHP guarantee and interest credit authority, and the criteria for allocating this assistance will be made public through a Notice of Funding Availability (NOFA). Once a NOFA has been published, lenders may submit a summary of proposed projects for scoring and ranking. All responses will be reviewed and ranked in accordance with selection criteria included in the NOFA. Applicants selected will be issued a Notice to Proceed With Processing (Notice to Proceed) an application for a loan guarantee.

1.8 ROLES AND RESPONSIBILITIES OF AGENCY, LENDER AND BORROWER

Each participant in the guarantee program has responsibilities that must be met if the program is to achieve its goals. Agency staff, participating lenders, and borrowers should understand the range of tasks for which they are responsible. The responsibilities are summarized below.

The Agency will:

- Approve qualified lenders and monitor lenders for compliance;
- Conduct the National Environmental Policy Act (NEPA) environmental review;
- Approve the loan guarantee application; and
- Process and pay claims.

The Lender must:

- Originate and service loans;
- Monitor the borrower and property for compliance with program requirements;
- Manage the mortgage asset through regular monitoring; and
- Provide reports to the Agency on loans in portfolio.

The Borrowers must:

- Develop and maintain property that is decent, safe, and sanitary;
- Ensure that the occupancy and rent requirements are met;
- Comply with all other program rules and regulations; and
- Comply with the loan requirements.

1.9 IDENTITY OF INTERESTS

Hidden identity of interest relationships may undermine the confidence of participants and the public that the program is fair and open. The lender is responsible for properly addressing any identity of interest situations and for disclosing their existence to the Agency using *Form RD 3560-30 or 3560-31*.



Identity of interest may exist between the borrower and another party, such as a general contractor, architect, engineer, attorney, subcontractor, material supplier, or equipment lessor (hereafter called “other entities”) in circumstances such as the following:

- When there is any financial interest of the borrower in any other entity, except provision of normal professional services by architects, engineers, attorneys or accountants with a client-
-

professional relationship, which will not constitute an identity of interest;

- When one or more of the officers, directors, stockholders, or partners of the borrower is also an officer, director, stockholder, or partner of any other entity;
- When any officer, director, stockholder, or partner of the borrower has any financial interest, whatsoever, in any other entity;
- When any spouse or relative (such as grandmother, aunt, daughter, granddaughter, grandfather, uncle, son, grandson, mother, sister, niece, cousin, father, brother, nephew), or step-relatives of the borrower, on its principals, has any significant financial interest in any other entity;
- When any other entity advances any funds to the borrower;
- When any other entity provides and pays, on behalf of the borrower, the cost of any legal services, architectural services, engineering services, or other development costs, other than those of a surveyor, general superintendent, or engineer employee by a general contractor, in connection with obligations under the construction contract;
- When any other entity takes significant stock or any interest in the borrower as part of the consideration to be paid;
- When there exists or comes into being any side deals, agreements, contracts, or undertakings that alter, amend, or cancel any of the required loan or construction closing documents; or
- When another party can significantly influence the management or operating policies of the transacting parties, or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

1.10 AGENCY EXCEPTION AUTHORITY

Exceptions to any requirement of this handbook or [7 CFR Part 3565], which are not inconsistent with any applicable law, may be approved by the Administrator or a designee, on an individual basis, if the application of the requirement or failure to take action would adversely affect the government's interest, adversely affect the accomplishment of the purposes of the program, or result in undue hardship. The Administrator may exercise such authority independently or at the request of the State Director. A request for an exception to any requirement may also be initiated by the Assistant Administrator for Housing.



The exception request must provide clear and convincing evidence of the need for the exception. At a minimum the request must include:

- A full explanation of the circumstances, including an explanation of the adverse effect on the government's interest or on the accomplishment of program purposes, or any undue hardship that may result if an exception is not granted;
- A discussion of proposed alternatives considered; and
- A discussion of how the adverse effect will be eliminated or minimized if the exception is granted.

State Office requests for exceptions regarding architectural and engineering, environmental, or civil rights issues must be accompanied by the review and comments of the appropriate State Office technical staff and will be referred to the appropriate National Office technical staff for further comment before a decision is made. Likewise, when exception requests on such issues are generated by the Administrator or National Office staff, such requests will be referred to the appropriate National Office technical staff for further comment before a decision is made.

1.11 REVIEWS AND APPEALS

Only the borrower and/or lender can appeal an Agency decision. The borrower and lender must jointly execute the written request for review of an alleged adverse decision made by the Agency and both must participate in the appeal. In cases where the Agency has denied or reduced the amount of final loss payment to the lender, the adverse decision may be appealed by the lender only. A decision by a lender adverse to the interest of the borrower is not a decision by the Agency, whether or not concurred in by the Agency. Appeals will be handled in accordance with the directions set out in 7 CFR Part 11.

An Agency decision that is not made in favor of the lender may be considered an adverse decision. Agency decisions may include administrative actions taken by Agency officials or the Agency's failure to take required actions within required or reasonable timeframes. The lender may request a review of adverse Agency decisions by the next-level supervisor except those decisions made by the Secretary. In addition, most adverse decisions may be appealed to the National Appeals Division (NAD). The Agency review and appeals policy for all programs can be found in Attachment 1-A.

SECTION 4: FEDERAL REQUIREMENTS

1.12 INTERGOVERNMENTAL REVIEW

The Agency is responsible for ensuring that intergovernmental review and comment is obtained on all proposals in accordance with RD Instruction 1940-J. The intergovernmental review process must be initiated by the lender or the borrower. This process should be completed as early as possible, since all comments must be submitted to the Agency for consideration as part of the environmental review.



1.13 NATIONAL FLOOD INSURANCE PROGRAM

Property located in Special Flood Hazard Areas designated by the Federal Emergency Management Agency (FEMA) are not eligible for Federal financial assistance, including loan guarantees, unless flood insurance through the National Flood Insurance Program (NFIP) is available. Flood Insurance through the NFIP must be purchased prior to loan closing and issuance of the guarantee, in accordance with the National Flood Insurance Act, as amended, and RD Instruction 426.2. These requirements are also addressed in Chapter 11.



1.14 HISTORIC PRESERVATION

The Agency is responsible for compliance with historic preservation statutes, regulations, and related directives, in accordance with RD Instruction 1940-G and RD Instruction 1901-F.



1.15 CIVIL RIGHTS

A. Nondiscrimination

Federal civil rights laws prohibit the denial of benefits provided under the program to any person based upon race, color, national origin, sex, religion, familial status, age, physical or mental disability, or source of income. Discrimination in employment practices also is prohibited. Exhibit 7-4 lists the applicable Federal laws and Executive Orders and highlights key aspects of these requirements.

Key Civil Rights Issues

- Access
- Consistency and fairness of treatment
- Disparate impacts -- intended or unintended
- Record keeping

The rules of nondiscrimination apply to all parties involved in this process. The lender is responsible for upholding the laws pertaining to nondiscrimination in selecting, assisting, and monitoring a borrower. Borrowers are also held accountable for any discrimination resulting

from development and management tasks, from the hiring of construction firms to the selection of tenants.

Effective program management and consistent policies and procedures are essential to ensure that all applicants are treated fairly. Poor program implementation, whether or not discrimination is intended, may have possible civil rights consequences. Attention to consistent procedures is especially important in several key areas listed below.

- **Outreach.** Information about the availability of GRRHP rental units and how to apply for tenancy must be broadly disseminated and the information, assistance, and courtesy extended to those who make inquiries must be equal and consistent.
- **Application-taking procedures.** Application-taking procedures must be fair and equally accessible to all potential tenant applicants.
- **Determining eligibility.** Lenders, borrowers, and property managers must use equal rigor for all applicants when verifying income, conducting credit checks, and allowing applicants to clarify information.
- **Making exceptions.** Standards for offering exceptions to policies and procedures must be applied equally and consistently.
- **Loan terms and subsidies.** Opportunities for subsidies and favorable loan terms must be made available equally and consistently.
- **Hearings and appeals.** Avenues for remedies when problems arise must be equally accessible to all applicants.

B. Reasonable Accommodations for Persons with Disabilities

It is unlawful for owners or managers to refuse to make reasonable accommodations in rules, policies, practices, or services, when such accommodations may be necessary to afford a disabled person equal opportunity to use and enjoy a dwelling unit, including public and common use areas. It is also unlawful for owners or managers to refuse to permit, at the expense of a disabled person, reasonable modifications of existing premises, occupied or to be occupied by a disabled person so that they may have full enjoyment of the premises of a dwelling.

1.16 FAIR HOUSING

Federal fair housing regulations provide the specific framework to ensure that Federal housing assistance is available to all individuals qualified by income and residence in rural areas, without regard to race, color, religion, sex, familial status,




national origin, or disability. This includes any actions in the financing, sale, rental, or advertising of the dwellings or in the provision of brokerage services that involve Federal assistance.

All participating lenders and borrowers must comply with the requirements of Title VIII of the Civil Rights Act of 1968, as amended by the Fair Housing Amendments Act of 1988 (the Fair Housing Act). Any lender or borrower that refuses to comply with the regulations is liable for sanctions as authorized by law.

If a resident or prospective resident believes that their denial of occupancy was based on discrimination, they may file a complaint with HUD.

1.17 ENVIRONMENTAL REQUIREMENTS

It is the Agency's policy to give environmental quality equal consideration with economic, social, and other factors in its program development and decision-making processes. The Agency is concerned with the impact of the project on important environmental resources, as well as the quality of life for residents and the long-term viability of the project as an investment. It is the responsibility of the Agency to effectively integrate the environmental policies and procedures, described in RD Instruction 1940-G, into loan guarantee origination and servicing activities. 

Lenders and borrowers must cooperate fully with the Agency and provide such information, as the Agency needs to complete its environmental review. Lenders must become familiar with the requirements so they can help advise borrowers and reduce the probability of unacceptable applications being submitted to the Agency and so they can speed Agency approval or consent to certain servicing actions.


The responsibilities of the lender and the Agency to address environmental issues are referenced in more detail in Chapter 11.


ATTACHMENT 1-A


REVIEW AND APPEALS OF ADVERSE AGENCY DECISIONS

A. INFORMING LENDERS OF THEIR RIGHTS

Whenever the Agency makes a decision that will adversely affect a lender, the Agency must inform the lender in writing that a review by the next-level supervisor may be requested. The Agency must also inform the lender whether or not the decision can be appealed to the National Appeals Division (NAD).

The lender can appeal an Agency decision made under this program. In cases where the Agency has denied or reduced the amount of final loss payment to the lender, the adverse decision may be appealed by the lender only. A decision by a lender adverse to the interest of the borrower is not a decision by the Agency, whether or not concurred in by the Agency. Appeals will be handled in accordance with 7 CFR Part 11. Any lender adversely affected by an Agency decision under this subpart may request a determination of appealability from the Director, National Appeals Division, USDA, within 30 days of the adverse decision. 

Review Requests. Lenders who want to request a review by the next-level supervisor must do so within 15 days of the date of the Agency's letter notifying the applicant of an adverse decision. The lender shall have the option to make the request in writing or verbally. Copies of written requests should be retained in the lender's files. If the lender chooses to make a verbal request, it should be carefully documented. The review must be completed within 45 days of the request. 

Appeal Requests. Lenders who wish to appeal an adverse decision must submit a written request to NAD within 30 days of receiving notice of an adverse decision. The request must be personally signed by the participant and include: a copy of the adverse decision to be appealed and a brief statement describing why the participant believes the decision is wrong. 

NAD will notify the participant and the Agency once it has made a final determination. If NAD reverses the Agency's decision, the next loan processing action that would have occurred had no adverse decision been made must be taken within 30 days after the effective date of the notice from NAD.

B. DECISIONS THAT CANNOT BE APPEALED

Decisions that cannot be appealed by the lender include:

- Interest rates set by the Agency's procedures, unless the participant alleges that an incorrect interest rate was applied;
- Decisions made in accordance with the statute;
- Denials of credit due to lack of funds; and
- Decisions made by the lender.

Participants may submit a written request to NAD to confirm that the decision cannot be appealed. Even though a decision is not appealable, Agency staff must provide the participant an opportunity for a review and explanation of the decision.

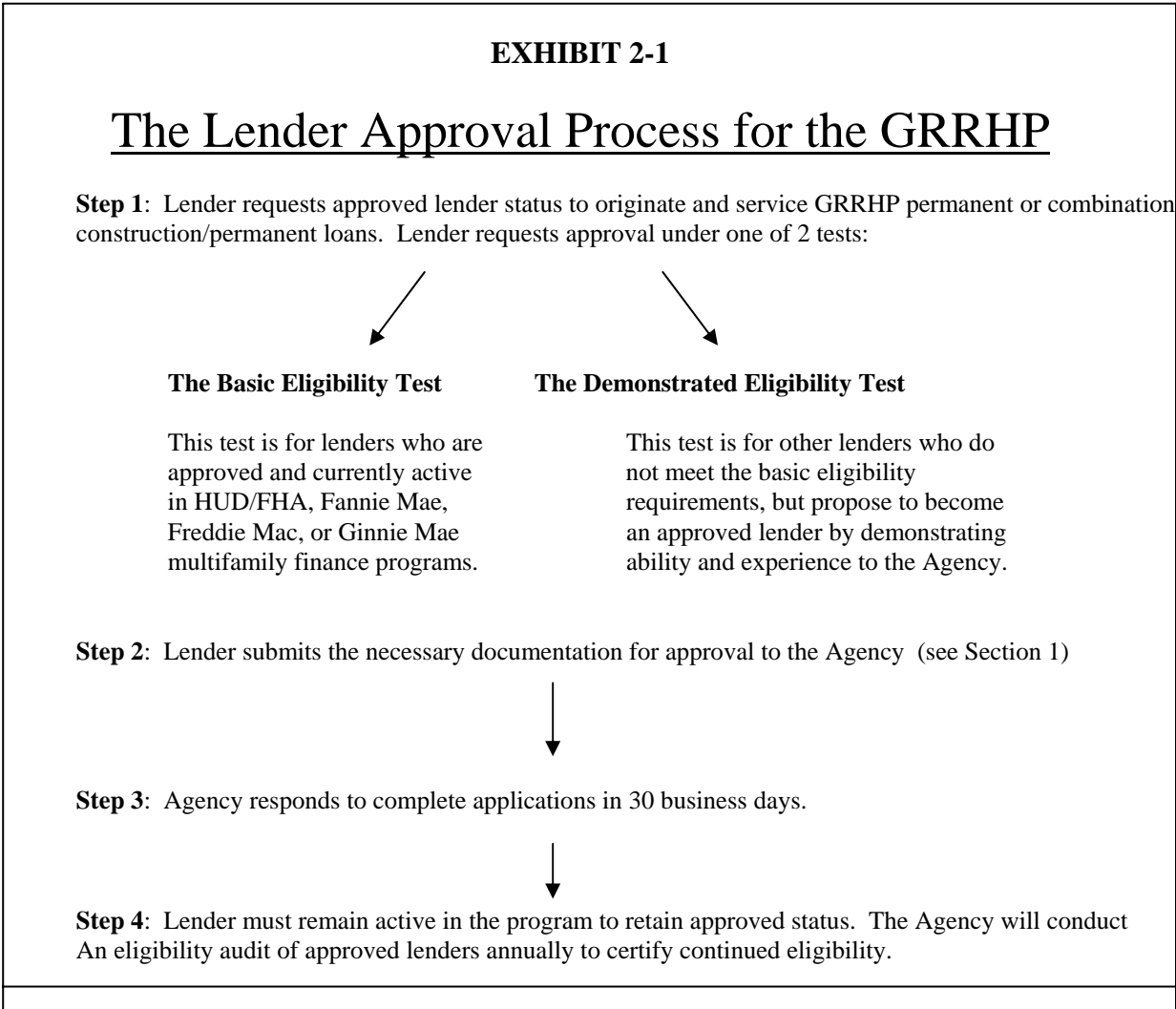
CHAPTER 2: LENDER ELIGIBILITY AND APPROVAL

2.1 PURPOSE AND OVERVIEW

For a lender to originate and service GRRHP loans, the Agency must determine that the lender meets the eligibility criteria set forth in the statute and corresponding regulations. The purpose of this chapter is to assist the lender in understanding these requirements and requesting and obtaining approved lender status from the Agency. An overview of the lender approval process is shown in Exhibit 2-1.

Key Topics in this Chapter

- Determining Lender Eligibility
- Approving Lenders
- Maintaining Approved Status
- Working with Other Lenders



SECTION 1: LENDER ELIGIBILITY

2.2 PURPOSE

The purpose of the GRRHP is to develop multifamily housing opportunities in rural areas where the supply of credit is not adequate. A goal of the program is to use the knowledge and expertise of eligible private sector lenders to originate and service GRRHP loans.

Lender eligibility is determined by meeting one of two tests:

- The basic eligibility test (see Paragraph 2.4); or
- The demonstrated eligibility test (see Paragraph 2.5).

Eligible lenders must be approved to originate or service permanent GRRHP loans and/or combination construction/permanent loans. These requirements are detailed in Paragraphs 2.6 and 2.7.

2.3 REQUESTING LENDER APPROVAL

The application for lender approval must be made at the same time as the first loan application. The first loan application means:

- The first application for a loan guarantee for a new loan; or
- The first application before ownership of any GRRHP loan is transferred to that lender.

A lender must be approved before a loan guarantee is issued or a guaranteed loan is acquired.

2.4 BASIC ELIGIBILITY TEST REQUIREMENTS

Two eligibility tests must be met before a lender may request approved lender status. Under the basic eligibility test, a lender must be an approved and currently active lender in one of the following multifamily housing programs.

- HUD/FHA insurance programs;
- Fannie Mae;
- Freddie Mac; or
- Ginnie Mae.

“Currently active” means that the lender has originated at least one multifamily loan in the last 24 months, or is currently servicing at least one multifamily loan in portfolio.

A letter or other verification of HUD, Fannie Mae, Freddie Mac, or Ginnie Mae program participation within the last 24 months must be provided to the Agency as evidence that the lender meets the basic eligibility requirements.

2.5 DEMONSTRATED ELIGIBILITY TEST REQUIREMENTS

If a lender does not meet the basic eligibility test, they may still apply to become an approved lender by demonstrating adequate ability to originate and service GRRHP loans.

A State or local housing finance agency, a member of the Federal Home Loan Bank System or other lender may be eligible to participate if they can demonstrate satisfactory experience with multifamily lending.

A lender can meet the demonstrated eligibility test if they demonstrate to the Agency’s satisfaction that they have:

- A thorough knowledge of multifamily lending and the capacity to underwrite, originate, process, close, service, manage, and dispose of multifamily housing loans in a reasonable and prudent manner; and
- A track record of making at least three multifamily loans, including at least one loan in the past two years.

2.6 APPROVAL REQUIREMENTS

A. Origination and Servicing Plan

As part of their application for approval, lenders must develop and submit an origination and servicing plan to be approved by the Agency. The plan must include the following information:

1. Policies and Procedures

The lender must provide a summary of their in-house policies and procedures from applicant screening through loan origination, processing, servicing, and termination.

2. Portfolio Performance Data

Lenders must verify their track record in servicing loans. A lender applying under the basic eligibility test may document the ability to service multifamily loans by verifying approved servicer status with HUD/FHA, Fannie Mae, Freddie Mac, or Ginnie Mae. Verification can be provided in the form of a letter or other verification of participation with any of these multifamily finance programs within the last 24 months.

Lenders who are not approved by HUD/FHA, Fannie Mae, Freddie Mac or Ginnie Mae must provide a summary of multifamily servicing activity. At a minimum, the summary must

include the dollar amount, number, and type of loans in the lender's portfolio, and information on delinquencies and losses over the past three years. Delinquent multifamily loans outstanding must not exceed three percent of all multifamily loans outstanding as of the application date, and historic losses must not exceed three percent of total dollars loaned. In the case of a new or reorganized servicing operation, the principal staff of the lender must demonstrate experience consistent with these benchmarks.

For the purpose of this plan, a delinquency will be any loan where the borrower has failed to make the full amount of a required payment on the due date or within any grace period.

3. Standard Documents to be used in Processing GRRHP Loans

To the extent that the lender has developed standard documents that will be used in originating, monitoring, or terminating GRRHP loans, samples of these documents must be included as part of the Origination and Servicing Plan. These documents may include, but are not limited to:

- The loan note,
- The mortgage,
- The security agreement,
- The regulatory agreement, and
- All loan closing documents.

If the lender does not submit standard documents, the Office of the General Counsel (OGC) must review these documents for each GRRHP loan unless OGC has directed otherwise.

4. Key Personnel Involved in GRRHP Loan Program

This section should detail qualifications of the lender's key personnel responsible for administering and monitoring the GRRHP loans, as well as any third party relationships. Resumes of all personnel to be involved in underwriting, construction management, servicing, and property disposition of GRRHP loans, regardless of whether they are in-house staff or a third party, must be submitted as part of this section.

5. Specific Areas Where the Lender's Policies and Procedures Will Deviate from Agency Standards

To the extent that the lender intends to use standards that are different from the Agency standards prescribed throughout this handbook, the lender must detail the proposed process or standard and obtain Agency approval.

B. Demonstrate the Lender's Financial Stability

Lenders meeting the basic eligibility test will be considered financially stable. All other private lenders must be rated BBB or better by a nationally recognized rating agency. HFA's must have a top-tier rating from Moodys or Standard & Poors rating service. Lenders that are not rated must submit data to the Agency to show they have sufficient capital and liquidity to meet any potential losses in their portfolio. Lenders must also submit an audited copy of the most recent annual financial statement prepared in accordance with Generally Accepted Accounting Practices (GAAP).

C. The Lender's Certification to Comply with Program Requirements

As a part of the origination and servicing plan, lenders are required to certify their commitment to comply with all Agency policies and procedures, including, but not limited to, standards for underwriting, servicing, and property disposition.

2.7 ADDITIONAL REQUIREMENTS FOR APPROVAL TO ORIGINATE AND SERVICE COMBINATION CONSTRUCTION/PERMANENT LOANS

A combination construction and permanent loan consists of a loan or fund advances to finance construction, and a permanent loan for a term of up to 40 years or the economic life of the loan, if less. The Agency will guarantee such loans, but requires additional information to determine that lenders are qualified to originate and service both the construction and permanent loan. The Agency cannot guarantee construction loans that are not combination loans, due to statutory restrictions.

The request for approval to originate and service combination construction and permanent loans must be made when the lender first applies to the program, or when an approved lender first submits a construction loan for a guarantee.

A lender who originates and services combination construction and permanent loans must agree to manage the construction and draw activities in the manner described in the Chapter 5.

Lenders must meet either the basic or the demonstrated eligibility test in Paragraphs 2.4 and 2.5 and the lender approval requirements set forth in Paragraph 2.6. Lenders must clearly identify policies and processes for multifamily construction lending. Lenders must also provide a summary of their multifamily construction lending activity in the same form as specified in Paragraph 2.5. The Agency may, at its discretion, consider other types of construction loans — such as those for commercial development — as a substitute for multifamily construction experience.

2.8 PARTICIPATION BY LENDERS WITHOUT DEMONSTRATED ABILITY

Lenders that do not meet the requirements for approval may participate in the loan or may act as an agent or broker of an approved lender. These arrangements are discussed in Section 4 of this chapter.

SECTION 2: LENDER APPROVAL PROCESS

2.9 OVERVIEW

All applications for lender approval must be submitted to the RHS State Office with the lender's first loan application. Requests for lender approval will be forwarded to the National Office with the first loan application. All of the items listed in Paragraph 2.11 are required as a part of the lender application. An application for approval as a participating lender can be found at any State Office.

2.10 AGENCY ASSESSMENT OF THE REQUEST

The Agency will respond to complete applications within 30 business days. Incomplete applications, especially those that do not include the submission requirements listed in Paragraph 2.11, will generally be returned automatically to the lender. Information required from third parties, such as the eligibility letter from HUD/FHA, Fannie Mae, Freddie Mac, Ginnie Mae or lender credit ratings, must be submitted as soon as possible.

The Agency will review completed applications and determine if the applicant meets all of the requirements for approval. The Agency may request additional information as necessary to evaluate the lender's qualifications.

As a part of the lender application, the Agency will collect a non-refundable fee. The application fee and other program fees are discussed in Chapter 6.

2.11 SUBMISSION REQUIREMENTS — LENDER APPLICATION

The following are submission requirements for lender approval applications.

- Lender legal name and legal address.
- Identification of contact person responsible for coordinating with the Agency including phone number, fax number, and e-mail address.
- List of principal officers and their responsibilities.

- Certification that the lender has not been debarred or suspended from Federal programs. Lenders must complete *Form AD 1047, Certification Regarding Debarment, Suspension, and other Responsibility Matters - Primary Covered Transactions*.
- Certification that the officers or principals of the lender have not been debarred or suspended from any Federal programs.
- Certification that the lender is not in default or delinquent on any Federal debt or loan.
- A recent letter, or other proof, verifying participation as a currently active, approved multifamily lender in good standing with HUD, Fannie Mae, Freddie Mac or Ginnie Mae (see Paragraph 2.4); or evidence that the lender is a State housing finance agency (HFA), a member of the Federal Home Loan Bank (FHLB) system, or other lender experienced in multifamily lending who can meet the requirements of the Agency.
- A copy of the lender’s origination and servicing plan for multifamily loans.
- Verification of lender credit rating or evidence of financial stability, as discussed in Paragraph 2.6 B.
- A certification by the lender that they will:
 - ◊ Comply with all Agency policies and procedures, including all monitoring requirements of the Agency;
 - ◊ Maintain all original eligibility and approval conditions; and
 - ◊ Inform the State Office in writing within 60 days if there are any substantive changes in corporate structure or business practices, such as a change in management or in the size or scope of business operations.



2.12 ISSUANCE OF APPROVED LENDER STATUS

Lenders will be informed in writing of lender approval or denial and the reasons for denial. The lender approval will be completed when the loan guarantee application is approved by the Agency.

If a lender is not approved, they may appeal the decision by following an informal appeals procedure, through mediation or alternative dispute resolution, or by following the formal appeals procedures referenced in Attachment 1-A.

SECTION 3: MAINTENANCE OF LENDER APPROVAL

2.13 REQUIREMENTS FOR RETAINING APPROVED STATUS

Lenders participating in the program are expected to maintain compliance with all of the requirements for participation as when first approved. If a change in the lender's operations or financial status results in the lender becoming ineligible, the Agency must be notified immediately. Lender approval under the program is automatically maintained until one of the following occurs:

- The lender is inactive for three consecutive years;
- The lender fails to maintain requirements for eligibility;
- The lender voluntarily withdraws from participation in the program; or
- The Agency removes a lender's approval.

Example: Lender Z has not participated in the program in any way (originating or owning a loan) in the past three years. Lender Z's approval therefore lapses. Lender Z may reapply for approval in the program when Lender Z next has a loan under the program.

Example: Lender Y originates loans guaranteed under the program, and then promptly sells them. Lender Y does this continuously, never going more than two years between originating loans under the program. Lender Y remains in the program in good standing and is considered an active participant.

The definition of an active lender is a lender who does at least one of the following:

- Has originated at least one loan under the program in the last 24 months; or
- Holds in their portfolio at least one loan guaranteed under the program.

All active lenders must have an "eligibility audit" annually within 120 days of the end of their fiscal year and send it to the National Office for review. The audit will consist of a financial and program performance audit conducted by a certified public accountant in accordance with Generally Accepted Government Accounting Standards. In addition, the Agency will periodically visit the lender's business office to conduct an on-site review. The lender must also certify that all eligibility requirements are being maintained.

Lenders who have lost approval must reapply to regain approved status. Their past performance under the program may count as demonstrated ability during the pre-application process. In the event of loss of approval, either through Agency action or voluntary termination by the lender, the Agency may require the transfer of servicing of loans to an approved lender. If the loss of approval is due to non-compliance, the Agency may pursue other actions against the lender, including, but not limited to, debarment, criminal proceedings, and civil proceedings.

SECTION 4: OTHER ISSUES

2.14 SUBSTITUTION OF LENDER

The Agency recognizes that lenders may wish to sell loans that they originate, but it has a duty to ensure that the government is not placed at higher risk as a result of this action. The Agency requires that all sales of loans, other than sales to Fannie Mae, Freddie Mac, or Ginnie Mae be approved in advance.

The Agency requires that lenders be approved before they can take ownership of a guaranteed loan. This policy is to ensure that loans are properly serviced at all times. Therefore, after the issuance of a Loan Note Guarantee, the lender must not sell or transfer the loan, or any portion, without the prior written approval of the Agency. The Agency will not pay any loss if a loan or portion of a loan is transferred without Agency approval.

To be approved, a substitute lender must:

- Be an approved lender or be eligible to become an approved lender in accordance with Section 1 of this chapter.
- Be able to service the loan in accordance with the original loan documents; and
- Agree in writing to assume all original loan requirements, including liabilities and servicing responsibilities.

The RHS Regional Attorney must review the proposed substitution documents to ensure that the substitution meets all legal requirements unless OGC has directed otherwise.

The USDA Finance Office must be notified of substitutions using *Form RD 1980-11, Guaranteed Rural Housing Lender Record Change*.

2.15 USE OF AGENTS AND BROKERS BY THE APPROVED LENDER

An approved lender may use agents or brokers to carry out their duties. However, the approved lender bears full and complete responsibility for all of the actions of their agents. For experienced lenders, the use of an agent or broker gives them the opportunity to reach out to other geographic areas where they might not usually do business. For the areas being served by these agents and brokers, it allows the greater availability of credit for multifamily development.



Use of agents and brokers is also allowed to provide the opportunity for inexperienced lenders to develop experience under the tutelage of experienced lenders. One example of use of a lender agent would be the use of a mortgage broker to underwrite and originate a loan for an

approved lender. The loan must be closed in the name of the approved lender, who retains ownership and responsibility for the loan. Lenders can use the experience gained acting as the agent for another lender as evidence of their demonstrated ability for multifamily lending should they wish to become approved in the future.

If an agent or broker originates or services a GRHHP loan, the lender must identify the broker or agent on the relevant documentation. If the lender proposes to use a broker or agent on a consistent basis, the Agency must be informed of this relationship but does not need to approve the arrangement unless the lender is delinquent or in default under the lender agreement.

2.16 LOAN PARTICIPATIONS

A loan participation is a loan that is funded by two or more lenders. Loan participations are permitted, subject to Agency review. In every case, a lead lender must be designated, and that lead lender must be an approved GRRHP lender. The lead lender will execute the lender agreement with the Agency and assume full responsibility for compliance with program requirements. The lead lender is responsible for establishing an intercreditor agreement with each participating lender and ensuring that the GRRHP loan is a first lien or a parity lien, if a parity lien is approved by the Agency. The lead lender will in most cases be the sole point of contact with the Agency for the loan.

2.17 TRANSFER OF SERVICING

In most cases, the Agency will require that the originating lender service the entire loan and remain mortgagee or secured party of record. In cases where the originating lender cannot service the loan, the Agency will permit the transfer of servicing responsibility to another lender, subject to Agency concurrence prior to the transfer.

Agency approval is not required for the transfer of servicing on guaranteed mortgages to Ginnie Mae.

Loans and/or mortgage servicing on loans backing Ginnie Mae guaranteed securities may only be transferred to a Ginnie Mae issuer and may only be transferred with prior Ginnie Mae approval.

CHAPTER 3: LENDER UNDERWRITING

3.1 INTRODUCTION

The underwriting of a loan is the process by which the lender determines whether the loan is a good investment of capital. The process involves a simultaneous analysis of the creditworthiness of the borrower and the economic value of the property as an income-producing investment. If the borrower is creditworthy and the property has sufficient value under existing market conditions, the lender can enter into the loan with reasonable confidence that the investment will be a good one. The underwriting of a GRRHP loan involves the same type of feasibility analysis as the lender uses for any other loan. The only difference is that the GRRHP loan will have certain restrictions on the use of the property that must be factored in to the underwriting analysis.

- Key Topics in this Chapter**
- Lender Responsibilities
 - Lender’s Underwriting Conclusions
 - Borrower Eligibility Requirements
 - Property Requirements
 - Determining Property Value
 - Financing Terms and Lender Commitment

This chapter brings together the borrower eligibility, property, and loan requirements of GRRHP that must be a part of the lender underwriting analysis. In evaluating each transaction, the lender must use prudent underwriting standards, consistent with the best industry practices and with the requirements set forth in this chapter.

SECTION 1: LENDER UNDERWRITING RESPONSIBILITIES

3.2 OVERVIEW

Prior to requesting a loan guarantee, the lender must underwrite and approve the loan. The underwriting analysis is a detailed evaluation of key elements of borrower experience and creditworthiness, market conditions, the value of improvements, and the ability of the property to attract the rents needed to support the loan. The lender underwriting must identify and evaluate all of the factors that could affect loan performance. Such factors must be reflected in the conclusions of the underwriter detailed in the Underwriter’s Narrative. The Agency expects the lender to apply the underwriting guidelines in the same manner as if the lender were making a conventional loan for its own portfolio.

3.3 SUMMARY OF LENDER RESPONSIBILITIES

The lender's underwriting responsibilities can be summarized as follows:

- Review borrower's qualifications and capacity to own and operate the property in accordance with the loan terms and program requirements;
- Approve the plans and specifications for the construction of the property;
- Determine that there is a market for the project – that is, that there is demand for additional rental units of the type proposed at market rents or at the proposed rents, if higher;
- Determine the expense amounts and the amount of replacement reserves;
- Determine the appropriate debt service coverage ratio;
- Review the management plan and management agreement for the management of the property;
- Ensure that all materials prepared by outside parties such as appraisers, architects, attorneys, environmental consultants, engineers, or cost estimators are adequate for their intended purpose and comply with Agency requirements; and
- Determine the value of the property.

SECTION 2: LENDER NARRATIVE

3.4 NARRATIVE REQUIREMENTS

The lender must submit a complete narrative summary of all of the factors affecting the transaction and provide supporting documentation for all decisions made in underwriting the loan. This will be submitted as part of the loan guarantee application (see Section 3 of Chapter 4). The lender is expected to identify those factors that may impact the performance of the loan. The lender's underwriting narrative must include the following elements:

Outline of Lenders Narrative

- Summary of Loan Request
- Financing Terms/Commitment
- Borrower/Sponsor's Qualifications
- Management Review
- Property History
- Site/Area/Neighborhood Analysis
- Improvements/Physical Needs
- Environmental Issues
- Market Analysis/Appraisal
- Income/Expense Proforma
- Valuation

- Summary of loan guarantee request, including the amount of the loan, guaranteed portion, and any subordinate financing;
- Conclusions about the borrower, including eligibility, financial capacity, and management review;
- Property history and loan purpose, including prior ownership and any outstanding financing;
- Conclusions about the property, including site and neighborhood analysis; and
- A summary of known or potential environmental concerns.
- Determination of the project's value, including market analysis, appraisal, income and expense analysis and valuation.

While the lender is expected to use their experienced judgement in making a determination of value and developing financing terms, lenders must consider the Agency underwriting guidelines contained in the following sections of this chapter in making loans for Agency guarantee.

SECTION 3: BORROWER ELIGIBILITY

3.5 OVERVIEW

The borrower's intentions, qualifications, and capabilities are crucial to maintaining housing that is decent, affordable, and financially sound. Lenders must determine that the borrower is financially and legally capable of meeting all program requirements and has a good record of compliance with Agency and other Federal program requirements and financial obligations. In reviewing borrower eligibility, the lender must examine the background and capabilities of all of the principals of the borrower (ownership) entity. While those principals holding management responsibilities will receive the most thorough scrutiny in terms of capacity to operate the property, all principals must be eligible in accordance with Paragraph 3.6.

3.6 ELIGIBLE BORROWERS

To be considered eligible the borrower must:

- Be a creditworthy entity. Borrowers who own any other business or engage in other business activities are eligible to participate in the program. However, due to liability concerns, it is in the best interest of the borrower and the Agency for the borrower to be a single asset entity. Agency staff should encourage borrowers to create a single asset entity for each project, and inform borrowers of the potential liability risk for borrowers who own other businesses or engage in diverse business activities;

- Any borrower that has been declared in default of a loan under the GRRHP, Section 515, or other Agency housing program, must be in compliance with an approved workout plan that addresses the deficiencies. The approved workout plan must have been in place and satisfactorily performed for at least six months for the borrower to be considered eligible for an initial or subsequent GRRHP loan.
- Be able and intend to maintain and operate rental housing in accordance with program objectives and requirements;
- Be in compliance with all legal and regulatory requirements with respect to any Agency program and any other Federal debt; and
- Be a U.S. citizen(s) or legal resident(s), a U.S. owned corporation, a limited liability corporation (LLC) or a partnership in which the principals are U.S. citizens or permanent legal residents.

The lender can establish the citizenship of a borrower by examining a birth certificate or passport, or by verifying the social security number or the taxpayer identification number. If the borrower is not a U.S. citizen, the borrower must provide acceptable evidence of eligible status as a qualified alien, as listed in Exhibit 3-1.

3.7 INELIGIBLE BORROWERS

Borrowers are not eligible to receive Agency guaranteed loans if:

- The borrower entity or any one of its principals has been debarred by the Agency from future participation in any USDA credit program; or
- The borrower entity or any one of its principals has defaulted on any Federal debt.

The state office will verify that the borrower does not appear on the debarment/suspension list by reviewing the “list of Parties Excluded from the Federal Procurement and Nonprocurement Programs” available on the Internet at <http://www.arnet.gov/epls/>, and filing a copy of the print out of the EPLS page in the application file.

3.8 BORROWER TYPES

The lender must determine that the type of borrower is appropriate to carry out the obligations under the loan and GRRHP requirements. Other than public agencies, Indian tribes, and individuals, borrowers must provide documentary evidence that they are valid legal entities, licensed to do business in the state in which the property is located and able to enter into agreements governing the loan and guarantee. The following are examples of eligible borrower types and the documentation, including any amendments, they must provide to prove their legal status for a GRRHP loan.

Exhibit 3-1

Acceptable Evidence of Qualified Aliens

- *Form I-551, Alien Registration Receipt Card* or prior to 1979, *Form I-151* (for permanent resident aliens).
- *Form I-94, Arrival-Departure Record*, with one of the following annotations:
 - ◇ “Admitted as Refugee Pursuant to Section 207”;
 - ◇ “Section 208” or “Asylum”;
 - ◇ “Section 243(h)” or “Deportation stayed by Attorney General”; or
 - ◇ “Paroled Pursuant to Section 212(d)(5) of the Immigration and Nationality Act (INA)” for a period of at least a year.
- If *Form I-94, Arrival-Departure Record*, is not annotated, it should be accompanied by one of the following documents:
 - ◇ A final court decision granting asylum (but only if no appeal is taken);
 - ◇ A letter from an asylum officer of the U.S. Immigration and Naturalization Service (INS) granting asylum (if application is filed on or after October 1, 1990) or from an INS district director granting asylum (if application filed before October 1, 1990);
 - ◇ A court decision granting withholding of deportation; or
 - ◇ A letter from an INS asylum officer granting withholding of deportation (if application filed on or after October 1, 1990).
- An alien who is granted conditional entry pursuant to section 203(a)(7) of the INA as in effect prior to April 1, 1980, is a qualified alien.
- A receipt issued by the INS indicating that an application for issuance of a replacement document in one of the above-listed categories has been made, and the applicant’s entitlement to the document has been verified.
- If other documents are determined by the INS to constitute acceptable evidence of eligible immigration status, they will be announced by a notice published in the Federal Register.

A. General or Limited Partnerships

A partnership is a business arrangement between one or more managing or general partners and one or more limited or equity partners, organized to carry out the activities related to ownership and operation of rental housing, or similar purposes. Partnerships must provide evidence of legal status in the form of a partnership agreement setting forth the terms of the business relationship. The partnership must be for a term at least equal to the term of the loan.

Lenders must verify that the partnership structure will ensure the sound ownership and management of the project over the life of the loan. Lenders should review and approve any changes in the partnership structure.

- The terms of any limited partnership agreement must require that the general partners maintain a minimum of five percent financial interest in the residual or refinancing proceeds of the partnership.
- Any limited partnership agreement must contain a clause that provides for obtaining prior consent from the lender when any of the following actions are taken:
 - ◊ Withdrawing a general partner;
 - ◊ Adding a general partner;
 - ◊ Substituting a general partner;
 - ◊ Amending the Limited Partnership Agreement or the Partnership's Certificate of Limited Partnership;
 - ◊ Selling all or substantially all of the assets of the partnership;
 - ◊ Dissolving or terminating the partnership; and
 - ◊ Borrowing funds from the general partners or third parties.

B. Corporations

A corporation is a for-profit or non-profit organization created for the purpose of owning and operating rental housing, or similar purposes. Corporations must provide evidence of legal status in the form of Articles of Incorporation. Corporate owners must clearly identify the officer(s) responsible for managing the ownership responsibilities of the GRRHP project and must be in good standing with state of incorporation and where project will be built.

Non-profit corporations may receive preference in ranking and are not subject to the same equity requirement as other borrower entities. Non-profits must provide evidence of their status in the form of:

- A tax-exempt ruling from the IRS designating the non-profit as a 501(c) or 501(c)(4) organization; and

- A purpose statement in Articles of Incorporation which includes a provision to provide decent housing that is affordable to low- and moderate-income persons.

C. Limited Liability Companies

A Limited Liability Company (LLC) is a legal entity created to own and operate rental housing, or for a similar purpose, and that is structured to provide limited liability in the ownership of real property. LLC's must provide evidence of legal status in the form of Articles of Organization and Operating Agreements. These documents must show that:

- The authority of the members of the LLC is limited, and an authorized member who will act on the LLC's behalf has been appointed;
- The management functions of the LLC are the responsibility of a member who holds at least a five percent financial interest in the LLC;
- The LLC has agreed that any new members may only be brought into the organization with prior consent of the Agency; and
- At least one member has committed to meet the equity contribution requirements if the LLC partnership is not able to do so at the time of loan request.

D. Trusts

A trust is an entity formed by a legal agreement for the purpose of owning and operating rental housing, or for a similar purpose. Organizational documents as evidence of legal status should be submitted.

E. Public Agencies

Public agencies are organizations, including State or local housing finance agencies (HFA's) or public housing authorities or agencies (PHA's), organized to finance and/or own and operate affordable rental housing, or similar purposes. Public Agencies must provide evidence of legal status in the form of State or local enabling or implementing legislation, or a resolution of an official public body authorizing the creation of the agency.

F. Indian Tribes

Indian tribes are legal entities recognized by the Federal government as representing the legal interests of tribal members. Indian tribes must provide evidence of legal status in the form of a certificate or other official document of recognition from the Interior Department or other authorized agency of the Federal government. Only those entities that meet the definition of "Indian tribe" as provided in the Glossary are considered eligible.

G. Individuals

An individual borrower is any citizen or legal resident of the United States aged 18 years of age or older who has the capacity to enter into a legal agreement to own and operate rental housing. Citizenship status of individuals is addressed in Paragraph 3.6.

3.9 CERTIFICATION OF LEGAL ELIGIBILITY

The lender's attorney must review the organizational documents of the borrower, each principal that is an entity, and the organizational documents of any entity that has an ownership interest in a principal and certify that the borrower meets Agency and program requirements.

3.10 BORROWER EXPERIENCE AND CAPACITY

Lenders must verify that borrowers have the experience and capacity to develop and operate the property to the standards established by the lender and the program.

Areas to be reviewed by the lender:

- The number and types of projects that the borrower has previously undertaken.
- The experience of the borrower in completing projects.
- The borrower's financial resources and management capacity to undertake the project and resolve problems that arise over the course of the loan.

The lender must be able to verify that:

- The borrower can construct or rehabilitate rental housing;
- The borrower can provide for the financially sound operation of the property over the life of the loan; and
- The borrower is legally able to enter into the necessary contracts with the builder, lender, and other parties involved in the development, financing, and operation of the property.

A. Construction and Rehabilitation Experience

The development team includes the people who will make the development of the project a reality. The development team must have experience with the type of construction involved and a history of sound performance. The lender must review and certify as acceptable each member of the development team. The core development team usually consists of the developer, architect, and contractor.

- The developer is the owner or borrower entity and the party with ultimate responsibility for getting the project completed. The developer coordinates or directs an agent to coordinate the work of other members of the development team. To demonstrate qualifications, the developer must provide a narrative description of its organization, including its history, approximate annual operating budget, staff size, resumes of key staff members, and if applicable, information about the board of directors. This narrative should also include a factual description of the developer's experience in residential real estate activities (i.e., the number and type of projects and units built, total square footage, the total cost of the projects and source of financing and pending litigation or mechanic's lien claims or contingent liabilities).
- The architect is responsible for the design of the project and for monitoring construction to ensure that it meets Agency requirements. The architect must provide a narrative about his/her firm that includes the history of the firm, professional staff, annual revenue, and experience designing similar projects.
- The contractor is responsible for construction of the project. The contractor must provide a narrative about his/her construction company including the history of the company, annual revenue, and track record in building projects of this type and size, and pending litigation or mechanic's lien claims or contingent liabilities.

B. Property Management Experience

The property manager and the management plan are crucial to the financial viability of rental housing projects. The lender must thoroughly evaluate the experience of the property manager, whether the borrower or a management agent. Particular attention should be given to:

- Knowledge of property management and marketing practices;
- Experience managing rental housing properties, with emphasis on similar properties and those managed in the same geographic area as the subject property; and
- Submission of an appropriate and comprehensive management plan and clear procedures for meeting the objectives of the plan.

If the borrower does not manage the property, a written management agreement must be executed with a qualified management company. The management agreement must clearly state the responsibilities of the management agent, the amount of management fees to be paid, and how fees are determined. If the property management agent or management plan is inadequate to the Agency, the loan will not be eligible for a guarantee by the Agency.

Additional information about the elements of an acceptable management plan and management agreement are included in Chapter 8.

C. Financial Capacity

The borrower and its principals must be financially stable and have sufficient resources to develop and operate the property. Credit reports will assist in determining the financial stability of the borrower and its principals. Newly formed entities will not be subject to credit report reviews, but the lender is expected to review credit reports of the principals. The borrower must demonstrate the financial resources to meet the specific requirements of the transaction.

The lender is responsible for verifying that the borrower has the cash and other marketable securities needed to close the loan and meet working capital requirements.

The borrower must meet the following equity and reserve requirements.

- **Equity Requirement.** In the case of a for-profit entity, the borrower must commit equity capital in an amount equal to at least 10 percent of the total development cost. Development cost is the total cost of project construction cost, financing fees, professional fees, and profit. In the case of a non-profit entity, the borrower must have equity capital in the amount of at least 3 percent of the total development cost. In either case, a deferred developer's fee cannot be used to fulfill the equity requirement. Equity must be in place prior to closing the construction loan note guarantee or the permanent loan note guarantee.
- **Working Capital and Construction Contingency.** In addition to equity capital, the borrower must commit working capital to (1) fund construction contingencies, and (2) an operating and maintenance (O&M) reserve. Neither of these reserve requirements are mortgageable costs. When the Agency is guaranteeing construction, the Agency requires the construction contingency reserve to be set at a minimum of 2 percent of the construction contract, inclusive of the contractor's fee, hard and soft costs.

The construction contingency reserve will be set up and fully funded as a cash contribution prior to or at the closing of the construction loan. The construction contingency reserve will be held and managed by the lender. The disbursement of funds from the construction contingency reserve will be made by the lender only for change order requests approved by the lender and an Agency representative. Unused funds in the construction contingency reserve cannot be released to the borrower until the project reaches occupancy of 90% for 90 days. This requirement remains in effect despite the lender establishing an additional guarantee reserve in lieu of the occupancy requirement. The lender will transfer unused funds in the construction contingency reserve to the project's O & M reserve after construction is complete and the original O & M reserve is depleted. The unused construction contingency reserve will be used

to support the project during lease-up immediately following the depletion of the original O & M reserve account. The lender will inform the state office servicing the project when unused construction contingency funds are transferred to the O & M reserve account.

The O&M reserve will be at least 2 percent of the loan amount. State offices may request additional O & M reserves if rent-up assumptions indicate the need for more reserves. The sources of the O & M reserve must be shown in the construction budget with a schedule of when the funds will be disbursed in the case of a construction loan note guarantee or funded prior to the closing of the permanent loan in the case of the a permanent loan note guarantee. Funds contributed as O&M reserve funds will be contributed from the borrower's own resources and are not to be included as part of the total development cost calculation. The funds will be deposited to the project's general operating account and lose their identity as O&M funds. The funds will not be returned except as a "surplus cash distribution" at the end of the year and only if the requirements of Paragraph 7.6 E. have been met.

In lieu of a cash contribution for the O & M reserve, the lender may accept an unconditional and irrevocable letter of credit that is issued by another lending institution in an amount that is at least equal to the required O&M contribution level (at least 2% of the loan amount). The letter of credit must remain in effect until the borrower has submitted an annual audited financial statement of the property to the lender (covering at least a 6 month period) and the lender has determined that the property is in good financial and physical condition and in compliance with the regulatory agreement. If these requirements are not met, the letter of credit must be extended for an additional year and until the requirements can be met.

SECTION 4: PROPERTY REQUIREMENTS

3.11 OVERVIEW

To achieve long term success, GRRHP projects must be competitive with other rental properties in their market area. Property characteristics such as location, size, amenities, and environmental conditions are important to the success of a rental housing project. Each of these characteristics affects a property's marketability, financial success, and value.

Ensuring that certain minimum property standards are met is important to maintaining the ability to remain competitive and financially viable over the long term. In evaluating property, lenders are expected to evaluate the site conditions as well as the buildings which will be constructed or rehabilitated on the site.

3.12 RURAL AREA DESIGNATION

Lenders must verify that projects are located in an area that meets the Agency’s definition of a rural area (see Paragraph 1.6). Lenders must contact the State Office to verify eligibility.

3.13 GENERAL SITE REQUIREMENTS

Multifamily housing properties must be located in areas that are appropriate for residential housing and represent reasonable real estate investments. To meet this requirement, the area where the site is located must be a residential area that provides adequate services and facilities and is free from undesirable conditions. The requirements for an appropriate location are detailed below.

A. Public Facilities and Services

Sites must have necessary public facilities and services to support the needs of the tenants. The lender must ensure that necessary facilities and services exist and that they are close and convenient to the site, including:

- Central water and sewer systems;
- Schools and hospitals; and
- Shopping, medical, and pharmaceutical services.

The “close and convenient” standard may differ by area based on local transportation and population density. Factors to consider include available transportation, traffic patterns, road conditions, and terrain.

B. Less Desirable Areas

The Agency’s requirements for site development prohibit development in “less desirable” areas unless more attractive alternatives are not available. Such areas create unpleasant living conditions for residents and depress the value of the investment.

<p style="text-align: center;">Examples of Less Desirable Areas</p> <p>Examples of less desirable areas include:</p> <ul style="list-style-type: none">• Sites adjacent to train tracks;• Industrial areas;• Sites with environmental concerns;• Grain elevators and grain storage bins;• Mobile home courts;• Older, declining neighborhoods;• Gas stations; and• Car lots.
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3.14 SITE STANDARDS

Planning for development must take into consideration topography, soils, climate, adjacent land use, environmental impacts, energy efficiency, local economy, aesthetic and cultural values, public and private services, housing and social conditions, and a degree of flexibility to accommodate changes in local needs.

<p style="text-align: center;">Technical Assistance on Site Standards</p> <p>Technical services such as architectural, engineering, land survey, or site planning services must be performed by professionals who are qualified and authorized to provide such services in the State where the project is developed.</p>

Lenders must review site plans for compliance with Agency site standards.

A. Applicable Codes

All multifamily housing projects must observe all applicable Federal, State, and local codes, laws, local ordinances, and zoning requirements, and regulations on health and safety standards.



B. Adequate Utilities and Infrastructure

Sites must have infrastructure and utilities that are adequate for the needs of the site and that meet all local requirements. Ideally, the utilities should be publicly owned and have adequate capacity for the proposed development. If the project will operate its own system, lenders must approve the justification for private ownership.

C. Grading and Drainage

Soil and geological conditions must be suitable for the type of construction proposed. In questionable and unserved areas, the lender must obtain an engineering report with supporting data to identify all pertinent subsurface conditions that could adversely affect the structure and show proposed solutions.

D. Size and Shape

The size and shape of a site must be adequate for the proposed units as well as walks, parking, any on-site septic system, and other site improvements.

E. Undesirable Physical Conditions

Sites must not have undesirable physical conditions that create hazards or unnecessary development costs, such as:

- Rocks or soil conditions that increase development costs;
- Noise from nearby roads, airports, or factories that create unacceptable residential conditions; and
- Pollution from nearby sources that create hazardous health conditions.

3.15 SITE DENSITY

Acceptable density standards will vary by market area and local codes. Because of these differences, program rules do not provide specific density standards. Instead, project density should be evaluated based on:

- Compatibility and consistency with the market and neighborhood.
- Sufficient size to accommodate necessary site features.
- Impact on total development costs and project budget.

3.16 NON-CONTIGUOUS SITES

The Agency prefers to guarantee loans for single and contiguous site projects, since projects on single sites or contiguous sites are generally easier to manage and monitor than non-contiguous sites. Non-contiguous sites may be eligible for guarantee if the lender certifies that the parcels of land are:

- Located in one market area (a neighborhood or similar area where the property competes for tenants);
- Managed under one management plan and one management agreement; and
- In sufficiently close proximity to permit convenient and efficient management of the property.

3.17 SITE CONTROL

At the time of closing, the borrower must have control of the housing and related land. Control means either current ownership rights to a long-term lease or a valid option to purchase or lease the land. After closing, the borrower must have a fully marketable title (fee interest) or land lease.

A. Land Ownership

The only form of ownership acceptable to the Agency is fee-simple ownership. Under this form of ownership the borrower holds a fully marketable title, which is evidenced by a deed unless received from an estate. The deed vests full interest in the property to the borrower. If proof of site control is in the form of a land purchase contract, full ownership interest must be converted to a deed prior to closing the loan.

B. Land Lease

A land lease is acceptable if the lease meets the following requirements:

- The lessor owns the land fee-simple;
- Neither the title nor the leasehold are subject to prior liens other than taxes not due and payable;
- The amount of the guaranteed loan does not exceed the market value of the property, including the value of the leasehold;
- The unexpired term of the lease exceeds the term of the mortgage by at least 25 percent; and
- Rent charged for the lease does not exceed the rate being paid for similar leases in the area.
- It is recorded in the location necessary to give notice to the public of its existence.

The lease must be in writing and must contain the following provisions:

- The lessor must authorize the proposed improvements required by the guaranteed mortgage;

- The lessor must authorize the lender and Agency the right to foreclose the guaranteed mortgage or to transfer the lease if the borrower defaults;
- The lender or the Agency are permitted to bid at a foreclosure sale or to accept deed in lieu of foreclosure;
- The borrower is permitted to transfer the leasehold as part of an ownership transfer of the property, in the event of default or inability to continue with the lease; and
- The lessor gives the Agency and the lender notice of lease default and a 60 day period of time for the Agency or lender to cure the default.

The lender must submit a copy of the leasehold agreement to the RHS State Office for approval prior to loan closing. Any subsequent changes in the leasehold agreement must be approved by the Agency.

3.18 ENVIRONMENTAL REQUIREMENTS

To protect the environment and to ensure the value of guaranteed loan, the Agency must undertake an environmental review. The Agency will request assistance of the lender in conducting this review. State office staff will initiate the governmental review process after the lender submits *Form RD 1940-20, Request for Environmental Information*, and supporting documentation. The environmental review entails the publication of a public notice regarding the project and written feedback from different state and local offices concerned with environmental issues. The environmental review is complete only after the publication period of the public notice has expired and the State Environmental Coordinator signs the appropriate documents. The environmental review takes at least 45 days to complete. More time will be needed if state and local environmental authorities have any findings. Delays in the environmental review process are certain if the project location is on an archaeological burial site, in flood plans, or protected areas. Properties must meet the Agency environmental standards in RD Instruction 1940-G and in Chapter 11.

A. Lender Responsibilities Prior to Requesting Guarantee

The Agency and the lender will incorporate into their lending practices an environmental risk management program. A major component of the environmental risk management program is the conduct of due diligence in the context of real estate transactions. The lender will ensure that due diligence is performed and the results taken into consideration through an appraisal as further detailed in Chapter 11.

B. Agency Environmental Review

The National Environmental Policy Act (NEPA) requires Federal agencies to take into consideration the potential impacts of a proposed project on the human environment and on any protected environmental resources in the vicinity of the proposed site.

Therefore, prior to loan approval, obligation of loan funds, issuance of a conditional commitment, or other commitment of Agency resources, whichever occurs first, the Agency must complete a NEPA environmental review. The environmental review examines the environmental consequences of the proposed action and ensures that alternatives are developed and incorporated into the proposal to either avoid environmental impacts or to mitigate adverse effects to the environment. Further information is found in Chapter 11. The Agency conducts the environmental review process in accordance with RD Instruction 1940-G.

3.19 Civil Rights

Residents of housing projects benefiting from Federal assistance have the right to live in their homes free from the burden of discrimination. Consequently, for every GRRHP project, the Agency Civil Rights staff will conduct a civil rights impact analysis to determine whether the proposed project would negatively or disproportionately affect tenants by virtue of their race, color, sex, national origin, religion, age, disability, or familial status.

The civil rights impact analysis will address two areas in particular:

- The extent to which the project serves all eligible members of the community. The Agency will examine applicant plans to market the project affirmatively and to implement nondiscriminatory occupancy policies and procedures.
- The extent to which the project creates disproportionately high and adverse human health or environmental effects on minority and low income populations. The Agency will examine the project proposal to ensure that there are no factors that create adverse environmental impacts. Examples of such factors include locating the project near a sewage treatment facility, train tracks, or a farm that routinely sprays or dusts crops.

Agency guidance on the Civil Rights Impact Analysis can be found in RD Instruction 2006-P.

3.20 PROJECT DEVELOPMENT

All construction, rehabilitation, and use of the property must comply with applicable governmental statutes, codes, rules, and regulations.

A. Project Size

Rental housing properties with less than five dwelling units are ineligible for guarantee. There is no maximum number of dwelling units that renders a project ineligible. However, the market analysis, which is a part of the underwriting process, takes into account market demand and could limit project size.

B. Agency Construction Requirements

New construction, rehabilitation, modular and manufactured structures must meet the standards contained in RD Instruction 1924-A and the site development standards



found in RD Instruction 1924-C. Unless an exception is granted for special housing needs as referenced in Paragraph 3.23, refinancing of existing housing and indebtedness is not an authorized use of guaranteed loan funds.

The lender is responsible for inspection of the project to ensure compliance with contract documents, State and local building requirements.

Acquisition with rehabilitation is permitted, subject to the following conditions:

- The portion of the guaranteed funds for acquisition with rehabilitation is limited to 25 percent of the program authority;
- Rehabilitation requires replacement or alteration of building spaces, mechanical systems, or project facilities;
- Existing structures must be structurally sound and functionally adequate prior to the start of repair work;
- Per unit rehab costs must be at least \$6,500 or more; and
- When completed, the rehabilitated building(s) must be energy efficient and in “like new” condition.

C. Federal Accessibility Requirements

All GRRHP loans are subject to the Americans with Disabilities Act and the Fair Housing Act. Projects receiving interest credit or other Federal financial assistance are also subject to Section 504 of the Rehabilitation Act of 1973. These regulations must be addressed in the proposed construction plans and specifications.



- **The Americans with Disabilities Act (ADA)** (42 U.S.C. 12131; 47 U.S.C. 155, 201, 218, and 225), addresses the civil rights of individuals with disabilities in the areas of employment, public accommodations, State and local government services, and telecommunications. The Act states that discrimination includes the failure to design and construct facilities (built for first occupancy after January 26, 1993) that are accessible to and usable by persons with disabilities. The ADA also requires the removal of architectural and communication barriers that are structural in nature in existing facilities, if the removal is readily achievable, easily accomplishable, and able to be carried out without much difficulty or expense.
- **The Fair Housing Act** (42 U.S.C. 3601-19) requires that multifamily dwellings meet the design and construction requirements at 24 CFR 100.205 that implement the Fair Housing Act.

- **Section 504 of the Rehabilitation Act of 1973** prohibits discrimination in Federally-assisted programs on the basis of disability. Section 504 imposes requirements to ensure that "qualified individuals with disabilities" have access to programs and activities that receive Federal funds. GRRHP lenders and borrowers are considered recipients and subrecipients under the Act if interest credit is awarded. The specific requirements under Section 504 are summarized in Exhibit 3-2. Under Section 504, recipients are *not* required to take actions that create undue financial and administrative burdens or alter the fundamental nature of the program. Contractors and vendors are subject to Section 504 requirements only in the work they do on behalf of a recipient or subrecipient.

Exhibit 3-2
Section 504 Requirements
Removal of Physical Barriers
<p>For new construction of multifamily projects, five percent of the units in the project (but not less than one unit) must be accessible to individuals with mobility impairments, and an additional two percent of the units (but not less than one unit) must be accessible to individuals with sensory impairments.</p> <ul style="list-style-type: none"> • The Section 504 definition of substantial rehabilitation multifamily projects includes construction in a project with 15 or more units for which the rehabilitation costs will be 75 percent or more of the replacement cost. In such developments, five percent of the units in the project (but not less than one unit) must be accessible to individuals with mobility impairments, and an additional two percent (but not less than one unit) must be accessible to individuals with sensory impairments. • When rehabilitation less extensive than substantial rehabilitation is undertaken, alterations must, to the maximum extent feasible, make the unit accessible to and usable by individuals with disabilities, until five percent of the units are accessible to people with mobility impairments. Alterations to common spaces must, to the maximum extent feasible, make the project accessible. • Accessible units must be, to the maximum extent feasible, distributed throughout projects and sites and must be available in a sufficient range of sizes and amenities so as not to limit choice. • Owners and managers of projects with accessible units must adopt suitable means to ensure that information regarding the availability of accessible units reaches eligible individuals with disabilities. They also must take reasonable non-discriminatory steps to maximize use of such units by eligible individuals. • When an accessible unit becomes vacant, before offering the unit to a non-disabled individual, the owner/manager should offer the unit, first to a current occupant of the project requiring the accessibility feature and second to an eligible qualified applicant on the waiting list requiring the accessibility features. • The usual standards for ensuring compliance with Section 504 are the Uniform Federal Accessibility Standards (UFAS), although deviations are permitted in specific circumstances.
Provide Program Accessibility
<ul style="list-style-type: none"> • Individuals with disabilities must be able to learn of, apply for, and participate in Federally-assisted programs or activities. • Special communication systems may be needed for outreach and ongoing communication (e.g., Telecommunications Devices for the Deaf (TDD), materials on tape or in Braille, or disabled-accessible locations for activities and meetings). • Policies and procedures must be non-discriminatory (e.g., housing providers may not ask people with disabilities questions not asked of all applicants, screen individuals with disabilities differently, or assess an individual's ability to live independently).
Make Employment Accessible
<ul style="list-style-type: none"> • Employers must not discriminate. • Employers must remove physical and administrative barriers to employment. • Employers must make reasonable accommodations for individuals with known disabilities (e.g., job restructuring, providing readers or sign interpreters, or making facilities accessible).
Administrative Requirements
<p>If recipients or subrecipients have 15 or more employees, they must:</p> <ul style="list-style-type: none"> • Designate a Section 504 Coordinator; and • Notify program participants and employees of non-discrimination policies. <p>All recipients and subrecipients must conduct self-evaluations of compliance with Section 504.</p>

SECTION 5: FINANCING TERMS

3.21 OVERVIEW

The lender must ensure that the loan submitted for Agency guarantee meets specific loan requirements established in the regulation and the NOFA. The lender must follow statutory and Agency policy on eligible use of proceeds, maximum loan amounts, maximum loan-to-value ratio, and loan terms and interest rates. In addition, lenders must observe Agency guidance on parity loans and participation loans with other lenders.

3.22 OCCUPANCY AND RENT RESTRICTIONS

The guaranteed loan program contains three distinct features with respect to affordability of units. Lenders must ensure that loans are underwritten and that mortgage documents adequately address these restrictions. GRRHP income limits can be found in RD Instruction 1980-D Exhibit C.


- **Tenant Income Restrictions.** At initial occupancy, tenancy is restricted to individuals and families whose incomes do not exceed 115 percent of area median income (adjusted for family size). The tenant income restriction must be supported by a deed restriction for each GRRHP loan.
- **Rent Restrictions.** At rent up and on a continuing basis thereafter, rents on any GRRHP unit, including tenant paid utility allowances, may not exceed 30 percent of 115 percent of area median income, adjusted for family size. In addition, the average rent for the entire project, including any tenant paid utilities, may not exceed 30 percent of 100 percent of area median income, adjusted for family size. For this purpose, area median incomes adjusted for family size are published annually by HUD in the Federal Register. 
- **Deed Restrictions.** The property must remain as affordable rental housing for the original loan term. To ensure compliance with this requirement even if the loan is prepaid, restrictive language must be recorded in the deed or any other instrument that conveys with the property if the mortgage is prepaid. Sample language is provided in Exhibit 3-3.

Exhibit 3-3

Example I: If the guaranteed loan were being used to finance the purchase of the property and the construction of the affordable rental housing, the following restriction would be placed on the deed:

"The owner(s), for themselves and their successors in interest, agree that until (insert date), the property can only be utilized as rental housing (not homeownership) and can only be leased to low or moderate income families or persons, whose incomes at the time of initial occupancy do not exceed 115 percent of the median income of the area (Eligible Tenants), as determined by the United States Department of Agriculture in accordance with 42 U.S.C. 1490p-2. No Eligible Tenant occupying the housing will be required to vacate nor any Eligible Tenant denied occupancy in violation of this provision. This restriction is enforceable by Eligible Tenants or the United States Department of Agriculture. For further questions contact the United States Department of Agriculture, Rural Housing Service at Director of Multi-Family Processing Division, 1400 Independence Avenue, SW, STOP 0781, Washington, DC 20250."

EXAMPLE II: If the applicant already owns the property, the lender will need to create and file a deed declaration in the suggested format:

"The owner(s), for themselves and their successors in interest, agree that until (insert date), the property can only be utilized as rental housing (not homeownership). The following property

[Legal description of property]

can only be leased to low or moderate income families or persons, whose incomes at the time of initial occupancy do not exceed 115 percent of the median income of the area (Eligible Tenants), as determined by the United States Department of Agriculture in accordance with 42 U.S.C. 1490p-2. No Eligible Tenant occupying the housing will be required to vacate nor any Eligible Tenant denied occupancy in violation of this provision. This restriction is enforceable by Eligible Tenants or the United States Department of Agriculture. For further questions contact the United States Department of Agriculture, Rural Housing Service at Director of Multi-Family Processing Division, 1400 Independence Avenue, SW, STOP 0781, Washington, DC 20250."

3.23 USE OF LOAN PROCEEDS

As a first step in determining the financing terms, lenders must determine



that all of the proceeds of the guaranteed loan will be used for eligible purposes as set forth in [7 CFR 3565.205]. The use of Agency guaranteed loan proceeds must comply with the standards and conditions for housing and facilities in RD Instruction 1924-A and the standards for site development in RD Instruction 1924-C. To be competitive in the market, the housing developed in this program may require additional features such as dishwashers, garbage disposals, or wall-to-wall carpeting. The Agency may approve a higher level of amenities, construction, or fees if the lender certifies that such costs and features are reasonable and customary for similar housing in the market area.

A. Eligible Uses of Loan Proceeds

The proceeds of a guaranteed loan may be used for the following purposes:

- New construction;
- Rehabilitation of buildings and acquisition costs when related to the rehabilitation;
- Acquisition of existing buildings, when approved by the Agency, for projects that serve a special housing need;
- Acquisition and improvement of land on which housing will be located;
- Development of on-site and off-site improvements essential to the use of the property;
- Development of related facilities such as community space, recreation, storage, or maintenance structures, except that any high cost recreational facility, such as swimming pools and exercise clubs or similar facilities, must be specifically approved by the Agency;
- Construction of on-site management or maintenance offices and living quarters for operating personnel for the property being financed;
- Purchase and installation of appliances and certain approved decorating items, such as window blinds;
- Development of the surrounding grounds, including parking, landscaping, and fencing;
- Costs associated with commercial space provided that:
 - ◊ The project is designed primarily for residential use;
 - ◊ The commercial use consists of facilities such as laundry rooms, that are considered essential and not conveniently available; and
 - ◊ The commercial space does not exceed 10 percent of the gross floor area of the residential units and common areas, and the commercial income does not exceed 10 percent of total project income, unless a higher level is specifically approved by the Agency.
- Costs for feasibility determination, loan application fees, appraisals, environmental studies, professional fees or other fees determined by the Agency to be necessary to the development of the project;

- Technical assistance to and by non-profit entities to assist in the formation, development, and packaging of a project, or formation or incorporation of a non-profit borrower entity;
- Education programs for a board of directors, both before and after incorporation of a borrower entity that will serve as the borrower;
- Construction interest;
- Relocation assistance, in the case of rehabilitation projects;
- Developers' fees; or
- Repaying applicant debts when:
 - ◊ The Agency authorizes the use of loan funds to pay debts for work, materials, land purchase, or other fees and charges before the loan closed; or
 - ◊ The Agency concurs with a determination by the lender that costs of work, fees and charges incurred prior to loan application are integral to development of the guarantee application and project.

B. Ineligible Uses of Loan Funds

Loan proceeds must not be used for the following:

- Specialized equipment for training or therapy;
- Student housing;
- Housing in military impact areas;
- Housing that serves primarily temporary and transient residents, such as students;
- Special care facilities and institutional type homes that require licensing as a medical care facility;
- Operating capital for central dining facilities or for any items not affixed to the real estate, such as special portable equipment, furnishings, kitchenware, dinnerware, eating utensils, movable tables and chairs, etc.;
- Payment of fees, salaries, and commissions or compensation to borrowers, with the exception of developers' fees; or

- Refinancing of an outstanding debt, except in the case of an existing guaranteed loan where the Agency determines that the refinancing is in the best interest of the government or the program. The term and amount of any refinanced loan must not exceed the maximum loan amount or term limits.

3.24 APPLYING SECTION 207(C) LOAN LIMITS



The loan amount must not exceed the applicable maximum per dwelling unit limitations amended by H.R. 1629, dated April 26, 2001, of Section 207(c)(3) of the National Housing Act. The limits are published by HUD, but the lender should contact the HUD State Office as adjustments to the limits are made for different locals. The Secretary (of HUD) may increase these limits up to an amount not to exceed 110 percent in any geographical area where the Secretary finds that cost levels so require, and up to 140 percent on a project-by-project basis where the Secretary determines it is necessary. The amount also may be increased by up to 20 percent, if necessary, to account for the cost of installation of certain energy improvements.

3.25 MORTGAGE TERMS

A. Maximum Loan Term

The lender is expected to determine the loan's repayment term. However, the repayment term cannot exceed 40 years or the remaining economic life of the project, whichever is less. Where interest rates available on shorter term loans result in lower unit rents, lenders are encouraged to make shorter, fully amortizing loans. The Agency will not permit negative amortization during the term of the loan.

As a result of Public Law 106-569, dated December 27, 2000, section 538 of the Housing Act of 1949 (42 U.S.C. 1490p-2) was amended to allow the implementation of a loan guaranteed by the GRRHP, to be made for a term of not less than 25 and not more than 40 years from the date of the loan and to provide a loan amortization period not to exceed 40 years, with a final payment of the balance due at the end of the loan term. State Offices may accept requests from lenders to restructure the loan terms of prior NOFA Awards accordingly. However, the amortization of the loan may not be less than the original submitted NOFA response, with a final payment of the balance due at the end of the loan term. For example:

A lender received an invitation to submit an application based on a past NOFA response that indicated the lender and the applicant had negotiated a loan with a 30-year term and an interest rate of 200 basis points over the 30-year Treasury Bond Yield. The lender and the applicant now agree that a mortgage with a 25-year loan term and a 30-year amortization would better suit their needs. This change to the lender's NOFA response would be permissible, as would a 25-year loan term and a 40-year amortization. However, if the NOFA request was for an amortization of 40 years, the lender could not request the loan structure be changed to a loan with a 30 year amortization, and in no instance will the interest rate change.

B. Maximum Interest Rate

The interest rate on the loan will be the best negotiated rate between the lender and the borrower. The loan must bear a fixed rate of interest over the entire term. Lenders that have requested interest credit for a project must establish the basis points above the Long Term Monthly Applicable Federal Rate (AFR) that it will charge the borrower, when the NOFA Response is submitted.

C. Interest Rate Reduction

The Agency will provide additional financial assistance for at least 20 percent of the loans by providing an interest credit to reduce the interest rate to the Long Term Monthly AFR. Interest credit awards are competitive. They are based on criteria and a scoring threshold established in each NOFA. No more than \$1.5 million of the loan amount will receive interest credit. Lenders must separately amortize the loan amount that receives interest credit from the loan amount that is not eligible for the interest credit award. The interest credit will be paid the following January 1 of the year in which the project has reached occupancy standards, and/or the construction guarantee has converted to a permanent guarantee.

D. Maximum Loan Amount

The lender is responsible for determining the appropriate maximum loan amount based on, among other things, market demand, absorption period, loan-to-value limits, other sources of financing, and total project development costs. Development costs include housing and related facilities. Lenders must determine the total development cost of the property by reviewing proposed plans and specifications and the construction bids presented by the borrower and the builder.

1. Determining Maximum Loan-to-Value

For borrower entities that are not State, local, or tribal government bodies, or non-profit organizations, the guaranteed loan cannot exceed 90 percent of the total development cost or property value (as determined by the lender), whichever is less. Non-profit entities and Indian tribes may borrow up to 97 percent of the lesser of total development cost or appraised value.

Issues such as market conditions and borrower and property weaknesses should affect the loan-to-value limit. For example, if the area in which the property is to be located is experiencing an economic downturn that is not yet reflected in comparable sales, the lender should consider a lower loan-to-value to hedge against the expected drop in property values.

2. Other Financing Sources

Projects may need additional financing to be feasible in a given market. Many GRRHP projects will include equity financing from Low Income Housing Tax Credits or will involve grants or loans from HOME funds or State or local housing assistance. In addition, some projects may involve secondary bank financing to cover costs not eligible or feasible under the guaranteed loan program. This additional capital should result in a lower loan-to-value ratio on the GRRHP loan.

SECTION 6: DETERMINING PROPERTY VALUE

3.26 OVERVIEW

The lender is ultimately responsible for determining the value of a property. In doing so, the lender must take into account the appraisal and all of the factors related to the borrower, property, and financing. There is not a formula that can be applied in every case, but rather a weighing of multiple factors and the unique circumstances of each property. The experience and knowledge of the lender's underwriter is key to making an appropriate determination. The underwriter determination must be clearly supported and accepted by the lender's loan committee.

The following is a discussion of the information that must be examined by the lender in determining property value.

3.27 CASH FLOW ANALYSIS

The lender must analyze the proposed cash flow for the property to be sure that it is reasonable and supported by information on income and expenses for similar properties. Any unique factors in the analysis must be explained. The lender must also review the borrower's estimate of future income and expenses for the property. This review should include a cash flow analysis over a 15-year period.

A. Operating and Maintenance Expense

The operating budget is used to project the income and expenses for the project and the net operating income (NOI) the project will have available for debt service. The operating budget must reflect the following:

- **Income Analysis.** The borrower must provide a schedule of proposed rents (exclusive of utility allowances) and any other project income. Supporting documentation must include rents, tenant paid utilities, and vacancy levels at comparable properties. Exhibit 3-4 outlines how the income side of a project budget is constructed.

Exhibit 3-4

The Income Projection

The income projection estimates rental and other income (revenue) and occupancy rates.

The project's **Effective Gross Revenue** is a function of:

- Gross Rent Potential (rents that would be collected if all units are rented and all tenants paid their rent).
- Less rent not collected due to vacancies, delays in lease-up, and bad debt.
- Plus other income from parking, laundry, commercial space, etc.

Sources of information for the development of this part of the proforma include:

- The Rent Roll (for existing properties and comparable properties) -- the rent roll is the source document for information on units occupied and vacant, rents charged and collected, bad debt, move-in and move-out dates, and so on.
- A Market Analysis (for newly constructed and substantially rehabilitated properties).

- **Operating Cost Projections.** Estimated operating expenses, including costs of maintenance, repairs, utilities, and taxes. These estimates must be based upon the specific requirements of the subject property. Borrowers should support estimates with written documentation, when possible. Exhibit 3-5 outlines how the expense side of the projected budget is constructed.

B. Debt Service

In determining value, lenders must consider whether the property will generate sufficient net operating income to pay debt service and provide a return to the owner. A rule of thumb for rental properties is that properties must have sufficient net income to provide a reasonable cash surplus after expenses, or “debt service coverage.” Debt service coverage (DSC) is the ratio of annual net operating income (NOI) to the annual mortgage principal and interest payment. The Agency requires lenders to use debt service coverage of at least 1.15, unless the lender justifies a lower ratio and receives Agency approval. The NOI and DSC calculations are shown in Exhibit 3-6.

Exhibit 3-5

The Expense Projection

The expense projection estimates the cost of operating the property; the project's total expenses are a function of:

- Rental expenses (marketing, promotions, rent concessions);
- Management costs or fees;
- Financing costs such as bond financing expenses;
- Annual renewal and one-time guarantee fees;
- Inspection fees;
- Utility and maintenance costs; and
- Taxes and insurance.

Sources of information for this part of the proforma include:

- Local and State tax offices;
- Property management companies;
- Utility companies; and
- Historical records on subject or comparable properties.

The proforma also includes the Reserve for Replacement Account. Virtually all projects must set aside a reserve to cover the costs of non-routine repairs and replacements, such as roofs, appliances, and other capital improvements. The amount of the Reserve depends upon local fixture costs, age and conditions.

Exhibit 3-6

Net Operating Income

Net operating income (NOI) and debt service coverage (DSC) are important terms used in underwriting a loan. Net operating income is total project income minus expenses.

$$\text{Total income} - \text{Total expenses} = \text{NOI}$$

The Debt service Coverage (DSC) is the ratio of NOI to the annual principal and interest payments on the mortgage.

$$\text{Debt Service Coverage} = \text{Annual NOI} \div \text{Annual P\&I Mortgage Payment}$$

The DSC must always be greater than 1, since cash flow needs to be more than the mortgage payment in order for the project to be feasible. For GRRHP loans, the minimum acceptable ratio is 1.15, or 115 percent. Lenders may set a higher requirement.

Example: A project is estimated to have an annual NOI of \$103,500 and annual mortgage payments of \$90,000. The Debt Service Coverage is $\$103,500 \div \$90,000 = 1.15$

3.28 Appraisal

The appraisal provides a complete, accurate description of the property, the market, and an estimate of the property's market value. The appraiser's conclusions must be based upon and supported by market data, logical analysis, and sound professional judgment.

A. Appraisal Requirements

All real property appraisals associated with Agency guaranteed loan making and servicing transactions must meet the requirements contained in the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 and the appropriate guidelines contained in Standards 1 and 2 of the Uniform Standards of Professional Appraisal Practices (USPAP). All appraisals must include consideration of the effect of a potential contamination from hazardous wastes and from the release of nearby hazardous substances and petroleum products on the security value of real property. This information will be made available to the appraiser through the due diligence report. Chapter 11 contains further details.



Appraisals used for Agency decision-making must be *current*. A *current appraisal* is an appraisal with a report date that is not more than one year old. A current appraisal is required before the loan guarantee will be issued. If an appraisal is not current, a new appraisal or an update of a prior appraisal must be obtained.

B. Appraiser Qualifications

The lender is responsible for selecting qualified appraisers. To be considered qualified, appraisers:

- Must be qualified to appraise rental housing;
- Be familiar with the market in which the properties are located; and
- Be licensed and certified in the State in which the property is located.

C. Appraisal Methods

The appraiser must provide a complete summary report, which considers the three generally accepted appraisal methods, and follow the standards identified in USPAP. Accepted appraisal methods include the **Market or Comparable Approach**, the **Cost Replacement Approach** and the **Income Approach**. The following is a brief description of each approach.

- The **Market or Comparable Approach** compares the property to sale prices of comparable properties in the area. Adjustments are made for differences in amenities, size and other factors between the comparables and the subject property.
- The **Cost Approach** determines the cost of building the project on the basis of current prices and using current standards of material and design.

- The **Income Approach** determines the current value of the property based on the present value of a stream of future income.

For program purposes, the appraiser must rely most heavily on the **Income Approach** to assess the value of the property because the property being considered for the guarantee is an income-producing property. The other appraisal methods, such as the Market or Comparable Approach, and the Cost Replacement Approach, cannot substitute the **Income Approach** for determining the value of the property.

D. Appraisal Report Guidelines

The appraisal report must include a market analysis and a narrative attachment that supports the appraiser's conclusions. Any facts or issues about the property or the market that the appraiser thinks are important to the value determination must be addressed in the appraisal report. The lender must thoroughly review the appraisal report and note any circumstances or factors that, in the lender's view, would modify the appraiser's conclusions.

E. Market Study

A separate market study will be conducted to support the appraisal, and it must include the material listed in Exhibit 3-7.

Exhibit 3-7**Required Contents of a Market Study**

The market study must include:

1. A complete description of the proposed site, including location of the land, location of services, and their distances from the site.
2. Major employment data including: the name, location, and date of establishment of any major employers within the community; the product or service of each employer, the number of employees and salary range for each employer, and business permits issued per year for the last three years.
3. Population by year, number, and total, plus the annual increase/decrease, and percentage.
4. Population characteristics by age.
5. Household data by number, year, and number of persons per household.
6. Breakdown of households by owners and renters.
7. Households by income group.
8. Building permits issued per year for single and multiple unit dwellings.
9. Housing stock as defined by total number of units: one unit buildings, two or more unit buildings, mobile homes, and the number of these lacking some, or all, plumbing facilities (substandard housing).
10. A survey of existing rental housing including: name, number of units, bedroom mix, family or elderly type, year built, rent, vacancies, location, and amenities.
11. Number of rent-overburdened households.
12. A projection of housing demand based on:
 - (a) Household growth.
 - (b) Units constructed since the last census.
 - (c) Number of owned and rented units.
 - (d) Number of replacements.
 - (e) Number of persons in the eligible income range.
13. For proposals where the applicant is requesting low income housing tax credits (LIHTC), the applicant must provide the number of LIHTC units and the maximum LIHTC incomes and rents by unit size. This information will determine the levels of incomes in the market area which will support the basic rents while also qualifying the borrower for tax credits.

CHAPTER 4: LOAN GUARANTEE APPLICATION PROCESSING

SECTION 1: AN OVERVIEW OF THE PROCESS

4.1 PURPOSE

The purpose of this chapter is to describe the process to obtain a guarantee. Step by step, it will inform the lender what must be done to request and obtain a loan guarantee from the Agency. Exhibit 4-1 presents a timeline of the process.



SECTION 2: NOTICE OF FUNDING AVAILABILITY (NOFA)

Key Activities in this Section

- NOFA is Published
- Project Proposals are Accepted by the Agency
- Proposals are Reviewed by the Agency for Fundamental Eligibility
- Eligible Proposals are Scored and Ranked Against NOFA Selection Criteria
- Selected Borrowers Receive a Notice to Proceed with Processing

4.2 PUBLICATION OF GRRHP REQUIREMENTS

On an annual basis, the Agency will publish a Notice of Funding Availability (NOFA) in the Federal Register. The NOFA will state the amount of GRRHP funding available for the fiscal year. In addition, the NOFA will identify any priorities for selection of proposed applications, and the process by which the Agency will score and rank the proposals. Information will also be included about submission forms and deadlines.

4.3 RESPONSE TO THE NOFA

In response to the NOFA, lenders must submit a NOFA response to the office address identified in the NOFA for the scoring and ranking of a proposed GRRHP project. The lender must provide the requested information concerning the project, which is published in the NOFA, to establish the purpose of the proposed project, its location, and how it meets the established priorities for funding. Lenders must submit their response to the NOFA in accordance with Paragraph 4.4.

Lenders must submit responses during the prescribed period specified in the NOFA. The Agency will determine the highest ranked responses based on priority criteria and a threshold score. Lenders with top ranked proposals will receive a "Notice to Proceed with Application Processing," inviting them to submit a GRRHP application to the State Office where the project is located. Once the "Notice to Proceed with Application Processing" is issued, lenders have 90 calendar days from receipt of the "Notice to Proceed with Application Processing" to notify the State Office, in writing, of the decision to withdraw the application, so that others with eligible proposals can be invited to apply. All lenders who submit a request for scoring and ranking will receive a written response from the Agency. Agency response time will be within 30 calendar days from receipt of the NOFA response.

4.4 INFORMATION TO BE INCLUDED IN RESPONSE TO THE NOFA

A. Descriptive Information

1. The Project

- A brief description of the proposed location of the project, including town, county, state, and congressional district.
- A description of the property and improvements, including lot size, number of units, building type, type of construction, etc., including preliminary drawings, if available.
- The proposed development schedule.
- Total project development cost.
- The proposed rent structure and area median income – (HUD published area median incomes can be found online at <http://www.huduser.org>).
- Evidence of site control by the proposed borrower or a purchase option.
- Description of any environmental issues that may affect the project.
- Amount of loan to be guaranteed.
- Type of project (e.g. elderly or family).

2. The Proposed Financing

- Proposed loan amount and the proposed borrower's equity.

- Proposed use of interest credit – If the lender proposes to use interest credit, this section should include the maximum basis points the lender will charge the borrower for the project. The interest rate may not be lower than the published Long Term Monthly Applicable Federal Rate (AFR) at the closing of the lender’s loan. Selection and scoring criteria that the project must meet to receive interest credit will be published in the NOFA.
- Estimated development budget (total and cost/unit), and the proposed sources and uses of funds. This information should include all proposed financing sources – the amount, type, rates and terms of loans, tax credits, or grant funds. Letters of application and commitment letters should be included, if available.
- Estimated loan-to-development cost ratio for the guaranteed loan.
- Proposed Agency guarantee percentage for guaranteed loan (under no condition can the percentage exceed 90 percent of the loan amount).
- Collateral - all security, in addition to the real property, proposed to secure the loan.

3. The Proposed Borrower

- The name of the borrower and the type of ownership entity — list the general partners if a limited partnership, officers if a corporation or members of an LLC.
- Borrower’s contact name, mailing address, phone and fax numbers, and e-mail address.
- Evidence that the borrower or principals of the ownership are not barred from participating in Federal housing programs and are not delinquent on any Federal debt.
- Borrower’s unaudited or audited financial statements.
- Statement of borrower's housing development experience.

B. Lender Eligibility and Approval Status

Evidence that the lender is either an approved lender for the purposes of the GRRHP or that the lender is eligible to apply for approved lender status. The lender’s application for approved lender status can be submitted with the NOFA Response but must be submitted to the National Office within 90 calendar days of the lender's receipt of the "Notice to Proceed with Application Processing."

C. Competitive Criteria

Information that shows how the proposal is responsive to the selection criteria specified in the NOFA.

D. Lender Certification

A commitment letter signed by the lender, on the lender's letterhead, indicating that the lender will make a loan to the borrower for the proposed project, under specified terms and conditions subject only to the issuance of a guarantee by the Agency.

4.5 AGENCY REVIEW OF NOFA RESPONSE

Agency review of the project proposal is designed to assess preliminary eligibility and feasibility. A good project proposal is one that clearly and completely responds to the criteria set forth in the NOFA. Project proposals will be returned if preliminary eligibility cannot be established. Preliminary eligibility means that the project meets the following criteria.

A. Was the Project Proposal on Time and Complete?

Project proposals will be date stamped when first received by the Agency. The reviewer can refer to the date stamp on the project proposal to determine whether the proposal was received by the submission deadline specified in the NOFA. Late and/or incomplete proposals will not be considered and will be returned to the lender.



B. Is the Borrower An Eligible Entity?

Eligible borrowers shall include individuals, corporations, state or local public agencies or an instrumentality thereof, partnerships, limited liability companies, trusts, Indian tribes, or any organization deemed eligible by the Agency. The ownership entity must be a valid entity in good standing under the laws of the jurisdiction in which it is organized. Borrowers must be U.S. citizens or permanent legal residents; a U.S. owned corporation, or a limited liability company, or partnership in which the principals are U.S. citizens or permanent legal residents. Borrowers must not be delinquent on any other Federal debt. The Agency reviewer will determine whether these conditions are met. If these conditions are not met or are unclear, additional steps must be taken as outlined below.

The following resources are available to establish the borrower's good standing with the Federal government:

- The publication, "List of Parties Excluded from Federal Procurement and Nonprocurement Programs," provides a monthly listing of all suspended and debarred individuals and is available on the Internet, at <http://www.arnet.gov/epl/>.



Once the site is entered, there are easy-to-follow user instructions that will guide the user through the Excluded Parties List System (EPLS) and main menu. A hard copy of this publication can be mailed to lenders without Internet access upon request to the Agency. The Agency shall verify that the borrower does not appear on the list, and provide evidence in the file such as a print out of the EPLS page with the date the list was checked or a copy of the AD-1047 Certification Regarding Debarment Suspension.

- The Department of Housing and Urban Development's Credit Alert Interactive Voice Response System (CAIVRS), identifies all individuals with delinquent Federal debt. If CAIVRS indicates that the borrower has a delinquent Federal debt, the reviewer must verify with the point of contact that the information regarding the borrower is current. If the information is current and the borrower is delinquent, the borrower is ineligible. The State Office will inform the borrower of the reason for their rejection and be provided with the telephone number CAIVRS lists as a point of contact.

The Agency reviewer will verify that there is satisfactory evidence that the borrower meets the other requirements of Paragraph 3.6.

C. Is the Lender Eligible?

The lender must provide evidence of approved lender status under the GRRHP program by submitting a duly signed copy of the Lender Agreement's with the submission of the NOFA response. Lenders that are eligible to apply for approved lender status must submit to the National Office an application with supporting documentation requesting lender approval within 90 calendar days of receiving the "Notice to Proceed with Application Processing" for the proposed GRRHP project. Information on the contents of an application for lender approval can be found in the published NOFA and Chapter 2 of this handbook. An application requesting lender approval submitted by a lender who is not eligible to become approved will be rejected and returned to the lender.

D. Is the Proposed Project Eligible?

The Agency will review the following evidence that the project meets basic program requirements.

- Is the proposed project located in a designated rural area as defined for all RHS programs? (See Paragraph 1.6 for the definition.) Prior to submitting a NOFA response, lenders should contact the State Office where the project is located to determine whether the project site is located within a designated rural area in that state.
- Are the proposed uses of funds for eligible purposes?
- Does the proposed financing comply with the requirements set forth in Chapter 3, Section 5 (including occupancy and rent limits, 207(c) limits, maximum loan term, interest rate and loan-to-value ratios)?

4.6 SCORING AND RANKING

If a NOFA response is determined to be eligible after the review of preliminary program requirements and threshold criteria, it will enter the ranking and scoring process as established in the NOFA and [7 CFR 3565.5]. In addition, specific ranking and scoring criteria will be determined annually and announced in the NOFA. The criteria may be used to determine project proposals that might receive a "Notice to Proceed with Application Processing" (Notice) or an interest credit award. (A sample "Notice Proceed with Application Processing" can be found in Attachment 4-A). When all other things are equal between two or more NOFA responses in the scoring and ranking process, the Agency will select NOFA responses submitted by a borrower who is a veteran of the United States armed services over NOFA responses submitted by a non-veteran borrower.

4.7 NOTICE TO PROCEED WITH APPLICATION PROCESSING

NOFA responses with or without interest credit requests will be processed as stipulated in the NOFA. Complete NOFA responses deemed eligible after the preliminary review for program requirements will be issued a Notice to Proceed. The Agency will fax a copy of the Notice to the lender and follow up with a hard copy of the letter. The office that processes the application will also receive a copy of the same Notice and a State Office Award Letter (see Attachment 4-B). A hard copy of the State Office Award Letter will be sent to the State Office where the project is located as well as the NOFA response that was submitted by the lender for the project.

The Notice will instruct the lender to contact the State Office where the project is located and complete the application process with State Office staff. The State Office Letter serves as a catalyst to initiate the interaction between the lender who is submitting the application and the State Office that will be processing it. Once the lender contacts the State Office concerning the project, State Office staff will schedule a meeting with the lender, borrower and other interested parties to review important programmatic, environmental and civil rights requirements, using the "Planning Meeting Agenda" in Attachment 4-H as a guide.

The Agency will continue to review NOFA responses and issue Notices until all available funds have been obligated for the fiscal year. The Agency will then publish a new notice in the Federal Register notifying the public that all funds have been exhausted and that the Agency will no longer accept NOFA responses for that fiscal year.

After the Notice has been issued, changes in the borrower entity or substitution of the lender with another approved lender are permitted, with prior State Office approval, so long as the loan purpose, scope of project, location, and terms related to scoring and ranking remain unchanged. The original lender must transfer the Notice to the substituting lender and the new lender must issue a commitment letter for the project. Any costs incurred in the transfer of a Notice from one lender to another approved lender cannot be charged to the project. The original lender may charge a fee to the borrower or the substituting lender for its work on the project that is being transferred to another approved lender. However, in no way will this cost be charged to

the project. If the original lender is unwilling to transfer the Notice, then the new lender must submit a new NOFA response. Incomplete NOFA responses will be sent to the lender with a letter notifying the lender of the incompleteness of the proposal (See Attachment 4-E). Lenders may resubmit the NOFA response for consideration in the same fiscal year if the submission date for Agency review of NOFA responses has not expired. A NOFA response that has been resubmitted will be treated as a new NOFA response and will receive a new Agency receipt date.

SECTION 3: APPLICATION FOR THE GUARANTEE

Key Activities in this Section

- Invite Submission of a NOFA Response ("Notice to Proceed with Application Processing")
- Receive and Process Applications
- Issuance of a Conditional Commitment

4.8 PURPOSE OF THE APPLICATION

In submitting an application for a loan guarantee, the lender is seeking a conditional commitment from the Agency. Before a conditional commitment can be issued, the Agency must determine if the project meets Agency threshold requirements and is eligible for a commitment.

A. The Proposed Project Meets the GRRHP Threshold Requirements

To be approved for a guaranteed loan, proposed projects must be able to meet the threshold criteria. The application for a loan guarantee must clearly demonstrate that the following criteria are or can be met before the Agency issues a guarantee:

- Evidence that the owner and development team have the qualifications and experience sufficient to carry out development, management, and ownership responsibilities.
- Evidence that the property is located in an eligible rural area.
- Evidence of readiness to proceed, including submission of a complete application for a guarantee, with evidence of at least a proposed conditional commitment from the lender for financing.
- Evidence of market and financial feasibility.

- Evidence the loan is reasonable for the given borrower.
- Evidence the loan is reasonable for the given borrower Evidence that the loan risk is reasonable, taking conventional lending practices into account.
- Evidence that the loan risk is reasonable given factors related to concentration of risk in a given market.

B. The Proposed Project is Eligible to Receive a Conditional Commitment

In addition to the threshold requirements, the following conditions must be met before a conditional commitment can be issued to the lender.

- The borrower and the lender are both eligible to receive a guarantee under the GRRHP.
- The lender has conducted due diligence and the results have been taken into consideration in the appraisal.
- The application fee of \$2,500 is paid.
- The Agency has completed a satisfactory environmental review required under the National Environmental Policy Act in accordance with RD Instruction 1940-G.

4.9 APPLICATION FORM AND DOCUMENTATION

The lender is responsible for preparing an application that is complete and accurate. The lender must submit the application to the RHS State Office where the project is located. The Standard Application Checklist is Attachment 4-C. The application is comprised of two components: (1) the lender’s certification and (2) exhibits and supporting information to the lender’s certification.

A. The Lender’s Certification

The lender’s certification will serve as assurance to the Agency that the borrower, the project, and the proposed financing meet the lender’s standards for loan making. The lender must certify that:

- The information contained in the exhibits is consistent with the lender’s underwriting and loan making standards;

- The lender has completed the lender's review as required by Paragraph 4.11 and has identified any significant findings in a narrative attached to this certification; and
- The lender agrees to make a loan to the borrower for the proposed project, subject to the Agency's issuance of a guarantee.

B. Exhibits and Supporting Information to the Lender's Certification

In addition to the submission of the certification, the lender must submit the supporting documentation outlined in Paragraph 4.8 B.

Because the application, in many cases, will be prepared before working drawings and an appraisal are complete, the lender must submit pro forma estimates at the application stage. Once a conditional commitment has been issued, the lender must submit complete documented information, as specified in the Conditional Commitment.

For more information about the complete requirements and documentation, see Chapter 3.

1. Agency Forms Included in the Application Package

Form RD 3565-1, Application for Loan and Guarantee. This form is to provide information needed for the analysis and loan determination process.

Form RD 1940-20, Request for Environmental Information. This form will provide an understanding of the environmental conditions of the proposed site and the project's potential impact on the environment, and will provide information to be used by the Agency to complete its environmental review under the National Environmental Policy Act.

ATTACHMENT 4-G, Housing Allowances for Utilities and Other Public Services. This exhibit shows the utility allowance for the proposed project and how it was developed.

Form RD 1944-37, Previous Participation Certification. This document describes a borrower's prior experience with Federal assistance programs.

Form RD 1944-30, Identity of Interest (IOI) Disclosure Certificate. This document describes the Identity of Interest relationships between the borrower and other businesses with whom the borrower may contract for goods or services.

RD Instruction 1940-Q Exhibit A-2, Statement for Loan Guarantees. The lender certifies that no funds have been or will be used in lobbying activities.

Form RD 1944-31, Identity of Interest (IOI) Qualification. This document provides information on organizations listed in the *Form RD 1944-30*.

Form RD 1910-11, Applicant Certification, Federal Collection Policies for Consumer or Commercial Debts. This document is a certification by the borrower that they are not delinquent on Federal debt.

Form HUD 9832, Management Entity Profile Form. This form outlines the proposed management agent and their organizational structure and discloses any identity of interest relationships the management agent may have.

Form HUD 935.2, Affirmative Fair Housing Marketing Plan. This document is required of all Federally guaranteed and assisted housing (except when the borrower is a Federally recognized Indian tribe and the housing units will be located on land over which the tribe has sovereignty/civil jurisdiction). It describes the process borrowers will use to assure that marketing and outreach efforts are targeted at all persons, regardless of race or disability, who are eligible for admission to the available housing.

AD 1047, Certification Regarding Debarment Suspension. This document certifies that the borrower entity is not debarred from participating in Federal housing programs.

AD 1048, Certification Regarding Debarment, Suspension, Ineligibility and Voluntary Exclusion – Lower Tier-Covered Transactions. This form is required of the General Contractor and each subcontractor when the Agency is guaranteeing the construction loan.

2. Other Information Requested in the Application Package

- Borrower information:
 - ◇ Financial statements with certification(s) (newly formed entities applying for a construction/permanent guarantee do not need to provide financial statements at the time of application)
 - ◇ Credit report for each principal and general partner of the entity, if a limited partnership or LLC member.
 - ◇ Proposed limited partnership agreement and certificate of limited partnership (if applicable). Agency requirements should be contained in one section of the agreement and their location identified by the borrower or their attorney in a cover sheet.
 - ◇ If a limited liability company, Articles of Organization & Operating Agreement.

- If the borrower is a nonprofit organization:
 - ◇ Tax-exempt ruling from the IRS designating them as a 501(c)(3) or 501(c)(4) organization. If the designation is pending, a copy of the designation request must be submitted.
 - ◇ Evidence of organization under State law, or copies of pending applications.
 - ◇ List of Board members.
- If a public body:
 - ◇ The enabling statute; or the State law of organization.
- To establish project information:
 - ◇ Project information including project name, location, number and type of units, the development team, property manager, lawyer, and syndicator. The development team includes the developer (including all principals), architect, and contractor.
 - ◇ Appraisal or market study.
 - ◇ Capital Needs Assessment (for rehab loans only).
 - ◇ State Clearinghouse comments or recommendations.
 - ◇ Certification that the lender has reviewed and approved the management plan and agreement and confirmed that they are consistent with Agency requirements.
 - ◇ Site plan, including contour lines.
 - ◇ Plot plan.
 - ◇ Floor plan of each living unit type and other type spaces.
 - ◇ Building exterior elevations.
 - ◇ Typical building exterior wall section.
 - ◇ Description and justification of any related facilities, and schedule of separate charges for related facilities, if any.
 - ◇ Design development/working plans/construction specifications.
 - ◇ Management plan and proposed management agreement.

Project financing information:

- ◇ Lender's conditional commitment on the lender's letterhead with lender's signature.
- ◇ Lender's narrative.
- ◇ SAUCE disc and hard copy (to be completed by RHS processing office).
- ◇ A copy of the pro forma budget detailing the first year and a typical year's operation.
- ◇ *Form RD 1924-13, Estimate and Certificate of Actual Cost.*
- ◇ Disclosure of any change in financing since NOFA response submission.
- ◇ Type of utilities and utility allowances (Attachment 4-G), if applicable.
- ◇ Interest Credit Request, if applicable (see Paragraph 4.10).

Required environmental information:

- ◇ *Form RD 1940-20, Request for Environmental Information*, to be completed by the lender or the lender's client.
- ◇ Phase I Environmental Site Assessment Report, as prescribed by the American Society for Testing and Materials.
- ◇ Compliance with historic and architectural laws, if applicable.
- ◇ Comments regarding relevant off-site conditions.
- ◇ Land survey.
- ◇ *FEMA Form 81-93, Standard Flood Hazard Determination.*

4.10 INTEREST CREDIT REQUEST AND DOCUMENTATION

Interest credit requests must be made in the NOFA response if interest credit is part of the proposed financing. Interest credit awards will be based on a numerical value earned on the scoring of priority criteria identified in the NOFA. Lenders will be notified of interest credit awards in the Notice. Lenders must justify the need for the interest credit award in the application package submitted to the State Office. Proformas with and without the interest credit award will serve as justification for the interest credit award.

The Agency will not accept the resubmission of a project proposal with an interest credit request if the project has been previously submitted without an interest credit request and demonstrated financial feasibility.

Interest credit is a subsidy available to eligible borrowers for the reduction of the effective interest rate on the loan to the Long Term Monthly (AFR) at the closing of the lender's loan with the borrower for the project. The AFR is the interest rate set by the U.S. Treasury for federal financing programs. At least twenty percent (20%) of the loans financed under the GRRHP will be awarded interest credit.

A. Amount of Interest Credit Subsidy

The Agency may choose to regulate the maximum interest rate charged on GRRHP loans. Agency regulation of the maximum interest rate will be announced each year in the NOFA. The spread between the best negotiated interest rate the lender charges on the loan and the Long Term Monthly AFR (the effective interest rate after the interest credit is applied) at the closing the lender's loan with the borrower determines the amount of interest credit subsidy. Lenders are scored on the maximum basis points that they are willing to charge on the loan in the submission of the NOFA response. At no time will the basis points buy down the loan below the Long Term Monthly AFR. The process for allocating interest credit may be competitive in years when there are more requests than credits available. The Agency may give preference to proposals that require less interest credit subsidy.

B. Demonstrated Need

The interest credit justification must demonstrate why the interest credit subsidy is needed. The Agency will review the proposed rents and operating budget and give preference to applications that demonstrate that the interest credit will result in lower rents or in a higher level of services for tenants in the event that demand for interest credit exceeds available funds.

C. Limits on Allocation of Interest Credit


In order to fairly distribute the amount of credit available in a given year, the Agency may set a limit on the amount of interest credit allocated to a single project. The Agency expects to accomplish this by limiting the size of loans eligible for interest credit to \$1.5 million. For highly ranked projects, the Agency may guarantee two parity loans -- one with interest credit (up to the maximum amount) and one without interest credit.

D. Payment of Interest Credit

The amount of interest assistance will be calculated by determining the difference between the best negotiated rate of interest on the loan and the Long Term Monthly AFR at the closing of the lender's loan with the borrower. No project will receive interest credit on more than \$1,500,000 of the total amount guaranteed. If the loan amount exceeds \$1.5 million, the lender is required to separate the loan amount that will receive interest credit from the loan amount that is not eligible for the interest credit award. A separate amortization schedule is necessary for each loan amount. Yearly payments of the interest credit award will be based on the declining balance of the \$1.5 million. Interest credit is established in accordance with *Form RD 1980-24, Request Interest Assistance/Interest Rate Buydown/Subsidy Payment to Guaranteed Loan Lender*. The calculation will be done in accordance with item 17 "Interest Payable". The Interest Credit will be paid every January 1 following the issuance of the permanent loan note guarantee. The interest credit calculation and the request will be part of the annual report provided to the Agency State Office. The State Office will review the calculation for accuracy and then forward the document on to the Finance Office for processing. The interest will be calculated from the date of the conversion to Final Loan Note Guarantee to the end of the year, so interest credit will always be paid in arrears. The formula for calculation is:

<p>Interest Payments Received + Accrued Interest at the End of the Period - Accrued Interest at the Beginning of the Period x Interest Assistance Rate ÷ Effective Interest Assistance Rate = Interest Payable</p>

Interest credit will be paid to the lender. It is anticipated that the lender will use the interest credit to reduce the interest rate on the loan and therefore enable the borrower to pass the savings on to the tenant in the form of reduced rents. We are using the "Long Term Monthly Rate" for purposes of section 1274(d) of the Internal Revenue Code.

<p>To Obtain the Long Term Monthly Applicable Federal Rate (AFR)</p> 
<p>Check the Internet site:</p> <ul style="list-style-type: none"> • http://ftp.fedworld.gov/pub/irs-utl/afrs.pdf <p style="text-align: center;">or</p> <ul style="list-style-type: none"> • the <i>Wall Street Journal</i> which publishes the AFR rate on the third Wednesday of each month. Locate the "Long Term Monthly Rate."

E. Cancellation of Interest Credit

The interest credit is tied to a specific loan. If a loan guarantee application is rejected or withdrawn, the interest credit application is similarly terminated. If the borrower defaults on a GRRHP loan, the interest credit contract will be canceled when the liquidation plan is approved by the Agency. Any unearned credit must be repaid to the Agency.

F. Closing of a Loan with Interest Credit

In order to assist the Finance Office in timely and accurate payments of Interest Credit, the State Office will complete Blocks 1, 4, 7, 8 and 9 of Form *RD 3560-9, Multiple Family Housing Interest Credit and Rental Assistance Agreement* as described below. The state office should only complete *Form RD 3560-9, Multiple Family Housing Interest Credit and Rental Assistance Agreement* as follows:

- Block 1: Enter Borrowers Case Number
- Block 4: Enter 241
- Block 7: Enter the Promissory Note Rate
- Block 8: Enter the Interest Credit Rate
- Block 9: Enter the difference between Block 7 and 8.

This form will be completed for the sole purpose of assisting the Finance Office in the tracking of Interest Credit and will therefore, not be completed in accordance with the *FMI* or signed by the borrower. This form will be submitted to the Finance Office when the *Form RD 1980-19, Guaranteed Loan Closing Report* is submitted as described in paragraph 4.18.

4.11 LENDER REVIEW OF THE BORROWER SUBMISSIONS

The lender must review all elements of the proposed project prior to submission of an application to the State Office for review. The lender must certify to the Agency that program requirements have been met and highlight significant information for Agency review.

A. Borrower Eligibility

The lender will review the following documents submitted by the borrower and assess whether they adequately establish that the borrower meets the eligibility criteria of Chapter 3, Section 3.

1. Acceptable Borrower Entity

The lender review will determine whether the borrower is an acceptable borrower entity by reviewing the following documents.

- **Draft organizational documents.** The organizational documents or Certificate of Good Standing, if the borrower is an existing organization.
- **Certification Regarding Debarment.** The lender will have already checked the list of debarred individuals against the applicant's *Form RD 1944-37* when the project proposal was first submitted. This certificate by the borrower on *Form AD-1047* or *AD-1048* must confirm the borrower's status as an entity in good standing with the Federal government.

2. Identity of Interest Disclosure

The lender will review the identity of interest disclosures in order to understand the borrower entity. *Form RD 1944-30* and *Form RD 1944-31* must be crosschecked. *Form RD 1944-30* must disclose all identity of interest companies and the lender must verify that each such disclosed company has completed a *Form RD 1944-31*.

3. Borrower Certification Regarding Debt Collection

The borrower must sign *Form RD 1910-11* to certify to their understanding of the collection policies that will be taken by the government to recover delinquent or defaulted debts. The lender must ensure that this form is included in the application and signed.

B. Project Eligibility

The lender must ensure that the property meets all program requirements.

1. Property Requirements

In reviewing the application, the lender must determine that any site or design issues and any issues raised by the due diligence report (relating to potential contamination from hazardous substances, hazardous wastes, and petroleum products), have been identified and resolved in a manner consistent with Agency requirements. If they cannot be resolved at the time of application, the lender must notify the Agency and propose an appropriate remedy.

The lender will submit the design development or final plans and construction documents to the RHS State Architect who will review them and concur with its compliance with program design requirements.

2. Clear Title and Necessary Local Approval

The preliminary title report is a part of the application. The lender must make sure that it does not show any encumbrances to the title that would affect the lender's ability to obtain a first lien.

The lender must ensure that all the necessary State or local approvals have been obtained, including proper zoning and necessary utility rights.

C. Project Feasibility Analysis

The lender must carefully review the borrowers proposed cost estimates to ensure that project costs are reasonable and customary for the type of project.

1. SAUCE

The Agency SAUCE program is a software tool to help underwriters determine whether the projected income stream will match projected costs. The State Office must conduct a feasibility analysis using SAUCE. If the projected income and costs do not match fairly evenly, the lender or borrower must revise the project costs and rent structure to bring the two in line or the project is not feasible.

2. Adequacy of the Operating & Maintenance Reserve

All borrowers must contribute cash from their own resources prior to loan closing in an amount equal to at least 2 percent of the loan amount as operating & maintenance reserve (or provide the lender with a letter of credit, as provided by Paragraph 3.10 C., in lieu of a cash contribution). The lender must provide the State Office with proof of deposit for the initial payment into the operating & maintenance reserve account. State Office staff should verify that the initial payment for operating & maintenance reserves has been made in accordance with the Reserve Account Agreement or any other mortgage document governing operating & maintenance reserve accounts. State Office staff will monitor the balance in the operating & maintenance reserve account on an annual basis from the lender's Annually Audited Financial Statements to verify consistency with the Reserve Account Agreement or other relevant mortgage documents.

The materials and equipment that are typically funded by the operating & maintenance reserve amount include, but are not limited to, property and liability insurance premiums, fidelity bond premiums when the borrower is an organization, utility installation charges and deposits, maintenance equipment, lease forms, loan payments that may become due during construction, purchase of office equipment and furniture, community room furnishing, other movable equipment and furnishing, congregate items, advertising expenses, management fees, etc.

The operating & maintenance reserve funds will be kept in a separate account and held by the lender. The lender must ensure that the items are necessary for the project, and the costs are similar to other comparable projects in the area. The lender will authorize all disbursement of funds from the operating & maintenance reserve account as needed prior to utilization. The lender may release any remaining funds from the operating & maintenance reserve account only in accordance with Paragraph 3.10 C.

3. Management Systems

The lender must certify that the borrower has adequate systems to manage the property successfully in accordance with Agency requirements.

In order for an application to be approved, borrowers must show that they will provide professional management to ensure the successful operation of the project. The lender must evaluate the acceptability of the management proposed for the project by analyzing *Form HUD 9832* and the proposed management plan. Chapter 8 provides details on how to evaluate the management profile information.

4.12 AGENCY REVIEW OF THE LOAN GUARANTEE APPLICATION

The analysis conducted at this stage is intended to verify and document feasibility and eligibility. Any changes to the proposal submitted in response to the NOFA must be carefully considered to ensure that the project continues to meet the selection and priority criteria. The application review consists of eight parts.

A. Determination that the Loan Guarantee Application Package is Complete

The Agency will determine if the lender has submitted all of the required application documentation and met the conditions in the NOFA.

B. Environmental Review by Agency

The State Office or RHS delegated processing office will complete an environmental review in accordance with the National Environmental Protection Act of 1969 (as amended) and RD Instruction 1940-G prior to taking any official action on an application for a loan guarantee. The RHS processing office will begin the environmental review process as soon as *Form RD 1940-20* and supporting documentation is received from the lender and borrower. The required information that must be provided by the lender and borrower is listed under Paragraph 4.9 B.

C. Civil Rights Impact Analysis

The Agency will conduct civil rights impact analyses to determine whether proposed actions will negatively and disproportionately affect minorities, women, or persons with disabilities, who are employees, program beneficiaries, or applicants for employment or program benefits in USDA conducted or assisted programs, by virtue of their race, color, sex, national origin, religion, age, disability, or marital or familial status. At the time of the site visit, a trained staff member will complete *Form RD 2006-38, Civil Rights Impact Analysis Certification*. The State Civil Rights Coordinator and, as necessary, the State Environmental Coordinator, will be consulted if problems are noted. RD Instruction 2006-P provides further guidance on these requirements.

D. Review of Other Federal Requirements

The Agency will determine that all Civil Rights Impact Analysis Certifications and all other Federal requirements, including intergovernmental review (RD Instruction 1940-J) and flood insurance requirements (RD Instruction 426.2), have been met prior to taking any official action on an application for a loan guarantee.




E. Review of Affirmative Fair Housing Marketing Plan (AFHMP)

As part of the application, borrowers (except when the borrower is a Federally recognized Indian tribe and the housing units will be located on land over which the tribe has sovereignty/civil jurisdiction) must submit to the lender *Form HUD 935.2* to describe their marketing plan for the project. The intent of this plan is to ensure that eligible persons and families are made aware of the availability of GRRHP multifamily rental housing units. While the lender must review the submission, the Agency must approve and sign this form.

The lender will use Exhibit 4-2 when reviewing the AFHMP. This exhibit describes the plan and provides guidance on what to look for in each part. The Agency may require revisions to the plan if any changes need to be made based on the Agency review.

Required AFHMP Attachments



- Copies of the specific pages(s) from the census report on which the plan was based
- Photograph or drawing of the project sign
- Copies of the newspaper advertisement or sample of proposed advertisement
- Sample community contact letters
- Brochures, leaflets, or handouts used
- Written instructions provided to staff concerning Federal, State, and local fair housing laws and regulations as well as concerning the AFHMP

Exhibit 4-2

**Actions to be Taken By Lender in Reviewing
the Affirmative Fair Housing Marketing Plan**

- A. Part 1 of the plan provides general information about the borrower and the project's location.
 - 1. Make sure the Census Tract is identified. Copies of the specific page(s) from the census report on which the plan was based must be attached. The areas considered to be the market area should be identified (highlighted) by the borrower.
 - 2. Information on the rental rates should indicate the lowest to the highest rents. If there is rental assistance, the lowest rent should be shown as zero.
- B. Part 2 of the plan indicates whether the market area is a minority, non-minority, or mixed area. Verify that the response corresponds directly to the census data.
- C. Part 3 of the plan indicates the groups toward which the marketing efforts are going to be directed. It should also correspond directly with the census data and the community contacts that are identified.
- D. Part 4 describes the marketing program.
 - 1. Ensure that the borrower has indicated they will advertise on an annual basis.
 - 2. Check to see if minority newspapers have been considered as part of the advertising plan.
 - 3. Make sure the borrower has attached a sample of the proposed advertisement.
 - 4. Review any copies of brochures, leaflets, or handouts the borrower intends to use. Review them to ensure the equal housing opportunity statement, logo, or slogan is used.
 - 5. A photo or rendering of the project sign must be provided. The dimensions of the project sign must be indicated and described in terms of feet and/or inches. The logo and the words "Equal Housing Opportunity" must be distinguishable in the photo or rendering. If it does not appear, recommend use of the accessibility logo.
 - 6. The proposed community contacts must reflect efforts directed towards groups identified in Part 3. Ensure each blank in this section is completed (address, phone numbers, etc.). The frequency of contacts must be stated, at a minimum, as "at least once annually" or "(date) and annually thereafter." Sample community contact letters must be attached.
- E. Part 5 describes future marketing activities. Make sure the borrower has indicated future marketing activities that include, as a minimum, "Newspapers, site sign, and community contacts."
- F. Part 6 describes the borrower's experience and the instructions given to staff regarding fair housing marketing. Make sure that the borrower has attached the instructions given to staff concerning Federal, State, and local fair housing laws and regulations, as well as instructions concerning the Affirmative Fair Housing Marketing Plan.
- G. Part 7 describes additional considerations that are planned to outreach to groups not previously mentioned in the plan or to groups identified as least likely to apply for the housing. If this plan is for an elderly project, the borrower must have included community contacts for the disabled, who are also eligible to reside at the project. If for a family project, make sure they have included efforts to make the units with special design features known to mobility impaired persons.
- H. Part 8 is the signature block. It must be signed by the legal borrower or by the borrower's agent.

F. Decision on Interest Credit Subsidy Awards

The processing office will review any information justifying the request for interest credit and have final determination on whether interest credit will be reserved for the project.

G. Decision on the Guarantee Amount

The guarantee amount will be negotiated between the lender and the processing office, up to 90 percent of the loan amount. To obtain a 90 percent guarantee, the property must meet all program requirements and be determined to be an average or better than average risk. Factors affecting this determination include:

- A debt service coverage ratio at or above 1.15 and a loan to value ratio at or below 90 percent.
- A strong market area, as indicated by a market vacancy factor of 5 percent or less for units renting at economic rents.
- A financially strong borrower and ownership entity, as evidenced by the borrower credit rating.
- An owner or members with extensive experience in the operation of similar housing.

If the lender has proposed a project, which is not qualified for a 90 percent guarantee, the lender may ask the State Office to consider a lesser guarantee.

H. Determination that the Loan is Acceptable for a Conditional Commitment

The lender must underwrite the loan and determine that it is a sound investment. The Agency will review the lender's underwriting and determine if the proposed guaranteed loan meets all program requirements. Such requirements include but are not limited to:

- The lender has certified that the proposed loan amount (for such part of the property that may be attributable to dwelling use) and the applicable maximum per unit dollar amount limitations under section 207(c) of the National Housing Act have been exceeded;
- The proposed loan term, including construction is not more than 40 years, but not less than 25 years;
- The proposed sources and uses of funds comply with the use of proceeds and lien;
- The loan to value ratio does not exceed program limits;
- The Agency guarantee percentage does not exceed 90 percent;

- The borrower has contributed at least 2 percent of the loan amount for operating & maintenance reserves (or provided the lender with a letter of credit, as provided by Paragraph 3.10 C., in lieu of a cash contribution) or at least a 2% construction contingency reserve, if applicable;
- The proposed interest rate is not higher than the limit published in the NOFA; and
- The proposed interest credit rate is not lower than the published Long Term Monthly AFR.

4.13 AGENCY DECISION

The State Office will review, assess and approve applications. An application, which the State Office determines to be acceptable for a guarantee, with any one of the following criteria must first be sent to the Director of Multi-Family Housing Processing Division at the National Office for review and concurrence prior to State Office approval. These criteria include any one of the following: (1) congregate care facilities for any loan amount; (2) a property with a loan to cost (LTC) or loan to value (LTV) of 75 percent or higher; or (3) an application for a loan amount greater than \$5 million. Applications that are sent to the National Office for review and concurrence must be accompanied by the State Office's written assessment of the application. An application that has been determined by the State Office NOT to be acceptable for a guarantee, should NOT be sent to the National Office for review and concurrence. In this case, the State Office will send to the lender his/her appeal rights along with the rejection letter explaining the reasons for rejection. Decisions on applications will normally be rendered within 60-120 calendar days of receipt of a complete application. In most cases, the Agency will be able to notify the lender of its decision in about 75 calendar days, however, the timing will vary depending on the intergovernmental review and the environmental assessments. If an application is determined ineligible to receive a conditional commitment, it will be returned to the lender.

SECTION 4: ISSUANCE OF CONDITIONAL COMMITMENT

4.14 GENERAL REQUIREMENTS

A conditional commitment to guarantee the loan will be made upon an Agency determination that:

- The borrower and the lender are both eligible to receive a guarantee under the GRRHP;
- All other program requirements have been met;
- The lender has determined that the project is financially feasible and made a conditional loan commitment;
- The Agency has completed a satisfactory environmental review required under the National Environmental Policy Act, in accordance with RD Instruction 1940-G; and

- The application fee has been paid.

Form RD 3565-2, Conditional Commitment is an agreement between the Agency and the lender in which the Agency agrees to guarantee the loan at a future date, if the conditions in the commitment are met within the term specified in the Conditional Commitment. Simultaneous with the issuance of a Conditional Commitment, the State Office will execute *Form RD 1940-3, Request for Obligation of Funds Guaranteed Loans* and *Obligation Request for Section 538 Loans* for the proposed project, which will be sent by the National Office to the state office at the beginning of each fiscal year. This form provides the National Office with project specific information not available in *Form RD 1940-3, Request for Obligation of Funds Guaranteed Loans*.

These forms will be faxed to program staff at the National Office for approval by the Division Director. National Office staff will obligate funds to the project in the Guaranteed Loan System (GLS) and provide a copy of the approved *Form RD 1940-3, Request for Obligation of Funds*, to the Finance Office for their records.

If a project cannot meet all of the above conditions, then a conditional commitment will not be issued to the lender and funds will not be obligated to the project.

4.15 TERMS OF CONDITIONAL COMMITMENT

The conditional commitment is valid for the length of time specified in the commitment letter not to exceed 24 months which is the maximum term of the commitment. If a commitment has been issued for fewer than 24 months, it may be extended up to 24 months. Up to two extensions of 60 to 90 calendar days each may be requested prior to the expiration of the commitment on the end of the 24th month. The Agency will charge a flat fee of \$500 for each extension of the commitment. Any extension which would result in material changes to the proposed financing interest rate will require a re-underwriting by the lender and a review by the Agency.



A. Subsidy Layering Review

Because the loan guarantee and interest credit subsidies are government resources, the Agency must conduct a subsidy layering review. The SAUCE review completed by the lender as part of the application will be reviewed by the Agency in accordance with Paragraph 3.25 D.3. at the conditional commitment stage, with an updated review at the permanent loan closing.

B. Guarantee Fee

At the issuance of the Loan Note Guarantee, the lender must pay a loan guarantee fee. The Guarantee Fee is calculated as 1% of the note principal amount times the percentage of guarantee. Although the fee is paid by the lender, it may be passed on to the borrower.

Calculation of the guarantee fee is discussed in Chapter 6. The guarantee fee is to be collected by the State Office at closing of the loan and transmitted to the Finance Office on *Form RD 451-2, Schedule of Remittances*. Code "30" should be entered into the "Miscellaneous Collection" box and it should be coded as a regular payment (R) in column #1. The check and Form RD 451-2 will be sent to: Wholesale Lock Box, P.O. Box 845084, Dallas, TX 75284-5084. Payment of the application fee and the annual renewal fee submitted by the lender will be handled in the same manner.

C. Transactions Backed by Ginnie Mae

Lenders who intend to have the GRRHP loan securitized by Ginnie Mae will inform the State Office of their intentions. State Office staff will include a condition to the Conditional Commitment for loans that will be securitized by Ginnie Mae stating the following:

"The lender must certify, in writing, that the loan amount guaranteed shall not be greater than 50% of total development costs."

D. Termination of the Conditional Commitment

The conditional commitment will expire if the terms are not met or if the lender decides not to originate the loan.

- **Withdrawal of an Application.** The lender must notify the State Office immediately of its intention to withdraw an application. In this case, the Agency will retain the loan application fee. The State Office will prepare *Form RD 1940-10, Cancellation Of U.S. Treasury Check and/or Obligation* and fax it to the National Office to request the de-obligation of funds to the project. National Office staff will de-obligate the funds to the project in the GLS, so that it may be used to fund another project. The de-obligation request will be faxed to the State Office with the date and initials of the person who de-obligated the funds.
- **Lapse of commitment.** If the loan guarantee is not issued within the period specified in the commitment letter, the commitment will automatically expire. On a case-by-case basis, the State Office may allow extensions of the loan commitment period. The lender must submit a written justification for the extension, which may be granted by the State Office if it appears the project can reasonably be completed within the extension period and failure to timely complete was beyond control of lender and borrower. The Agency will charge a flat fee of \$500 for this extension/reopening of the application.

E. Substitution of Lender

There are some circumstances, such as bank mergers, which require a substitution of

lender, and a transfer of conditional commitment from one lender to another. A transfer of a commitment is permitted if the transfer and the substitute lender are approved by the State Office and the substitute lender agrees to the underwriting terms approved in the conditional commitment. The substituted lender must provide the State Office with written approval from the original lender for the substitution and the transfer of the application and supporting documentation to the substituted lender. To obtain Agency approval, the borrower and substitute lender must certify that there are no changes in the borrower's ownership or control and that the loan purposes and all other elements of the application supporting the conditional commitment remain the same.

F. Lender's Agreement

The lender must execute for *Form RD 3565-3, Lender's Agreement*, prior to the issuance of the loan guarantee, unless a current *Form RD 3565-3* is already on file with the Agency. The lender signs the Lender's Agreement with the State Office, which processes and closes the lender's first Loan Note Guarantee. The State Director or his designee will sign the Lender's Agreement on behalf of the Agency. The State Office will keep the original copy of the Lender's Agreement on file. State Office staff are directed to send a copy of the duly signed Lender's Agreement to National Office program staff for the file. Once a lender has a signed Lender's Agreement with the Agency, a copy of *Form RD 3565-3* must be included in each subsequent submission of NOFA responses for proposed projects.

G. Loan Note Guarantee Agreement

Form RD 3565-4, Loan Note Guarantee, is the only form used to execute the construction guarantee and the permanent guarantee. For a permanent loan guarantee, the guarantee becomes effective upon execution of the form by the State Director and the lender. For a construction guarantee, the guarantee for the construction loan becomes effective when funds are first drawn down. The construction guarantee converts to a permanent guarantee when the State Office gives written confirmation to the lender of the conversion date, which is based on satisfaction of the 90% occupancy requirement for 90 days or a fully funded additional operating reserve equal to 2% of the appraised value of the project or total development costs, whichever is greater, prior to closing the construction loan, and meeting the requirements for a permanent guarantee. The State Office will provide the Finance Office and National Office with a copy the written confirmation of conversion for their records.

SECTION 5: RESPONSE TO THE CONDITIONAL COMMITMENT AND LOAN CLOSING

4.16 GENERAL CONDITIONS

Once a lender receives a conditional commitment from the State Office, the lender must respond to the conditions detailed in that commitment within 60 calendar days of receipt. When all of the conditions are resolved and the other requirements outlined in Section 7 of this chapter are met, the Agency will issue a permanent guarantee.

As part of loan closing procedures, the state office must review the lender's underwriting calculations, proformas and mortgage documents for consistent use of the same interest rate in all documents. The lender must correct any discrepancy prior to loan closing.

Among the conditions specified in the conditional commitment, the lender must submit the following for State Office approval before loan closing occurs. Regional OGC review of these documents is mandatory for the issuance of the State's first Loan Note Guarantee and is encouraged thereafter.

- Final organizational documents for the borrower entity or Certificate of Good Standing, if applicable;
- An opinion letter from lender's Legal Counsel. (See Attachment 4-D); and
- A copy of the proposed closing documents (See Attachment 4-F).

4.17 DEVELOPMENT OF THE REGULATORY AGREEMENT

A regulatory agreement governing the relationship between the borrower and lender must be developed by the lender and executed by both the borrower and the lender. The regulatory agreement must contain the provisions specified in Paragraph 7.15. While the Agency will not be a party to the agreement, the agreement will state that the Agency may assume the role of the lender if necessary to force borrower compliance with the agreement.

As a part of the closing documents, the lender's attorney must certify that the regulatory agreement submitted for Agency review meets the requirements of this paragraph.

4.18 LOAN CLOSING

Once the closing documents have been approved by the State Office, the lender should prepare a closing statement showing how funds will be disbursed, and begin to coordinate and schedule the closing date for the loan. All conditions of the conditional commitment must be fulfilled prior to the issuance of the loan note guarantee. If the loan is a construction loan, then the requirements of Section 6 will apply and the construction guarantee will only cover advances

for construction. If the loan is a permanent loan, then the guarantee will be issued in accordance with Section 7. In addition to the regulatory agreement, *Form RD 3565-3, Lender's Agreement*, must be executed prior to the issuance of the guarantee. Once the loan is closed, *Form RD 1980-19, Guaranteed Loan Closing Report*, will be prepared by the lender, signed by both the lender and the State Office, and submitted to the Finance Office. If the loan will receive interest credit, *Form RD 3560-9, Multiple Housing Interest Credit and Rental Assistance Agreement*, will also be completed and submitted in accordance with Paragraph 4.10. *Forms RD 1980-19* and *3560-9* and the executed Loan Note Guarantee will be faxed to the Finance Office, ATTN: Guaranteed Loan Branch, (314) 457-4279 and to the National Office.

SECTION 6: GUARANTEE DURING CONSTRUCTION

4.19 CONSTRUCTION GUARANTEE

In the case of a construction loan, the construction guarantee will go into effect with the first draw of the construction loan (see Chapter 5). The construction guarantee is only intended to cover the construction contract. The construction guarantee does not cover the rent-up period. Thus, the Agency will only guarantee the construction loan amount disbursed and expended during the construction phase. Disbursements that have been made without specific work in place are not guaranteed. The construction phase is complete when certificates of occupancy are obtained. In the case of construction of multiple buildings, certificates of occupancy are to be obtained as the buildings are completed. The guaranteed construction loan amount will gradually decrease by the amount of disbursed funds used in the construction of the buildings that are complete. In no case will the construction guarantee exceed 24 months from the date of issuance. Funds disbursed after the 24 months of construction are not covered by the guarantee.

In the case where the Agency has been requested to provide a construction guarantee and a permanent guarantee, the lender has the option to set up an additional conversion reserve prior to closing the construction loan equal to no less than 2% of the loan amount. If the lender opts to set up the 2% additional conversion reserve, the Agency will convert the guarantee from the construction loan to the permanent loan after all conditions for the permanent guarantee are fulfilled. Conversion from a construction guarantee to a permanent guarantee will become effective when the Agency provides the lender with written confirmation of the conversion date. If the lender does not set up the additional conversion reserve prior to closing the construction loan with the borrower, the project must attain 90 percent occupancy for 90 days at pre rent-up assumptions before conversion from the construction guarantee to a permanent guarantee can take place. The lender will be without a guarantee during the time that construction is complete (certificates of occupancy are issued) and fulfillment of the occupancy requirement 90 percent for 90 days.

The Agency will guarantee construction advances by the lender, not to exceed 90 percent of the work in place, if the lender provides acceptable credit enhancements. Acceptable credit enhancements include any one of the following:

- Surety bonding or a performance and payment bond (the preferred enhancement).
- An irrevocable letter of credit acceptable to the Agency.
- A pledge by the lender of acceptable collateral.

Chapter 5 provides additional detail regarding the requirements for a construction guarantee.

SECTION 7: PERMANENT GUARANTEE

The requirements for issuing the permanent guarantee are identified below.

4.20 OCCUPANCY

The permanent guarantee may not go into effect until the lender has provided the State Office with copies of rent rolls showing occupancy levels at 90% for 90 days. The minimum level of occupancy is to be set for each transaction. In general, minimum level of occupancy means at least 90 percent occupancy for three months at the pro forma assumptions for rent and debt service coverage. In lieu of meeting the minimum level of occupancy, borrowers may establish an additional operating reserve at a level acceptable to the Agency. The operating reserve will be at least 2% of the appraised value of the project or 2% of the total development cost, whichever is greater. This cash contribution is an additional amount, over and above the required initial operating and maintenance reserve contribution, that is described in Paragraph 3.10 C.

If tax credits are used in conjunction with the GRRHP, the borrower must meet any occupancy requirements in the tax credit partnership agreement before the permanent guarantee is issued.

4.21 DOCUMENTATION REQUIREMENTS

The following documentation must be submitted for the permanent guarantee to be issued:

- A final appraisal prepared in accordance with the appraisal standards set forth in USPAP.
- A certificate of substantial completion executed by the architect, lender, contractor, and borrower.
- A certificate of occupancy from the local jurisdiction.
- A final inspection conducted by an Agency representative.
- A final cost certification.
- A certification from the borrower and lender that all parties involved in the pre-construction, site development and construction of the property have been paid in full.

- A complete closing docket for the permanent loan closing (see Attachment 4-F for requirements).
- Lender's Agreement executed by the lender (for lender's with the first loan note guarantee only).
- An updated necessary assistance review by the Agency.
- Evidence that the annual guarantee fee has been paid.
- Copy of Loan Note Guarantee executed by the Agency with written confirmation from state office of the effective date of the permanent guarantee (for construction/permanent loan guarantee only).

The state office will review all submitted documents and verify that the project is free and clear of liens prior to the issuance of the permanent guarantee.

SECTION 8: TERMINATION OF THE LOAN GUARANTEE

4.22 REASONS FOR TERMINATION

If the GRRHP loan is terminated or if the lender fails to comply with the program requirements, the guarantee will be terminated or not issued respectively. The guarantee will terminate under several circumstances identified below.

A. Repayment of the Loan

Once the loan note has been completely paid off, the loan guarantee will automatically terminate.

B. Payment of a Claim

Once a claim has been paid, the loan guarantee automatically terminates.

C. Voluntary Termination of the Guarantee Agreement by the Lender

If a guarantee agreement is voluntarily terminated by the lender, the program restrictions must remain in place unless approved by the National Office pursuant to Chapter 7.

D. Non-Compliance with Program Requirements

The loan guarantee may be terminated for non-compliance with the program requirements. The Agency will exercise its rights to cancel the guarantee only if the Agency has given the lender notice of the acts or omissions that it considers to constitute such grounds, specifying the applicable provisions of the Statute, Regulations, Loan Note Guarantee, or Lender's Agreement

- the lender has not cured the acts or omissions within 90 calendar days after such notice, and
- the acts or omissions can reasonably be expected to have a material adverse effect on the credit quality of the guaranteed mortgage or the physical condition of the property securing the guaranteed mortgage. If such acts or omissions cannot be cured within a 90 calendar day period, the 90 calendar day cure period automatically shall be extended so long as curative activities commence during the 90 calendar day period. At no time shall the curative period extend more than 270 calendar days of the expiration of the original 90 calendar day cure period. The lender will remain bound to all obligations under the Loan Note Guarantee, Lender’s Agreement, and the Agency program regulations. Non-compliance with program requirements includes, but is not limited to:

1. *Negligent Servicing*

Failure to service the loan is a violation of program requirements (see Chapter 7). Negligent servicing is defined as the failure to perform services, which a reasonably prudent lender would perform in servicing its own portfolio of loans. This includes not only the concept of a failure to act, but also not acting in a timely manner, or acting in a manner contrary to that of a reasonably prudent lender.

2. *Failure to Pay the Annual Fee*

Guarantee may be reinstated upon payment of all past due annual loan guarantee fees. The Agency will charge interest penalties on any unpaid guarantee fee.

3. *Improper Sale*

If the Agency determines that the loan has been sold or otherwise transferred without Agency approval, the guarantee will be terminated.

E. *Fraud*

If the Agency determines that fraud took place on the part of the lender in the loan application process, the Agency may terminate the loan guarantee.

In the event of termination, the lender is required to reimburse the Agency for any unused interest credit. A termination is appealable under the adverse action procedures (see Paragraph 1.11).

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ATTACHMENT 4-A
SAMPLE -- NOTICE TO PROCEED WITH APPLICATION PROCESSING

John Dow
Vice President
Rural Mortgage Corporation
123 Farm Road
Ruraltown, USA 00000

RE: Section 538 Guaranteed Rural Rental Housing Program
Fiscal Year 0000 Notice of Funding Availability (NOFA) Selection

Applicant: Rural Partners, LP
Project Location: Adairsville, Georgia
Loan Amount: \$3,563,143
Interest Credit Score: 75 points

Dear Mr. Dow:

I am pleased to inform you that the above subject response has been selected for further processing with an interest credit award. The scoring threshold for an interest credit award is 65 points. Your project scored 75 points. As you have indicated in your NOFA response, the interest rate for the selected project will not exceed 250 basis points over the Long Term Monthly Applicable Federal Rate (AFR) at loan closing. In accordance with the NOFA, no more than \$1.5 million of the loan amount will receive an interest credit award. If the loan amount exceeds \$1.5 million, you are required to separate the loan amount that will receive interest credit from the loan amount that is not eligible for the interest credit award. A separate amortization schedule is necessary for each loan amount. Yearly payment of the interest credit award will be based a declining balance of the \$1.5 million loan amount.

This selection is not a commitment of a loan guarantee. A conditional commitment of guarantee will be issued after the application for loan guarantee has been successfully processed. The conditional commitment of guarantee and obligation of guarantee funds are awarded on a "first-come-first served basis." It is imperative that you complete an application for the selection as soon as possible.

- Please proceed with the development of an application for the subject response in accordance with Chapter 4 of HB-1-3565. Rural Development staff in the State Office in which the project is located will assist you in the application process. Please contact John Smith, Multi-Family Housing Program Director, (000) 000-0000 to arrange a meeting between you, the developer, the State Environmental Coordinator, State Architect or Engineer. Mr. Smith will

provide you with details concerning:

- The environmental assessment,
- Coordination of the application process, and
- Submission of the application fee.

A complete application and application fee for the subject response must be submitted to the State Office within 90 calendar days from the date of this letter. A delay in the submission of a complete application may result in the cancellation of the selection or interest credit award.

If you have any questions regarding the selection award, you may contact the Multi-Family Housing Processing Division, (202) 720-1604.

Sincerely,

Deputy Administrator
Multi-Family Housing

**ATTACHMENT 4-B
SAMPLE -- STATE OFFICE AWARD LETTER**

TO: _____
State Director
Rural Development
Anywhere, USA

FROM: _____
Administrator
Rural Housing Service

SUBJECT: Section 538 Guaranteed Rural Rental Housing Program Notice of Funding
Availability (NOFA) Selection for Fiscal Year 2004
Applicant: Rural Mortgage Corporation

We are pleased to forward to you this package containing the following NOFA response for the project located in your State. The subject request has been selected for further processing with an interest credit award as a result of our ongoing NOFA review.

Project: The Oaks of Adairsville
Location: Adairsville, Georgia
Loan Amount: \$3,563,143
Interest Credit Score: 75

The lender has been notified of this selection and advised to proceed in the development of the application for this loan as described in Chapter 4 of the Guaranteed Rural Rental Housing Program (GRRHP) Origination and Servicing Handbook (HB-1-3565). You were sent a copy of this letter under separate cover.

Your staff should begin working with the lender in the development of this application as soon as possible. As stipulated in the HB-1-3565, the application must be submitted within 90 calendar days from the date of the notification letter to the lender. Otherwise, the award may be cancelled.

The Agency's environmental review of the property, as required in accordance with RD Instruction 1940-G, must be initiated as early as possible. The environmental review must be prepared simultaneously with the development of the application package. The Agency cannot issue a conditional commitment prior to receipt of the \$2,500 application fee, completion of the environmental review, and publication of the Finding of No Significant Impact (FONSI), if appropriate, and the expiration of the public comment period.

The applicant will be expected to work with the Agency in the collection of environmental information. The applicant may also need to consult with appropriate Federal, State, and local regulatory agencies; assist in public involvement; and adopt mitigation measures to avoid adverse environmental impacts.

Applicants should be cautioned against taking any actions which limit the range of alternatives to be considered in the environmental assessment or which have an adverse effect on the environment.

Therefore, it is important that you promptly contact the lender to arrange a meeting between the appropriate State Office staff (Multi-Family Housing Program Director, the State Environmental Coordinator and the State Architect or Engineer), the lender, and the borrower/developer. This meeting should be held within 14 calendar days of this letter. Your staff should provide the lender and borrower with details concerning the following actions:

- The preparation of an environmental assessment,
- Coordination of the application process, and
- Submission of the complete loan application and the \$2,500 application fee.

If the lender is unresponsive to your requests for a meeting, you will need to send your request in writing and give the lender 14 calendar days to respond, or the invitation to submit an application for the loan note guarantee will be withdrawn.

After the meeting has taken place, your office should reiterate the issues discussed during the meeting in a letter to the lender, using the format of the attached sample letter. This letter should provide the lender with timeframes for submission of the application and other pertinent information that may be needed prior to the issuance of the conditional commitment. The lender should be given no more than 90 calendar days to submit the application and \$2,500 application fee. It is important to assist the lender in meeting these timeframes.

Attachments

ATTACHMENT 4-C

Section 538 GRRHP Application Checklist

This checklist is a consolidation of required information contained in the GRRHP Origination and Servicing Handbook for the completion of a GRRHP application.

The lender is responsible for preparing an application that is complete and accurate. The lender must submit the GRRHP application to the RHS State Office where the project will be located. The GRRHP application is comprised of two components: (1) a list of lender certifications and (2) exhibits and supporting information.

(1) The lender's certification will serve as assurance to the Agency that the borrower, the project, and the proposed financing meet the lender's standards for loan making. The lender must certify on the lender's letterhead the following:

- The information contained in the application is consistent with the lender's underwriting and loan making standards (HB-1-3565, section 4.9A).
- The lender has completed the lender's review as required by Paragraph 4.11 of the GRRHP Origination and Servicing Handbook and has identified any significant findings in a narrative attached to this certification (HB-1-3565, section 4.9A).
- The lender agrees to make a loan to the borrower for the proposed project, subject to the Agency's issuance of a guarantee (HB-1-3565, section 4.9A).
- The lender must provide to the Agency a certification from the borrower that the borrower is not under any state or federal order suspending or debaring participation in state or federal loan programs and that the borrower is not delinquent on any non-tax obligation to the United States (HB-1-3565, section 4.11 A(1) and (3)).
- The lender must certify that the proposed loan amount (for such part of the property attributable to dwelling use) and the applicable maximum per unit dollar amount limitations under section 207 (c) of the National Housing Act have not been exceeded (HB-1-3565, section 4.12H).
- The lender must certify that the owner and development team have the qualifications and experience sufficient to carry out development, management, and ownership responsibilities (HB-1-3565, section 4.8A).

- The lender must certify that the property is located in an eligible rural area (HB-1-3565, section 4.8A).
- The lender must certify that it has conducted due diligence and the results have been taken into consideration in the appraisal (HB-1-3565, section 4.8B).
- The lender must certify that it has reviewed and approved the management plan and agreement and confirmed that they are consistent with Agency requirements (HB-1-3565, section 4.9B(2)).

(2) Exhibits and Supporting Information:

Agency Forms to be included in the application package:

- Form RD 3565-1, Application for Loan and Guarantee (HB-1-3565, section 4.9B(1)).
 - Form RD 1940-20, Request for Environmental Information (HB-1-3565, section 4.9B(1)).
 - ATTACHMENT 4-G, Housing Allowances for Utilities and Other Public Services (HB-1-3565, section 4.9B(1)).
 - Form RD 1944-37, Previous Participation Certification (HB-1-3565, section 4.9B(1)).
 - Form RD 3560-30, Certification of No Identity of Interest (IOI), if applicable (HB-1-3565, section 4.9B(1)).
 - Form RD 3560-31, Identity of Interest Disclosure/Qualification Certificate, if applicable (HB-1-3565, section 4.9B(1)).
 - Form RD 1910-11, Applicant Certification, Federal Collection Policies for Consumer or Commercial Debts (HB-1-3565, section 4.9B(1)).
 - Form HUD 9832, Management Entity Profile Form (HB-1-3565, section 4.9B(1)).
 - Form HUD 935.2, Affirmative Fair Housing Marketing Plan (HB-1-3565, section 4.9B(1)).
 - AD 1047, Certification Regarding Debarment Suspension (HB-1-3565, section 4.9B(1)).
 - AD 1048, Certification Regarding Debarment, Suspension, Ineligibility and Voluntary Exclusion – Lower Tier-Covered Transactions (HB-1-3565, section 4.9B(1)).
-

- FEMA Form 81-93, Standard Flood Hazard Determination (HB-1-3565, section 4.9B(2)).
- Form RD 1924-13, Estimate and Certificate of Actual Cost (HB-1-3565, section 4.9B(2)).
- Form RD 400-4, Assurance Agreement, (HB-1-3565, section 7.14C).

Other Required Supporting Information:

Borrower information:

- Financial statements with certification(s) (newly formed entities applying for a construction and permanent guarantee do not need to provide financial statements at the time of application) (HB-1-3565, section 4.9B(2)).
- Credit report for each principal and general partner of the entity, if a limited partnership or LLC member (HB-1-3565, section 4.9B(2)).
- Proposed limited partnership agreement and certificate of limited partnership (if applicable). Agency requirements should be contained in one section of the agreement and their location identified by the borrower or their attorney in a coversheet (HB-1-3565, section 4.9B(2)).
- If a limited liability company, Articles of Organization & Operating Agreement (HB-1-3565, section 4.9B(2)).

If the borrower is a nonprofit organization:

- Tax-exempt ruling from the IRS designating them as a 501(c)(3) or 501(c)(4) organization. If the designation is pending, a copy of the designation request must be submitted (HB-1-3565, section 4.9B(2)).
- Evidence of organization under State law, or copies of pending applications (HB-1-3565, section 4.9B(2)).
- List of Board members (HB-1-3565, section 4.9B(2)).

If a public body:

- The enabling statute; or the State law of organization (HB-1-3565, section 4.9B(2)).

Project Information:

- An application fee of \$2,500,(HB-1-3565, section 4.8B).
- An appraisal or market study (HB-1-3565, section 4.9B(2)).
- Project information including project name, location, number and type of units, the development team, property manager, lawyer, and syndicator. The development team includes the developer (including all principals), architect, and contractor (HB-1-3565, section 4.9B(2)).
- Capital Needs Assessment (for rehab loans only) (HB-1-3565, section 4.9B(2)).
- State Clearinghouse comments or recommendations (HB-1-3565, section 4.9B(2)).
- Site plan, including contour lines (HB-1-3565, section 4.9B(2)).
- Plot plan (HB-1-3565, section 4.9B(2)).
- Floor plan of each living unit type and other type spaces (HB-1-3565, section 4.9B(2)).
- Building exterior elevations (HB-1-3565, section 4.9B(2)).
- Typical building exterior wall section (HB-1-3565, section 4.9B(2)).
- Description and justification of any related facilities, and schedule of separate charges for related facilities, if any (HB-1-3565, section 4.9B(2)).
- Design development/working plans/construction specifications (HB-1-3565, section 4.9 (2)). Plans, specifications, and estimates must fully describe all of the work to be completed, including all landscaping, construction, repairs, and site development work. The plans must be clear and accurate, with adequate dimensions and sufficient scale for estimating purposes. Technical data, tests, or engineering evaluations needed to support the design of the development must be included (HB-1-3565, section 5.7).
- Management plan and proposed management agreement (HB-1-3565, section 4.9B(2)).

Financing Information:

- Lender's conditional commitment on the lender's letterhead with lender's signature (HB-1-3565, section 4.9B(2)).
-

CHAPTER 5: CONSTRUCTION REQUIREMENTS

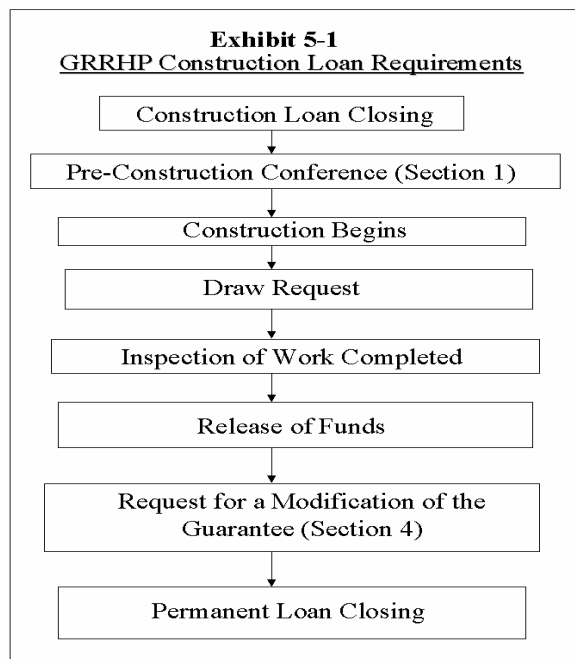
5.1 INTRODUCTION

A primary goal of the GRRHP is to encourage the construction of affordable yet safe and sanitary housing units in rural areas. To achieve this goal, the Agency will review the quality of construction of any housing developed under the program. However, the Agency will be more involved when it is guaranteeing construction advances. This chapter will detail the basic construction requirements that must be met whenever the Agency will be providing assistance through loan guarantees, as well as the additional requirements that apply when the Agency guarantees construction advances.

Key Topics in this Chapter

- Pre-Construction Conference
- Construction Requirements
- Guarantees of Construction Advances
- Application Processing for Construction Advance Guarantees

The construction loan processing steps are detailed in Exhibit 5-1.



SECTION 1: PRE-CONSTRUCTION CONFERENCE

5.2 CONFERENCE REQUIREMENTS

After a contract is awarded and all documents are completed and signed, and prior to any actual construction work, a pre-construction conference must be held between the borrower, contractor, architect, and lender representatives, including the lender's fee inspector. The Agency must be notified of the conference and Agency representatives may attend. The conference is held to reach mutual understandings on all terms and conditions of the contract documents. The adequacy of the plans and specifications, as well as the cost estimates, must be reviewed.

The Agency's environmental review must be examined and any required mitigation measures discussed at this time. The construction schedule must be reviewed to ensure that the work can be completed in a timely manner. If any changes in the plans and specifications are proposed, they must be approved as described in Paragraph 5.18. The Agency has developed a suggested format to record the minutes of the pre-construction conference (*Form RD 1924-16, Record of Pre-Construction Conference*) which is available upon request.

SECTION 2: BASIC CONSTRUCTION REQUIREMENTS

5.3 OVERVIEW

For both permanent loans and combination construction and permanent loans, the lender must ensure that the construction meets all local codes and that the product will comply with the Agency environmental guidelines. When there is no guarantee requested for the construction loan; the construction must meet the state standards and will be discussed in full detail with the Agency during the planning meeting that will be scheduled after the lender has received the Notice to Proceed letter. The State Director has some latitude on the requirements for construction that the Agency has because the risk to the Agency is minimal when the Agency is not guaranteeing the construction. The Agency may waive the requirements for architectural services if it feels that the builder and the lender can ensure that the construction can be completed in an acceptable manor. When the project is built the Agency should be able to assess the quality and suitability for the Guaranteed Rural Rental Housing Program.

The lender must ensure that all of the construction requirements described in this section will be met when the Agency is providing a guarantee for construction/permanent loans. For a guarantee covering the permanent only loan, refer to Attachment 5-A.

5.4 CONSTRUCTION CONTRACTOR EXPERIENCE AND CAPACITY

The lender must ensure that the contractor has demonstrated overall financial stability and is experienced in building multiple-family housing of a size, design, scope and complexity that is similar to the proposed project.

<p>Construction Requirements</p> <p>The construction requirements cover the following topics:</p> <ul style="list-style-type: none"> • Contractor experience and capacity; • Debarment and suspension; • Architectural Services; • Plans, specifications and cost estimates; • Environmental requirements; • Construction; • Inspections; and • Warranty

5.5 DEBARMENT AND SUSPENSION

The lender must ensure that the general contractor, and all subcontractors and suppliers, sign certification statements indicating that they are not currently debarred or suspended from participating in Federally funded programs. The certification statement is included on *Form AD-1048, Certification Regarding Debarment, Suspension, Ineligibility, and Voluntary Exclusion - Lower Tier Covered Transactions*, which is available from the Agency. The signed form must be submitted with each proposal to the borrower, including the proposal from the general contractor and each subcontractor. Failure to provide the signed certificate is sufficient grounds to reject the company's bid or proposal. Information on debarred or suspended contractors is available on the Internet at <http://www.arnet.gov/epl/>.

The Agency will verify that the general contractor does not appear on the debarment/suspension list. When the Agency guarantees either the construction/permanent loan or the permanent only loan, *Form AD-1048* must be reviewed by the lender as part of the application for loan guarantee (see Chapter 4, Section 3).

5.6 ARCHITECTURAL SERVICES

The services of a professional architect or engineer must be obtained to perform architectural services related to the construction of the project. This person or organization must be duly licensed and qualified in accordance with State law.

Architectural services include:

- Schematic designs and preliminary cost estimates;
- Preparation of bid documents;
- Design development exhibits;

- Working drawings and specifications for the construction of the entire project in accordance with applicable regulations and codes, and review of the final construction budget;
- Assistance in the selection of the contractor and the preparation of the construction contract;
- Attendance at pre-construction conference to discuss work and schedules;
- Administration of the construction contract including periodic inspections of all phases of construction;
- Review/approval of pay requests;
- Preparation of change orders/directives;
- Preparation of “punchlist” items needing completion and documentation for, and participation in, the final inspection;
- Advice and consultation regarding the warranty items; and
- Development of final “as built” drawings.

5.7 PLANS, SPECIFICATIONS AND COST ESTIMATES

The borrower must use the services of a professional architect or engineer duly licensed and qualified in accordance with State law to provide architectural services, including the development of plans, specifications and cost estimates. The lender must provide a copy of preliminary plans, specifications, and cost estimates as part of the application package for Agency review.

Plans, specifications, and estimates must fully describe all of the work to be completed, including all landscaping, construction, repairs, and site development work. The plans must be clear and accurate, with adequate dimensions and sufficient scale for estimating purposes. Technical data, tests, or engineering evaluations needed to support the design of the development must be included.

The level of housing amenities provided in the plan must be competitive within that market. For example, washers, dryers, and air conditioning may be necessary for the units to be competitive within the local market. Amenities must not, however, include such luxury items as swimming pools and health clubs unless specifically approved by the Agency.

The State Architect will review the preliminary documents. This review will take into account the amenities being provided, the quality of materials being used, development costs, and other items pertinent to the quality and cost of construction and the operation of the property. The project architect must make appropriate changes to the plans, specifications, and cost estimates to respond to Agency concerns prior to submitting a final set of plans, specifications, and cost estimates to the lender. When these items are submitted to the lender, the project architect must also provide a Plan Certification on *Form RD 1924-25, Plan Certification*, which is available from the Agency.

The lender must provide a copy of the final plans, specifications, and cost estimates, together with the Plan Certification, to the Agency for written concurrence by the State Architect. All of these items will be retained as a part of the Agency file. Construction documents that must be submitted to the Agency are shown in Attachment 1.

5.8 ENVIRONMENTAL REQUIREMENTS

The Agency is required by law to complete an environmental review under the National Environmental Policy Act (NEPA) prior to issuing a conditional commitment of guarantee to the lender. This environmental review may require redesign or relocation of structures, as well as mitigation measures to be taken during and after construction to protect any important resources which may be affected by the project. The lender must comply with all applicable Federal, State, and local laws regarding environmental protection and pollution abatement, in addition to applicable permitting and zoning ordinances. It is the responsibility of the lender to ensure that the borrower/developer, architect, and contractor are fully aware of and comply with the mitigation measures contained in the Agency's environmental review and all other applicable Federal, State, and local laws and regulations.

5.9 CONSTRUCTION

The contractual arrangements for the construction of a rural rental housing project must be contained in a written contract between the borrower and the construction company (general contractor).

The construction contract form published by the American Institute of Architects (*AIA Document A-101*) is acceptable provided that it is modified to meet the Agency's requirements. Agency requirements for construction contracts are described in RD Instruction 1924-A at § 1924.13(e)(1)(ii), and RD Instruction 1924-A, Guide 1, Attachment 6. Other AIA documents used and supplemented in RD Instruction 1924-A, Guides 1 and 4, are: Instructions to Bidders; Architect's Agreement; and General Conditions to the Construction Contract. The AIA construction contract form is available from the AIA.

Construction of the housing and related facilities must be in conformance with the approved plans and specifications, applicable laws, ordinances, codes and regulations, and good construction practices. To avoid future maintenance problems, quality materials must be used. As a minimum, the materials must be consistent with those described in the Marshall & Swift Company's basic description of "average quality multifamily residences." Consider materials and systems and determine which are most economical, considering the sum of all costs: initial, operation, and maintenance.



5.10 INSPECTIONS

Actual construction work needs to be inspected by or on behalf of the lender to verify that the terms and conditions of the construction contract are met. This includes verifying that work is being performed in accordance with the approved plans and specifications without deviation. The contract documents and all referenced codes, standards, and other ordinances are the instruments used to judge the acceptability of the work. Items that do not meet the requirements and specifications of these documents must be removed, corrected, or accepted as change orders by the lender, with an appropriate price adjustment.

The lender may use its own staff or the services of a qualified independent fee inspector to periodically inspect the development work to determine that the construction and land development conform to the drawings and specifications. In any case, the lender must ensure that the inspector has experience inspecting work similar in size, design, scope, and complexity to the project. Fees paid to the inspector must be reasonable and customary in the local area for similar work. The lender's inspections must be made as frequently as necessary. If environmental mitigation measures are required, the inspector must follow-up on the implementation of such measures and document compliance in his or her inspection report. Noncompliance with environmental mitigation measures must be promptly reported to the Agency.

At a minimum, inspections must be made at the three stages of development described below, as well as prior to each payment:

- Stage 1. An Initial inspection immediately prior to or during the placement of concrete footings or monolithic footings and floor slabs.
- Stage 2. An inspection when the building is enclosed, structural members are still exposed, rough in for heating, plumbing, and electrical work is in place and visible, and wall insulation and vapor barriers are installed. Customarily, this is prior to installation of brick veneer or any interior finish which could include lath, wallboard and finish flooring.



- Stage 3. A final inspection when all on-site and off-site development has been completed and the structure is ready for occupancy for its intended use.
- Prior to Payment. In addition to the inspections described above, inspections must be made prior to each payment to the contractor to confirm the estimated values of work completed and stored materials. Payments must be adjusted if there are any discrepancies in the reported values.

Note that inspections at each of these stages must be made of each building. In a project with multiple buildings, inspection of one building will not be deemed sufficient to meet these requirements.

The lender must notify the Agency when each of these three major inspections is scheduled so that an Agency inspector may, if time permits, join the lender's inspector in conducting these inspections.

Any work or material deficiencies noted or alleged as a result of any inspections by the lender's inspector must be reported to the borrower or borrower's architect, or other party with the authority to demand that the contractor make necessary corrections.

Documentation must be provided for deviations from the approved plans and specifications. For cases where the Agency guarantee is only on the permanent loan, "as built" plans must be provided. For cases where the Agency is guaranteeing the construction advance as well as the permanent loan, contract change orders are discussed in Paragraph 5.18.

5.11 Warranty

The lender must ensure that the contractor or contractors provide a legally enforceable, one-year warranty to the owner indicating that the work done and materials supplied conform to those specified in the contract documents and applicable regulations. The warranty must provide that the contractor agrees to repair defective workmanship and repair or replace any defective materials at his own expense for the period of the warranty. The lender will do its first annual inspection of the property as defined in Chapter 7, paragraph 7.13, before the expiration of the warranty period.

5.12 CONSTRUCTION REQUIREMENTS CERTIFICATION

To ensure that each of the basic construction requirements described in Section 2, have been met, the lender must provide a signed certification to the Agency prior to the issuance of the loan guarantee.

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SECTION 3: GUARANTEES OF CONSTRUCTION ADVANCES

5.13 OVERVIEW

The Agency will guarantee construction advances, secured by an acceptable credit enhancement, only as part of a combination construction and permanent loan. A combination construction and permanent loan is a loan that becomes effective at the time construction of an eligible multifamily property begins. The lender underwrites the loan and the Agency provides a guarantee that covers up to 90 percent of the amounts actually advanced by the lender. As more construction work is accomplished and more funds are advanced by the lender, the monetary amount of the loan that is covered by the guarantee increases. In no case will the guarantee during the construction period exceed 90 percent of the original principal amount of the combination loan.

Total development cost	=	\$1,000,000
Lender underwritten loan	=	\$900,000
First loan advance	=	\$70,000
Guarantee (\$70,000 x 90%)	=	\$63,000
First plus second loan advances	=	\$150,000
Guarantee (\$150,000 x 90%)	=	\$139,000

The Agency will convert the guarantee on the construction advance to a guarantee on the permanent loan in accordance with Chapter 4, Paragraph 4.20 and 4.21.

The Agency will only guarantee construction advances, which have credit enhancements to protect the government’s guarantee. Acceptable credit enhancements include any one of the following:

- Surety bonding or performance and payment bonding (preferred).
- An irrevocable letter of credit acceptable to the Agency.
- A pledge by the lender of acceptable collateral.

5.14 INSURANCE

The lender must ensure that property and liability insurance are in place during the course of construction to protect the borrower, the lender, and the contractor from a variety of losses. The construction contract must not become valid until proof of insurance is obtained. The contractor is usually responsible for obtaining and carrying the insurance policies. The amount of coverage, the deductible, and the beneficiary of the policy must be in accordance with commonly accepted lending practices or state or local law.

5.15 SURETIES

Payment and performance bonds covering the contractor’s work must be executed prior to the start of any work. The bonds must each have a face value of 100 percent of the construction contract. These surety bonds must be obtained from a corporate bonding company listed on the current Department of Treasury *Circular 570* (published annually in the Federal Register), as holding a certificate of authority as an acceptable surety on Federal bonds, and legally doing business in the state where the project is located.



5.16 LETTERS OF CREDIT

In lieu of payment and performance bonds, the lender may accept an unconditional and irrevocable letter of credit issued by another lending institution to secure the completion of construction. The letter of credit must equal not less than 25% of the construction contract and must remain in effect until the date of final acceptance of work by the owner and the lender, and all certificates of occupancy from the local jurisdiction are issued. In addition, the letter of credit must stipulate that the lending institution that issued the letter of credit, upon written notification by the owner or lender of the contractor’s failure to perform under the terms of the contract, will provide payment for an amount not less than 25% of the amount of the contract to satisfy all prior debts incurred by the contractor in performing the contract and all funds necessary to complete the work.

An irrevocable Letter of Credit issued by a bank or other approved financial institution must meet strict credit quality requirements (see Exhibit 5-2 for credit quality requirements) and be valid and collectable.


Exhibit 5-2		
Credit Quality Requirements for Letters of Credit		
Thomson's Bankwatch	N/A	"B" or better
S&P	Long term debt, if rated, or long term bank deposit	"A" or better
Moody's	Long term debt, if rated, or long term bank deposit	"A" or better

Criteria for letters of credit are as follows:

- The issuing institution must not be an affiliate of the lender, unless it has an acceptable rating from an approved rating agency, which is not an affiliate of the lender.
- Federal Home Loan District Bank enhancement of a member bank letter of credit is an acceptable method for meeting Agency credit standards.

- The Lender must be named as the sole beneficiary.
- The term must be a minimum of one year and remain in effect until the requirements for release of the Letter of Credit are met as defined in paragraph 5.16.
- The form of the letter of credit and the sight draft (demand for payment) must be reviewed by the Agency. However, the guaranteed lender is solely responsible for ensuring that the letter of credit is acceptable and enforceable.
- For GRRHP loans that are backing Ginnie Mae guaranteed securities, the Lender will follow Ginnie Mae procedures for letters of credit.

5.17 PAYMENT PROCEDURES

Payments to the general contractor should usually be made on a monthly basis.  The format of the payment request must be consistent with AIA Document 702, *Application and Certificate for Payment*, which is published by the American Institute of Architects. The payment requests must provide the same breakdown of construction costs as the final and approved cost estimate before construction began. They must be signed by the contractor and approved in writing by the borrower, the borrower's architect, and the lender.

The amount of the partial payments are based on the amount of work completed, the amount of materials stored on site, and the amount of retainage. The determination of the amount of work completed and the amount of stored materials must be made by the lender after consultation with the borrower, the borrower's architect, and on-site observations. The amount of retainage will be set by the lender. The retainage amount must be withheld until 100 percent of the construction contract is complete, including punchlist items.

Payment requests may include charges for change orders only after the change orders have been signed by the lender and the Agency representative. Partial payments for overhead and profit may be made to contractors provided the percentages paid on each item are no higher than the percentage of total construction completed.

When construction is determined to be substantially complete, an amount determined to be adequate to cover any remaining work items must be withheld from the contractor. This amount is normally included in the retainage. If the amount of remaining work is higher than the budgeted retainage, then the retainage must be adjusted upward accordingly.

5.18 CONTRACT CHANGE ORDERS

Any construction changes that occur after a contract is executed, which affect design, costs, time, or the provision of financial assistance in connection with the change order, must be documented as a contract change order. Changes that do not affect design, cost, or time are deemed minor and must be documented as field orders by the architect. These minor changes do not require the preparation of a change order. All proposed change orders must be signed

by the borrower, borrower's architect, contractor, lender, and Agency representative in writing before the work involved in the change is started or the costs are included in a payment request. Provision of additional financial assistance in connection with a contract change order does not require preparation of an environmental review by the Agency, provided that the action will not alter the purpose, operation, location, or design of the project as originally approved.

Agency approval of contract change orders must be performed in order to ensure that any changes in design or quality of materials/construction do not adversely impact the appraised value of the completed project, holding other appraisal factors (income approach and comparable sales) constant.

5.19 MODIFICATION OF MAXIMUM AMOUNT GUARANTEED FOR A CONSTRUCTION/PERMANENT LOAN AND PERMANENT ONLY LOAN

There are two situations, which may result in a modification of the maximum loan amount that will be guaranteed during the construction period.

- If following full underwriting by the lender and the issuance by the Agency of a conditional commitment to guarantee part of the loan, but prior to the start of construction, there are changes in the proposed construction or development work that will reduce the loan amount, the lender must notify the Agency. While the amount covered by the guarantee will be reduced, the percentage of the loan amount guaranteed will remain the same.
- If the construction is not in accordance with approved plans and specifications, the Agency may not issue the guarantee or may reduce the guarantee amount. For example, if the materials used are below the standards described in the approved specifications, the Agency may disapprove or reduce the guarantee percentage.

5.20 REPORTING DURING CONSTRUCTION PERIOD

The lender is responsible for ensuring that the Agency is provided a copy of approved payment estimates and the related inspection reports prepared by the lender's fee inspector and by the project architect. This documentation must be provided in a timely fashion to the Agency following each draw.



Once a new draw is issued, the lender is responsible for ensuring that the Agency has the information needed to adjust the guarantee amount. In addition the lender must submit *Form RD 1980-41, Guaranteed Loan Status Report*, on a monthly basis to the USDA Finance Office. This information is listed in Attachment 2.

Exhibit 5-3 shows the notifications to the Agency required during the construction guarantee period.

Exhibit 5-3		
Notifications Required During the Construction Guarantee Period		
Notification	When to Notify	Reference
Major inspections	As soon as a major inspection is scheduled	Paragraph 5.10
Project changes requiring an environmental review	As soon as the project change is proposed, that alters purpose, operation, location, or design, as according to Paragraph 5.18	Paragraph 5.18
Project changes reducing the loan amount	After Agency issues guarantee but prior to construction start	Paragraph 5.19

5.21 FINAL PAYMENT

The lender must ensure the following items have been completed before final payment is provided to the contractor.

- Final inspection. The lender should coordinate the final inspection with all parties, including the borrower's architect, the lender's fee inspector, the local government, and the Agency, so that the inspections may be done at the same time. In all cases, the Agency will conduct a final inspection.
- Completion of construction. All construction must have been completed in an acceptable manner. The borrower, the borrower's architect, and any local jurisdiction must state their final acceptance, in writing, before the lender issues its acceptance, as defined in paragraph 5.16.
- Final cost certification. The lender is responsible for certifying to the Agency that the borrower's cost certification accurately represents the actual cost of the work performed in connection with the construction. However, if a cost certification is prepared for any other funding source (e.g., an agency providing Low-Income Housing Tax Credits), then a copy of that cost certification is acceptable. If the cost certification indicates any "to be paid" costs, those amounts must be included in the amount of retainage being withheld.

- Warranties. A builder's warranty of at least one year, and other required product/material warranties and information must be provided to the borrower before final payment is made. The warranties should become effective on the date of substantial completion.
- Final payment documents. All final payment documents required by the lender, such as release of liens, must have been executed and must be available at the time of final payment.

5.22 CERTIFICATION THAT ADDITIONAL REQUIREMENTS HAVE BEEN MET

To ensure that the lender has addressed each of the additional construction requirements described in Section 3, Guarantees of Construction Advances, of this Chapter, the lender must include a signed form certifying that each requirement has been met prior to the Agency issuance of a permanent loan guarantee. The lender must not issue final payment until the requirements in paragraph 5.21 have been fulfilled.

SECTION 4: APPLICATION PROCESSING FOR GUARANTEES ON CONSTRUCTION ADVANCES

5.23 OVERVIEW OF PROCESS

As more construction work is accomplished and more funds are advanced by the lender, the monetary amount of the loan that is covered by the 90 percent guarantee increases.

Once construction begins, the guarantee will be adjusted based on the amount of money advanced. Adjustment of the guarantee will be automatic as long as the lender complies with the reporting requirements of this chapter.

SECTION 5: CLAIMS PROCESSING FOR GUARANTEES ON CONSTRUCTION ADVANCES

5.24 OVERVIEW OF PROCESS

For loans on construction advances where a default occurs prior to the issuance of the permanent guarantee, liquidation, disposition, and claims processing should be in accordance with Chapter 10.

Attachment 5-A

CONSTRUCTION DOCUMENTS THAT MUST BE SUBMITTED FOR ANY LOAN GUARANTEE (GUIDANCE FOR RD STAFF)

Issue	Permanent Loan Guarantee	Combination Loan Guarantee	Paragraph
Preconstruction Conference	Agency will attend if available ⁷	Agency will attend if available ⁷	5.2
Preliminary plans, specs, and cost estimate	Review, provide comments, and file ¹	Review, provide comments, and file ¹	5.7
Design Development Documents	Review, provide comments, and file ²	Review, provide comments, and file ²	5.7
Final (WD) plans, specs, cost estimate, and Form 1924-25 Plan Certification	Review, concur, and file ³	Review, concur, and file ³	5.7
Construction Contract	-----	Review, concur, and file ⁴	5.9
Debarment and Suspension	Review web site list ⁵	Review web site list ⁵	5.5
Surety Bonds and Letter of Credit	-----	Review, approve, and file ⁶	5.15 and 5.16
Inspections:			5.20
Footing	Conduct if available	Conduct if available	
Framing	Conduct if available	Conduct if available	
Final	Conduct, document, and file ⁸	Conduct, document, and file ⁸	
Payments to contractor	-----	File only ⁹	5.17
Change Orders	-----	Review, approve, and file ¹⁰	5.18
Final Cost Certification	Review, accept, and file ¹¹	Review, accept, and file ¹¹	5.21
As-built Plans and Specs	Review	Review	5.10
Certification that additional construction requirements have been met	-----	-----	5.22
Form 1980-41 Guaranteed Loan Status Report	-----	Monitor	5.20
Lender –approved payment estimates and related inspection reports	-----	Review and file	5.17 and 5.20

NOTES

1. These are submitted after the PrePlanning Meeting and with the application. They include LCCA for roofing, paving, exterior wall, and mechanical systems.
2. These are in response to the preliminary design review. These documents may be skipped and go directly to the final (WD) documents.
3. The WD Documents include the plan certification, bidding and contract documents due prior to start of construction.
4. A written agreement is NOT required to be on an AIA form.
5. RD reviews the GSA Website List for the General Contractor. Lender reviews Form AD-1048.
6. Letter of Credit may be substituted for payment and performance bonds.
7. Conference must be held. Agency attendance is highly recommended.
8. Agency must be notified of all inspections. Agency participation in required only in the final.
9. Payments are processed and approved by Lender.
10. Agency uses same criteria employed in reviewing final plans and specs.
11. Cost certification required from IOI contractors only and must be audited.
12. Documents not required to be reproducible.

- Lender's narrative (HB-1-3565, section 4.9B(2)).
- A copy of the pro forma budget detailing the first year and a typical year's operation (Proformas with and without the interest credit award will serve as justification for the interest credit award) (HB-1-3565, section 4.9B(2)).
- Disclosure of any change in financing since NOFA response submission (HB-1-3565, section 4.9B(2)).
- Type of utilities and utility allowances (Attachment 4-G), if applicable (HB-1-3565, section 4.9B(2)).
- Interest Credit Request, if applicable (see Paragraph 4.10) (HB-1-3565, section 4.9B(2)).

Required environmental information:

- Phase I Environmental Site Assessment Report, as prescribed by the American Society for Testing and Materials (HB-1-3565, section 4.9B(2)).
- Compliance with historic and architectural laws, if applicable (HB-1-3565, section 4.9B(2)).
- Comments regarding relevant off-site conditions (HB-1-3565, section 4.9B(2)).
- Land survey (HB-1-3565, section 4.9B(2)).

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6. The Guaranty has been duly executed by the Guarantors and is a legal, valid and binding joint and several obligations of the Guarantors, enforceable in accordance with its terms, except to the extent that the enforceability (but not the validity) thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors' rights.
7. All necessary consents, approvals, or authorizations of any governmental agency or regulatory authority or of stockholders which are necessary have been obtained. The improvements and the use of the property comply in all respects with all Federal, State, and local laws applicable thereto.
8. (In cases involving subordinate or other than first lien position.) That the mortgage/deed of trust on Borrower's real estate and (fixtures, e.g. machinery and equipment) and the security interest on (type of collateral, e.g., machinery and equipment, accounts receivables and inventory) both given as security to the Lender for the Loan, will be subordinate to (first mortgage) given as security for a loan in the amount of \$_____ and the security interest in Borrower's (type of collateral, e.g., accounts inventory) given to (secured creditor) as security for a loan (state type of loan, i.e., revolving line of credit, if known) in the amount of \$_____.
9. That there are no liens, as of the date hereof, on record with respect to the property of Borrower other than those set forth above.
10. There are no actions, suits or proceedings pending or, to the best of our knowledge, threatened before any court or administrative agency against Borrower which could materially adversely affect the financial condition and operations of Borrower.
11. Borrower has good and marketable title to the real estate security free and clear of all liens and encumbrances other than those set forth above. I/we have no knowledge of any defect in the title of the Borrower to the property described in the Loan Instruments.
12. Borrower is the absolute owner of all property given to secure the repayment of the loan, free and clear of all liens, encumbrances, and security interests.
13. Duly executed and valid functioning statements have been filed in all offices in which it is necessary to file financing statements to fully perfect the security interests granted in the Loan Instruments.
14. Duly executed real estate mortgages/deeds of trust have been recorded in all offices in which it is necessary to record to fully perfect the security interests granted in the Loan Instruments.

15. (IN SOME OTHER CIRCUMSTANCES) The Indemnification Agreement has been duly executed by the Indemnitors and is a legal, valid and binding joint and several obligation of the Indemnitors, enforceable in accordance with its terms, except to the extent that the enforceability (but not the validity) thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors' rights.
 16. That the lease contains a valid and enforceable right of assignment and right of reassignment, enforceable in accordance with its terms, except to the extent the enforceability (but not the validity) thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors' rights.
 17. The Lender's lien has been duly noted on all motor vehicle titles, stock certificates or other instruments where such notations are required for proper perfection of security interests therein.
 18. That a valid pledge of the outstanding and unissued stock and/or shares of Borrower has been obtained and the Lender has a validly perfected and enforceable security interest in the shares/stock of Borrower, except to the extent the enforceability thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors rights.
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ATTACHMENT 4-E

LETTER NOTIFYING LENDER OF INCOMPLETE NOFA RESPONSE

John Dow
Vice President
Rural Mortgage Corporation
123 Farm Road
Ruraltown, USA 00000

RE: Section 538 Guaranteed Rural Rental Housing Program
Fiscal Year 0000 Notice of Funding Availability (NOFA)

Dear Mr. Dow:

The Agency has received your NOFA response dated 00-00-0000. Unfortunately, we are unable to process your NOFA because the following information is missing:

- Missing documentation, and
- Missing information.

You are welcome to resubmit another NOFA response for the project prior to the closing date of the NOFA.

Sincerely,

Deputy Administrator
Multi-Family Housing

Enclosures

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ATTACHMENT 4-F

CLOSING DOCUMENTS TO BE SUBMITTED AS PART OF THE FINAL APPLICATION

After the conditional commitment for guarantee has been issued, the proposed closing documents will be prepared by the lender and forwarded to the Agency with the lender's counsel's opinion in the suggested format of Attachment 4-D. Prior to issuing the loan note guarantee, the State Director will forward the loan docket including all required documents to the Office of the General Counsel (OGC) for review unless otherwise directed by OGC. After an administrative review, the State Director will include with the docket a letter of recommendation indicating any special items, documents, or problems that need to be addressed. The docket will be assembled by the lender for OGC review in accordance with guidance listed below, and indexed and tabbed.

DOCUMENTS TO BE SUBMITTED FOR OGC REVIEW

- (1) Letter from RHS National Office authorizing loan guarantee and containing conditions (if applicable);
- (2) *Form RD 3565-2, Conditional Commitment*;
- (3) Promissory Notes;
- (4) Security documents - Real Estate Mortgage, Security Agreement, Financing Statements, and Leases (if applicable);
- (5) Personal or corporation guarantees with related security documents;
- (6) *Form RD 3565-3, Lender's Agreement*;
- (7) *Form RD 3565-4, Loan Note Guarantee*;
- (8) Opinion of Lender's Counsel in form prescribed by OGC (Attachment 4-D);
- (9) Regulatory Agreement with attached certification from the lender's attorney (see Paragraph 4.17); and
- (10) Deed Restriction or other recordable instrument acceptable to the Agency that declares that housing must remain available for occupancy by low and moderate income households for the original term of the guaranteed loan.

Do not submit for OGC review feasibility studies, title information, or the original application unless specifically requested to do so.

OGC will review the docket and furnish advice to the Agency on whether it may issue the loan note guarantee after the loan is closed. Such advice is for the benefit of the agency only and does not relieve the lender of its responsibilities under agency regulations. OGC at his/her option may attend the loan closing.

HB-1-3565

ATTACHMENT 4-G
HOUSING ALLOWANCES FOR UTILITIES AND OTHER PUBLIC SERVICES

NAME OF BORROWER: _____
EFFECTIVE DATE: _____
LOCATION OF PROJECT: _____

PART I PROJECT BASED PAID UTILITIES AND SERVICES

MONTHLY DOLLAR ALLOWANCES

UTILITY OR SERVICE 0-bdrm 1-bdrm 2-bdrm 3-bdrm 4-bdrm 5-bdrm

HEATING

- a. Natural gas
- b. Bottle gas
- c. Electric
- d. Oil

AIR CONDITIONING

COOKING

- a. Natural gas
- b. Bottle gas
- c. Electric

**OTHER ELECTRIC LIGHTING,
REFRIGERATION, ETC.**

WATER HEATING

- a. Natural gas
- b. Bottle gas
- c. Electric
- d. Oil

WATER

SEWER

TRASH COLLECTION

OTHER (Specify)

TOTAL ALLOWANCE

Prepared by: _____
Borrower or Agent Title Signature Date

**PART II ALLOWANCES FOR UTILITIES AND SERVICES BILLED AND PAID
DIRECTLY BY TENANT**

TO: _____
Address of Tenant

Number of Bedrooms: _____

You will be billed directly for utilities and service charges. Below are the allowances credited in your rent for the payment of utilities. You may be billed for more or less than shown below depending on your use of utilities.

UTILITY OR SERVICE	PER MONTH EXPENSE
Heating	\$ _____
Air Conditioning	\$ _____
Cooking	\$ _____
Other Electric	\$ _____
Water Heating	\$ _____
Water	\$ _____
Sewer	\$ _____
Trash Collection	\$ _____
Other (Specify) _____	\$ _____
_____	\$ _____
_____	\$ _____
TOTAL	\$ _____

Signature of Borrower or Agent

Date

Planning Meeting Agenda

The purpose of this meeting is to present and discuss USDA Rural Development (Agency) requirements for developing a Guaranteed Rural Rental Housing project. Topics marked with an asterisk (*) include procedures that apply only when an Agency construction loan guarantee is combined with a permanent loan guarantee. Additional information on the topics may be provided in Agency administrative notices, guides, and other documents. The Agency will document the meeting with a list of attendees and note whether it took place in person or via conference call.

	TOPICS	REFERENCES		COMMENTS
		Regulation	HB-1-3565 / Other	
1.	Sites			
A.	Location	3565.251 and 1924.106(c)	3.12 and 3.13	
B.	Services / facilities		3.13	
C.	Professional services	1924.105(a)(2)	3.14	
D.	Site standards	1924.107(2) and 1924.108	3.14	
E.	Site density		3.15	
F.	Non-contiguous sites	3565.251(c)	3.16	
G.	Site control	3565.152	3.17	
2.	Environmental			
A.	NEPA process and responsibilities	3565.255 and 1940-G	3.18 and 5.8 and Chap. 4 and 11	
B.	Lender's Phase I ESA included in NEPA review	3565.254(b) and 1940-G	3.18 and 5.8 and 11.5	
C.	FEMA form 81-93	1806-B	11.5	
D.	Timing issues/scheduling	1940.331	Chap 4 and 11	
E.	Parties involved from local and state agencies	3565.254(b)	Chap 11	
F.	Lender documentation	3565.254(b)	Chap 11	
3.	Design			
A.	Property standards	3565.254(a) and 1924.5(d)(1)	3.20 and 5.3	
B.	Drawings and specifications	1924.5(d)(2) and 1924.13(c),(d)	4.4A1, 5.6. and 5.7	
C.	Professional services	3565.256 and 1924.13(a)	5.6	
D.	Agency Reviews	1924.5(h)	5.7	

Planning Meeting Agenda

	TOPICS	REFERENCES		COMMENTS
		Regulation	HB-1-3565 / Other	
E.	Plan certification	3565.256 and 1924.5(f)(1)	5.7 and 5.12	
F.	Life Cycle Costs Analysis		5.9	
4.	Accessibility			
A.	Americans with Disabilities Act (ADA) compliance	3565.251(d)	3.20.C and ADAAG	
B.	Van accessible parking space for on-site office and public spaces		ADAAG 4.1.2(5)(b)	
C.	Fair Housing Amendments (FHA) Act of 1988 compliance	3565.251(d)	3.20.C and FHA / AG	
D.	All common areas accessible		FHA / AG Sec. 5, Req. 2; and UFAS 4.1.3	
E.	All ground floor units adaptable.		FHA / AG Sec. 5, Req. 4	
F.	Section 504 of the Rehabilitation Act of 1973	7 CFR 15b and 3565.251(d)	3.20.C and UFAS	
G.	5% fully accessible units		UFAS 4.1.4(11)(b) and 4.34	
H.	Front loading washers		UFAS 4.34.7.2	
5.	Construction			
A.	Contract documents	1924.6(a) and 1924.13(e)(1)(ii)	5.9 and Exh 5.2 and 5.4	
B.	Pre Construction Conference	1924.6(a)(11)	5.2	
C.	Debarment / Suspension	1940-M	5.5	
D.	Procurement	3565.257		
E.	Insurance *		5.14	
F.	Inspections	3565.303(c)(3) and 3565.303(d)(4)	3.20 and 4.21 and 5.10 and 5.20	
G.	Substantial Completion	3565.303(d)(2)		
H.	Warranty	1924.12	5.11 and 5.21	
I.	Sureties *	3565.303(c)(2)	5.15 and 5.16	
J.	Payments *	1924-A, and 3565.303 (c)(3)	5.17 and 5.20 and 5.21	
K.	Change orders *	1924.10(c)	5.18	
L.	Cost Certification	3565.303(d)(5)	5.21	
M.	Annual inspections	3565.351(c)	7.13.A.2	

Planning Meeting Agenda

	TOPICS	REFERENCES		COMMENTS
		Regulation	HB-1-3565 / Other	
6.	Professional Mgmt. & Servicing			
A.	Affirmative Fair Housing Marketing Plan		7.14 A	
B.	Assurance Agreement		7.14 C	
C.	Title VI of Civil Rights Act of 1964		Exhibit 7-5	
D.	Occupancy Requirements		8.12 A, B, D, E	
E.	Tenant Grievances		8.14, 8.15	
F.	Pre-Rent Up Instructions		8.2 I	

Date _____

Location _____
(indicate if teleconference)

Attendees:

	Name	Contact Information
1.	_____	_____
2.	_____	_____
3.	_____	_____
4.	_____	_____
5.	_____	_____
6.	_____	_____
7.	_____	_____
8.	_____	_____

CHAPTER 6: PROGRAM FEES

6.1 OVERVIEW

This chapter provides information on the type and amount of fees that the Agency may charge to lenders. The chapter will also explain when fees should be collected and who is responsible for submitting payment. Exhibit 6-1 provides an overview of each fee discussed in this chapter. None of the fees are refundable.


Lenders must submit fees to multifamily housing staff in the State Office in which the project is located. The State Office staff will process the fee, including *Form RD 451-2, Schedule of Remittances*, and forward it to the Finance Office via lock box. State Office staff will transmit the fee and *Form RD 451-2* to: Wholesale Lock Box, P.O. Box 845084, Dallas, TX 75284-5084.

Exhibit 6-1				
Loan Guarantee Fees				
FEE	SUBMISSION	AMOUNT	EXAMPLE	TOTAL
Guarantee Fee	At the time the guarantee is issued	1% of total loan amount x % of the guarantee	$\$1,000,000 \times .01 \times 0.90 =$	\$9,000
Annual Renewal Fee	This fee will be collected, in advance, on January 1st of each calendar year	0.5% of the outstanding principal amount of the loan	$\$1,000,000 \times .005 =$	\$5,000
Application Fee	When application is submitted	Flat Fee		\$2,500
Extension Fee	When the request is made	Flat Fee		\$500
Reopening Fee	When the request is made	Flat Fee		\$500
Transfer of Ownership Fee	When the request is made	Flat Fee		\$1,250

6.2 FEES ASSOCIATED WITH THE LOAN GUARANTEE


The lender pays all fees associated with the loan guarantee to the Agency. A description of the fees and submission requirements are described below.

A. Guarantee Fee

The guarantee fee is the financing fee a lender must pay to the Agency for the loan guarantee. The guarantee fee is a one-time fee equal to one percent of the guarantee amount. For purposes of calculating this fee, the guarantee fee is equal to 1% of the total loan amount times the percentage of the guarantee. 

The fee must be paid to the Agency at the closing of the loan note guarantee.

B. Annual Renewal Fee

The annual renewal fee is a non-refundable amount that the lender must pay each year that the loan guarantee remains in effect. The fee is calculated as of December 31 and paid in advance for the upcoming calendar year. The annual renewal fee is not charged in the first year that the loan note guarantee goes into effect since the guarantee fee is paid at the closing of the loan note guarantee. The lender will pay an annual renewal fee of at least 50 basis points (one-half percent) of the outstanding total principal amount of the loan each year. This fee will be collected on January 1st of each calendar year. 

C. Surcharge for Guarantees on Construction Advances

No surcharge will be assessed unless specified in the NOFA.

6.3 ADDITIONAL AGENCY FEES

There are other fees that may be incurred by the lender or borrower during the life of the guarantee. The following is a list of fees and time when fees are due.

A. Application Fee

The Agency will charge the lender a flat application fee of \$2,500. The fee will be used to help defray the administrative costs associated with processing the application. This non-refundable fee is to be paid when the application is submitted.

B. Extension and Reopening Fees

The Agency may charge the lender a flat fee for an extension of the commitment term. If the extension is granted, the lender must pay a fee of \$500 per extension. The fee must be submitted when the request for the extension is made. This fee will cover any administrative costs associated with the process of extending the commitment.

If the commitment ends and the Agency decides to reopen the commitment, the lender must pay a flat fee of \$500 per reopening. This fee is used to cover any opportunity and processing costs associated with reopening the commitment.

C. Transfer Fee

The Agency may charge the lender a transfer fee for administrative costs associated with the transfer of the property from one owner to another one. A fee of \$1,250 will be collected at the time a transfer request is submitted. The Agency fee will be in addition to any fee the lender may charge to cover the lender's administrative costs associated with the transfer process.

CHAPTER 7: SERVICING PERMANENT LOANS

7.1 INTRODUCTION

This chapter is designed to serve as a best practice guidebook for servicing of GRRHP loans. While it establishes minimum servicing standards, the Agency expects lenders to service the loans according to the same standards of excellence as other properties in the lender's portfolio.

Key Topics in this Chapter

- Section 1: Servicing Goals and Objectives
- Section 2: General Servicing Requirements
- Section 3: Asset Management
- Section 4: Special Servicing

SECTION 1: SERVICING GOALS AND OBJECTIVES

7.2 OBJECTIVES

In establishing servicing standards for GRRHP loans, the Agency has three major objectives:

- Protecting the Value of the Asset;
- Protecting the Tenants; and
- Protecting the Government's Interest.

7.3 PROTECTING THE VALUE OF THE FINANCIAL ASSET

The financial asset includes both the loan and the security property that serves as collateral. Protecting the value of the asset ensures that the property will remain available as affordable housing for the term of the loan and protects the financial interests of the lender and the Agency. The lender has the primary responsibility with the borrower for protecting the value of the asset through regular monitoring, inspections of the property, and management of reserves and escrow accounts.

7.4 PROTECTING THE TENANTS' RIGHTS

By statute, GRRHP units must be available to persons of low and moderate income. Tenants who reside in GRRHP properties have the right to remain in a rental unit even if their income increases, so long as they meet the requirements of the lease. Moreover, the Agency has determined to keep units affordable by controlling unit rents. These goals are set forth in Chapter 8. The lender must ensure that the occupancy requirements, rent restrictions, and tenant protections are met by the borrower throughout the term of the guarantee, or in the case of the income restrictions, the original mortgage term.

7.5 PROTECTING THE GOVERNMENT'S INTERESTS

As a condition for lender approval under [7 CFR part 3565, subpart C], the lender must operate under a plan for originating and servicing GRRHP loans. The Agency expects that the lender will service the loans according to the same standards as it services all other multifamily loans in its portfolio. The requirements for the origination and servicing plan that establishes the lender's policies and procedures for servicing multifamily loans can be found in Chapter 2.

The Agency servicing standards are designed to preserve the asset and protect the interests of the government. This includes, but is not limited to:

- Minimum requirements for annual reviews of the physical and financial conditions of the property.
- Reporting requirements designed to keep the Agency informed of key indicators of the GRRHP portfolio.
- Minimum standards for special servicing for loans that are delinquent or in default.

SECTION 2: GENERAL SERVICING REQUIREMENTS

7.6 FUNDS MANAGEMENT



A. Collecting and Processing Borrower Payments

The lender will collect and apply borrower payments on the loan in accordance with Generally Accepted Accounting Practices. At a minimum, such standards should meet the requirements established by Fannie Mae, Freddie Mac or Ginnie Mae for similar properties.

B. Escrow and Reserve Account Management

The lender is responsible for proper maintenance of the borrower's escrow accounts. Escrows shall include escrow accounts established for both hazard (fire) insurance and flood insurance to reserve the monthly share of annual property tax and property insurance payments. In addition, each property must have a reserve account for replacement to receive monthly deposits for projected replacement of appliances, furnishings, equipment, and major repairs.

C. Interest Credit

The interest credit will be paid following the January 1 of the year in which the project has reached occupancy standards and the Loan Note Guarantee is converted to the Final Loan Note Guarantee. The interest credit calculation and the request will be part of the annual report provided to the Agency State Office. The State Office will review the calculation for accuracy and then forward the document on to the Finance Office for processing. The interest will be calculated from the date of the conversion to the Final Loan Note Guarantee to the end of the year.

D. Approval of Reserve Releases

1. Agency Recommended Approval Requirements

Lenders must establish their own reserve management protocols in the lender servicing plan. The procedures should include, at a minimum, the following:

- **Lender approval** of releases of funds from required reserve accounts.
- **Documentation of completed work.** Most requests should be processed on a post-approval basis, once the work is completed or expenses paid and the required documentation submitted. While the Agency does not have specific requirements for verification of expenses, the lender should ensure that reserve funds are used for eligible purposes. Documentation should include original receipts and a borrower certification that the work described has been completed.

2. Approval of Structural Repairs

The Agency recommends pre-approval by the lender for repairs involving structural work. A review and approval of the plans and specifications for such work may also be warranted.

3. Obtaining Bids in the Use of the Reserve Account

Lenders should require borrowers to obtain bids on major repairs, construction projects, or purchases. A recommended standard is three written bids for any single purchase or project that exceeds \$10,000. Borrowers should be required to justify any bid accepted that is higher than the lowest bid.

4. Minimum Replacement Reserve Levels

Required deposits to a replacement reserve account should be determined by the lender through a capital needs assessment. These amounts should be reviewed annually and modifications made if the reserve deposits are not sufficient to address long term replacement needs. A balance of \$1,000 per unit is recommended by the Agency as a minimum level for the reserve account by the time the project reaches its third year of occupancy. A lesser reserve amount must be justified by a capital needs assessment. This will ensure availability of funds for unexpected repairs or temporary needs. This level should be achieved by the end of the third full year of occupancy.

Required deposits to the replacement reserve account after the first three years of occupancy will continue to be determined by the lender through the capital needs assessment. The Agency recommends an annual contribution of no less than \$275.00 per year with periodic adjustments for inflation. These amounts should be reviewed annually, and modifications made if the reserve deposits are not sufficient to address long term replacement needs. Any drop below recommended levels should be reported to the Agency as part of the annual report on the property.

5. Eligible Uses of Reserve Funds

Reserve funds should be used for the repair and replacement of depreciable physical property. The lender has the discretion to approve or disapprove the use of reserve funds, even if an item is permitted by Agency guidance, if the lender feels it is in the best financial interest of the property. A list of eligible uses is suggested below. Items permitted by Fannie Mae, Freddie Mac and Ginnie Mae as eligible reserve release items will also be considered eligible.

Replacement items should be at least comparable in quality to items approved at the time of the original construction of the property, and in accordance with the initial plans and specifications. When replacing obsolete or broken appliances, the purchase of new energy efficient models should be encouraged.

On an annual basis, the lender must submit to the Agency a summary of the reserve withdrawal requests made and related work inspection reports for the prior year.

While enhancements to the property such as a personal computer or software may be considered for funding, items generally considered routine maintenance items and capital improvement items should be ineligible for funding from the replacement reserve account. The Agency may require a lender to justify any release of reserve funds for these purposes.

The use of reserve funds is normally considered a categorical exclusion under the Agency's environmental review process, unless the funds will be used in ways that alter the purpose, operation, location, or design of the project. Particular care should be taken that reserve funds are not used to alter the historic integrity of places listed or eligible for listing on the National Register of Historic Places until an environmental review is completed in accordance RD Instruction 1940-G. Lenders must check with the Agency regarding the possible need for an environmental review prior to approval of use of reserve funds.

Examples — Eligible Uses of Replacement Reserve Account Funds

- Replacement of refrigerators, ranges, and other major appliances in the dwelling units.
- Replacement of kitchen and bathroom sinks and counter tops, bathroom tubs, water closets, and doors (exterior and interior).
- Major roof repairs, including replacement of sheathing, gutters, downspouts, and eaves or soffits.
- Major plumbing and sanitary system repairs.
- Replacement or major overhaul of central air conditioning and heating systems, including cooling towers, water chilling units, furnaces, stokers, boilers, and fuel storage tanks.
- Overhaul of elevator systems.
- Repaving/resurfacing/sealcoating of sidewalks, parking lots, and driveways.
- Repainting of the entire building exterior or interior common areas.
- Replacement of siding.
- Fire alarms.
- Playground equipment.
- Replacement of exterior (lawn) sprinkler systems.

E. Approval of Surplus Cash Distribution to the Borrower

Surplus cash is defined as year-end cash available after the project has met all operating expense and debt service payments, including the required funding of reserves. While a surplus cash distribution to the owner is not restricted as to the amount, Agency

regulations require that the lender ensure that the property be in “good financial and physical condition and in compliance with the regulatory agreement” prior to any distribution of surplus cash.

1. Borrower Request for Distribution of Surplus Cash

At the end of the project’s fiscal year, the borrower may request the release of surplus cash. As a prior condition for such release, the borrower must submit an annual audited financial statement of the property to the lender (see Paragraph 7.11 A.1. for information on audit requirements). The audit must not have any unresolved findings. Once the lender reviews the statement and certifies that the borrower is in compliance with program requirements, the lender may permit the owner to have access to all or a portion of any surplus cash.

2. Lender Denial of Surplus Cash

If the borrower has any current or previous unresolved audit findings or any violation of program requirements, the lender may deny access to surplus cash. Exhibit 7-1 gives examples of reasons for denial of surplus cash.

<p style="text-align: center;">Exhibit 7-1</p> <p style="text-align: center;">Examples of Reasons for Denial of a Year-End Surplus Cash Distribution</p> <ul style="list-style-type: none">• Fair Housing violations• Violations of State or local law• Underfunded reserve accounts• Failure to submit a budget or other reporting requirements to the lender in a timely manner• Failure to properly maintain the property• Failure to comply with the mortgage documents or regulatory agreement
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3. Borrower Withdrawal of Surplus Cash Without Lender Approval

Primary responsibility for control of surplus cash distribution remains with the lender. If a borrower withdraws surplus cash without lender approval, the lender must require the borrower to replace the funds into the proper operating account. If appropriate, the lender may permit repayments in installments as part of a corrective action plan. If the borrower fails to comply, the lender must enforce the technical default clause under the regulatory agreement and accelerate the loan.

This action must be reported to the Agency in the same manner as a monetary default on the mortgage.

7.7 ADDRESSING DEFAULTS AND DELINQUENCIES

Lender actions to remedy delinquencies and defaults must be addressed in the lender servicing plan. Since delinquencies and defaults trigger special servicing actions, it is important to identify when they occur and when the lender must initiate special action. Unless otherwise approved in the servicing plan, the following definitions will apply to delinquencies and defaults.

A. Delinquencies

For the purpose of this chapter, a project will be considered to be delinquent when the borrower has failed to make the full amount of a required payment on the due date plus any grace period, or fails to comply with non-monetary requirements. Once the loan becomes delinquent, the lender must submit monthly reports to the Finance Office in accordance with Paragraph 7.11 B.3.

B. Declaring a Default

For the purpose of this handbook, a lender may declare a default if the delinquency remains outstanding after 30 days from the due date of the payment or written notice of a non-monetary delinquency.



C. Initiating Special Servicing

Special servicing should be initiated in accordance with Section 4 of this chapter as soon as a default occurs. A workout plan must be submitted to the



Example – Initiating Special Servicing – Failure to Pay Mortgage

1st of the month – The mortgage payment is due.

15th of the month – The mortgage payment has not been received. A delinquency notice is sent to the borrower warning them of a default under the mortgage documents if a full payment is not received by the end of the month.

End of the month – The mortgage payment has not been received, the loan is now in default. The lender informs the borrower of the default and demands payment. Borrower may request a workout plan. If lender agrees to the workout plan, the borrower submits plan to the lender.

End of the second month – The lender determines if the plan is acceptable (see Section 4 of this chapter). If so, then the plan is submitted to the Agency. It must be submitted to the State Office by the end of the second month (60 days from the date of default).

Agency no later than 60 calendar days after the date the lender notifies the borrower that they are in default.

Transfer of ownership is normally considered a categorical exclusion under the Agency's environmental review process, unless the transfer will result in an alteration to the purpose, operation, location or design of the project as originally approved.

7.8 TRANSFER OF OWNERSHIP

A. Changes in the Ownership Entity

The lender must approve all changes in the ownership entity. These include changes in the general partners or in limited partners with a partnership interest greater than 10 percent, or any other change that requires modification of the title.

<p>Approval of Ownership Changes</p> <ul style="list-style-type: none">• The lender must approve all changes in general or limited partners, or a change that requires a modification to the title.• The Agency must approve all transfers of the entire ownership entity.
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Prior to approving a change in the ownership entity, the lender must assure that the proposed new partner or entity is not currently on the GSA debarment list and that they are able to obtain a *Form RD 1944-37* clearance on the entity. The lender may access the GSA debarment list online at: <http://www.arnet.gov/epls/>

If an entity is approvable under the above conditions, the lender must determine if the transfer will adversely affect the value or operation of the property for its own purpose. The lender must document the reason for a denial and notify the applicant in writing.

B. Transfers of Title/Transfers of Physical Assets

Written Agency approval is required for transfers that involve the entire ownership entity. The lender must conduct a review of property conditions prior to recommending the transfer for Agency approval. All transfers of the entire ownership entity must include a plan to bring the property into full compliance with program requirements and loan documents, including any physical repairs or deficiencies in reserve amounts.

7.9 TRANSFER OF LOANS OR MORTGAGE SERVICING

The transfer of servicing is prohibited unless the Agency determines that circumstances warrant such action and the proposed lender is an eligible lender approved by the Agency. The transfer of servicing must be approved by the Agency in advance.

SECTION 3: ASSET MANAGEMENT

7.10 OVERVIEW

Asset management involves regular monitoring of the operation and maintenance of a loan and security property to ensure that the value of the asset is maintained or enhanced over the life of the loan, taking into account market conditions. Asset management includes financial and physical management of the property and compliance with program and other Federal requirements.

7.11 FINANCIAL MANAGEMENT

A. Borrower Reports to the Lender

The purpose of the borrower reporting requirements is to provide the lender with the information necessary to adequately monitor the guaranteed loan. The lender may require additional reporting for its own purposes. Borrower reporting requirements must be applied consistently to all GRRHP loans. The Agency also expects the lender to obtain additional information regarding the property through management reviews and physical inspections of the property. The lender must outline the complete reporting requirements and planned reviews and inspections in the servicing plan.

1. *Annual Audited Financial Reports*

Within 90 days of the end of the project fiscal year, the borrower must submit to the lender an audited annual financial statement conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). GAGAS will provide the lender with a financial audit of the property as well as information regarding compliance with program requirements. The program review requirements for the GAGAS audit can be found in Exhibit 7-2. In addition to this report, the borrower must also certify that they are in compliance with the rent restrictions established in [7 CFR 3565.203].



2. *Failure of the Borrower to Comply with Lender Reporting Requirements*

The lender may require additional information from the borrower at any time if necessary to fulfill its reporting requirements to the Agency or to properly fulfill its oversight and monitoring responsibilities.

Failure on the part of the borrower to comply on a timely basis with the reporting requirements outlined in this handbook and any additional reporting requirements established by the lender in writing, may result in penalties against the borrower ranging from denial of surplus cash distribution to acceleration of the mortgage.

Exhibit 7-2

Supplemental GAGAS Audit Guide

- For years in which loan funds were expended, either outright or through interim financing, test expenditures to determine if they were budgeted and were made for only authorized loan purposes within the prescribed loan limits and limitations on the use of loan funds. Note: Testing should be expanded, as appropriate, for expenditures involving parties having an identity of interest with the borrower (related parties).
- Ascertain whether the GRRHP project is capitalized in the borrower's financial records at the total development cost, including the portion financed by the Agency and contributed by the borrower, less depreciation.
- Ascertain whether the borrower has written documentation supporting a request to, and prior approval from, the Agency for any changes in stockholders, general partners, or trustees.
- Ascertain whether there were any changes in limited partners, and if so, whether the borrower has written documentation supporting a notification to the Agency.
- For years in which the project is being constructed, ascertain by reviewing the borrower's financial records whether the borrower contributed the required percentage toward the project's development cost, and whether any cash contribution was expended prior to loan funds.
- Ascertain whether any liabilities were improperly charged to, or paid from, project operations for contributions made by the borrower equal to, or in excess of, the required contributions for development costs.
- Test whether funds disbursed from the accounts were for actual, reasonable, and necessary expenditures incurred for authorized purposes, and if required monthly debt service payments and transfers to escrow and reserve accounts were made. Disbursements made for purposes not related to the GRRHP project, including loans to other projects or enterprises, and partnership or corporate legal, tax preparation, and accounting fees, are not authorized or allowable. Note: Testing should be expanded, as appropriate, for expenditures involving parties having an identity of interest with the borrower (related parties).
- Ascertain whether the reserve account is current by comparing the actual amount in reserve to the amount that should have accumulated since the date the project began operation (see loan agreement), less any authorized withdrawals approved by the Agency. Obtain a confirmation of the reserve account balance from the applicable financial institution, also checking for any encumbrances against the reserves.

Exhibit 7-2 (Continued)

- Ascertain whether a separate bank account is maintained for tenant security deposits, and if sufficient funds are in the account to cover security deposits collected from current tenants. Obtain a confirmation of the tenant security deposit account balance from the applicable financial institution, also checking for any encumbrances against the funds. Test withdrawals to ensure they represent either refunds to tenants or transfers to the general operating accounts for lease violations.
- If any surplus funds existed after payment of general operating expenses, debt service requirements, reserve account installments, and returns on investment, ascertain whether the borrower obtained written approval from the Agency for the disposition of such funds.
- Ascertain whether the borrower timely prepared and submitted audited financial statements for the previous year if required.
- For the tenants selected under the audit procedures, review the borrower's records to ensure there is an original tenant certification on file and the tenant's income was independently verified.
- Test the accuracy of the information and figures reported on the tenant certifications by reconciling the information and figures with the most current leases, independent income (earned, unearned, public assistance, etc.) verifications, and other information obtained by the borrower.
- Ascertain whether the borrower has a management plan, and a management agreement, if required, which have been approved by the lender.
- Test whether the management services provided, compensation paid, and other management-related expenses incurred were in accordance with the management plan and agreement.
- Ascertain whether the borrower is: (1) maintaining the required fidelity bond coverage; (2) maintaining adequate property, worker's compensation, liability, and flood (where applicable) insurance; and (3) timely paying real estate and other applicable personal property taxes.

B. Lender Reports to the Agency

The lender must periodically report to the Agency on each GRRHP loan in its portfolio. These reports will provide the Agency with an accurate assessment of the condition of the guaranteed loan portfolio. The Agency will collect additional information on the lender's portfolio of guaranteed loans during the annual lender audit process. Periodic reports include those listed below.

1. Annual Reports

Within 120 calendar days of the end of each project’s fiscal year, the lender must submit a report to the Agency detailing their review of the project annual financial statement. The report must contain any findings related to the following items if deficiencies have been identified during the lender's annual review of the project:



- Any unresolved audit findings;
- Outstanding physical and financial deficiencies. Such deficiencies should be ranked in accordance with the Agency Classification Scale (see Exhibit 7-3);

<p>Exhibit 7-3</p> <p>Classification System of RHS Projects</p> <p><u>Class A</u></p> <p>No specific problems with project.</p> <p><u>Class B</u></p> <p>Approved workout agreement in place and on schedule.</p> <p><u>Class C</u></p> <ol style="list-style-type: none">1. Unauthorized return to owner.2. Required monthly/quarterly reports not submitted.3. Deferred maintenance.4. Below average rating from last lender inspection.5. Unapproved workout agreement in place and on schedule. <p><u>Class D</u></p> <ol style="list-style-type: none">1. Delinquent loan account.2. Annual Financial Statement not submitted.3. Delinquent reserve account.4. Taxes not paid.5. Insurance not paid.6. High vacancy -- reduced rental revenue of 10 percent or more.7. Health, safety or environmental problems.8. Noncompliance with Equal Opportunity and Fair Housing requirements.9. Unsatisfactory rating from last lender inspection.10. Substantial deferred maintenance.11. Unauthorized owner/manager agent withdrawal from project funds.
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- Underfunded reserves and escrows, including:
 - ◊ Tax and insurance escrows, and
 - ◊ Replacement reserve levels below \$1,000 per unit;
- Current debt service coverage ratios below 1.15;
- Vacancy levels greater than the original underwriting level;
- Tenant income and family size characteristics; and
- Information on unit rent levels and average project rents for the period.

In submitting the information required above, the lender must also certify that the borrower is in compliance with the rent restrictions established in [7 CFR 3565.203].

2. Quarterly Reports

The lender must submit a quarterly report to the USDA Finance Office using *Form RD 1980-41, Guaranteed Loan Status Report* to detail the current status of the GRRHP loan.

3. Monthly Reports

The lender must submit monthly reports to the Agency on all loans in its portfolio which are in default or delinquent in meeting program requirements.  *Form RD 1980-44, Guaranteed Loan Borrower Default Status*, must be submitted to the USDA Finance Office for this purpose. The lender must also submit a monthly report to the State Office detailing:

- The reason for the delinquency;
- The physical condition of the property;
- The occupancy rate of the property;
- The amount of the delinquency;
- The corrective action plan being implemented to resolve the delinquency; and

- The workout plan (or a time frame when the Agency should expect a workout plan, if one has not yet been received) showing all non-compliance with program or loan requirements and actions and timetables for resolution.

All loans reported delinquent must be serviced in accordance with Section 4 of this chapter, including the development of a workout plan in accordance with Agency requirements.

4. Failure of the Lender to Comply with Agency Reporting Requirements

Failure of the lender to comply with Agency reporting requirements in a timely manner may result in revocation of lender approval and the transfer of all GRRHP loans to another approved lender. If the lender fails to comply with the Agency transfer requirements, the guarantee may be cancelled.

7.12 COMPLETING THE CAPITAL NEEDS ASSESSMENT AND RESERVE ANALYSIS

The purpose of the capital needs assessment and reserve analysis is to ensure that reserve levels will continue to meet the expected capital repair and replacement needs of the property.

A. The Capital Needs Assessment



A capital needs assessment must be completed during the underwriting of all loans involving rehab and reviewed by the lender at least once every five years (or more often if the lender requires). The Agency recommends that the lender use capital needs assessment to determine adjustments to the reserve level requirements for all loans it underwrites, in accordance with Paragraph 7.6 B.

B. Adjusting the Reserve Deposit Requirement

1. Increasing the Reserve Deposit

On an annual basis the lender must review the reserve level and adjust the deposit requirements accordingly. If reserves have fallen below \$1,000 per unit, the lender should determine whether to require an increase in the monthly deposit amount to bring the reserve levels above this recommended threshold. In making this determination, the lender should weigh the need for the increased reserves against the financial security of the property.

2. *Decreasing or Suspending the Reserve Requirement*

In certain cases the lender may choose to decrease or suspend the reserve requirement. This might happen if:

- Reserve levels are adequate, based on the lender’s assessment of the capital needs assessment for the property; or
- The property is financially troubled and in need of the amount deposited in the reserve account to meet other monthly expenditures (this situation should be documented in the workout plan).

The Agency should be notified, as part of the quarterly reporting process, of all cases where reserve deposits are suspended.

7.13 PHYSICAL MAINTENANCE AND OVERSIGHT

A. Physical Standards and Inspections

1. *Physical Standards*

The lender must develop standards for physical inspections consistent with industry standards. Construction standards listed in RD Instruction 1924-A, §1924.5 (d) may be used as a guide.



2. *Physical Inspection Reporting*

The lender must inspect each property on an annual basis and report the summary findings to the Agency as a part of the lender’s regular annual report. The lender must use the *Form HUD 9822, Physical Inspection Report* to document the findings of the physical inspection and, when required by Paragraph 7.11 B.3., to report them to the Agency.

3. *Responding to Deficiencies*

Lenders may allow borrowers 90 calendar days from receipt of the lender’s physical inspection report to resolve the deficiencies and/or submit a corrective action plan. If deficiencies remain outstanding beyond the 90-day period, the lender must submit the complete physical inspection report to the Agency along with the lender’s proposed action plan for resolving the deficiencies.



B. Capital Improvement Plans

It is the responsibility of the lender to establish standards for the development of capital improvement plans for each property. This format and process must be outlined in the approved servicing plan. A capital improvement plan must be developed by the borrower if the lender determines that the property is physically troubled or if the capital needs assessment detailed in Paragraph 7.12 is no longer working. The Capital Improvement Plan (CIP) would then serve as the capital needs assessment for future annual assessments of the project's reserve levels.

If the lender determines the property has serious capital deficiencies, the lender must report the findings to the Agency and submit a CIP as part of the regular quarterly reporting process.

7.14 COMPLIANCE WITH OTHER FEDERAL REQUIREMENTS

A. Affirmative Fair Housing Marketing Plan

As a part of the lender's monitoring and oversight responsibilities, the lender will monitor compliance with the Affirmative Fair Housing Marketing Plan (*Form HUD 935.2*). If the lender discovers modifications are needed to the plan, such modifications should be suggested to the borrower. Borrowers who repeatedly fail to comply with the established plan must be reported to the Agency. Chapter 8 provides additional information with regards to this plan.



B. Annual Fair Housing Reporting Requirements

Section 526 of Public Law 100-242 of the Housing and Community Development Act of 1987 requires the Administrator to assess the extent to which RHS housing and community facilities programs comply with the Federal Fair Housing Act requirements. The Agency will require lenders to submit a report from the borrower on fair housing compliance as part of the annual audit. This report should detail, for each unit, gross income, race, national origin, head of household, gender, elderly and disability status. This information is collected for statistical purposes only.



C. Other Civil Rights Laws

Exhibit 7-4 shows other civil rights laws with which GRRHP loans must comply. Lenders must understand the provisions of these laws, and must have a management plan to monitor compliance by their employees, contractors, borrowers and management agents, as appropriate.

Interest credit is classified as Federal Financial Assistance. Therefore, borrowers with loans receiving interest credit must also comply with the civil rights laws in Exhibit 7-5.

In addition, all borrowers must sign an assurance agreement (*Form RD 400-4*) and will be subject to civil rights compliance reviews, regularly scheduled no less than once every three years. Compliance reviews will be conducted in accordance with RD Instruction 1901-E and documented on *Form RD 400-8, Compliance Review.* They must comply with the design requirements of the Uniform Federal Accessibility Standards, in addition to the HUD Accessibility Guidelines and the ADA Accessibility Guidelines. In addition, borrowers who receive interest credit must provide reasonable accommodations to tenants and prospective tenants, at the expense of the borrower.



Exhibit 7-4

**Major Civil Rights Laws Affecting All
Multifamily Housing Loan and Grant Programs**

- **American with Disabilities Act (ADA).** Guarantees equal opportunity for individuals with disabilities in employment, public accommodations, transportation, State and local government services, and telecommunications.
- **Equal Credit Opportunity Act (ECOA).** Prohibits discrimination in the extension of credit on the basis of race, color, religion, national origin, sex, marital status, age, income from public assistance, and exercise of rights under the Consumer Credit Protection Act.
- **Title VIII of the Civil Rights Act of 1968** (also known as the Fair Housing Act of 1988, as amended). Prohibits discrimination in the sale, rental, or financing of housing on the basis of race, color, religion, sex, national origin, familial status, or disability.
- **Executive Order 11246.** Nondiscrimination in Employment by Construction Contractors (and subcontractors) receiving Federal construction contracts and Federally assisted construction contracts in excess of \$10,000 – provides for equal employment opportunity without regard to race, color, religion, sex or national origin. For purposes of this Executive Order, Federally assisted construction contracts includes any Federal program involving a grant, loan, insurance, or guarantee.
- **Executive Order 12898 — Environmental Justice.** Requires each Federal Agency to make environmental justice a part of its mission by identifying and addressing disproportionately high and adverse human health or environmental effects of its programs, policies, and activities on minority and low-income populations.

Exhibit 7-5

**Civil Rights Laws Affecting
Federally Assisted Multifamily Housing Programs**

- **Section 504 of the Rehabilitation Act of 1973.** Prohibits discrimination in a Federally-assisted program on the basis of disability.
- **Age Discrimination Act of 1975.** Prohibits discrimination in a Federally-assisted program on the basis of age.
- **Title VI of the Civil Rights Act of 1964.** Prohibits discrimination in a Federally-assisted program on the basis of race, color, and national origin.
- **Title IX of the Education Amendments of 1972.** Prohibits discrimination on the basis of sex in education programs and activities receiving Federal financial assistance from Rural Development.
- **Executive Order 11063 as Amended by 12259.** Prohibits discrimination in Federally-assisted housing financing on the basis of race, color, religion, sex, or national origin.
- **Executive Order 11246.** Prohibits discrimination in employment by construction contractors (and subcontractors) receiving Federally-assisted construction contracts in excess of \$10,000. It provides for equal employment opportunity without regard to race, color, religion, sex, and national origin.

7.15 COMPLIANCE WITH OTHER PROGRAM REQUIREMENTS


A. Regulatory Agreement Compliance

A regulatory agreement governing the relationship between the borrower and lender must be developed by the lender and executed by both the borrower and the lender. While the Agency will not be a party to the agreement, the agreement will state that the Agency may assume the role of the lender if necessary to force borrower compliance with the agreement.

In the case where the Agency assumes the property in the role of mortgagee-in-possession (MIP), the regulatory agreement will remain in force at the Agency's sole discretion.

The regulatory agreement must be transferable from lender to lender in the event that the property or the guarantee is transferred to an Agency approved lender.

This agreement must, at a minimum, stipulate the following:

- That it is binding upon the borrower and any of its successors and assigns, as well as upon the lender and any of its successors and assigns, for the duration of the guaranteed mortgage.
- That the borrower must make all payments due under the note and all payments to required escrows and reserves for future capital needs.
- That the borrower must maintain the project as affordable housing in accordance with the purposes and for the duration defined in the statute.
- That the borrower must maintain the project in good physical and financial condition at all times.
- That the borrower must maintain complete project books and financial records, and provide the Agency and the lender with an annual audited financial statement within 90 calendar days of the end of the project's fiscal year. 
- That the borrower must make project books and financial records available for review by the USDA Inspector General, Agency Staff and the General Accounting Office (GAO) or their representatives, upon appropriate notification.
- That the borrower must comply with the Affirmative Fair Housing Marketing Plan and all other Fair Housing requirements.

- That borrower must comply with Civil Rights laws affecting Federally assisted multifamily housing programs and the Americans with Disabilities Act.
- That the borrower must operate as a single asset ownership entity.
- That the borrower must comply with applicable Federal, State and local environmental laws.
- That the borrower must provide management satisfactory to the Agency and comply with the lender-approved management plan and agreement for the property.
- That the borrower will work with the lender in a workout situation.

B. Preservation of Affordable Housing

For the period of the original term of the guaranteed loan, the housing must remain available for occupancy in accordance with [7 *CFR* 3565.352]. This applies unless the housing is acquired by foreclosure or an instrument in lieu of foreclosure, or the Agency waives the applicability of this requirement after determining that the following three circumstances exist.

- There is no longer a need for low- and moderate-income housing in the market area in which the housing is located.
- Housing opportunities for low-income households and minorities will not be reduced as a result of the waiver.
- Additional Federal assistance will not be necessary as a result of the waiver.

All requests for removal of the affordable housing restrictions must first be made to the lender. The lender must assess the housing using the three criteria above and forward the borrower's request to the Agency, along with the lender's assessment of the property's compliance with the above tests. The State Director will make the final determination as to whether the income restrictions may be terminated.

SECTION 4: SPECIAL SERVICING

7.16 OVERVIEW

In accordance with Paragraph 7.7, the lender must begin special servicing actions when a property is in default of the guaranteed loan.

7.17 ROLES AND RESPONSIBILITIES OF THE SERVICING LENDER

A. Development of a Workout Plan



At a minimum, a workout plan must be submitted to the Agency using the Section 515 workout plan format (see Exhibit 7-6) no later than 60 days after the lender has notified the borrower that they are in default under the regulatory agreement.

Exhibit 7-6

Information to be Included in a Workout Agreement

Background information. This section describes the project’s location, type, and size.

Description of the problem. This section identifies the project’s deficiencies and needs, including specific compliance and financial concerns. It should identify the basic causes of the difficulties.

A plan to correct deficiencies. This plan must include the following information:

- Borrower actions needed to correct the problem(s).
- Resources needed in order to accomplish the correction, including those that will come from the lender and those that will come from the borrower.
- A timetable for taking action and applying the resources.
- A summary of the anticipated outcomes.

Agreement by borrower to provide periodic financial statements, including any income and expense reports and bank statements, if appropriate.

The signature of the borrower and the lender on the workout agreement.

A request for Agency consideration. (The State Director or designated State staff will approve the agreement.)

Once the lender has submitted the workout plan to the State Office for Agency review, the lender and the borrower will be considered in compliance with the terms of the note for the purposes of the claims process outlined in Chapter 10. The timeframes for submission of a claim and the disposition plan will not be applicable unless the borrower (or lender) falls out of compliance with the approved workout plan or if the workout plan expires before the borrower cures the default.

If the lender chooses not to pursue a workout agreement with the borrower, the Agency will review this action prior to approval of the liquidation plan.

B. Bankruptcy of Borrower

The lender is responsible for protecting the guaranteed loan and all collateral securing the loan in bankruptcy proceedings. These responsibilities include, but are not limited to, the following:

- The lender must file a proof of claim where necessary and all the necessary papers and pleadings concerning the case.
- The lender must participate in meetings of the creditors and all court proceedings.
- When permitted by the Bankruptcy Code, the lender must request modification of a reorganization plan whenever it appears that additional recoveries are likely.
- The lender must keep the Agency adequately and regularly informed in writing of all aspects of the proceedings.
- The lender must take whatever reasonable affirmative action is necessary to protect the interest of the government including motions to dismiss, exceptions to discharge, and objections to exemptions.
- In a Chapter 11 reorganization, if the Agency determines that an independent appraisal of collateral is necessary, the lender must obtain an independent appraisal report set forth in Chapter 3.

C. Loss Claims During Bankruptcy

When the loan is involved in reorganization proceedings, payment of loss claims may be made as defined in Chapter 10.

7.18 ROLES AND RESPONSIBILITIES OF THE BORROWER

This paragraph details the borrower responsibilities with regards to the workout plan.

A. Submission of Information to the Lender

During special servicing actions and the development of a workout plan, the lender may request information from the borrower in addition to what they are already receiving on a quarterly basis. The borrower's failure to comply with the lender's request could result in a technical default under the regulatory agreement.

B. Development and Execution of the Workout Plan

The borrower must work with the lender to develop a workout plan for the lender's approval. This plan should be completed and ready for lender approval within 30 days of the date of default, in order to ensure that the lender has adequate time to approve the plan and submit it to the State Office Agency for review. In developing a workout plan, the time frame for conclusion of the plan should not exceed 2 years. Extensions to that timeframe may be approved by the Agency on a case by case basis.



C. Compliance With the Workout Plan

Once a plan is established, a borrower will be considered to be in compliance with program requirements so long as they remain in compliance with the workout agreement. While the lender must report to the Agency monthly on the property, the timeline for submission of a claim and a liquidation plan may be delayed until such time as the workout agreement expires or the borrower fails to comply with its terms.

If a borrower fails to comply with the terms of the agreement, the property will be considered in default and the lender must begin processing a notice of liquidation. These procedures are outlined in Chapter 10.

7.19 SPECIAL SERVICING OPTIONS

A workout or special servicing plan may utilize any of the following tools to bring the loan into compliance. If a plan requires modification to the guarantee or a payment of claim by the Agency, the Agency must approve such action.

A. Loan Modifications

A loan modification requires State Office approval. A loan modification would include any change in the amount or term of the guarantee:

- Reamortizing to extend the term of the current loan or
- Writing off a portion of the debt.

B. Partial Payment of Claim

A partial payment of claim is another tool that may be used to workout troubled loans. Under a partial payment of claim, the Agency pays a claim on a portion of the guaranteed loan, thereby reducing the debt that must be amortized. Partial payments must be approved by the National Office prior to the execution of the workout plan.

The Agency reserves the right to require the attachment of a second lien on the property for partial claims paid if the original ownership entity remains in place. If a change in the entire ownership entity is a condition of the workout plan, the Agency will not attach a “soft second” note to the property for a partial claim amount.

If a partial payment of claim is approved, the claim will be processed in accordance with the procedures outlined in Chapter 10.

C. Transfer of Physical Assets

A transfer of physical assets is a sale, gift, or other transfer of the property to another party where the original loan remains in place. In a special servicing situation, the transfer of physical assets (TPA) must be approved as outlined in Paragraph 7.8. All other changes in the ownership entity must be approved by the lender and recommended to the Agency for concurrence. Although a transfer and assumption is normally considered loan servicing, it should be processed in the same manner as a new loan.

D. Agency Approval of Reserve Releases

The Agency reserves the right to control reserve releases in a special servicing situation. Requests for the use of reserve funds on a workout plan must first be approved by the lender. On a case by case basis, the Agency will review requests for uses of reserve funds outside the scope of the eligible uses (e.g. use of reserve funds to pay taxes). In these situations, the borrower must submit the request to the lender. The lender will forward the request and any supporting documentation to the State Office with its recommendation. These requests will be approved on a case-by-case basis in the servicing office.

E. Lender Recommendation of Enforcement Action

In situations where the lender believes that the borrower is in violation of regulatory requirements, the lender may recommend that the Agency take enforcement action against the borrower. Such actions may include suspension, debarment, limited denial of participation, or other judicial remedies.

GRRHP Lender Servicing Compliance Checklist

✓	Required Report or Activity	Reporting Interval	When Due	Submitted to	Reg/HB Reference	Remarks
	Form RD 1980-24, "Request Interest Assistance/Interest Rate Buydown/Subsidy Payment to Guaranteed Loan Lender" with amortization schedule for the loan (for properties receiving interest credit payments)	Annually	Feb 28	State Office	HB 4.10 D.	State Office reviews and submits to Finance Office
	Borrower's annual audited financial statement	Annually	Within 90 days of borrower's fiscal year end	Lender	3565.351(d)(1) HB 7.11 A. 1.	Inspectable item in compliance reviews
	Borrower certification of compliance with the rent restrictions established in 7 CFR 3565.203	Annually	Within 90 days of borrower's fiscal year end	Lender	3565.351(d)(1) HB 7.11 A. 1.	Inspectable item in compliance reviews
	Lender's review of the borrower's annual audited financial statements	Annually	Within 120 days of borrower's fiscal year end	State Office	3565.351(d)(2) HB 7.11 B. 1.	
	Summary of the replacement reserve account withdrawal requests and related work completed with reserve funds	Annually	Within 120 days of borrower's fiscal year end	State Office	HB 7.6 D. 5.	
	Form HUD 9822, "Physical Inspection Report"	Annually	Within 120 days of borrower's fiscal year end	State Office	HB 7.13 A. 2.	
	Federal Fair Housing Act compliance report from the borrower as required by Section 526 of Public Law 100-242 of the Housing and Community Development Act of 1987	Annually	Within 120 days of borrower's fiscal year end	State Office	3565.351(a)(8) 3565.354 HB 7.14 B.	
	Review Affirmative Fair Housing Marketing Plan (Form HUD 935.2)	Annually	Within 120 days of borrower's fiscal year end	Lender	3565.353	Inspectable item in compliance reviews
	Form RD 1980-41, "Guaranteed Loan Status Report" (permanent loan phase)	Quarterly	Dec 31, Mar 31, Jun 30, Oct 31	Finance Office	HB 7.11 B. 2.	Lender copies the State Office
	Property under a Capital Improvement Plan	Quarterly	Dec 31, Mar 31, Jun 30, Oct 31	State Office	HB 7.13 B.	
	Form RD 1980-41, "Guaranteed Loan Status Report" (construction phase)	Monthly	Last day of the month	Finance Office	HB 5.20	Lender copies the State Office
	Deposits into insurance and tax escrow account (prorated share of annual property tax and property insurance payment)	Monthly	Monthly	Lender	3565.402(2) HB 7.6 B.	Inspectable item in compliance reviews
	Deposits into replacement reserve account for capital improvements	Monthly	Monthly	Lender	3565.402(2) HB 7.6 B.	Inspectable item in compliance reviews
	Form RD 1980-44, "Guaranteed Loan Borrower Default Status" (all loans which are in technical or monetary default or delinquency) until current	Monthly	Last day of the month	Finance Office	3565.351 (d)(2)(ii) HB 7.11 B. 3	Lender copies the State Office
	Monitor borrower's compliance with the Affirmative Fair Housing Marketing Plan (Form HUD 935.2). Borrowers who repeatedly fail to comply with the established plan must be reported	As needed	When non-compliance is identified	State Office	3565.351 (a)(8) HB 7.14 A.	Plan must be reviewed annually by Lender per 3565.353

CHAPTER 8: PROPERTY MANAGEMENT

8.1 INTRODUCTION

The quality of property management has a direct bearing on the performance of a GRRHP loan. While providing for acceptable property management is the responsibility of the borrower, the lender is responsible for ensuring that the asset value is preserved. In this role, the lender has an obligation to establish standards and to review the borrower's actions in developing a management plan and selecting a property manager or management agent. Throughout the life of the loan, the lender must monitor property management through, among other means, review of financial reports and periodic site visits to assess property operations and physical conditions.

Key Topics in this Chapter

- Role of Lender in Property Management
- Management Plan
- Property Manager
- Management Agreement
- Occupancy Requirements
- Tenant Protection and Grievance Procedures
- Reference and Conclusion

SECTION 1: ROLE OF LENDER IN PROPERTY MANAGEMENT

8.2 RESPONSIBILITIES OF THE LENDER

The Agency and the lender have a mutual interest in assuring that GRRHP properties are managed to:

- Protect the economic value of the property, which will support timely repayment of the loan and minimize losses; and
- Ensure that the property is operated in compliance with the program requirements and continues to provide decent, affordable housing in rural areas.

The lender must monitor GRRHP loans to verify that properties are well managed. To accomplish this, the lender must evaluate key management issues. These issues are briefly summarized below. Major issues such as the management plan, project manager qualifications and performance, management agreement and occupancy requirements are discussed in more detail in the remaining sections.

A. Management Plan

The management plan specifies the borrower and property manager's plan for operating the property. The lender must approve the management plan. Part of the plan will be site-specific and part of the plan will be a generic description of the property

manager's procedures and staffing. To determine if the property will be well managed, the proposed management plan must be appropriate for the property type and market area.

B. Property Manager Qualifications

The lender must examine the property manager's qualifications to operate the property successfully and in compliance with the Agency's requirements. The manager should have experience with similar properties, and the staffing and organizational capacity to meet all of the property management requirements.

C. Management Agreement

The lender should review the management agreement or contract between the borrower and the property manager covering the terms and conditions under which the property manager will provide services. Section 4 of this chapter details the issues the lender must review or require in the management agreement.

D. Site Visits

The lender must inspect the property annually to ensure that it is being maintained in compliance with program requirements, local codes, and the management plan [7 CFR 3565.351 (e)].



E. Occupancy and Rent

The GRRHP contains a number of unique program requirements on tenant eligibility and rent restrictions. These include a limit on the income of tenants at initial occupancy, unit rent restrictions, and average project rent restrictions. The specific provisions are detailed in Section 5 of this chapter. The lender must ensure that the borrower and property manager thoroughly understand and comply with these requirements.

F. Affirmative Fair Housing Marketing Plan

The lender must review the borrower's *Form HUD 935.2, Affirmative Fair Housing Marketing Plan*, as a part of the management plan and determine if it is appropriate for the specific property and market area. It must be reviewed annually and modified when necessary if the goals of the plan are not being met. Instructions for review of this plan can be found in Chapter 4.



G. Reporting

The lender must obtain periodic reports from the borrower on the condition of the property. At a minimum these reports must include:

- On an annual basis, an audited annual financial statement conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). This report will include a balance sheet, income and expense statement, and a statement of borrower compliance with program requirements.
- On a quarterly basis, once the loan note guarantee is issued, the lender must submit *Form RD 1980-41* to the USDA Finance Office.
- On a monthly basis, for properties that are delinquent or in default, the lender must provide the Agency with a delinquency report including information about:
 - ◇ The amount of any monetary delinquency;
 - ◇ The physical condition of the property;
 - ◇ The financial status of the property;
 - ◇ The status of any non-monetary compliance problems; and
 - ◇ Proposed actions and timetable to resolve the delinquency, default, or non-compliance issues.

H. Relationship Reporting

The management agent must complete a *Form HUD 9832, Management Entity Profile* that provides information about the management agent and each member of the management team. Any identity of interest relationship with the property manager must be fully disclosed in *Form HUD 9832*. An identity of interest is defined in Chapter 1.

I. Pre-Rent up Instructions

After the lender has been invited by the State Office to proceed with GRRHP application processing, the lender will hold a teleconference with the State Office processing staff, and the borrower to discuss compliance issues related to rent-up of the property. This meeting should take place before the management company begins leasing the property. During the teleconference, State Office staff will inform the borrower and lender of the following required compliance items: (1) the posting of Affirmative Fair Housing Marketing Plan (AFHMP); (2) the need to maintain documentation that demonstrates fulfillment of the AFHMP; (3) the maintenance of a standardized, nondiscriminatory application and waiting list for prospective tenants; (4) the nondiscriminatory logo, clause and statements in pamphlets, brochures and newsletters;

(5) handicap accessibility to public areas, including, but not limited to the rental office; (6) the collection of race and national origin data on tenants to be reported annually by the borrower in the "Fair Housing Report"; (7) knowledge and correct usage of current median income limits; and (8) the need for site managers that are properly trained on the aforementioned GRRHP requirements. The lender will be responsible for ensuring borrower compliance with these requirements.

SECTION 2: MANAGEMENT PLAN

8.3 OVERVIEW

The management plan is the borrower's and property manager's plan for operating the property. It should address all aspects of property operation, maintenance, and compliance with applicable laws, regulations, and other program requirements. Standards and deadlines for performance must be included in the plan. The lender should assess the management plan for responsiveness to the specific requirements of the program [7 CFR 3565.351] as well as for information which indicates that the plan is appropriate to the requirements of the specific property.

The Agency requires that certain provisions be included in the management plan. These components are identified below. Attachment 8-A provides additional detail on the desired content of the required provisions.

8.4 MANAGEMENT PLAN REQUIREMENTS

The management plan is the document that tells the lender how the property will be operated over the life of the loan. The lender should review the plan to determine if it is appropriate for the property and the program requirements. It is the responsibility of the lender to monitor the management of the property for compliance with the management plan. A copy of the current plan must be kept on file in the lender's office. The Agency will not generally need to receive a copy of the management plan.

A. Management Plan Contents

The lender must decide if the proposed management plan is suitable to meet the property's needs and if it addresses the minimum requirements identified below. Lenders may add additional requirements to address specific circumstances or market conditions. Remember that the management plan is an active document. The management plan can and should be revised as circumstances warrant.

It is anticipated that GRRHP properties may have supplemental financing or housing subsidies, and attendant occupancy or management requirements. Some of the other financing programs, such as low income housing tax credits, may have more restrictive income or tenant eligibility rules. The borrower has the responsibility to maintain compliance with all of these requirements. The Agency will, in most cases, comport its management requirements with the most stringent requirements imposed as a result of alternative financing sources. However, this may not be appropriate in all cases. For example, if a project's occupancy is suffering due to inadequate numbers of qualified tenants under the "most stringent rules," and may result in a default on the GRRHP loan, the Agency may require the lender to adhere to Agency occupancy standards to avoid a default.

Key management plan components to look for in the management plan are summarized here. They are described in more detail in Attachment 8-A.

- **Occupancy.** Has the property manager shown how it will perform standard operations such as rent collection and tenant screening, and how it will maintain compliance with the Affirmative Fair Housing Marketing Plan and unique tenant eligibility rules?
- **Maintenance.** Are there effective maintenance programs and good routines to respond to tenant work orders? Are utility costs monitored and energy conservation practices encouraged?
- **Personnel management.** Is the staffing appropriate for the size and services of the property? Are the job descriptions clear regarding on-site vs. main office personnel? Are the bundle of services included in the management fee distinguished from the charges to operations for on-site staff?
- **Financial management.** Are there adequate administrative procedures for money management, rent collection, reporting, recordkeeping, and data systems? What are the procedures for monitoring the operating and reserve accounts and insurance policies?
- **Tenant services.** Does the plan address the quality of services for the tenants, including safety and security, maintenance services, communication with the property manager, and tenant grievance procedures?

B. Agency Review

Although the Agency does not approve the management plan, the Agency must approve the *HUD Form 935.2, Affirmative Fair Housing Marketing*



Plan, which is to be prepared for the specific property and market area. Approval standards for this plan are detailed in Chapter 4.

SECTION 3: PROPERTY MANAGER

8.5 OVERVIEW

This section describes issues related to the property manager that must be reviewed by the lender. Under the direction of the borrower and within the parameters of the management plan, the professional property manager has the direct responsibility for the property's daily operations. As a result, they play a key role in successfully marketing the property and in maintaining property values over time. The quality of their work also directly affects the quality of services to tenants.



The lender must review and approve the qualifications of the property manager selected by the borrower. The *Form HUD 9832* required of the management agent will provide important information about the ownership of the property management firm and its prior experience.

The Agency, the lender, and the borrower all have a keen interest in ensuring the highest quality management of the property and compliance with GRRHP regulations. The lender should be sure that property managers are familiar with the key features of this program, including:

- The risk-sharing nature of the program which provides that the lender and the borrower will lose money if the loan defaults due to failure to comply with all loan and program requirements;
- Statutory income restrictions that must be certified at initial occupancy;
- Rent restrictions that limit unit rents and average project rents, and rents and utility allowances that must be certified annually; and
- The likelihood that secondary or supplemental financing will be involved and may require additional occupancy and rent restrictions.

Additional detail on the program occupancy requirements are provided in Section 5 of this chapter.

8.6 KEY PROPERTY MANAGER ISSUES

Some of the key property manager issues the lender should review include:

- **Relationship to the lender.** Does the lender have hiring and firing authority over the property manager if the borrower fails to act in a timely manner to resolve management deficiencies? Is the management agreement assignable to the lender, and ultimately to the Agency, in case of a default on the loan?
- **Management compensation.** Is the management fee clearly expressed? Are fees customary and typical for the market area for similar housing?
- **Industry knowledge and management training.** Is the property manager current on affordable housing issues and requirements? Is there a training program in place for training staff on GRRHP, other housing program requirements, and property management techniques? Is the property manager using current data management and recordkeeping technology?
- **On-site management.** Are there clear written job descriptions and responsibilities for on-site staff? Are management policies clearly documented? If the property is too small for on-site management, is the property manager’s headquarters close enough to the property to effectively manage on a daily basis?



8.7 PROPERTY MANAGER EXPERIENCE

The property manager must be qualified to fulfill the management plan requirements and have experience managing small rural housing developments. The property manager must provide evidence of knowledge of the GRRHP and compliance with laws and standards governing the property’s operations such as: fair housing, local property standards, environmental hazards, equal employment, accessibility laws, and related laws on equal opportunity and maintaining a drug free workplace.



Because GRRHP properties are likely to have additional sources of project financing, the property manager must also have adequate experience to manage the income and occupancy requirements of each financing program. These may include: Low Income Housing Tax Credits, HOME funds, Community Development Block Grant Funds, and State or local affordable housing assistance. The property manager must have a process to stay current on affordable housing issues and requirements.

The property management firm must have at least one person in a supervisory position with a minimum of two years of experience and satisfactory performance directing and overseeing the management of multifamily properties serving a similar resident clientele.

The lender is encouraged to visit the sites currently managed by the proposed property management firm as a reference check.

8.8 PREVIOUS PARTICIPATION AND OTHER FEDERAL REQUIREMENTS

The lender must obtain a *Form RD 1944-37, Previous Participation Certification* from the property manager and retain the original in the files. This certification must state that neither the property management entity nor its principals are debarred or suspended from Federal work. The lender must confirm this and may do so by accessing the GSA debarment list online at <http://www.arnet.gov/eplis/> or in CAIVRS (Credit Voice Response System). If a borrower wants to use a debarred or suspended property management firm and believes it has a sufficiently good reason, the borrower may appeal to the lender. If the lender agrees, then the appeal must be forwarded to the Agency. The Agency reserves the right to reject a property management firm based on previous participation.



SECTION 4: MANAGEMENT AGREEMENT

8.9 OVERVIEW

The management agreement details the contractual relationship between the borrower and the property manager. It must require the property manager to conduct its operations according to the Agency’s requirements and applicable laws. The lender must review and approve the management agreement and confirm that the terms are reasonable and customary. Also the lender must obtain an assignment of management agreement from the borrower in the event that the mortgage goes into default for monetary or non-compliance reasons and the property management agreement must be assigned to the lender or the Agency as appropriate. The executed management agreement and an executed assignment of management agreement must be kept on file with the lender.

8.10 TERMS AND CONDITIONS

The management agreement commits the manager to managing the property in accordance with the management plan and other requirements. The agreement provides the legal authorization for the property manager to act as the borrower’s agent in carrying out authorized activities. The principal authorized activities include: budget preparation, entering into contracts for work at the property, collection of rents, and eviction of tenants.

Additional provisions of the agreement typically include: an indemnification of the property manager for good faith actions taken to carry out the borrower’s policies, and an acknowledgment that the property manager is not financially obligated to fund the project expenses.

In the event that the property manager does not comply with the terms of the loan, management agreement, or the management plan, the lender must have the authority to require the borrower to replace the management agent with a qualified and competent agent. The lender’s loan documents and the management agreement must include this requirement and, upon failure to comply, provide for the lender or the Agency, as appropriate, to take control of

the property as mortgagee-in-possession with the ability to terminate the management agreement.

8.11 MANAGEMENT FEE

The management fee, including any incentives or bonuses to be paid from property funds to the property management firm, or any other party, must be reasonable and customary for similar properties in the market area. The total management compensation should be specified in the management agreement.

SECTION 5: OCCUPANCY REQUIREMENTS

8.12 OCCUPANCY REQUIREMENTS AND LENDER REVIEW

[7 CFR 3565.202 and 3565.203]

The lender must ensure that the property is managed in conformance with the following occupancy requirements.

A. Income of Residents

Units are to be available only to households whose incomes (as defined in Paragraph 8.12 C.), at the time of initial occupancy, do not exceed 115 percent of the area median income. After initial occupancy, a tenant's income may exceed this limit.
[7 CFR 3565.202].

B. Tenant Income Certifications

The initial tenant certifications must contain certain basic information required by the Agency such as types of income and sources. Annual recertification of tenant income is not required under the GRRHP, however, property managers will have to recertify tenant incomes if required by other financing or housing assistance programs. When certifying or recertifying tenant income, any industry accepted certification form may be used if it provides all information required by the Agency. For example, if the property is also a tax credit property, the tax credit certification form may be used to calculate income for GRRHP purposes. If the property has no other subsidies attached, *Form RD 1944-8, Tenant Certification*, must be used.

When completing the income certification form, the property manager should only complete the portions of the form that are applicable to the GRRHP, such as name, address, telephone number, household members, and source and amount of income of all adults. Applicants are not eligible to claim deductions from income as permitted by Section 515 and certain other programs.

C. GRRHP Definition of Income

Income should be calculated per household as follows:

- The sum of all income of each adult member of the household for the prior year, including any interest income from any assets. Income must include all transfer payments such as child support and alimony.
- No adjustments to income will be made, such as exclusions for lump sum, SSI payments, student financial aid, adoption assistance payments, local employment training program participation, payments in support of a developmentally disabled family member at home, or similar payments.

D. Reporting of Income

To document statutory compliance and to provide required fair housing reports, the lender must periodically provide information on the characteristics of tenants, such as tenant incomes and household size. Because some tenants will have incomes recertified annually due to other program requirements, this requirement may be fulfilled by submission of these recertifications. However, the lender must also obtain tenant income and household information on all other tenants.

The borrower must include a provision in the tenant lease that asks tenants to complete a one-page questionnaire at the time of lease renewal, to be collected by the property manager and reviewed by the auditor as part of the annual financial audit of the property. To assure tenants that they are not subject to annual recertification of income, property managers should make clear in writing that tenants whose incomes have increased from the time of initial occupancy are eligible for continued occupancy at the property.



E. Restrictions on Rent

The Agency has established certain rent restrictions to preserve affordability of GRRHP units over time. The rent restrictions for the program are as follows:

- The monthly rent for any individual housing unit, including any tenant-paid utilities, must not exceed an amount equal to $1/12^{\text{th}}$ of 30 percent of 115 percent of area median annual income, adjusted for family size; and
- On an annual basis, the average monthly rent for a project, taking into account all individual unit rents, including any tenant-paid utilities, must not exceed $1/12^{\text{th}}$ of 30 percent of 100 percent of area median annual income, adjusted for family size. [7 CFR 3565.203].

To comply with these rent restrictions the borrower must establish an estimate of tenant-paid utility costs. The calculation for tenant paid utilities for each unit size and type of heating fuel must be made at initial occupancy when the rent structure is established. Exhibit A-6 of RD Instruction 1944-E, Housing Allowances for Utilities and Other Public Services, may be used for this purpose.



The analysis must be updated annually or when information is received from utility companies of a utility cost increase. This process should reduce the administrative effort to track utilities on a unit and household basis, yet maintain an appropriate allowance for utilities paid by tenants in the rent calculation. If the lender believes that the rent structure has become distorted over time due to inaccurate utility expense estimates, then the property manager may undertake a utility survey. Utility surveys are not required by the Agency if the tenant-paid utility allowance appears to be accurate.

F. Use Restrictions

The goal of the program is to provide and maintain the supply of affordable housing for low- and moderate-income residents of rural areas. GRRHP properties must not be operated as temporary or transient housing, or for use as migrant housing. Nor can the property be operated as a health facility or student housing. The initial and subsequent terms of the lease must be 12 months or greater, unless special servicing issues warrant a shorter lease term.

SECTION 6: TENANT PROTECTION AND GRIEVANCE PROCEDURES

8.13 OVERVIEW

The lender must receive confirmation from the borrower or property manager that the tenants have been informed in writing of their rights under the grievance and appeal section of the regulations [7 CFR 3565.351]. In addition, the lender must ensure that the borrower or property manager provide rejected applicants with relevant civil rights information. Tenants must receive and sign for receipt of a packet of information at lease signing that includes the grievance and appeals information. Tenants should also receive information about property rules and regulations, how to contact the property manager, and basic community information.



Some areas of the country have concentrations of non-English speaking residents. In such markets, or if the property has a large number of non-English speaking applicants or tenants, the borrower or property manager must make reasonable efforts to provide tenant information in the tenants' language.

8.14 TENANT PROTECTION

The lender must verify that the property manager maintains a process for addressing tenant concerns about the management and maintenance of the property. An action or possible inaction by the borrower or property manager may adversely affect tenants of the project. Tenants are entitled to the benefits of the Agency grievance process or to pursue grievances under applicable local, State and Federal law.

8.15 GRIEVANCE PROCEDURES

The lender must ensure that the borrower or property manager notifies the tenants that they have access to an approved grievance process and appeals system. Borrowers are required to post the Fair Housing Poster and other Agency information in accordance with 7 CFR part 1944, subpart L that informs tenants of their rights under the grievance procedures. Exhibit 8-2 provides a flowchart of the process. Attachment 8-B provides details on the hearing requirements.

When there is a grievance, it is important to determine whether the grievance is appropriate for the Agency's grievance process. Often the grievance is more properly addressed in other venues, such as a civil court in the case of personal disputes between tenants, or by the Secretary of HUD or the Secretary of Agriculture in the case of alleged civil rights discrimination (as discussed in Paragraph 8.16). Tenant complaints which are appropriately addressed under the Agency grievance process include unauthorized rent changes or lease modifications, inequitable enforcement of terms of the lease, and inadequate maintenance of the unit or property. Exhibit 8-1 lists the circumstances in which a tenant may or may not be able to file a complaint under the grievance process for this program.

Exhibit 8-1

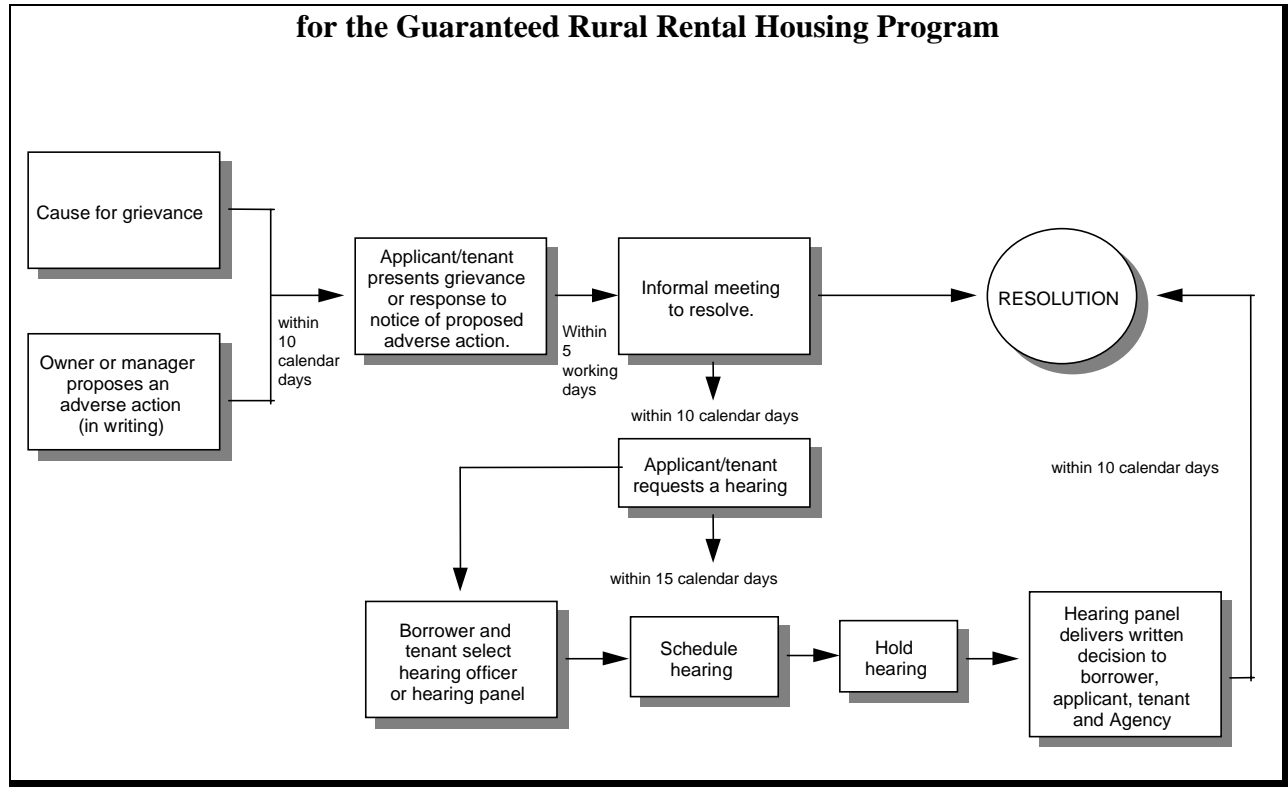
Tenant Grievances – Allowable Circumstances	
<i>A complaint may <u>not</u> be filed if:</i>	<i>A complaint <u>may</u> be filed if:</i>
<ul style="list-style-type: none"> • There is a proposed rent change that is authorized by the Agency. • A tenant or prospective tenant believes that he/she has been discriminated against. This issue cannot be resolved through the appeals process, however, if a person believes that discrimination has occurred they should file a complaint with the Secretary of HUD. • A project has formed a tenants’ association and all parties involved have agreed to use this association as a method of settling grievances. • There are changes in the rules that are required by the Agency and proper notice has been given. • The tenant is in violation of the lease and those violations result in termination of tenancy. • Disputes between tenants that do not involve the borrower or management agent. • The grievance is related to displacement or other effects as a result of Agency-approved prepayment of a guaranteed loan. 	<ul style="list-style-type: none"> • There is a modification of the lease; change in the rules; or changes in the rent that are not authorized by the Agency. • The borrower or management agent fails to maintain the property in a manner that is decent, safe, and sanitary.

The grievance process should only be employed after informal discussions between the aggrieved party and the property manager or borrower have failed and the Agency is asked to intervene. The parties will select a hearing panel or hearing officer to govern the hearing which will be held within 15 calendar days of the request by either party for a hearing. Exhibit 8-2 illustrates the grievance and appeals process.



Exhibit 8-2

Tenant Grievance and Appeals Process Flowchart



8.16 CIVIL RIGHTS [7 CFR 3565.8]

A. Lender Obligations

The lender must require certification from the borrower that the property manager will conduct its activities without regard to race, color, religion, sex, familial status, national origin, age, or disability. This includes any actions in the sale, rental, or advertising of the dwellings.

Compliance with the Fair Housing Amendments Act, and the Americans with Disabilities Act is required for all participants in the program. These Federal laws direct lenders, borrowers, and their agents, specifically including property managers, to:

- Examples of Unit Features That May Be Modified to Accommodate Tenants**
- Doorknobs/handles
 - Bathroom fixtures
 - Light switches
 - Appliance handles/knobs
 - The size of doorways

- Make accommodations in rules, policies, practices, or services to provide a person with a disability an opportunity to use or continue to use a dwelling unit and all public and common use areas.

- Allow an individual with a disability to modify a unit at his or her expense, to make it more suitable or enjoyable. The tenant can be required to escrow funds to restore the unit to its original condition if the modifications are not suitable to the rental market.

Property managers should provide training to their staff on these subjects and establish an internal monitoring program to routinely check compliance with these requirements.

B. Penalties

Lenders, borrowers or their agents, who fail to comply with the requirements of Title VIII of the Civil Rights Act of 1968, as amended by the Fair Housing Amendments Act of 1988 (the Fair Housing Act), are liable to sanctions authorized by law, including, but not limited to, cancellation of the guarantee and investigation by the U.S. Attorney and/or HUD.



8.17 HOUSING DISCRIMINATION

No form of housing discrimination will be tolerated in the GRRHP. Any resident or prospective resident seeking occupancy or use of a unit, property or related facility for which a loan guarantee has been provided, and who believes that he or she is being discriminated against, may file a complaint with the servicing lender, the Agency or HUD. Complaints may be filed with the Office of Civil Rights, U. S. Department of Agriculture, Washington, D.C., or with the Office of Fair Housing and Equal Opportunity, U.S. Department of Housing and Urban Development, Washington, D.C.

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ATTACHMENT 8-A

MANAGEMENT PLAN REQUIREMENTS FOR THE GUARANTEED RURAL RENTAL HOUSING PROGRAM

There is no required form of management plan for the GRRHP, however, this exhibit provides detailed guidance on each of the required management plan components identified in Paragraph 8.4. The lender must insure that the borrower has provided for acceptable property management services and practices. References to the regulations are noted where applicable.

GRRHP MANAGEMENT PLAN REQUIREMENTS




1. Occupancy Requirements and Monitoring

This part of the plan includes a statement of the occupancy requirements for the property, including the GRRHP requirements and the requirements of any other financing program that is applicable. The plan should describe how the property management firm will implement the requirements and ensure compliance over time.

Because of the important statutory and program requirements, the lender must carefully review this part of the management plan and then submit it to the Agency for final approval.

- **Non-contiguous or scattered sites with one loan.** Scattered sites are to be managed under one management plan and must be located within an area small enough to allow convenient, efficient management. The plan should detail how this will be accomplished and whether on-site or off-site management is planned.
- **Plans and procedures for marketing units and maintaining compliance with the Affirmative Fair Housing Marketing Plan.** The completion of a *Form HUD 935.2, Affirmative Fair Housing Marketing Plan*, is a statutory requirement. The plan must take into account the unique circumstances of the property and market area and must be able to be implemented by the property manager over the life of the guaranteed loan. The initial plan must be reviewed by the lender and forwarded to RHS for approval. The plan must be reviewed annually by the lender thereafter. [7 CFR 3565.353]



- **Procedures for determining applicant eligibility.** Property managers must demonstrate knowledge of the unique income eligibility rules of the program [7 CFR 3565.202]. Due to the likelihood of GRRHP properties being developed with multiple sources of financing, the property manager must be able to interview and document prospective tenants under the requirements of the other programs while meeting all of the GRRHP requirements. Some of the other programs will have more limitations on tenants' incomes than this program so the property manager must know and manage the distinct rules appropriately. 
- **Leasing and occupancy policies.** Property managers must demonstrate the capacity to manage the unique leasing occupancy restrictions of the GRRHP program, and other applicable programs [7 CFR 3565.203]. Some programs will have requirements, which exceed those of the GRRHP, such as the annual rent recertification requirement of the tax credit program, and managers must be knowledgeable of those requirements. 
- **Rent collection.** How and where the tenant pays the monthly rent must be described — whether by mail, to a lock box, or collected on-site. Clear and consistent rules on collection of delinquent rent and assessment of late fees must be in the written plan and in the tenant lease.
- **Termination of leases and eviction.** The plan must identify key lease provisions pertaining to termination of leases and eviction, and how the property manager will monitor compliance and take action to enforce these provisions. The provisions and the enforcement process must be fully consistent with Agency policies as well as with local, State and Federal law.
- **Tenant Protection and Grievance Procedures.** The borrower or management agent must provide tenants with a copy of the tenant protection and grievance procedures at the time of lease execution, and, must provide civil rights information to rejected applicants. Tenant grievance procedures must be posted in a conspicuous public location at the property such as the entry or common areas [7 CFR 3565.351(c)]. 
- **Security.** Adequate security must be provided to the property and the tenants. A written security plan to address issues such as tenant protection measures, vandalism, and drugs, is recommended. Any special security concerns for the site should be identified and remedial measures fully described.

2. Tenant Services

The borrower and property manager are encouraged to offer tenant services appropriate to the needs of residents. Such services might include an after-school program for families or social programs for elderly residents. The cost of such services must be included in the operating budget if they are to be paid from project funds. Property managers must also provide a link to other resources in the community for services to the tenants whenever possible. The borrower and property manager must describe which community-based services will be supported at the property. Information packets must be available to new residents which include lists of resources and area employers.

3. Maintenance

- **Plans for carrying out an effective maintenance, repair, and replacement program.** Routine and non-routine maintenance procedures must be explained in the plan, including how tenants access the maintenance system, and how work requests from tenants will be handled in a timely manner.
- **Environmental review compliance.** The plan must describe how the property manager will manage compliance with applicable Federal and State environmental laws and any conditions set forth in the Agency's environmental review.
- **Energy conservation measures and practices.** The plan must describe any practices to be used to reduce energy and water consumption in common areas and by tenants. Education programs on conservation energy in their units must be included as part of such practices.

4. Personnel Management

- **Personnel policies and staffing arrangements.** The property manager must detail the management and maintenance staffing plan for both on-site and off-site staff, provide job descriptions and delegation of authority, and list emergency contacts in the management plan. The number, type, and compensation of the staff must be appropriate for the property.
- **Training.** Information about staff training on program requirements and on management procedures and techniques must be included in the plan.

5. Financial Management and Reporting

The plan must describe how the required reports to the lender will be prepared and submitted in a timely manner, including:

- **Access to Books and Records.** The borrower and property manager must agree to provide access to the project books and records for review by the USDA staff and Office of Inspector General, the General Accounting Office, and the Department of Justice, or their representatives, upon appropriate notification [7 CFR 3565.351(a)(7)].
- **Accounting and Record-keeping.** The plan must include information on accounting and recordkeeping, including data systems, and software used to address:
 - ◇ Rent rolls, lease-up and vacancy information;
 - ◇ Scheduled maintenance;
 - ◇ Reserve withdrawals;
 - ◇ Accounts payable and receivable;
 - ◇ Tenant income reporting;
 - ◇ Monthly bank statements and reconciliations; and
 - ◇ Procedures to maintain books in accordance with Generally Accepted Government Auditing Standards (GAGAS).
- **Insurance and Fidelity Coverage.** Insurance coverage must be provided in accordance with Agency standards. The type and level of property and fidelity insurance coverage must be specified in the plan. The plan must specifically highlight any unique insurance coverage appropriate for the property area.

ATTACHMENT 8-B

THE HEARING PROCESS FOR TENANT GRIEVANCES AND APPEALS FOR THE GUARANTEED RURAL RENTAL HOUSING PROGRAM

THE HEARING PROCESS

A. Request for a Hearing

If an informal meeting between the tenant or prospective tenant does not resolve a tenant grievance, a grievance hearing may be requested. The tenant or prospective tenant shall present their request within ten days after the receipt of the summary of the informal meeting. The request must contain the following information:



- The reason for the grievance or contest of the borrower or management agent's proposed action;
- The action or relief sought; and
- Any additional information pertinent to the report.

If the tenant or prospective tenant's request for a hearing is not received within the prescribed time, the right to a hearing will be withdrawn and the borrower or management agent's decision will become final.

B. Selection of the Hearing Panel or Hearing Officer

The two parties shall elect a hearing officer. If a hearing officer cannot be agreed upon, the two parties shall choose members to serve on a hearing panel. The hearing panel will consist of three members. The tenant and the borrower or management agent must each elect one person to the panel. It is then the responsibility of the two chosen members to elect a third member to the panel. If within 30 days of the date a hearing is requested a hearing panel has not been formed, the borrower or management agent must inform the Agency. Within ten days of reviewing the facts, the Agency will appoint a hearing officer. Once a hearing officer or panel is selected, the Agency will inform them in writing of their responsibilities for governing the hearing.



Helpful information for selecting a hearing panel or hearing officer includes:



- The hearing officer cannot be a person selected solely by the tenant or management agent.
- The hearing panel members should be impartial.

To minimize time and the level of effort, a management agent may elect to have a standing panel to hear tenant grievances for each project managed. If a standing panel is chosen, the following process should be substituted for the process discussed above.

- A hearing panel consisting of three members including at least one tenant panelist, and one panelist selected by the agent.
- Tenants will nominate and vote for both a panel member and an alternate. Residents must be notified of the time, date, and location of the election.
- The borrower or management agent will select two members to serve on the standing panel. One will serve as the alternate.
- The third member of the panel must be selected jointly by the tenants and management agent.
- The chairperson shall be elected by the other two interested parties. Each party will only have the opportunity to give one vote, even if two people were elected to serve on the panel.
- Each member should be asked to serve on the panel for a specified term. All members of the standing panel shall be willing to render their services without compensation.

C. Hearing Schedule

The hearing shall be scheduled 15 days after the receipt of the tenant's request for a hearing. It is the responsibility of the two parties to agree upon a place and time that is mutually convenient to hold the hearing. If the two parties cannot agree on a place and time, the hearing officer or hearing panel will select a time and place.



D. Examination of Records

At a reasonable time before the hearing, the borrower or management agent must allow the tenant the opportunity to examine all files that are going to be used during the hearing. Documents can be examined and copied at the tenant's expense if:

- The document, record, or policy is one that will be used during the hearing process; and
- The document, record, or policy is not subject to any laws or confidentiality agreements that prohibit reproductions.

Documents That May Not Be Copied

1. Credit reports
2. Project budgets
3. Supervisory findings

E. Escrow Deposits

Tenants may establish escrow accounts whenever a grievance involves a rent increase not authorized by the Agency or a failure to maintain the property in a decent and sanitary manner. The tenant must make timely rent payments to the account, but the borrower or management agent will not receive the payment until the grievance has been settled. When an escrow account is employed, tenants must adhere to the following list of rules:

- All rent payments must be made to the escrow account on time and continue until the grievance is resolved. Failure to do so will terminate the entire process, and all sums will be due immediately.
- The escrow account must be established in a Federally insured institution.
- All receipts of deposit must be made available for examination by the borrower/agent.



REQUIREMENTS GOVERNING THE HEARING

The hearing is an informal proceeding at which evidence is presented to a hearing officer or hearing panel. The hearing must be designed to ensure that the rights of all parties involved are protected and must permit:

- Both parties to be represented by counsel or another person(s) chosen as their representative;
- The right of the tenant or prospective tenant to request a private hearing;

- The right of the tenant or prospective tenant to present oral and written evidence and arguments in support of their grievance or appeal and to refute the evidence of all witnesses on whose testimony or information the borrower or management agent relies; and
- The right of the borrower or management agent to present oral and written evidence and arguments in support of the decision, to refute evidence relied upon by the tenant or prospective tenant, and to question and cross-examine all witnesses in whose testimony or information the tenant or prospective tenant relies.

During the hearing, each party may present evidence to support their position. All participants of the hearing are to conduct themselves in an orderly manner. Participants that can not conduct themselves in an orderly manner will be excluded from the proceedings and may, as a result, receive an unfavorable decision.

If the tenant or prospective tenant fails to appear at a scheduled hearing, the hearing officer or hearing panel may choose to postpone the hearing for no more than five days or determine that the party has waived his or her right to a hearing. All parties involved in the hearing shall be informed of the hearing panel's decision.



THE HEARING DECISION

It is the responsibility of the hearing officer or hearing panel to prepare and submit a written decision to both parties. The hearing officer or hearing panel shall inform the Agency of the decision and the reasons for making that decision. The decision should be based on the facts that were presented during the hearing. The decision is not final until it has been approved by the Agency. The Agency approval is only to make sure that the decision is in compliance with other Agency programs. The requirement for Agency review should be noted in the decision letter.

CHAPTER 9: INSURANCE REQUIREMENTS

9.1 INTRODUCTION

Insurance protects the GRRHP loan against loss or damage. Lenders must review the borrower's insurance policies to confirm that the coverage is adequate to protect against financial loss due to property damage, employee dishonesty or error, and personal injuries that occur on the property. Lenders intending to sell GRRHP loans in the secondary market must require insurance coverage consistent with the standards of Fannie Mae, Freddie Mac or Ginnie Mae.

KEY TOPICS IN THIS CHAPTER

- Types of Insurance
- Acceptable Coverages
- Authorized Providers

Lenders must continue to monitor the insurance policies over the term of the loan so that each GRRHP property is continuously insured with acceptable property and liability insurance policies. The named insured must be the borrower.

The following section identifies the types of insurance and the specific provisions that must be included in the policy.

SECTION 1: OVERVIEW OF INSURANCE REQUIREMENTS

9.2 OVERVIEW

Described throughout this chapter are the different types of Agency insurance requirements for the GRRHP program. At a minimum, lenders must establish insurance standards for GRRHP loans that meet or exceed the insurance requirements of Fannie Mae, Freddie Mac or Ginnie Mae. Failure to ensure that proper insurance is maintained on the property may result in denial of the guarantee payment by the Agency.



SECTION 2: TYPES OF INSURANCE

9.3 PROPERTY INSURANCE

Property insurance protects the physical asset against loss due to damage. Property insurance includes:

- **Hazard Insurance** to protect the property against fire and weather-related damage, as well as damage from civil commotion, aircraft, or other vehicles. The policy must be endorsed to include all the extended coverage perils. An “all risks” policy is recommended.

- **Flood Insurance** to protect the property against losses caused by flooding due to natural disasters such as hurricanes. Flood insurance through the National Flood Insurance Program is required for all properties located in a Special Flood Hazard Area (SFHA) as identified by FEMA. For every GRRHP loan, the lender must complete FEMA Form 81-93, Standard Flood Hazard Determination, and must determine whether any of the improvements on a property are or will be located in a SFHA.
- **Builder's Risk Insurance** to protect the property against loss or damage during construction or reconstruction after an insured loss. Builder's risk insurance is required during all periods of reconstruction and rehabilitation.
- **Boiler and Machinery Coverage** may be required for any property that operates steam boilers, turbines, engines, or other pressure vessels, to cover the cost of boiler replacement and other machinery in the event of an accident.
- **Sinkhole or Earthquake Insurance** is required in areas where there is a risk of damage from this form of natural disaster.
- **Business Income Insurance** is required to cover the loss of income to a property resulting from an event that makes one or more units temporarily uninhabitable.

9.4 FIDELITY INSURANCE

Fidelity insurance protects the property against loss due to employee dishonesty. The policy must provide coverage on all persons with control over or access to project income or other assets. Fidelity coverage may also be known as Blanket Crime Coverage or Fidelity Bonding.

9.5 MORTGAGE'S ERRORS AND OMISSIONS (E&O) INSURANCE

E&O coverage protects the borrower against loss resulting from negligence, errors, or omissions committed by those persons covered under the borrower's fidelity insurance policy. Obtaining E&O insurance does not diminish or limit the borrower's documentary obligations and responsibilities.

9.6 LIABILITY INSURANCE

This coverage insures against any personal injury that might occur in or on the property's common areas, common elements, commercial space, and public areas.

9.7 WORKER'S COMPENSATION

This insurance coverage, also known as employer's liability coverage provides for replacement of lost wages to workers that suffer job injuries. This coverage is not required by the Agency but may be required by State or local law.

9.8 EVIDENCE OF INSURANCE, TERMS, AND COVERAGE

The lender must obtain the original policy or the declaration page, and evidence that one (1) full year's premium has been paid for all required insurance coverage. Either originals or certified copies of current insurance policies must be kept on file by the lender. The term of the insurance policy may not be less than one year. All policies must be on an occurrence basis. The lender must determine what is an acceptable level of coverage based on the needs of the property.

SECTION 3: AUTHORIZED INSURANCE PROVIDERS

9.9 OVERVIEW

Borrowers are responsible for selecting an insurance provider that is reputable and financially sound. The lender must review all relevant available information about insurers including financial statements, Best's Insurance Reports, and information from State insurance authorities.

The borrower is required to disclose any identity of interest relationships with the insurer company or must certify to the lender that none exists.

9.10 ACCEPTABLE RATINGS FOR INSURANCE PROVIDERS

A hazard or property insurance provider needs to meet one of the acceptable rating categories established by one of the rating agencies approved by Fannie Mae, Freddie Mac or Ginnie Mae.

CHAPTER 10: CLAIMS

10.1 PURPOSE AND OVERVIEW

This chapter addresses the property liquidation and claims process. When all reasonable efforts to resolve deficiencies in loan performance have failed, the lender must liquidate the loan and dispose of the property in order to submit a final loss claim. An overview of the GRRHP liquidation and claim payment process is shown in Exhibit 10-1.

KEY TOPICS IN THIS CHAPTER

- Pre-Liquidation Requirements
- Property Liquidation
- Agency Election of Assignment or Conveyance
- Determination of the Claim Amount
- Payment of the Final Claim

EXHIBIT 10-1

THE LIQUIDATION PROCESS FOR GRRHP

The lender submits a liquidation plan and supporting documentation to the Agency within 30 calendar days of the decision to liquidate.



The Agency approves the plan or notifies the lender of differences within 20 calendar days of receipt of the plan from the lender. If the Agency fails to respond to the lender within 20 calendar days of receipt of the proposal, the liquidation plan will be considered approved by default, and the 90 day period for interest accrual will commence.

If liquidation is expected to exceed 90 calendar days, the lender must submit Form RD 449-30, "*Loan Note Guarantee Report of Loss*," for an estimated loss payment with the liquidation plan.

Payment on the estimated loss claim is made within 30 calendar days after Agency approval of Form 449-30.

The lender acquires and disposes of the property in accordance with the liquidation plan.

The lender submits a final report of loss on Form RD 449-30 to the Agency.

The final loss claim is paid within 60 calendar days of the accounting of the collateral.

SECTION 1: PRE-LIQUIDATION REQUIREMENTS

10.2 OVERVIEW

Before a decision to liquidate can be considered, the lender must make all reasonable attempts to resolve the deficiencies with the property. Chapter 7 provides a variety of Agency-recommended special servicing actions to help lenders restore a property to physical and financial health. Implementation of a workout plan can often delay or eliminate the need to liquidate the account. As a part of the notification to the Agency of a decision to liquidate, the lender must certify that they have made all reasonable attempts to resolve the issues using special servicing methods.

SECTION 2: DECISION TO LIQUIDATE

10.3 OVERVIEW

A decision to liquidate must be made by the lender when it determines that the default cannot be cured through special servicing and it is in the best interest of the Agency and the lender to liquidate.

In the event of a default involving a loan to an Indian tribe or tribal corporation, which is secured by an interest in land within such tribe's reservation (as determined by the Secretary of the Interior), including a community in Alaska incorporated by the Secretary of the Interior pursuant to the Indian Reorganization Act (25 U.S.C. 461 et seq.), the lender shall only pursue liquidation after offering to transfer the account to an eligible tribal member, the tribe, or the Indian housing authority serving the tribe. If the lender subsequently proceeds to liquidate the account, the lender shall not sell, transfer, or otherwise dispose of or alienate the property except to one of the entities described in the preceding sentence.

Liquidation should be considered when any of the following circumstances exist:

- A loan has been delinquent for 90 calendar days and the lender and borrower have not been able to agree on the terms to cure the delinquency;
- The borrower has failed to comply with the approved workout plan; or
- Delaying liquidation will impair the recovery value of the collateral or jeopardize full recovery on the loan.

Once a decision is made to liquidate a loan, the lender must meet the following deadlines in order to be eligible for payment under the guarantee:



- Notify the borrower and the Agency within 7 calendar days from the date of the decision to liquidate (see Paragraph 10.4);
- Submit a liquidation action plan for Agency approval within 30 calendar days of the notice to Agency (see Paragraph 10.5); and
- Submit Form RD 449-30, "*Loan Note Guarantee Report of Loss*" for an estimated loss payment if the liquidation is expected to exceed 90 calendar days. (see Paragraph 10.7).

When the lender decides to liquidate they must report to the Agency on a monthly basis using *Form RD 1980-41*, until the account is satisfied or the guarantee is terminated.

10.4 NOTICE OF LIQUIDATION AND POTENTIAL CLAIM

Once the lender has made a decision to liquidate the account, they must notify the Agency and the borrower within 7 calendar days of the decision. This notification will inform the borrower that liquidation proceedings will commence and alert the Agency to expect a submission of the liquidation plan.



10.5 SUBMISSION OF A LIQUIDATION PLAN

Within 30 calendar days after notifying the Agency of the decision to liquidate, the lender must submit, in writing, the proposed method of liquidation. Upon approval by the Agency, the lender will commence liquidation. If, within 20 calendar days of the Agency's receipt of the liquidation plan, the Agency's fails to respond to the lender's proposal or request revisions be made to the plan, the liquidation plan will be approved by default.

A liquidation plan must include, but is not limited to, the following:

- Documentation to establish the lender's ownership of the guaranteed loan, promissory note, and related security instruments and a copy of the payment ledger or equivalent which reflects the current loan balance and accrued interest to date, and the method of computing the interest.
- A full and complete list of all collateral, including any personal and corporate guarantees.

- The recommended liquidation methods for making the maximum collection possible on the indebtedness, and the justification for such methods, including recommended actions for:
 - ◊ Acquiring and disposing of all collateral; and
 - ◊ Collecting from guarantors.
- An appraisal of the collateral and the due diligence report. In order to formulate a liquidation plan that maximizes recovery, collateral must be evaluated in accordance with the requirements contained in Chapter 11, for the release of hazardous substances, petroleum products, or other environmental hazards that may adversely impact the market value of the collateral. The appraisal must consider this information in developing an appraised value.
- The proposed date of foreclosure.
- The proposed date of liquidation.
- Steps to be taken to preserve the collateral and protect the tenants.
- Copies of the borrower's latest available financial statements.
- Copies of the personal or corporate guarantor's latest available financial statements.
- An itemized list of estimated liquidation expenses expected to be incurred along with justification for each expense.
- A schedule to periodically report to the Agency on the progress of liquidation.
- An estimate and justification of protective advances.
- Proposed protective bid amounts on collateral to be sold at auction and a breakdown to show how the amounts were determined.
- A determination of whether a deed-in-lieu of foreclosure will be considered.
- If a voluntary conveyance is considered, the proposed amount to be credited to the guaranteed debt.
- Any relevant legal opinions, including, for example, opinions on environmental issues, title search, and bankruptcy.



10.6 APPROVAL OF LIQUIDATION PLAN

The Agency will accept or reject the lender's liquidation plan within 20 calendar days after receipt of the plan or request that the lender make revisions to the plan. If the Agency fails to meet this deadline, the plan will be approved by default. When a liquidation plan is approved by the Agency, the lender must proceed expeditiously with liquidation, in accordance with the terms of the plan. Agency approval of the lender's liquidation plan is normally classified as a categorical exclusion under the Agency's environmental review process, unless the proposed method of liquidation will result in an alteration of the purpose, operation, location, or design of the project as originally approved.

The liquidation plan will be approved by the State Director if the loan balance is within the State Director's delegated loan servicing authority. In the event the loan balance is in excess of the delegated authority, the liquidation plan and supporting documentation must be forwarded to the National Office for review and concurrence. The liquidation plan may be modified when conditions warrant. All modifications must be approved, in writing, by the Agency prior to implementation.

10.7 FILING AN ESTIMATED LOSS CLAIM

Upon approval of the liquidation plan, all interest credit payments from the Agency will cease and the lender will submit an estimated loss payment with the liquidation plan, if the liquidation plan is expected to exceed 90 calendar days. Any estimated loss payment must be applied to the outstanding principal and interest of the guaranteed debt. Estimates must be prepared and submitted by the lender on *Form RD 449-30* using the basic loss formula as provided on the report. The estimated loss claim will be promptly processed. Payment of the estimated loss amount will be made to the lender within 30 calendar days after the loss estimate has been approved by the Agency.

10.8 WITHDRAWAL OF A CLAIM

At the request of the lender, if the borrower cures the default prior to the earliest payment of the estimated loss claim or foreclosure, the guarantee will continue as if the default had not occurred.

SECTION 3: PROPERTY LIQUIDATION

10.9 PROPERTY ACQUISITION

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The first step in the liquidation process is to acquire the property. The liquidation plan must inform the Agency of the proposed method of acquisition, including:

- Judicial foreclosure;
- Non-judicial foreclosure; and
- Deed-in-lieu of foreclosure.



The lender must estimate the time frame when the acquisition should occur. In most cases, acquisition should be completed within 120 calendar days from approval of the liquidation plan. If the lender foresees a longer acquisition period, the reasons for the delay must be explained in the liquidation plan. Examples of appropriate reasons for a delay include:

- A State law declaration of bankruptcy by the borrower;
- Time to provide written notice to tenants or similar tenant protection measures;
- Constraints imposed by other liens or financing on the property; and,
- Court backlog.

Unless otherwise approved by the Agency, the amount bid by the lender at foreclosure sale must equal the lesser of the sum of the outstanding principal and interest, liquidation expense, and approved protective advances, or the appraised value of the property.

Once the collateral has been purchased through foreclosure, the borrower has conveyed title to the lender, or an estimated loss payment is made by the Agency, no transfer of physical assets can be made. Interested purchasers of the REO property may negotiate with the lender, at the lender's discretion, once the lender has title to the property.

10.10 LENDER LIQUIDATION

If a property is acquired through foreclosure or other method of conveyance, the lender must dispose of the property in accordance with the liquidation plan. If complications in the liquidation process lead to unforeseen delays, the lender must immediately notify the Agency of the reason for the delay and submit a revised date for expected liquidation. Failure to inform the Agency of the unforeseen circumstance could result in the denial of payments to the lender under the guarantee.



While the Agency expects the lender to dispose of the property in a manner that will yield the highest possible market value, marketing and liquidation actions must ensure that protections afforded to tenants 7 CFR part 3560, subpart D are provided.



10.11 FAILURE TO COMPLY WITH THE LIQUIDATION PLAN

The purpose of the liquidation plan is to ensure timely liquidation of property at the lowest cost to the Agency. If the lender fails to comply with the liquidation plan that has been approved by the Agency, it may result in the denial of benefits to the lender under the guarantee.

If the lender becomes aware of any situation that would change any part of the liquidation plan, it must immediately inform the Agency of the reasons for such change and submit an amendment to the liquidation plan for approval by the Agency.

SECTION 4: AGENCY ELECTION OF ASSIGNMENT OR CONVEYANCE

10.12 OVERVIEW

While liquidation by the lender will occur in almost every case, the Agency reserves the right to require the lender to assign the loan or convey the property to the government prior to liquidation if it determines that assignment or conveyance of title is in the best interest of the government. In these cases, the lender may submit a claim in accordance with the provisions of Section 5 of this chapter.

Examples of reasons the Agency may require loan assignment or conveyance of title include:

- It would be less costly to the government for the Agency to dispose of the property;
- Tenant protection issues are of such a complicated nature that disposal or retention of the property by the Agency is necessary; and
- The lender has been grossly negligent in servicing the loan.

After a review of the proposed liquidation plan, the Agency will inform the lender if it will require an assignment or conveyance of title.

10.13 ASSIGNMENT OF THE LOAN

An assignment of the guaranteed loan to the Agency must be in written and recordable form and must be completed within 90 calendar days of the Agency notice to the lender. The assignment documents will be forwarded to the RHS Regional Attorney for review. The assignment will be considered complete once the following transactions are completed to the Agency's satisfaction.



- Conveyance to the Agency of all rights and interests arising under the loan.
- Assignment to the Agency of all claims against the borrower or others arising out of the loan transaction, including:
 - ◇ All collateral agreements affecting financing, construction, use, or operation of the property; and
 - ◇ All claims under policies of title, or other insurance, surety bonds, or other guarantees.
- A due diligence report, which evaluates the effect of potential contamination from hazardous wastes and from the release of hazardous substances and petroleum products on the security value of real property, and an appraisal which takes the findings of the due diligence report into consideration.

If the Agency requires an assignment, the lender must stop any liquidation actions that are in process.

10.14 CONVEYANCE OF TITLE TO THE AGENCY

When the Agency requires a conveyance of title to the property, the lender must inform the Agency of the method and timeframe for obtaining title to the property. The lender must obtain a deed in lieu of foreclosure from the borrower or implement the approved liquidation plan. Once the foreclosure action is completed and the lender has obtained title to the property, the lender must transfer the title to the Agency. The Agency will accept the conveyance of title upon acceptance of the documents listed below and receipt of a satisfactory warranty deed.

- A release of all claims of the lender or other holder of the guarantee against the property.

- A due diligence report, which evaluates the effect of potential contamination from hazardous wastes and from the release of hazardous substances and petroleum products on the security value of real property, and an appraisal which takes the findings of the due diligence report into consideration.
- An assignment of the lender's rights to any operating funds and any reserves or escrow account established for such purposes as:
 - ◊ The maintenance of the property, including any replacement reserve or capital improvement reserves; or
 - ◊ The payment of property taxes and insurance.

Prior to acceptance of conveyance of property, the Agency will conduct an inspection to determine the physical condition, security, and need for rehabilitation and repair. This inspection will encompass site conditions, building exteriors, common elements, and interiors of all units.

SECTION 5: DETERMINATION OF THE CLAIM AMOUNT

10.15 INTRODUCTION

The determination of the claim amount actually begins during the development of the liquidation plan. Factors such as the date of the decision to liquidate, estimated liquidation value of the security property, estimated date of foreclosure and estimated date of liquidation will all affect the amount the Agency will be required to pay to the lender. The Agency will review the liquidation plan to be sure that the costs and timeframes of acquisition and liquidation minimize losses to the government. Calculating the amount payable under the guarantee is a multi-step process detailed below.

If there is a loss claim due to contamination from a release of hazardous substances, hazardous wastes, or petroleum products, the Agency shall not finalize loss claims until the guaranteed lender has sold the property or the Agency has accepted assignment or conveyance of title to the property.

10.16 DETERMINATION OF THE DATE OF LOSS

A. Lender Liquidation

The date of loss is the date the loan is terminated due to foreclosure or other means of conveyance. This date will be the earliest of:

- The date on which the property is acquired; or
- The proposed date of acquisition in the liquidation plan, or any approved modifications to the liquidation plan.

If the date of acquisition is later than the date approved by the Agency, the date of loss for the purpose of calculation of the claim will be the Agency's approved date.

B. Assignment or Conveyance of Title to the Agency

Where the Agency requires an assignment of the loan or conveyance of title, the date of loss will be the date on which the Agency accepts assignment of the loan or conveyance of title.

In submitting the liquidation plan to the Agency, the lender must specify the estimated date of assignment or conveyance of title. Unless the delay in assignment or conveyance is due to Agency action or inaction, the date of loss may be no later than the date approved in the liquidation plan or any amendment.

10.17 CALCULATION OF LOSS

In order to receive payment under the guarantee, the lender must calculate and submit for Agency approval *Form RD 449-30, Loan Note Guarantee Report of Loss*. The information contained in the report will be used to estimate the loss to the Agency on an individual loan. The aggregate amounts reported by all lenders will be used to forecast the amount the Agency will need to disburse in claim payments in a fiscal year. When completing the report of loss, the lender should use the following as a guide:

A. Request for Estimated Loss Claim

Form RD 449-30 must be completed following the guidance in Paragraph 10.7. Unpaid principal and interest figures inserted in lines 11 and 12 must be calculated as of the date of submission of the form.

B. Final Report of Loss (when an estimated loss claim payment has not been made)

The unpaid principal and interest figure on *Form RD 449-30* must be calculated based on the date of loss as explained in Paragraph 10.16 A. For interest calculation purposes, the Agency will pay interest that accrues no more than 90 calendar days from the date the liquidation plan is approved by the Agency.

10.18 PROTECTIVE ADVANCES

The calculation of the loss amount may include any amounts approved by the Agency for protective advances in excess of project resources. In general, protective advances are funds necessary to protect the value of the asset and ensure the security, health, and safety of the tenants. Such amounts may include:

- Property taxes,
- Water and sewer charges and other special assessments that are liens prior to the guaranteed loan; and
- Property insurance.

The lender will make an estimate of the amount of protective advances as part of the liquidation plan (see Paragraph 10.5). Once the plan is approved by the Agency, this amount must be used by the lender to complete calculations for the report of final loss on *Form RD 449-30*, unless a different amount is approved by the Agency.

10.19 LIQUIDATION EXPENSES

The calculation of the loss amount will include any amounts approved by the Agency for liquidation expenses. In general, liquidation expenses are defined as those expenses necessary to market and dispose of the property. Such amounts may include:

- Loan guarantee fees paid after the borrower default;
- Reasonable third-party expenses to maintain and liquidate the property; and
- Independent appraiser’s fees, including the cost of the due diligence report.

10.20 LEGAL EXPENSES DURING BANKRUPTCY PROCEEDINGS

The Lender is responsible for protecting the guaranteed loan and all collateral securing the loan in bankruptcy proceedings. The State Office will immediately notify



the National Office of all bankruptcy and pending bankruptcy proceedings and shall submit status reports to the National Office on a monthly basis.

When a bankruptcy proceeding results in a liquidation of the borrower, legal expenses will be handled as directed by the court and reasonable and customary legal expenses to protect the collateral may be shared on a 90/10 basis between the Agency and the lender. Two provisions of the U.S. Bankruptcy Code will typically apply to GRRHP loans. Chapter 11 of the Bankruptcy Code pertains to a reorganization of a business, where legal protection is afforded to the business. Expenses incurred by the lender in a Chapter 11 reorganization can never be liquidation expenses unless the proceeding becomes a Chapter 11 liquidation.

10.21 MAXIMUM GUARANTEE PAYMENT

The maximum guarantee payment will not exceed the product of 90 percent, or such lesser guarantee percentage as set forth in the Loan Note Guarantee Agreement, times the allowable loss amount, as determined in *Form RD 449-30*. The maximum guarantee payment must be approved by the Agency in accordance with Section 6 of this chapter.

SECTION 6: PAYMENT OF THE FINAL CLAIM

10.22 OVERVIEW

Within 60 calendar days of liquidation of the property, the lender must submit a report of final loss to the Agency using *Form RD 449-30*.

The lender must certify that all possibilities of collection have been exhausted as a condition for payment of the final claim. Upon payment, in whole or in part, the note or judgement evidencing the debt shall be assigned to the United States and the lender shall have no further claim against the borrower or the United States.

10.23 SUBMISSION OF A REPORT OF FINAL LOSS

If the final loss is less than the estimated loss payment, the lender will reimburse the Agency for the overpayment, using *Form RD 1980-43, Lender's Guaranteed Loan Payment to USDA*.

In those instances where the lender has made authorized protective advances not included in the estimated loss payment, it may claim recovery for the guaranteed portion of approved amounts advanced, and interest resulting from such advances, not to exceed 90 calendar days from the Agency's approval of the liquidation plan. Such payment will be made by the Agency when the final report of loss is approved.

10.24 THE APPROVED CLAIM AMOUNT

If the State Office reviewing the lender's claim is satisfied with the lender's calculation of the final claim amount, then the office will forward the claim payment request to the USDA Finance Office for processing. The Finance Office will process the claim within 60 calendar days of receipt of the claim request from the State Office.

CHAPTER 11: ENVIRONMENTAL REQUIREMENTS

11.1 PURPOSE AND OVERVIEW

The purpose of this chapter is to describe the environmental requirements that must be met by the Agency and by the lender as a part of multifamily housing loanmaking and loan servicing activities.

Key Topics in this Chapter

- Agency Review During Loan Origination
- Environmental Requirements for Servicing Actions
- Other Environmental Requirements

11.2 GENERAL ENVIRONMENTAL REQUIREMENTS

The Agency will complete an environmental review in accordance with the National Environmental Policy Act and RD Instruction 1940-G, prior to taking any official action on an application for loan guarantee.



NEPA requires that Agency actions be classified into three basic categories of action:

- Those that qualify as categorical exclusions;
- Those that require an Environmental Assessment (EA); and
- Those that require an Environmental Impact Statement (EIS).

Due to the wide range of activities funded by the Agency, it established two categories of actions requiring an EA:

- Class I Actions – actions which require an environmental assessment with limited detail and analysis; and
- Class II Actions – actions requiring a fully detailed environmental assessment.

The classification of actions provides the Agency with a starting point for beginning its environmental review. Most multifamily housing activities will qualify for a Class I EA, but some will qualify for a Class II EA. For a complete list of housing actions and their classifications, refer to RD Instruction 1940-G.



The Agency environmental review must examine the potential impacts of the proposed project on the environment and on a wide range of protected resources. Exhibit 11-1 provides a list of major resources that must be considered.

Exhibit 11-1	
Major Protected Resources	
Wetlands	Natural Landmarks
Floodplains	Important Farmland
Wilderness Areas	Prime Forestland
Wild and Scenic Rivers	Pine Rangeland
Historical and Archeological Sites Area	Coastal Zone Management
Critical Habitat or Endangered or Recharge Area	Sole Source Aquifer

The Agency environmental review will provide the necessary documentation to:

- Demonstrate compliance with the requirements for the protection of the environment, including the development of practicable alternatives (which must always include the “no action” alternative) to either avoid or lessen adverse environmental impacts; and
- Demonstrate why the potential impact on the environment is not considered to be significant and therefore, an EIS is not required. Environmental files must include appropriate, detailed, and accurate supporting documentation, maps, results of consultation, and evidence that required public notices were published and sent to the parties listed in RD Instruction 1940.331.
- All mitigation measures listed in the environmental review will be included in legally binding documents, such as the Letter of Conditions and Conditional Commitment for Guarantee.
- Evidence that mitigation measures were implemented during project completion. This evidence will be obtained and included in the environmental file.

11.3 ENVIRONMENTAL RISK MANAGEMENT

The Agency and the guaranteed lender will incorporate into their lending practices an environmental risk management program. The purpose of this risk management program is two-fold:

- To minimize adverse impacts to the security interests of the Agency and the lender in real property caused by potential contamination from hazardous substances, hazardous wastes, and petroleum products; and

- To establish a process by which the Agency and the lender can minimize their liability under the laws regulating management of hazardous substances, hazardous wastes, and petroleum products.

A major component of this risk management program will be the performance of due diligence. Due diligence is the process of inquiring into the environmental condition of the real estate in the context of a real estate transaction, to determine the presence of contamination from hazardous wastes and petroleum products, and to determine what impact such contamination may have on the market value of the property.

Lenders are required to perform due diligence in conjunction with appropriate loan processing and servicing actions. The minimum standard the Agency will accept as evidence of due diligence is the most current version of the *ASTM Standard E-1527, Phase I Environmental Site Assessment*, published by the American Society for Testing and Materials (ASTM), completed by a qualified environmental professional. Guaranteed lenders may incorporate the ASTM standards into their processing and servicing procedures or use an equivalent process of due diligence approved by the State Environmental Coordinator in consultation with the Regional Office of the General Counsel. Lenders must provide the Agency with a copy of the due diligence report and maintain a copy in the loan file. Noncompliance with this section may jeopardize the Agency's payment of loss claims due to environmental contamination.

Due diligence will be performed for:

- All applications for existing multifamily housing units, when:
 - ◇ An appraiser reports to the Agency or to the guaranteed lender that potential contamination from hazardous substances, hazardous wastes, or petroleum products has been observed on the property or encountered through research or interviews with individuals knowledgeable about the property; or
 - ◇ The Agency or the guaranteed lender becomes aware of possible contamination through some means other than the appraiser's report.
- All applications for new construction of multifamily housing units.

Additionally, if underground storage tanks are present at existing structures, the lender will ensure that the tanks comply with appropriate regulatory requirements or they will be removed.

11.4 RESPONSIBILITY FOR ENVIRONMENTAL REVIEWS

The Agency is responsible for completing the appropriate level of environmental review in accordance with RD Instruction 1940-G. This includes the assembly and analysis of relevant material, the development and analysis of practicable alternatives and mitigation measures, and the development of recommendations and decisions.



The Agency will require information from the lender and the lender's applicant to complete this environmental review. Lenders have a responsibility to become familiar with Federal environmental requirements so that they can advise applicants and reduce the probability of unacceptable applications being submitted to the Agency. Lenders are also expected to cooperate in the collection of any environmental data which the Agency determines is necessary and in the resolution of potential environmental problems.

The Agency approval official will use the environmental review documents and the recommendations of the State Environmental Coordinator to make the Agency's final decision regarding an environmental impact determination and compliance with environmental requirements, as well as flood insurance requirements. This decision will be documented on *Form RD 1940-22, Environmental Checklist for Categorical Exclusions*, for a categorical exclusion, a Finding of No Significant Impact (FONSI) for an EA, or a Record of Decision (ROD) for an EIS.

The State Environmental Coordinator is available to provide technical assistance and guidance to Agency staff, lenders and borrowers. They are also available to assist in problem resolution on environmental issues. Environmental issues or problems should be referred promptly to the State Environmental Coordinator.

11.5 ENVIRONMENTAL REVIEWS DURING LOAN ORIGATION

The Agency's environmental review of the property, as required under NEPA will be initiated as early as possible, but no later than the selection of the proposal for further processing. This means the environmental review will normally be prepared simultaneously with the development of the application package. This review must be complete and a Finding of No Significant Impact (FONSI) issued prior to the Agency's issuance of a conditional commitment.

A. The NOFA Submission Stage


One of the NOFA submission requirements is a description of any "known environmental issues that may affect the project." During this stage, the Agency will

take note of environmental issues that are disclosed by the lender in assessing the preliminary feasibility of the property. It is important that all known information is disclosed at this stage. Information not disclosed, that was known to the lender or borrower, could be grounds for disqualification of funding at a later stage.


B. The Application Submission Stage

1. Submission Requirement

The lender must submit the following information (unless such information was previously submitted) as part of the loan application package (see paragraph 4.9B):

- *Form RD 1940-20, Request for Environmental Information.* This form must include information about the environmental conditions of the proposed site and the project's potential impact on the environment. This completed form should be submitted to the Agency as quickly as possible, since it is used to assist the Agency in completing its environmental review. 
- Phase I Environmental Site Assessment report as prescribed by the American Society for Testing and Materials (ASTM).
- Lender comments regarding relevant off-site conditions.
- Land survey.
- *FEMA 81-93, Standard Flood Hazard Determination.*

2. Agency Response

As early as possible in the planning and decision making process, the Agency will initiate the collection of environmental information and the appropriate level of environmental review in accordance with RD Instruction 1940-G. 

The environmental review will be completed prior to loan approval, obligation of funds, or other commitment of Agency resources, including issuance of a conditional commitment for guarantee whichever occurs first; and prior to the Agency decision on any servicing action which is subject to Agency approval. A commitment of Agency resources may not be made subject to completion of the environment review.

The environmental review is considered complete when the environmental documents have been properly executed, when all applicable public notices have been published, the

associated public comment periods have expired, and the Agency has taken any necessary actions to address the comments received.

11.6 ENVIRONMENTAL REVIEWS DURING THE SERVICING PERIOD

All lender servicing actions which require prior approval of the Agency are subject to the Agency's completion of a NEPA environmental review. Agency approval of a liquidation action plan will normally qualify as a categorical exclusion, provided the proposed disposition of the property will not alter the purpose, operation, location or design of the project as originally approved. However, it is the lender's responsibility to ensure that due diligence is conducted in conjunction with the appraisal for all loan servicing actions which require a determination of security value or which could lead to acquisition of real property by the Agency or the guaranteed lender.

If, through environmental audits, due diligence or some other means, a release or threatened release of hazardous substances, hazardous wastes, or petroleum products is discovered on a borrower's property, the Agency official, in consultation with the State Environmental Coordinator and the guaranteed lender, will promptly notify the borrower in writing that immediate corrective action must be taken, consistent with appropriate regulatory authority requirements. Simultaneously, the State Environmental Coordinator will notify the appropriate regulatory authority for any necessary enforcement action.

In the case of a defaulted loan where the Agency may consider taking title from the lender, the Agency will review the due diligence report and the appraisal, prior to accepting title. If contamination is present and the cost of mitigation exceeds the market value or the amount of the debt, the Agency may decide not to accept title from the lender. If there is a loss claim due to contamination, the Agency will not finalize the loss claim until the lender has sold the property. The Agency will also review the due diligence report and appraisal prior to its consent to the release of security property by the guaranteed lender and when there are bankruptcy proceedings.

11.7 OTHER ENVIRONMENTAL REQUIREMENTS

A. Flood Hazard Determination

Property located in Special Flood Hazard Areas designated by the Federal Emergency Management Agency are not eligible for federal financial assistance, including loan guarantees, unless flood insurance through the National Flood Insurance Program (NFIP) is available. The lender must ensure that NFIP flood insurance is purchased prior to loan closing and issuance of the guarantee, in accordance with the National Flood Insurance Act, as amended, and RD Instruction 426.2.

The lender is responsible for ensuring the completion of *FEMA Form 81-93, Standard Flood Hazard Determination* and for submitting a copy to the Agency with the request for guarantee. The form provides specific information with regard to the proposal's location in a floodplain, the community's NFIP eligibility, its proximity to floodplains and the availability of flood insurance. This information is necessary for a determination of site eligibility by the Agency. The environmental review conducted by the Agency will examine whether or not there is a reasonable alternative to a proposed purchase/construction in the floodplain.

Flood insurance must cover the lesser of the outstanding principle balance of the loan or the maximum amount of coverage allowed under FEMA's National Flood Insurance Program. Prior to loan closing, the lender is responsible for sending the applicant a copy of *Form RD 3550-6, Notice of Special Flood Hazards, Flood Insurance Purchase Requirements, and Availability of Federal Disaster Relief Assistance*. The applicant must sign and return the form at or before loan closing.

B. Clean Air Act and Water Pollution Control Act

Federal contracts that exceed \$100,000, must meet all applicable standards, orders, or requirements issued under section 306 of the Clean Air Act; section 508 of the Clean Air Act, Executive Order 11738; and EPA regulations 40 CFR Part 15. The lender must ensure compliance with this requirement during construction of the property and throughout the servicing period.

CHAPTER 12: SECONDARY MARKET

KEY TOPICS IN THIS CHAPTER

- Transfer to the Secondary Market
- Holder Demand for Repurchase
- Repurchase of the Loan or Note by Lender
- Repurchase of the Loan or Note by Agency

12.1 PURPOSE AND OVERVIEW

This chapter will describe how GRRHP loans are sold in the secondary market and how the guarantee comes into play in event of borrower default. The secondary market is a mechanism that allows lenders to obtain liquidity to make additional loans. Through the secondary market the lender receives the following benefits which may then be passed on to the borrower in the form of lower interest rates and longer fixed rate terms:

- Reduced interest rate risk by transferring the risk of interest rate increases to the secondary market.
- Increased liquidity by using funds received from a loan sale for additional lending or investing activity.
- Increased return on investment by selling the loan to the secondary market and keeping a servicing fee. A lender may increase their return on the loan and reduce their interest rate risk.

SECTION 1: TRANSFER TO THE SECONDARY MARKETS

12.2 HOLDER VERSUS PARTICIPANT

The Agency makes a clear distinction between a holder of the loan and a participant in the loan. A holder is a person or organization other than the lender who holds all or part of the loan with no servicing responsibilities, except possibly in the instance of a Government Sponsored Entity (GSE), such as Fannie Mae. The holder "holds" the note and the guaranteed portion of the note is backed 100 percent by the "Full Faith and Credit" of the U.S. Government in case of default. Unless otherwise noted, all holders must have *Form RD 3565-5, Assignment Guarantee Agreement*, that has been executed by the Agency or a duly executed Agency approved assignment guarantee agreement.

A participant is a person or organization that buys an interest in the loan in which the originating lender keeps the note, the collateral securing the note, and all responsibility for loan servicing. A participant does not hold any part of the note but has a participation arrangement with the lender. A participant has no claim to the guarantee in case of default.

12.3 TRANSFER TO THE SECONDARY MARKET

A. Loan Requirements For Sale On The Secondary Market

The lender may sell, assign, or participate all or part of the loan to one or more holders at or after loan closing, only if the loan is not in default. Lenders are regularly contacted by and normally maintain a list of brokers or dealers interested in the purchase of GRRHP loans, or they may work directly with Fannie Mae, Freddie Mac or be a Ginnie Mae Issuer.

Below is an example of an average transaction involving the steps a lender and a broker would take in the sale of a guaranteed loan on the secondary market:

- Contact several brokers. The brokers will need to know:
 - ◇ Loan amount and the size of the guaranteed portion
 - ◇ Interest rate
 - ◇ Maturity date
 - ◇ Payment schedule
 - ◇ If it is a new loan, when it will be funded
- Determine loan-servicing fee.
 - ◇ The Agency encourages lenders to charge a minimum loan-servicing fee of 25 basis points.
- Select a bid.
 - ◇ Negotiations concerning premiums and fees. The Agency will participate in such negotiations only as a provider of information.
- Review Documents. The broker or intermediary should send the lender a purchase commitment letter. The lender must notify the Agency that the loan is being sold and obtain the documents that the Agency will need to execute. In order to complete the sale, the lender should sign and return one copy of the commitment letter to the broker along with the following:
 - ◇ Copy of the note
 - ◇ Executed Form RD 3565-4, *Loan Note Guarantee*
 - ◇ Executed Form RD 3565-5, *Assignment Guarantee Agreement* (See Paragraph 12.3 B) or an Agency approved assignment guarantee agreement.



- Close the transaction.
 - ◇ Upon receipt of the forms, the holder or broker prepares Form RD 3565-5, *Assignment Guarantee Agreement* or an Agency approved assignment guarantee agreement and sends it to the lender in triplicate. The lender signs all 3 forms and forwards them to the Agency for execution. The Agency signs the forms and forwards them to the lender or investment broker, and the settlement date is established.
 - ◇ The broker returns the original copy to the lender and another copy to the Agency.
 - ◇ On settlement date, the broker wires the funds to the lender.

Once documents are received by the Agency, it will endeavor to return executed forms to the lender within 7 calendar days.

B. Agency Execution of *Form RD 3565-5, Assignment Guarantee Agreement*

The lender must provide the Agency with copies of all appropriate forms used in the sale or assignment. Once the lender accepts a specific buyer's offer, the lender must notify the Agency that the loan is being sold and will submit *Form RD 3565-5, Assignment of Guarantee* to the Agency for execution. The authorized Agency official shall execute *Form RD 3565-5* after reviewing it according to this paragraph. The form does not have to be signed by the holder before Agency approval of the assignment. After execution by the lender and the Agency, the holder will execute it and return a copy to the Agency for retention in the borrower's case file.

Before executing *Form RD 3565-5* the authorized Agency official will review the documents to determine the following items.

- To whom is the loan being sold? A loan may not be sold to the borrower or someone who has a relationship to the borrower or is an owner or subsidiary of the lender itself.
- Is the loan delinquent? Delinquent loans may not be sold into the secondary market.

Upon the lender's sale or assignment of the loan, the lender will remain bound to all obligations indicated in the Loan Note Guarantee, the Lender's Agreement, the Agency program regulations, and future program regulations.

The lender will send the holder the borrower's executed note attached to the Guarantee and the holder will succeed to all rights of the Loan Note Guarantee pertaining to the portion of the loan purchased.

C. Loans Involving Ginnie Mae, Freddie Mac and Fannie Mae

For GRRHP loans that are backing Ginnie Mae guaranteed securities, the Lender will follow Ginnie Mae procedures to close secondary market transactions. Lenders that do business with Freddie Mac and Fannie Mae will follow their respective procedures to close secondary market transactions involving GRRHP loans. The Lenders must provide the Agency with proper documentation to evidence the secondary market transaction in the borrower's case file. The Agency will then update its loan tracking system accordingly.

For the assignment of GRRHP loans that are backing Ginnie Mae guaranteed securities, the Lender does not need to execute a *Form RD 3565-5*. Loans and/or mortgage servicing backing Ginnie Mae guaranteed securities may only be assigned to a Ginnie Mae issuer, with prior Ginnie Mae approval.

For GRRHP loans that are backing Ginnie Mae guaranteed securities where there is a conflict between this Chapter and Ginnie Mae requirements, the Ginnie Mae requirements shall prevail.

SECTION 2: REPURCHASE FROM A SECONDARY MARKET HOLDER

12.4 Holder Demand for Repurchase



The holder may make written demand on the lender to repurchase the unpaid portion of the loan when either:

- the borrower has not made a payment of principal and interest due on the loan for at least 60 days, or
- the lender has failed to give the holder its pro-rata share of any payment made by the borrower within 30 calendar days of receipt of a payment.

The holder must concurrently send a copy of the demand letter to the Agency.

When a lender is requested to repurchase a loan from the holder, the lender must consider the request according to the servicing actions that are necessary on the loan. In order to facilitate servicing and simplified accounting of loan transactions, lenders are encouraged to repurchase the loan upon the holder's request.

The lender will notify the holder and the Agency of its decision to repurchase within 10 business days from the date of the written demand letter by the holder. The lender may agree to repurchase the unpaid portion of the entire loan from the Holder, even though the guarantee will not cover the unguaranteed portion of the loan. If the lender decides to repurchase, the lender has 30 calendar days from the date of the holder's written demand letter to do so. The guarantee will not cover the unguaranteed portion of the loan or the note interest to the holder on the guaranteed loan portion accruing after 90 calendar days from the date of the demand letter to the lender requesting the repurchase. The lender may deduct the lender's servicing fee from the repurchase amount.

The lender will accept an assignment without recourse from the holder upon repurchase. The lender is encouraged to repurchase the loan to facilitate the accounting of funds, resolve the problem, and prevent default, where and when reasonable. Upon repurchase, the lender shall notify the Agency by returning the original Assignment Agreement. The Agency will then update its loan tracking system accordingly.

12.5 Lender Initiated Repurchase

If due to loan default or imminent loan restructuring, the lender determines that its repurchase is necessary to adequately service the loan, the lender may repurchase the loan from the holder. Lender repurchase is not required if the holder will agree to the restructured terms of the note. If interest is capitalized, a new note is taken, the original note is amended, or the principal amount is modified, the lender must ensure that the assignment is amended to reflect the actual guaranteed portion held by the holder.

The lender will not repurchase from the holder for arbitrage purposes. The lender must document all attempts to repurchase the loan from the holder in the loan file.

12.6 Purchase of the Loan or Note by the Agency



If the lender does not repurchase the loan as provided in Paragraph 12.4, the Agency will purchase from the holder the unpaid principal balance of the **guaranteed portion** together with accrued interest to date of repurchase, less the lender's servicing fee, within 30 calendar days after written demand to the Agency from the holder. This demand notice is in addition to the copy of the written demand on the lender. The guarantee will not cover the note interest to the holder on the guaranteed loan accruing after 90 calendar days from the date of the original demand letter of the holder to the lender requesting the repurchase.

With its demand on the Agency, the holder will include:

- A copy of the written demand made upon the lender
- Originals of the Loan Note Guarantee and note properly endorsed to the Agency, or the original of an Agency approved assignment guarantee agreement
- A copy of any written response to the demand provided by the lender to the holder
- An account number which the Agency can forward the purchase amount to via electronic funds transfer

The Agency will notify the lender of its receipt of the holder's demand for payment. The lender must provide the Agency with the information necessary for the Agency to determine the appropriate amount due the holder within 10 business days from the date of the written demand letter to the lender from the holder requesting repurchase of the guaranteed portion. The lender will furnish a current statement certified by an appropriate authorized officer of the lender stating the unpaid principal and interest then owed by the borrower on the loan and the amount then owed to any holder. Any discrepancy between the amount claimed by the holder and the information submitted by the lender must be resolved between the lender and the holder before payment will be approved. The Agency will coordinate the resolution of the discrepancy. Such conflict will suspend the running of the 30 calendar day payment requirement.

The authorized Agency official shall review the borrower's loan file and

- Verify the amounts owed to the lender and the holder, and
- Complete *Form RD 1980-37, Purchase of a Guaranteed Loan Portion*, and return it to the Finance office for processing.

At the time of purchase by the Agency, the holder will assign the original Agency approved assignment guarantee agreement to the Agency without recourse, including all rights, title, and interest in the loan. Purchase by the Agency does not change, alter, or modify any of the lender's obligations to the Agency specified in the Lender's Agreement or the Loan Note Guarantee. Nor does the purchase waive any of the Agency's rights against the lender. The Agency succeeds to all rights of the holder under the Loan Note Guarantee including the right to set-off any payments the Agency owes the lender.

12.7 Repurchase Price of the Loan or Note

The Agency Loan Note Guarantee will not cover servicing fees that the lender accrues after the repurchase or the unguaranteed portion of the loan.

GLOSSARY

Administrator. The Administrator of the Rural Housing Service, or his or her designee.

Agency. The Rural Housing Service.

Allowable claim amount. The total losses incurred by the holder of guarantee, as calculated pursuant to Subpart J of Part 3565.

Applicable Federal Rate (AFR). The interest rate set by the federal government for federal financing programs pursuant to Section 42 of the Internal Revenue Code.

Approved lender. An eligible lender who has been authorized by the Agency to originate guaranteed multifamily loans under the program.

Assignment. The delivery by a lender to the Agency of the note and any other security instrument securing the guaranteed loan; and any and all liens, interest, or claims the lender may have against the borrower that is party to the note.

Assistance. Financial assistance in the form of a loan guarantee or interest credit received from the Agency.

Borrower. The entity created for purposes of owning and operating a project.

Claim. The presentation to the Agency of a demand for payment for losses incurred on a loan guaranteed under the program.

Combination construction and permanent loan. A guaranteed loan that becomes effective at the time construction of an eligible multifamily property begins.

Conditional commitment. The written commitment by the Agency to guarantee a loan subject to the stated terms and conditions.

Correspondent relationship. A contractual relationship between an approved lender and a non-approved lender or mortgage broker in which the correspondent performs certain origination, underwriting or servicing functions for the approved lender.

Default. Failure by a borrower to meet any obligation or term of a loan, grant, or regulatory agreement.

Delinquency. Failure to make a timely payment under the terms of the promissory note or regulatory agreement.

Eligible borrower. A borrower who has met the requirements of Subpart D of Part 3565.

Eligible lender. A lender who has met the requirements of Subpart C of Part 3565.

Eligible loan. A loan that meets the requirements of Subpart E of Part 3565.

Fannie Mae. A government sponsored enterprise created by Congress to purchase, sell or otherwise facilitate the purchase or sale of mortgage in the secondary mortgage market. These activities support the availability and affordability of mortgage credit.

Federal Home Loan Bank System. A system of savings and loans, banks and other lenders whose primary business is the making of housing loans.

Final claim payment. The amount due to the lender (or the Agency) after disposition of the security collateral is complete and the proceeds from such sale as well as the initial claim payment, if any, are applied against the allowable claim amount.

Foreclosure. The process by which the ownership interest of a borrower in a mortgaged property is extinguished. This process may involve a sale of the property at public auction, with the proceeds of the sale being applied to the mortgage debt.

Freddie Mac. A government sponsored enterprise created by Congress to purchase, sell or otherwise facilitate the purchase or sale of mortgage in the secondary mortgage market. These activities support the availability and affordability of mortgage credit.

Ginnie Mae. Ginnie Mae is a reference to the Government National Mortgage Association.

Government National Mortgage Association. The Government National Mortgage Association (Ginnie Mae) is a government corporation within the Department of Housing and Urban Development. Ginnie Mae guarantees privately issued securities backed by mortgages or loans which are insured or guaranteed by the Federal Housing Administration (FHA), the Department of Veteran Affairs (VA), or the Rural Housing Service (RHS) and certain other loans or mortgages guaranteed or insured by the government.

Guarantee agreement. The written agreement between the Agency and the lender setting forth the terms and conditions of the guarantee with respect to an individual loan.

Guarantee fees. The fees paid by the lender to the Agency for the loan guarantee. An initial guarantee fee is due at the time the guarantee is issued. An annual guarantee fee is due at the beginning of each year that the guarantee remains in effect.

Guaranteed loan. Any loan for which the Agency provides a loan guarantee.

Holder. A person or entity, other than the lender, who owns all or part of the guaranteed portion of the loan with no servicing responsibilities. When the single note option is used and the lender assigns a part or all of the guaranteed note to an assignee, the assignee becomes a holder only when the Agency receives notice and the transaction is completed through use of an assignment guarantee agreement form approved by the Agency.

Housing finance agency. A state or local government instrumentality duly authorized to issue housing bonds or otherwise provide financing for housing.

Identity of interest. With respect to a project, a financial interest of any type, or appearance of same, that exists or will exist between the borrower, management agent, suppliers of materials or services, or vendors, in any combination of relationships.

Income eligibility. A determination that the income of a tenant at initial occupancy does not exceed 115 percent of the area median income as such area median income is defined by the Department of Housing and Urban Development (HUD) or its successor.

Indian tribe. Any Indian tribe, band, nation, or other organized group or community of Indians, including any Alaska Native village or regional or village corporation, as defined by or established pursuant to the Alaska Native Claims Settlement Act (43 U.S.C. 1601 et seq.), that is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians pursuant to the Indian Self-Determination and Education Assistance Act of 1975 (25 U.S.C. 450 et seq.); or any entity established by the governing body of an Indian tribe, as described in this definition, for the purpose of financing economic development.

Interest credit. A subsidy available to eligible borrowers that reduces the effective interest rate of the loan to the Long Term Monthly AFR.

Land lease. A written agreement between a landowner and a borrower stipulating the terms for possession and use of land for a specified period of time.

Lease. A contract setting forth the rights and obligations of a tenant or cooperative member and a borrower, including the amount of the monthly occupancy charge and other terms under which the tenant will occupy the housing.

Lender. A bank or other financial institution that originates and/or services the guaranteed loan.

Lender Agreement. The written agreement between the Agency and the lender setting forth the requirements the lender must meet on a continuing basis to participate in the program.

Loan. A mechanism by which a lender funds the acquisition and development of a multifamily project. A loan in this context is secured by a mortgage executed by the lender and borrower.

Loan guarantee. An Agency pledge to pay part of the loss incurred by a lender or holder in the event of default by the borrower.

Loan participation. A loan made by more than one lender wherein each lender funds a portion of the loan.

Loan-to-value ratio. The amount of the loan divided by the appraised value of the development.

Maximum guarantee payment. The maximum payment by the Agency under the guarantee agreement computed by applying the guarantee percentage times the allowable claim amount. (See Chapter 10 for further detail.)

Mortgage. A written instrument evidencing or creating a lien against real property for the purpose of providing collateral to secure the repayment of a loan. For program purposes, this may include a deed of trust or any similar document.

Multifamily project. A project designed with five or more living units.

Negligent Servicing or Origination. Negligent servicing or origination is a failure to perform those services, which a reasonably prudent lender would perform in servicing or originating its own portfolio, and includes not only the failure to act, but also the failure to act in a timely manner.

NOFA. A “Notice of Funding Availability” published in the Federal Register to inform interested parties of the availability of assistance and other non-regulatory matters pertinent to the program.

Non-monetary default. A default that does not involve the payment of money.

Note. Any note, bond, assumption agreement, or other evidence of indebtedness pertaining to a guaranteed loan.

Office of the General Counsel (OGC). The Office of the General Counsel of the USDA.

Office of the Inspector General (OIG). The Office of Inspector General of the USDA.

Payment effective date. For the month payment is due, the day of the month on which payment will be effectively applied to the account by the lender, regardless of the date payment is received.

Permanent loan. A permanent loan is defined as a mortgage loan usually covering development costs, interim loans, construction loans, financing expenses, marketing, administrative, legal, and other Agency approved costs. This loan differs from the construction loan in that financing goes into place after the project is completely constructed and open for occupancy. It is a long-term obligation, generally for a period of no less than 25 years and no more than 40 years.

Prepayment. The payment of the outstanding balance on a loan prior to the note's original maturity date.

Program requirements. Any requirements set forth in any pertinent loan document, guarantee agreement, statute, regulation, handbook, or administrative notice.

Project. The total number of rental housing units and related facilities subject to a guaranteed loan that are operated under one management plan with Regulatory agreement.

Recourse. The lender's right to seek satisfaction from the borrower's personal financial resources for any monetary default.

Regulatory agreement. The agreement that establishes the relationship between the Agency, the lender, and the borrower; and sets forth the borrower's responsibilities with respect to all aspects of the management and operation of the project.

Rural area. A geographic area as defined in title 5 of section 538 of the Housing Act of 1949.

Rural Development. A mission area within USDA which includes RHS, Rural Utilities Service (RUS), and Rural Business-Cooperative Service (RBS).

Rural Housing Service. The Rural Housing Service within the Rural Development mission area of the U.S. Department of Agriculture or its successor agency, which administers Section 538 loans.

Servicing. The broad scope of activities undertaken to manage the performance of a loan throughout its term and to assure compliance with the program requirements.

Servicing lender. A lender or other entity approved to service a permanent guaranteed loan.

Single asset ownership. A limitation on the real estate assets that may be owned by a borrower.

Surplus cash. The borrower's remaining funds at the property's fiscal year end, after making all required payments.

Tenant. The individual or individuals that hold the right to occupy a unit in accordance with the terms of a lease executed with the project owner.

U.S. citizen. An individual who resides as a citizen in any of the 50 States, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin islands, Guam, American Samoa, the Commonwealth of the Northern Marianas, the Federated States of Micronesia, the Republic of Palau, or the Republic of the Marshall Islands.

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7 CFR PART 3565--Guaranteed Rural Rental Housing Program

Subpart A--General Provisions

Sec. 3565.1 Purpose.

The purpose of the Guaranteed Rural Rental Housing Program (GRRHP) is to increase the supply of affordable rural rental housing, through the use of loan guarantees that encourage partnerships between the Rural Housing Service, private lenders and public agencies.

Sec. 3565.2 Applicability and authority.

The regulation prescribes the policies, authorizations, and procedures for the guarantee of multifamily loans under section 538 of the Housing Act of 1949.

Sec. 3565.3 Definitions.

Administrator. The Administrator of the Rural Housing Service, or his or her designee.

Agency. The Rural Housing Service, or a successor agency.

Allowable claim amount. The total losses incurred by the lender, as calculated pursuant to subpart J of this part.

Applicable Federal Rate (AFR). The interest rate set by the federal government for federal financing programs pursuant to section 42 of the Internal Revenue Code.

Approved lender. An eligible lender who has been authorized by the Agency to originate and service guaranteed multifamily loans under the program.

Assignment. The delivery by a lender to the Agency of the note and any other security instruments securing the guaranteed loan; and any and all liens, interest, or claims the lender may have against the borrower.

Assistance. Financial assistance in the form of a loan guarantee or interest credit received from the Agency.

Borrower. The individuals or entities responsible for repaying the loans.

Claim. The presentation to the Agency of a demand for payment for losses incurred on a loan guaranteed under the program.

Combination construction and permanent loan. The Agency may guarantee a construction contract which has credit enhancements to protect the Government's interest. The construction guarantee will be converted to a permanent guarantee when construction is completed and the requirements contained in the conditional commitment are met.

Conditional commitment. The written commitment by the Agency to guarantee a loan subject to the stated terms and conditions.

7 CFR Part 3565
Sec. 3565.3 (Con.)

Correspondent relationship. A contractual relationship between an approved lender and a non-approved lender or mortgage broker in which the correspondent performs certain origination, underwriting or servicing functions for the approved lender.

Default. Failure by a borrower to meet any obligation or term of a loan, grant, or regulatory agreement, or any program requirement.

Delinquency. Failure to make a timely payment under the terms of the promissory note or regulatory agreement.

Department of Housing and Urban Development (HUD). A federal agency which may be a partner in some of the Agency guarantees.

Due diligence. The process of evaluating real estate in the context of a real estate transaction for the presence of contamination from release of hazardous substances, petroleum products, or other environmental hazards and determining what effect, if any, the contamination has on the regulatory status or security value of the property.

Eligible borrower. A borrower who meets the requirements of subpart D of this part.

Eligible lender. A lender who meets the requirements of subpart C of this part or any successor regulation.

Eligible loan. A loan that meets the requirements of subpart E of this part or any successor regulation.

Eligible rural area. An eligible rural area is an area which meets the requirements of part 3550 of this chapter or any successor regulation.

Fannie Mae. A Federally chartered--publicly owned enterprise created by Congress to purchase, sell or otherwise facilitate the purchase or sale of mortgages in the secondary mortgage market.

Federal Home Loan Bank System. A system of member savings and loans, banks and other lenders whose primary business is the making of housing loans.

Final claim payment. The amount due to the lender (or the Agency) after disposition of the collateral is complete and the proceeds from liquidation, as well as any other claim payments, are applied against the allowable claim amount.

Foreclosure. The process by which the ownership interest of a borrower in a mortgaged property is extinguished and the security is liquidated with the proceeds applied to the loan.

Freddie Mac. A Federally chartered, publicly owned enterprise created to purchase, sell or otherwise facilitate the purchase or sale of mortgages in the secondary mortgage market.

Ginnie Mae. Ginnie Mae is a reference to the Government National Mortgage Association.

Government National Mortgage Association. The Government National Mortgage Association (Ginnie Mae) is a government corporation within the Department of Housing and Urban Development. Ginnie Mae guarantees privately issued securities backed by mortgages or loans which are insured or guaranteed by the Federal Housing Administration (FHA), the Department of Veteran Affairs (VA), or the Rural Housing Service (RHS) and certain other loans or mortgages guaranteed or insured by the Government.

GRRHP. Guaranteed Rural Rental Housing Program.

Guarantee fees. The fees paid by the lender to the Agency for the loan guarantee.

(1) An initial guarantee fee is due at the time the guarantee is issued.

(2) An annual guarantee fee is due at the beginning of each year that the guarantee remains in effect.

Guaranteed loan. Any loan for which the Agency provides a loan guarantee.

Sec. 3565.3 (Con.)

Holder. A person or entity, other than a lender, who owns all or part of the guaranteed portion of the loan with no servicing responsibilities. When a single note option is used and the lender assigns a part of the guaranteed note to an assignee, the assignee becomes a holder only when the Agency receives notice and the transaction is completed through use of an assignment guarantee agreement form approved by the Agency.

Housing Finance Agency (HFA). A state or local government instrumentality authorized to issue housing bonds or otherwise provide financing for housing.

Identity of interest. With respect to a project, an actual or apparent financial interest of any type, that exists or will exist among the borrower, contractor, lender, syndicator, management agent, suppliers of materials or services, including professional services, or vendors (including servicing and property disposal), in any combination of relationships which may result in an actual or perceived conflict of interest

Income eligibility. A determination that the income of a tenant at initial occupancy does not exceed 115 percent of the area median income as such area median income is defined by HUD or a successor agency.

Indian tribe. Any Indian tribe, band, nation, or other organized group or community of Indians, including any Alaska Native village or regional or village corporation, as defined by or established pursuant to the Alaska Native Claims Settlement Act (43 U.S.C. 1601 et seq.), that is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians pursuant to the Indian Self-Determination and Education Assistance Act of 1975 (25 U.S.C. 450 et seq.); or any entity established by the governing body of an Indian tribe, as described in this definition, for the purpose of financing economic development.

Interest credit. A subsidy available to eligible borrowers that reduces the effective interest rate of the loan to the AFR.

Land lease. A written agreement between a landowner and a borrower for the possession and use of real property for a specified period of time.

Lease. A contract containing the rights and obligations of a tenant or cooperative member and a borrower, including the amount of the monthly occupancy charge and other terms under which the tenant will occupy the housing.

Lender. A bank or other financial institution, including a housing finance agency, that originates or services the guaranteed loan.

Lender Agreement. The written agreement between the Agency and the lender containing the requirements the lender must meet on a continuing basis to participate in the program.

Loan. A mechanism by which a lender funds the acquisition and development of a multifamily project. A loan in this context is secured by a mortgage executed by the lender and borrower.

Loan guarantee. A pledge to pay part of the loss incurred by a lender in the event of default by the borrower.

Loan guarantee agreement. The written agreement between the Agency and the lender containing the terms and conditions of the guarantee with respect to an individual loan.

Loan participation. A loan made by more than one lender wherein each lender funds an individual portion of the loan.

Loan-to-value ratio. The amount of the loan divided by the appraised market value of the project.

Maximum guarantee payment. The maximum payment by the Agency under the guarantee agreement computed by applying the guarantee percentage times the allowable claim amount, but not to exceed original principal amount.

Mortgage. A written instrument evidencing or creating a lien against real property for the purpose of providing collateral to secure the repayment of a loan. For program purposes, this may include a deed of trust or any similar document.

Multifamily project. A project designed with five or more living units.

Negligent servicing or origination. Negligent servicing or origination is a failure to perform those services which a reasonably prudent lender would perform in servicing or originating its own portfolio and includes not only the failure to act but also the failure to act in a timely manner.

NOFA. A "Notice of Funding Availability" published in the Federal Register to inform interested parties of the availability of assistance and other non-regulatory matters pertinent to the program.

Non-monetary default. A default that does not involve the payment of money.

Note. Any note, bond, assumption agreement, or other evidence of indebtedness pertaining to a guaranteed loan.

Office of Inspector General (OIG). The agency of USDA established under the Inspector General Act.

Payment effective date. For the month payment is due, the day of the month on which payment will be effectively applied to the account by the lender, regardless of the date payment is received.

Permanent loan. A permanent loan is defined as a mortgage loan usually covering development costs, interim loans, construction loans, financing expenses, marketing, administrative, legal, and other Agency approved costs. This loan differs from the construction loan in that financing goes into place after the project is completely constructed and open for occupancy. It is a long-term obligation, generally for a period of no less than 25 years and no more than 40 years.

Prepayment. The payment of the outstanding balance on a loan prior to the note's maturity date.

Project. The total number of rental housing units and related facilities subject to a guaranteed loan that are operated under one management plan and one Regulatory Agreement.

Program requirements. Any requirements contained in any loan document, guarantee agreement, statute, regulation, handbook, or administrative notice.

Promissory Note. See "Note".

Qualified alien. For the purposes of this part, qualified alien refers to any person lawfully admitted into the country who meets the criteria of 42 U.S.C. 1436a.

Real Estate Owned. Denotes real estate that has been acquired by the lender or the Agency (often known as "inventory property").

Recourse. The lender's right to seek satisfaction from the borrower's personal financial resources or other resources for monetary default.

Regulatory Agreement. The agreement that establishes the relationship among the Agency, the lender, and the borrower; and contains the borrower's responsibilities with respect to all aspects of the management and operation of the project.

RHS. The Rural Housing Service within the Rural Development mission area, or a successor agency, which administers section 538 guarantees.

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Rural area. A geographic area as defined in section 520 of the Housing Act of 1949.

Rural Development. A mission area within USDA which includes RHS, Rural Utilities Service, and Rural Business-Cooperative Service.

Servicing. The broad scope of activities undertaken to manage the performance of a loan throughout its term and to assure compliance with the program requirements.

Single asset ownership. A borrower who owns only one project.

Surplus cash. The borrower's remaining funds at the project's fiscal year end, after making all required payments, excluding required reserves and escrows.

Tenant. The individual that holds the right to occupy a unit in accordance with the terms of a lease executed with the project owner.

U.S. citizen. An individual who resides as a citizen in any of the 50 States, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Marinas, the Federated States of Micronesia, the Republic of Palau, or the Republic of the Marshall Islands.

USDA. The United States Department of Agriculture.

Sec. 3565.4 Availability of assistance.

The Agency's authority to enter into commitments, guarantee loans, or provide interest credits is limited to the extent that appropriations are available to cover the cost of the assistance. The Agency will publish a NOFA in the Federal Register to notify interested parties of the availability of assistance.

Sec. 3565.5 Ranking and selection criteria.

(a) Threshold criteria. Applications for loan guarantee submitted by lenders must include a loan request for a project that meets all of the following threshold criteria:

(1) The project must involve an owner and a development team with qualifications and experience sufficient to carry out development, management, and ownership responsibilities, and the owner and development team must not be under investigation or suspension from any government programs;

(2) The project must involve the financing of a property located in an eligible rural area;

(3) Demonstrate a readiness, for the project to proceed, including submission of a complete application for a loan guarantee and evidence of financing;

(4) Demonstrate market and financial feasibility; and

(5) Include evidence that the credit risk is reasonable, taking into account conventional lending practices, and factors related to concentration of risk in a given market and with a given borrower.

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(b) Priority projects. Priority will be given to projects: in smaller rural communities, in the most needy communities having the highest percentage of leveraging, having the lowest interest rate, having the highest ratio of 3-5 bedroom units to total units, or located in Empowerment Zones/Enterprise Communities or on tribal lands. In addition, the Agency may, at its sole discretion, set aside assistance for or rank projects that meet important program goals. Assistance will include both loan guarantees and interest credits. Priority projects must compete for set-aside funds. The Agency will announce any assistance set aside and selection criteria in the NOFA.

Sec. 3565.6 Inclusion of tax-exempt debt.

Tax-exempt financing can be used a source of capital for the guaranteed loan.

Sec. 3565.7 Agency environmental requirements.

The Agency will take into account potential environmental impacts of proposed projects by working with applicants, other federal agencies, Indian tribes, State and local governments, and interested citizens and organizations in order to formulate actions that advance the program goals in a manner that will protect, enhance, and restore environmental quality. Actions taken by the Agency under this subpart are subject to an environmental review conducted in accordance with the requirements of 7 CFR part 1940, subpart G or any successor regulations.

Sec. 3565.8 Civil rights compliance.

(a) All actions taken by the Agency, or on behalf of the Agency, by a lender will be conducted without regard to race, color, religion, national origin, sex, marital status, age, income from public assistance or having exercised their right under the Consumer Credit Protection Act, and in accordance with the Equal Credit Opportunity Act (ECOA).

(b) Any action related to the sale, rental or advertising of dwellings; in the provision of brokerage services; or in making available residential real estate transactions involving Agency assistance, must be in accordance with the Fair Housing Act, which prohibits discrimination on the basis of race, color, religion, sex, national origin, familial status or handicap. It is unlawful for a lender or borrower participating in the program to:

(1) Refuse to make accommodations in rules, policies, practices, or services if such accommodations are necessary to provide a person with a disability an opportunity to use or continue to use a dwelling unit and all public and common use areas; and

(2) Refuse to allow an individual with a disability to make reasonable modifications to a unit at his or her expense, if such modifications may be necessary to afford the individual full enjoyment of the unit.

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(c) Any resident or prospective resident seeking occupancy or use of a unit, property or related facility for which a loan guarantee has been provided, and who believes that he or she is being discriminated against may file a complaint with the lender, the Agency or the Department of Housing and Urban Development. A written complaint should be sent to the Secretary of Agriculture or of the Department of Housing and Urban Development in Washington, DC.

(d) Lenders and borrowers that fail to comply with the requirements of title VIII of the Civil Rights Act of 1968, as amended (the Fair Housing Act), are liable for those sanctions authorized by law.

(e) For guaranteed loans with "interest credit," the following additional civil rights laws will apply and be enforced by the agency delivering this guarantee program: title VI of the Civil Rights Act of 1964, section 504 of the Rehabilitation Act of 1973, the Americans with Disabilities Act, Age Discrimination Act of 1975, and title IX of the Education Amendments of 1972.

(f) In accordance with title VI, borrowers will be subjected to compliance reviews for projects that receive interest credit.

Sec. 3565.9 Compliance with federal requirements.

The Agency and the lender are responsible for ensuring that the application is in compliance with all applicable federal requirements, including the following specific statutory requirements:

(a) Intergovernmental review. 7 CFR part 3015, subpart V, "Intergovernmental Review of Department of Agriculture Programs and Activities", or successor regulation, including the Agency supplemental administrative instruction, RD Instruction 1940-J (available in any Rural Development Office).

(b) National flood insurance. The National Flood Insurance Act of 1968, as amended by the Flood Disaster Protection Act of 1973; the National Flood Insurance Reform Act of 1994; and 7 CFR part 1806, subpart B, or successor regulation.

(c) Clean Air Act and Water Pollution Control Act Requirements. For any contract, all applicable standards, orders or requirements issued under section 306 of the Clean Air Act; section 508 of the Clean Water Act; Executive Order 11738; and EPA regulations at part 32, of title 40.

(d) Historic preservation requirements. The provisions of 7 CFR part 1901, subpart F or successor regulation.

(e) Lead-based paint requirements. The provisions of 7 CFR part 1924, subpart A, or successor regulation.

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Sec. 3565.10 Conflict of interest.

(a) Objective. It is the objective within the Rural Development mission area to maintain the highest standards of honesty, integrity, and impartiality by employees.

(b) Rural Development requirement. To reduce the potential for employee conflict of interest, all Rural Development activities will be conducted in accordance with 7 CFR part 1900, subpart D, or successor regulation by Rural Development employees who:

- (1) Are not themselves a beneficiary;
- (2) Are not family members or known relatives of any beneficiary; and
- (3) Do not have any business or personal relationship with any beneficiary or any employee of a beneficiary.

(c) Rural Development employee responsibility. Rural Development employees must disclose any known relationship or association with a lender or borrower or their agents, regardless of whether the relationship or association is known to others. Rural Development employees or members of their families may not purchase a Real Estate owned property, security property from a borrower, or security property at a foreclosure sale.

(d) Loan closing agent responsibility. Loan closing agents (or members of their families) who have been involved with a particular property are precluded from purchasing such properties.

(e) Lender and borrower responsibility. Lenders, borrowers, and their agents must identify any known relationship or association with a Rural Development employee.

Secs. 3565.11-3565.12 [Reserved]

Sec. 3565.13 Exception authority.

An Agency official may request and the Administrator or designee may make an exception to any requirement or provision, or address any omission of this part, if the Administrator determines that application of the requirement or provision, or failure to take action, would adversely affect the government's interest or the program objectives, and provided that such an exception is not inconsistent with any applicable law or statutory requirement.

Sec. 3565.14 Review and appeals.

Whenever RHS makes a decision that is adverse to a lender or a borrower, RHS will provide written notice of such adverse decision and of the right to a USDA National Appeals Division hearing in accordance with 7 CFR part 11 or successor regulations. The lender or borrower may request an informal review with the decision maker and the use of available alternative dispute resolution or mediation programs as a means of resolution of the adverse decision. Any adverse decision, whether appealable or non-appealable may also be reviewed by the next level RHS supervisor. Adverse decisions affecting project tenants or applicants for tenancy will be handled in accordance with 7 CFR part 1944, subpart L or successor regulations.

Sec. 3565.15 Oversight and monitoring.

The lender, borrower, and all parties involved in any manner with any guarantee under this program must cooperate fully with all oversight and monitoring efforts of the Agency, Office of Inspector General, the U.S. General Accounting Office, and the U.S. Department of Justice or their representatives including making available any records concerning this transaction. This includes the annual eligibility audit and any other oversight or monitoring activities. If the Agency implements a requirement for an electronic transfer of information, the lender and borrower must cooperate fully.

Sec. 3565.16 [Reserved]

Sec. 3565.17 Demonstration programs.

To test ways to expand the availability or enhance the effectiveness of the guarantee program, or for similar purposes, the Agency may, from time to time, propose demonstration programs that use loan guarantees or interest credit. Toward this end, the Agency may enter into special partnerships with lenders, financial intermediaries, or others to carry out one or more elements of a demonstration program. Demonstration programs will be publicized by notices in the Federal Register.

Secs. 3565.18-3565.49 [Reserved]

Sec. 3565.50 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart B--Guarantee Requirements

Sec. 3565.51 Eligible loans and advances.

Upon approval of an application from an approved lender, the Agency will commit to providing a guarantee for a permanent loan or a combination construction and permanent loan, subject to the availability of funds. The Agency will not guarantee a construction loan that is not a combination construction and permanent loan.

Sec. 3565.52 Conditions of guarantee.

A loan guarantee under this part will be evidenced by a Loan Note Guarantee issued by the Agency. Each lender will execute a Lender's Agreement. If a valid Lender's Agreement already exists, it is not necessary to execute a new Lender's Agreement with each loan guarantee.

(a) Rights and liabilities. A guarantee under this part is backed by the full faith and credit of the United States and is incontestable except for fraud or misrepresentation of which the lender had knowledge at the time the lender acquired the guarantee or assigned the loan, or which a lender participates in or condones. The guarantee will be unenforceable by the lender to the extent any loss is occasioned by a violation of usury laws, negligent servicing or origination by the lender, including a failure to acquire required security, or as a result of a use of loan funds for purposes other than those authorized by the Agency. These acts in the previous sentence constitute grounds for the refusal to make full payment under the guarantee to the lender and will not be taken until the Agency gives the lender notice of the acts or omissions that it considers to constitute such grounds, specifying the applicable provisions in the Statute, Regulations, Loan Note Guarantee, or Lender's Agreement; the lender has not cured the acts or omissions within 90 calendar days after such notice; and the acts or omissions can reasonably be expected to have a material adverse effect on the credit quality of the guaranteed mortgage or the physical condition of the property securing the guaranteed mortgage. If such acts or omissions cannot be cured within a 90 calendar day period, the 90 calendar day cure period automatically shall be extended so long as curative activities commence during the 90 calendar day period. At no time shall the curative period extend more than 270 calendar days of the expiration of the original 90 calendar day cure period. When a guaranteed portion of a loan is sold to a holder, the holder shall succeed to all rights of the lender under the Loan Note Guarantee to the extent of the portion purchased. The lender will remain bound to all obligations under the Loan Note Guarantee, Lender's Agreement, and the Agency program regulations.

(b) Liability of the holder. The holder shall not be liable for the actions of the lender including, but not limited to, negligence, fraud, abuse, misrepresentation or misuse of funds, and its rights under the guarantee shall be fully enforceable notwithstanding the actions of the lender, unless the holder has knowledge of fraud, misrepresentation or misuse of funds when it becomes the holder or condones or participates in such actions.

(c) Guarantee percentage and payment. Both permanent loans and combination construction and permanent loans are eligible for a guaranty subject to the following limitations:

(1) Permanent loans. The Agency will issue a permanent loan guarantee after a minimum level of acceptable occupancy of 90% for 90 consecutive days is attained or an additional operating reserve equal to 2% of the appraised value of the project or total development costs, whichever is greater, is set aside. This cash contribution is an additional amount, over and above the required initial operating and maintenance contribution. In either case, the permanent guarantee will be issued when the 2% additional reserve amount is set aside prior to closing the construction loan or the minimum level of occupancy is attained prior to expiration of the Conditional Commitment, including any extensions thereto. The maximum guarantee for a permanent loan will be 90 percent of the unpaid principal and interest up to default and accrued interest 90 calendar days from the date the liquidation plan is approved by the Agency, as defined in §3565.452. Penalties incurred as a result of default are not covered by the guarantee. The Agency may provide a lesser guarantee based upon its evaluation of the credit quality of the loan. The Agency liability under any guarantee will decrease or increase, in proportion to any increase or decrease in the amount of the unpaid portion of the loan, up to the maximum amount specified in the Loan Note Guarantee.

(2) Combination construction and permanent loans. For combination construction and permanent loans, the Agency will guarantee advances during the construction loan period (which cannot exceed 24 months). The guarantee of construction loan advances will cover a permanent

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loan once the minimum level of acceptable occupancy of 90% for 90 consecutive days is attained or an additional operating reserve equal to 2% of the appraised value of the project or total development costs, whichever is greater, is set aside prior to closing the construction loan. This cash contribution is an additional amount, over and above the required initial operating and maintenance contribution. The maximum guarantee of construction advances related to a combination construction and permanent loan will not at any time exceed the lesser of 90 percent of the amount of principal and interest up to default advanced for eligible uses of loan proceeds or 90 percent of the original principal amount and interest up to default of the combination loan. Penalties incurred as a result of default are not covered by the guarantee. The Agency may provide a lesser guarantee based upon its evaluation of the credit quality of the loan. Conversion to a permanent loan guarantee will become effective when the Agency provides the lender with written confirmation of the conversion date.

In addition, the lender shall require credit enhancements to protect the Government's guarantee. Acceptable credit enhancements include:

- (i) Surety bonding or performance and payment bonding (the preferred credit enhancement);
 - (ii) An irrevocable letter of credit acceptable to the Agency; or
 - (iii) A pledge by the lender of acceptable collateral.
- (3) Maximum loss payment. The maximum loss payment to a lender or holder is as follows:
- (i) To any holder, 100 percent of any loss sustained by the holder on the guaranteed portion of the loan and on interest due on such portion.
 - (ii) To the lender, the lesser of:
 - (A) Any loss sustained by the lender on the guaranteed portion, including principal, interest and accrued interest up to 90 days evidenced by the notes or assumption agreements and secured advances for protection and preservation of collateral made with the Agency's authorization; or
 - (B) The guaranteed principal advanced to or assumed by the borrower and any interest and accrued interest up to 90 days due thereon.

Sec. 3565.53 Guarantee fees.

As a condition of receiving a loan guarantee, the Agency will charge the following guarantee fees to the lender.

(a) Initial guarantee fee. The Agency will charge an initial guarantee fee equal to one percent of the guarantee amount. For purposes of calculating this fee, the guarantee amount is the product of the percentage of the guarantee times the initial principal amount of the guaranteed loan.

(b) Annual guarantee fee. An annual guarantee fee of at least 50 basis points (one-half percent) of the outstanding principal amount of the loan will be charged each year or portion of a year that the guarantee is in effect. This fee will be collected on January 1, of each calendar year.

(c) Surcharge for guarantees on construction advances. The Agency may, at its sole discretion, charge an additional fee on the portion of the loan advanced during construction. This fee will be charged in advance at the start of construction and will be announced in NOFA before loan approval.

Sec. 3565.54 Transferability of the guarantee.

A lender must receive the Agency's approval prior to any sale or transfer of the loan guarantee.

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Sec. 3565.55 Participation loans.

Loans involving multiple lenders are eligible for a guarantee when one of the lenders is an approved lender and agrees to act as the lead lender with responsibility for the loan under the loan agreement.

Sec. 3565.56 Suspension or termination of loan guarantee agreement.

A guarantee agreement will terminate when one of the following actions occurs: (In accordance with subpart H of this part, use restrictions on the property will remain if the following actions take place prior to the term of the loan and RHS determines the restrictions apply.)

(a) Voluntary termination. A lender and borrower voluntarily request the termination of the loan guarantee.

(b) Agency withdrawal of guarantee. The Agency withdraws the loan guarantee in the event of fraud, misrepresentation, abuse, negligence, or failure to meet the program requirements.

(c) Mortgage pay-off. The loan is paid.

(d) Settlement of claim. Final settlement of the claim.

Sec. 3565.57 Modification, extension, reinstatement of loan guarantee.

To protect its interest or further the objectives of the program, the Agency may, at its sole discretion, modify, extend, or reinstate a loan guarantee. In making this decision the Agency will consider potential losses under the program, impact on the tenants and the public reaction that may be received regarding the action. Further, the Agency may authorize a guarantee on a new loan that is originated as a part of a workout agreement.

Secs. 3565.58-3565.99 [Reserved]

Sec. 3565.100 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart C--Lender Requirements

Sec. 3565.101 Responsibility of lenders.

A participating lender must originate and service a guaranteed loan in accordance with the regulation and program requirements throughout the life of a loan or guarantee, whichever is less. When it is in the best interests of the Agency, the Agency may permit the transfer of servicing from the originating lender to a servicer.

Sec. 3565.102 Lender eligibility.

An eligible lender must be a licensed business entity or HFA in good standing in the state or states where it conducts business; be approved by the Agency; and meet at least one of the criteria contained below. Lenders who are not eligible may participate in the program if they maintain a correspondent relationship with a lender who is eligible. An eligible lender must:

- (a) Meet the qualifications of, and be approved by, the Secretary of HUD to make multifamily housing loans that are to be insured under the National Housing Act;
- (b) Meet the qualifications and be approved by Fannie Mae, Freddie Mac, or Ginnie Mae to make multifamily housing loans that are to be sold or securitized by such corporations;
- (c) Be a state or local HFA, or a member of the Federal Home Loan Bank system, with a demonstrated ability to underwrite, originate, process, close, service, manage, and dispose of multifamily housing loans in a prudent manner;
- (d) Be a lender who meets the requirements for Agency approval contained in this subpart and has a demonstrated ability to underwrite, originate, process, close, service, manage, and dispose of multifamily housing loans in a prudent manner; or
- (e) Be a lender who meets the following requirements in addition to the other requirements of this subpart and of subpart I of this part:
 - (1) Have qualified staff to perform multifamily housing servicing and asset management;
 - (2) Have facilities and systems that support servicing and asset management functions; and
 - (3) Have documented procedures for carrying out servicing and asset management responsibilities.

Sec. 3565.103 Approval requirements.

The Agency will establish and maintain a “list of approved Lenders”. To be an approved lender, eligible lenders must meet the following requirements and maintain them on a continuing basis at a level consistent with the nature and size of their portfolio of guaranteed loans.

- (a) Commitment. A lender must have a commitment for a guaranteed loan or an agreement to purchase a guaranteed loan.
- (b) Audited statement. A lender must provide the Agency with an annual audited financial statement conducted in accordance with generally accepted government auditing standards.
- (c) Previous participation. A lender may not be delinquent on a federal debt or have an outstanding finding of deficiency in a federal housing program.
- (d) Ongoing requirements. A lender must meet the following requirements at initial application and on a continuing basis thereafter:
 - (1) Overall financial strength, including capital, liquidity, and loan loss reserves, to have an acceptable level of financial soundness as determined by a lender rating service (such as Sheshunoff, Inc.); or to be an approved Fannie Mae, Freddie Mac, Ginnie Mae or HUD Federal Housing Administration multifamily lender; or, if a state housing finance agency, to have a top tier rating by a rating agency (such as Standard and Poor's Corporation);
 - (2) Bonding and insurance to cover business related losses, including directors and officers insurance, business income loss insurance, and bonding to secure cash management operations;
 - (3) A minimum of two years experience in originating and servicing multifamily loans;

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- (4) A positive record of past performance when participating in RHS or other federal loan programs;
- (5) Adequate staffing and training to perform the program obligations; the head underwriter must have 3 years of experience and all staff must receive annual multifamily training;
- (6) Demonstrated overall financial stability of the business over the past five years;
- (7) Evidence of reasonable and prudent business practices for management of the program; and
- (8) No negative information on Dunn & Bradstreet or similar type report.
- (9) The lender must certify that they have computer systems that comply with year 2000 technology.

Sec. 3565.104 Application requirements.

Eligible lenders must submit a lender approval application, in a format prescribed by the Agency. The lender approval application submission must occur at the time the lender submits its first application for a loan guarantee, or its first application to purchase a guaranteed loan. The application must include documentation of lender compliance with Sec. 3565.103. A non-refundable application fee will be charged for each review of a lender's application. The amount of the fee will be announced in NOFA.

Sec. 3565.105 Lender compliance.

A lender will remain an approved lender unless terminated by the Agency. To maintain approval, the lender must comply with the following requirements.

- (a) Maintain eligibility in accordance with Sections 3565.102 and 3565.103;
- (b) Comply with all applicable statutes, regulations, and procedures;
- (c) Inform the Agency of any material change in the lender's staffing, policies and procedures, or corporate structure;
- (d) Cooperate fully with all program or Agency monitoring and auditing policies and procedures, including the Agency's annual audit of approved lenders; and
- (e) Maintain active participation in the multifamily guaranteed loan program by initiating a new loan guarantee or holding a loan guaranteed under this program.

Sec. 3565.106 Construction lender requirements.

A lender making a construction loan, as part of a combination construction and permanent loan, must demonstrate an ability to originate and service construction loans, in addition to meeting the other requirements of this subpart.

Sec. 3565.107 [Reserved]

Sec. 3565.108 Responsibility for actions of agents and mortgage brokers.

An approved lender is responsible for the actions of its agents and mortgage brokers.

Sec. 3565.109 Minimum loan prohibition.

A lender must not establish a minimum loan amount for loans under this program.

Sec. 3565.110 Insolvency of lender.

The Agency may require a lender to transfer a guaranteed loan or loans to another approved lender prior to a determination of insolvency by the lender. If the lender fails to transfer a loan when required, the guarantee will be considered null and void.

Sec. 3565.111 Lobbying activities.

An approved lender must comply with RD Instruction 1940-Q (available in any Rural Development Office) regarding lobbying activities.

Secs. 3565.112-3565.149 [Reserved]

Sec. 3565.150 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart D--Borrower Eligibility Requirements

Sec. 3565.151 Eligible borrowers.

Guaranteed loans must be made to an eligible borrower whose intention is to provide and maintain rural rental housing. The ownership entity must be a valid entity in good standing under the laws of the jurisdiction in which it is organized. Eligible borrowers shall include individuals, corporations, state or local public agencies or an instrumentality thereof, partnerships, limited liability companies, trusts, Indian tribes, or any organization deemed eligible by the Agency. Eligible borrowers must be U.S. citizens or permanent legal residents; a U.S. owned corporation, or a limited liability company, or partnership in which the principals are U.S. citizens or permanent legal residents.

Sec. 3565.152 Control of land.

At time of application, the lender must have evidence of site control by the borrower (option to purchase, lease, deed or other evidence acceptable to the Agency). At the time of loan closing, the lender's closing docket must provide documentary evidence that the borrower owns or has a long-term lease on the land on which the housing is or will be located. The form of ownership or the leasehold agreement must meet Agency requirements. Notwithstanding any investment in the site, the site may not be accepted based on the Agency's environmental assessment.

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Sec. 3565.153 Experience and capacity of borrower.

At the time of application, the lender must certify that the borrower:

- (a) Has the ability and experience to construct or rehabilitate multifamily housing that meets the requirements established by the Agency, the lender and the loan agreement;
- (b) Has the legal and financial capacity to meet all of the obligations of the loan; and
- (c) Has the ability and experience to meet the property management requirements established by the Agency, the lender, and the loan agreement.

Sec. 3565.154 Previous participation in state and federal programs.

Loans to borrowers who are delinquent on a federal debt may not be guaranteed. Furthermore, borrowers or principals thereof who have defaulted on state or local government loans will not be eligible for a guarantee unless the Agency determines that the default was beyond the borrower's control, and that the identifiable reasons for the default no longer exist. At the time of application, the lender must obtain from the borrower a certification that the borrower is not under any state or federal order suspending or debaring participation in state or federal loan programs and that the borrower is not delinquent on any non-tax obligation to the United States.

Sec. 3565.155 Identity of interest.

At the time of application, the lender must certify that it has disclosed any and all identity of interest relationships and preexisting conditions with respect to its relationships and that of the borrower, or that no identity of interest relationships exists. Identity of interest relationships include any financial or other relationship that exists or will exist between a lender, borrower, management agent, supplier, or any agent of any of these entities, that could influence, give the appearance of influencing or have the potential to influence the actions of the parties in carrying out their responsibilities under the program. Disclosure will be in a form and manner established by the Agency.

Sec. 3565.156 Certification of compliance with federal, state, and local laws and with Agency requirements.

At the time of application, the lender must obtain from the borrower a certification of compliance with all applicable federal, state, and local laws, and with Agency requirements regarding discrimination and equal opportunity in housing, including title VIII of the Civil Rights Act of 1968, and the Fair Housing Amendments Act of 1988. The borrower must also certify that it is not the subject of any federal, state, or local sanction or punitive action.

Secs. 3565.157-3565.199 [Reserved] Sec. 3565.200 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart E--Loan Requirements

Sec. 3565.201 General.

To be eligible for a guarantee, a loan must comply with the provisions of this subpart and be originated by an approved lender.

Sec. 3565.202 Tenant eligibility.

(a) Limits on income of tenants. The housing units subject to a guaranteed loan must be available for occupancy only by low or moderate-income families or individuals whose incomes at the time of initial occupancy do not exceed 115 percent of the area median income. After initial occupancy, a tenant's income may exceed these limits.

(b) Citizenship status. A tenant must be a United States citizen or a noncitizen who is a qualified alien as defined in Sec. 3565.3.

Sec. 3565.203 Restrictions on rents.

The rent for any individual housing unit, including any tenant-paid utilities, must not exceed an amount equal to 30 percent of 115 percent of area median income, adjusted for family size. In addition, on an annual basis, the average rent for a project, taking into account all individual unit rents, must not exceed 30 percent of 100 percent of area median income, adjusted for family size.

Sec. 3565.204 Maximum loan amount.

(a) Section 207(c) limits and exceptions. For that part of the property that is attributable to dwelling use, the principal obligation of each guaranteed loan must not exceed the applicable maximum per-unit limitations under section 207(c) of the National Housing Act.

(b) Loan-to-value limits. (1) In the case of a borrower that is a nonprofit organization or an agency or body of any State, local or tribal government, each guaranteed loan must involve a principal obligation that does not exceed the lesser of 97 percent of:

(i) The development costs of the housing and related facilities, or

(ii) The lender's determination of value not to exceed the appraised value of the housing and facilities.

(2) In the case of a borrower that is a for-profit entity or other entity not referred to in paragraph (b)(1) of this section, each guaranteed loan must involve a principal obligation that does not exceed the lesser of 90 percent of:

(i) The development costs of the housing and related facilities, or

(ii) The lender's determination of value not to exceed the appraised value of the housing and facilities.

(3) To protect the interest of the Agency or to further the objectives of the program, the Agency may establish lower loan-to-value limits or further restrict the statutory maximum limits based upon its evaluation of the credit quality of the loan.

7 CFR Part 3565
Sec. 3565.204 (Con.)

(c) Necessary assistance review. (1) A lender requesting a loan guarantee must review all loans to determine the appropriate amount of assistance necessary to complete and maintain the project. The lender shall recommend to the Agency an adjustment in the loan amount if appropriate as a result of this review.

(2) Where the project financing combines a guaranteed loan with Low-Income Housing Tax Credits or other Federal assistance, the project must conform to the policies regarding necessary assistance in 7 CFR part 1944, subpart E or successor provision.

Sec. 3565.205 Eligible uses of loan proceeds.

Eligible uses of loan proceeds must conform with standards and conditions for housing and facilities contained in 7 CFR part 1924, subpart A or successor provision, except that the Agency, at its sole discretion, may approve, in advance, a higher level of amenities, construction, and fees for projects proposed for a guaranteed loan provided the costs and features are reasonable and customary for similar housing in the market area.

(a) Use of loan proceeds. The proceeds of a guaranteed loan may be used for the following purposes relating to the project.

- (1) New construction costs of the project;
- (2) Moderate or substantial rehabilitation of buildings and acquisition costs when related to the rehabilitation of a building as described in paragraph (b) of this section;
- (3) Acquisition of existing buildings, when approved by the Agency, for projects that serve a special housing need;
- (4) Acquisition and improvement of land on which housing will be located;
- (5) Development of on-site and off-site improvements essential to the use of the property;
- (6) Development of related facilities such as community space, recreation, storage or maintenance structures, except that any high cost recreational facility, such as swimming pools and exercise clubs or similar facilities, must be specifically approved in advance by the Agency;
- (7) Construction of on-site management or maintenance offices and living quarters for operating personnel for the property being financed;
- (8) Purchase and installation of appliances and certain approved decorating items, such as window blinds, shades, or wallpaper;
- (9) Development of the surrounding grounds, including parking, signs, landscaping and fencing;
- (10) Costs associated with commercial space provided that:
 - (i) The project is designed primarily for residential use;
 - (ii) The commercial use consists of essential tenant service type facilities, such as laundry rooms, that are not otherwise conveniently available;
 - (iii) The commercial space does not exceed 10 percent of the gross floor area of the residential units and common areas, unless a higher level is specifically approved in writing by the Agency; and
 - (iv) The commercial activity is compatible with the use of the project and that the income is not more than 10 percent of the total annual operating income of the project.
- (11) Costs for feasibility determination, loan application fees, appraisals, environmental documentation, professional fees or other fees determined by the Agency to be necessary to the development of the project;

Sec. 3565.205 (Con.)

(12) Technical assistance to and by non-profit entities to assist in the formation, development, and packaging of a project, or formation or incorporation of a borrower entity;

(13) Education programs for a board of directors, both before and after incorporation of a cooperative that will serve as the borrower;

(14) Construction interest accrued on the construction loan;

(15) Relocation assistance in the case of rehabilitation projects;

(16) Developers' fees; and

(17) Repaying applicant debts in the following cases:

(i) When the Agency authorizes in writing in advance the use of loan funds to pay debts for work, materials, land purchase, or other fees and charges before the loan is closed; or

(ii) When the Agency concurs in writing with a determination by the lender that costs for work, fees and charges incurred prior to loan application are integral to development of the guarantee application and project.

(b) Rehabilitation requirements. Rehabilitation work must be classified as either moderate or substantial as defined in exhibit K of 7 CFR part 1924, subpart A or a successor document. In all cases, the building or project must be structurally sound, and improvements must be necessary to meet the requirements of decent, safe, and sanitary living units. Applications must include a structural analysis, along with plans and specifications describing the type and amount of planned rehabilitation. The project as rehabilitated must meet the applicable development standards contained in 7 CFR part 1924, subpart A or a successor regulation, as well as any applicable historic preservation requirements. All proposed rehabilitation projects are subject to an environmental review completed in accordance with 7 CFR part 1940, subpart G or a successor regulation.

Sec. 3565.206 Ineligible uses of loan proceeds.

Loan proceeds must not be used for the following:

(a) Specialized equipment for training and therapy;

(b) Housing in military impact areas;

(c) Housing that serves primarily temporary and transient residents;

(d) Nursing homes, special care facilities and institutional type homes that require licensing as a medical care facility;

(e) Operating capital for central dining facilities or for any items not affixed to the real estate, such as special portable equipment, furnishings, kitchen ware, dining ware, eating utensils, movable tables and chairs, etc.;

(f) Payment of fees, salaries and commissions or compensation to borrowers (except developers' fees); or

(g) Refinancing of an outstanding debt, except in the case of an existing guaranteed loan where the Agency determines that the refinancing is in the government's interest or furthers the objectives of the program. The term and amount of any loan for refinancing must not exceed the maximum loan amount or term limits.

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Sec. 3565.207 Form of lien.

The loan originated by the lender for a guarantee must be secured by a first lien against the property.

Sec. 3565.208 Maximum loan term.

(a) Statutory term limit. The lender may set the term of the loan, but in no instance may the term of a guaranteed loan exceed the lesser of 40 years or the remaining economic life of the project.

(b) Prepayment of loans. A guaranteed loan may be prepaid in whole or in part at the determination of the lender, and upon the lender's written notice to the Agency at least 30 days prior to the expected date of prepayment. The Agency will not pay any lockout or prepayment penalty assessed by the lender. The lender must certify the following in the notice of prepayment:

(1) The lease documents used by the borrower or its agent prohibit the abrogation of tenant leases in the event of prepayment; and

(2) The borrower has notified tenants of the request to prepay the loan, including notice of the prohibition against abrogation of the lease and the policy and procedure for handling complaints regarding compliance with the long-term use restriction as contained in subpart H of this part.

Sec. 3565.209 Loan amortization.

Each guaranteed loan shall be made for a period of not less than 25 nor greater than 40 years from the date the loan was made and may provide for amortization of the loan over a period of not to exceed 40 years with a final payment of the balance due at the end of the loan term.

Sec. 3565.210 Maximum interest rate.

The interest rate for a guaranteed loan must not exceed the maximum allowable rate specified by the Agency in NOFA. Such rate must be fixed over the term of the loan.

Sec. 3565.211 Interest credit.

(a) Limitation. For at least 20 percent of the loans made during each fiscal year, the Agency will provide assistance in the form of interest credit, to the extent necessary to reduce the agreed-upon rate of interest to the AFR as such term is used in section 42(I)(2)(D) of the Internal Revenue Code of 1986, 26 U.S.C. 7805, Sec. 1.42-1T.

(b) Selection criteria. The Agency will select projects to receive interest credits using any of such criteria as the Agency may establish for priority projects as contained in subpart A of this part.

Sec. 3565.212 Multiple guaranteed loans.

The Agency may guarantee more than one loan on any project if all guaranteed loans, in the aggregate, comply with these regulations, including without limitation:

(a) In the aggregate, loans do not exceed the maximum guaranteed loan amount and loan-to-value limits, as contained in Sec. 3565.204;

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(b) In the aggregate, loans are all to be secured equally by a first lien as the Agency may, at its sole discretion, determine necessary to ensure repayment of the loans; and

(c) If different lenders originate the loans, each lender has executed an interest creditor agreement in form and substance acceptable to the Agency.

Sec. 3565.213 Geographic distribution.

The Agency may refuse to guarantee a loan in an area where there is undue risk due to a concentration in the market of properties subject to a Agency guaranteed loan. The Agency will consider the credit quality of the loan and overall market conditions in making a determination of undue risk. If any of the Agency guaranteed loans in the market are experiencing vacancy rates in excess of 15% and the vacancy is due to market conditions, the Agency will invoke this provision and not guarantee the loan.

Sec. 3565.214 [Reserved]

Sec. 3565.215 Special conditions.

(a) Use of third party funds. As a condition of receiving a guaranteed loan, the Agency, or the lender if designated by the Agency, must review the terms and conditions of any secondary financing or funding of projects, including loans, capital grants or rental assistance.

(b) Recourse. If required by the lender, loans guaranteed under this program may be made on a recourse or nonrecourse basis, or with any personal or special borrower guarantees on collateralization.

Sec. 3565.216-3565.249 [Reserved]

Sec. 3565.250 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

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Subpart F--Property Requirements

Sec. 3565.251 Eligible property.

To be eligible for a guaranteed loan, a property must be used primarily for residential dwelling purposes and must meet the following requirements or the requirements of this subpart:

(a) Property location. All the property must be located in a rural area.

(b) Minimum size of development. The property must consist of at least five rental dwelling units.

(c) Non-contiguous sites. For a loan secured by two or more non-contiguous parcels of land, all sites must meet each of the following requirements:

(1) Located in one market area;

(2) Managed under one management plan with one loan agreement or resolution for all of the sites; and

(3) Consist of single asset ownership.

(d) Compliance with Statutes. All properties must comply with the applicable requirements in section 504 of the Rehabilitation Act of 1973, the Fair Housing Act, the Americans with Disabilities Act, and other applicable statutes.

Sec. 3565.252 Housing types.

The property may include new construction or rehabilitation of existing structures. The units may be attached, detached, semi-detached, row houses, modular or manufactured houses, or multifamily structures. Manufactured housing must meet Agency requirements contained in 7 CFR part 1924, subpart A or a successor regulation. The Agency will guarantee proposals for new construction or acquisition with moderate or substantial rehabilitation of at least \$6,500 per dwelling unit. The portion of the guaranteed funds available for acquisition with rehabilitation may be limited in the annual Notice of Fund Availability.

Sec. 3565.253 Form of ownership.

The property must be owned in fee simple or be subject to a ground lease or other legal right in land acceptable to the Agency.

Sec. 3565.254 Property standards.

(a) Housing quality and site and neighborhood standards. The property must meet the site and neighborhood requirements established by the state or locality, and those standards contained under 7 CFR part 1924, subparts A and C or any successor regulations.

(b) Third party assessments. As part of the application for a guaranteed loan, the lender must provide documentation of qualified third parties' assessments of the property's physical condition and any environmental conditions or hazards which may have a bearing on the market value of the property. These assessments must include:

Sec. 3565.254 (Con.)

- (1) An acceptable property appraisal.
- (2) A Phase I Environmental Site Assessment (American Society of Testing and Materials).
- (3) A Standard Flood Hazard Determination.
- (4) In the case of the purchase of an existing structure, rehabilitation or refinancing, a physical needs assessment.

Sec. 3565.255 Environmental requirements.

Under the National Environmental Policy Act, the Agency is required to assess the potential impact of the proposed actions on protected environmental resources. Measures to avoid or at least mitigate adverse impacts to protected resources may require a change in site or project design. A site will not be approved until the Agency has completed the environmental review in accordance with 7 CFR part 1940, subpart G or successor regulation.

Sec. 3565.256 Architectural services.

Architectural services must be provided for the project in accordance with 7 CFR part 1924, subpart A or successor regulation, including plan certifications.

Sec. 3565.257 Procurement actions.

All construction procurement actions, whether by sealed bid or by negotiation, must be conducted in a manner that provides maximum open and free competition.

Secs. 3565.258-3565.299 [Reserved]

Sec. 3565.300 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart G--Processing Requirements

Sec. 3565.301 Loan standards.

An approved lender must originate and underwrite the loan and appraise the subject property in accordance with prudent lending practices and Agency criteria addressing the following factors:

- (a) Borrower qualifications and creditworthiness;
- (b) Property, vacancy, market vacancy or collection loss;
- (c) Rental concessions and rent levels;

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- (d) Tenant demand and housing supply;
- (e) Property operating and maintenance expense;
- (f) Property requirements as contained in subpart F of this part;
- (g) Debt coverage ratio;
- (h) Operating and long-term capital requirements;
- (i) Loan-to-value ratio;
- (j) Return on borrower equity; and
- (k) Estimated long-term marketability of the project.

Sec. 3565.302 Allowable fees.

(a) Lender fees. The lender is authorized to charge reasonable and necessary fees in connection with a borrower's application for a guaranteed loan.

(b) Agency fees. The Agency will charge one or more types of fees deemed appropriate as reimbursement for reasonable and necessary costs incurred in connection with applications received from lenders for monitoring or annual renewal fees. These fees will be published in NOFA. Agency fees may include, but are not limited to the following:

(1) Site Assessment and Market Analysis or preliminary feasibility fee. A fee for review of an application for a determination of preliminary feasibility.

(2) Application fee. A fee submitted in conjunction with the application for a loan guarantee.

(3) Inspection fee. A fee for inspection of the property in conjunction with a loan guarantee.

(4) Transfer fee. A fee in connection with a request for approval of a transfer of physical assets or a change in the composition of the ownership entity.

(5) Extension or reopening fees. A fee to extend the guarantee commitment or to reopen an application when a commitment has expired.

Sec. 3565.303 Issuance of loan guarantee.

(a) Preliminary feasibility review. During the initial processing of a loan, the lender may request a preliminary feasibility review by the Agency when required loan documentation is submitted.

(b) Conditional commitment to guarantee a loan. The Agency will issue a conditional commitment to guarantee a loan. This commitment will be good for such time frame as the Agency deems appropriate based on project requirements. The commitment to guarantee a loan, will specify any conditions necessary to obtain a determination by the Agency that all program requirements have been met. A conditional commitment can be issued, subject to the availability of funds, after:

(1) Completion by the Agency of an environmental review in accordance with 7 CFR part 1940, subpart G or successor regulation, and the National Environmental Policy Act; and

(2) Selection of the proposed project for funding by the Agency in accordance with ranking and selection criteria.

Sec. 3565.303 (Con.)

(c) Guarantee during construction. For combination construction and permanent loans, the Agency will issue an initial guarantee to an approved construction lender.

(1) This guarantee will be subject to the limits contained in subpart B of this part and in the loan closing documentation.

(2) In all cases, the lender must obtain a payment and performance bond covering contract work or acceptable credit enhancement as discussed in Sec. 3565.52(a).

(3) The lender must verify amounts expended prior to each payment for completed work and certify that an independent inspector has inspected the property and found it to be in conformance with Agency standards. The lender must provide verification that all subcontractors have been paid and no liens have been filed against the property.

(d) Permanent loan guarantee. The guarantee on the permanent loan will be issued once the following items have been submitted to and approved by the Agency.

(1) An updated appraisal of the project as built;

(2) A certificate of substantial completion;

(3) A certificate of occupancy or similar evidence of local approval ;

(4) A final inspection conducted by a qualified Agency representative;

(5) A final cost certification in a form acceptable to the Agency;

(6) A submission to the Agency of the complete closing docket;

(7) A certification by the lender that the project has reached an acceptable minimum level occupancy;

(8) An executed regulatory agreement.

(9) The Lender certifies that it has approved the borrower's management plan and assures that the borrower is in compliance with Agency standards regarding property management, contained in subparts E and F of this part;

(10) Necessary information to complete an updated necessary assistance review by the Agency; and

(11) Compliance with all conditions contained in the conditional commitment for guarantee.

(e) Modification of guarantee amount after commitment. The Agency may modify the guarantee amount or decline to issue a loan guarantee when a lender fails to honor obligations or to fulfill representations made under the guarantee commitment.

Sec. 3565.304 Lender loan processing responsibilities.

(a) Application. The lender will be responsible for submitting an application for a loan guarantee in a format prescribed by the Agency. Lenders may submit an application at the feasibility stage or when they request a conditional commitment.

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Sec. 3565.304 (Con.)

(b) Project servicing, management and disposition. Unless otherwise permitted by the Agency, the originating lender must perform all loan functions during the period of the guarantee. These functions include servicing, asset management, and, if necessary, property disposition. The lender must maintain and service the loan in accordance with the provisions of subpart I of this part and Agency servicing procedures.

Sec. 3565.305 Mortgage and closing requirements.

It is the lender's responsibility to ensure that the loan closing statement and required loan documents are in a form acceptable to the Agency and included in the closing docket. The lender is responsible for resolving any underwriting and loan closing deficiencies that are found. The Agency's review of the lender's loan closing documentation does not constitute a waiver of fraud, misrepresentation, or failure of judgment by the lender.

Secs. 3565.306-3565.349 [Reserved]

Sec. 3565.350 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart H--Project Management

Sec. 3565.351 Project management.

As a condition of the guarantee, the lender is to obtain borrower certification that the project is in compliance with local, state, federal laws and program requirements.

(a)Regulatory agreement. A regulatory agreement between the borrower and lender which will be executed at the time of loan closing and contain the following covenants:

- (1) That it is binding upon the borrower and any of its successors and assigns, as well as upon the lender and any of its successors and assigns, for the duration of the guaranteed loan;
- (2) That the borrower makes all payments due under the note and to the required escrow and reserve accounts;
- (3) That the borrower maintains the project as affordable housing in accordance with the purposes and for the duration defined in the statute;
- (4) That the borrower maintains the project in good physical and financial condition at all times;
- (5) That the borrower obtains and maintains property insurance and any other insurance coverage required to protect the security;
- (6) That the borrower maintains complete project books and financial records, and provides the Agency and the lender with an annual audited financial statement after the end of each fiscal year;

Sec. 3565.351 (Con.)

(7) That the borrower makes project books and records available for review by the Office of Inspector General, Rural Development staff, General Accounting Office, and the Department of Justice, or their representatives or successors upon appropriate notification;

(8) That the borrower prepares and complies with the Affirmative Fair Housing Marketing Plan and all other Fair Housing requirements

(9) That the borrower operates as a single asset ownership entity, unless otherwise approved by the Agency;

(10) That the borrower complies with applicable federal, state and local laws; and

(11) That the borrower provides management satisfactory to the lender and to the Agency and complies with an approved management plan for the project.

(b) Management plan. The lender must approve the borrower's management plan and assure that the borrower is in compliance with Agency standards regarding property management, including the requirements contained in subparts E and F of this part.

(c) Tenant protection and grievance procedures. Tenants in properties subject to a guaranteed loan are entitled to the grievance and appeal rights contained in 7 CFR part 1944, subpart L or successor regulation. The borrower must inform tenants in writing of these rights.

(d) Financial management.

(1) Borrower reporting requirements. At a minimum, the lender must obtain, on an annual basis, an audited annual financial statement conducted in accordance with generally accepted government auditing standards.

(2) Lender reporting requirements. The lender must review the financial reports to assure that the property is in sound fiscal condition and the borrower is in compliance with financial requirements. The lender must report findings to the Agency as follows:

(i) Annual reports. The lender must submit to the Agency a copy of the annual financial audit of the project and must report on the nature and status of any findings. To the extent that outstanding findings or issues remain, the lender must submit to the Agency a copy of a plan of action for any unresolved findings.

(ii) Monthly reports. The lender must submit monthly reports to the Agency on all loans that are either in default, delinquent, or not in compliance with program requirements. This report must provide information on the financial condition of each loan, the physical condition of the property, the amount of delinquency, any other non-compliance with program requirements and the proposed actions and timetable to resolve the delinquency, default or non-compliance.

(3) Reserve releases. The lender is responsible for approving or disapproving all borrower requests for release of funds from the reserve and escrow accounts. Security deposit accounts will not be considered a reserve or escrow account.

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Sec. 3565.351 (Con.)

(4) Insurance requirements. At loan closing, the borrower will provide the lender with documentary evidence that Agency insurance requirements have been met. The borrower must maintain insurance in accordance with Agency requirements until the loan is repaid and the lender must be named as the insurance policy's beneficiary. The lender must obtain insurance on the secured property if the borrower is unable or unwilling to do so and charge the cost as an advance.

(5) Distribution of surplus cash. Prior to the distribution of surplus cash to the owner, the lender must certify that the property is in good financial and physical condition and in compliance with the regulatory agreement. Such compliance includes payment of outstanding obligations, debt service, and required funding of reserve and escrow accounts.

(e) Physical maintenance. The lender must annually inspect the property to ensure that it is in compliance with state and local codes and program requirements. The lender must certify to the Agency that a property is in such compliance, or report to the Agency on any non-compliance items and proposed actions and timetable for resolution. Failure to provide responsive corrective action can result in reduction or cancellation of the guarantee by the Agency.

Sec. 3565.352 Preservation of affordable housing.

(a) Original purpose. During the period of the guarantee, owners are prohibited from using the housing or related facilities for any purpose other than an approved program purpose.

(b) Use restriction. For the original term of the guaranteed loan, the housing must remain available for occupancy by low and moderate income households, in accordance with subpart E of this part. This requirement will be included in a deed restriction or other instrument acceptable to the Agency. The restriction will apply unless the housing is acquired by foreclosure or an instrument in lieu of foreclosure, or the Agency waives the applicability of this requirement after determining that each of the following three circumstances exist.

(1) There is no longer a need for low-and moderate-income housing in the market area in which the housing is located;

(2) Housing opportunities for low-income households and minorities will not be reduced as a result of the waiver; and

(3) Additional federal assistance will not be necessary as a result of the waiver.

Sec. 3565.353 Affirmative fair housing marketing.

As a condition of the guarantee, the lender must ensure that the lender and borrower are in compliance with the approved Affirmative Fair Housing Marketing Plan. This plan must be reviewed annually by the lender to ensure that the borrower remains in compliance and to recommend modifications, as necessary.

Sec. 3565.354 Fair housing accommodations.

The lender must ensure that the borrower is in compliance with the applicable fair housing laws in the development of the property, the selection of applicants for housing, and ongoing management. See subpart A of this part.

Sec. 3565.355 Changes in ownership.

Any change in ownership, in whole or in part, must be approved by the lender and the Agency before such change takes effect.

Secs. 3565.356-3565.399 [Reserved]

Sec. 3565.400 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart I--Servicing Requirements

Sec. 3565.401 Servicing objectives.

The participating lender is responsible for servicing the guaranteed loan throughout the term of the loan or guarantee, whichever is less. In all cases, the lender remains responsible for liquidation of the property in accordance with the Loan Note Agreement, unless otherwise determined by the Agency. A lender-servicing plan must be designed and implemented to achieve the following objectives.

- (a) To preserve the value of the loan and the real estate;
- (b) To avoid a loss to the lender or the Agency and to limit exposure to potential loss;
- (c) To protect the interests of the tenants; and
- (d) To further program objectives.

Sec. 3565.402 Servicing responsibilities.

The lender must service the loan in accordance with this subpart and perform the services contained in this section in a reasonable and prudent manner. The lender is responsible for the actions of its agents and representatives.

(a) Funds management. The lender must have a funds management system to receive and process borrower payments, including the following.

(1) All principal and interest (P&I) funds and guarantee fees collected and deposited into the appropriate custodial accounts.

(2) Payments to custodial escrow accounts for taxes and insurance premiums, assessments that might impair the security (such as ground rent), and reserve accounts for repair and capital improvement of the property.

(b) Asset management. The lender must ensure that the property securing the guaranteed loan remains in good physical and financial condition, in accordance with project management requirements contained in subpart H of this part.

(c) Management of delinquencies and defaults. Each month the lender must report to the Agency any delinquencies and defaults in accordance with subpart H of this part.

Sec. 3565.403 Special servicing.

Special servicing must be initiated when regular servicing actions are insufficient to resolve borrower default or property deficiencies.

(a) Repurchase from holder. For securitized loans, the holder may require the lender or Government to repurchase the security in accordance with the provisions of §3565.405.

(b) Responsibility of the lender. It is the lender's responsibility during special servicing to make a special effort to ensure that maintenance of the property meets Agency requirements and the tenants' rights are protected, until such time that the property is liquidated by the lender, the loan is paid in full, or the loan is assigned to the Agency. The lender must update the Agency monthly until the default is cured or a claim is filed. The lender must maintain adequate records of any and all efforts to cure the default or to foreclose.

(c) Initiating special servicing. When special servicing is initiated, the lender must submit for Agency review a special servicing plan that includes proposed actions to cure the deficiencies and a timeframe for completion. The special servicing plan will specify the proposed terms of any workout agreement recommended by the lender. The lender must obtain Agency approval of the terms of any workout agreement with the borrower. The workout agreement may include a loan modification, transfer of physical assets, or partial payment of claim and reamortization of the loan. Failure to comply with terms contained in the executed workout agreement will be considered a default of the guaranteed loan.

(1) Loan modification. The borrower and lender may agree to a loan modification when such action will improve the financial viability of the project and its operations, and when a circumstance exists that is beyond the borrower's control. The Agency must approve in advance any loan modification that extends the life of the loan or requires an increase in the amount of the guarantee. All changes must be within the requirements of section 538 of the Housing Act of 1949.

(2) Change in ownership and transfer of physical assets. A default or delinquency may be resolved by a change of the ownership entity in whole or in part. The Agency must approve all changes in ownership prior to the effective date of the transfer, and may require additional resources from the lender or borrower to resolve project deficiencies.

Sec. 3565.403 (Con.)

(3) Partial payment of claims. The lender may request a partial payment of claim as a result of a loss experienced by the lender as a means to work out a troubled loan. The Agency will accept such claim if it determines that it is in the best interest of the government. In applying the partial payment, the lender must assign the obligation covered by the partial payment to the Agency, and, if required by the Agency, reamortize the obligation using the amount of the remaining obligation over an agreed-upon term.

(d) Claims processing. In the event of a loss, the lender must submit claims under the guarantee in accordance with subpart J of this part. Prior to submitting a claim, the lender must exhaust all possibilities of collection on the loan.

(e) Displacement prevention. The actions of the lender must not harm the property's tenants through displacement.

Sec. 3565.404 Transfer of loans or mortgage servicing.

Transfer of servicing is prohibited unless the Agency determines that circumstances warrant such action, the proposed lender is an eligible lender approved by the Agency, and the transfer of servicing is approved by the Agency in advance.

Secs. 3565.405-3565.449 [Reserved]

Sec. 3565.405 Repurchase of guaranteed loans.

(a) Repurchase by lender. The holder may make written demand on the lender to repurchase the unpaid guaranteed portion of the loan when the borrower is in default not less than 60 calendar days on principal or interest due on the loan; or the lender has failed to remit to the holder its pro rata share of any payment made by the borrower within 30 calendar days of the lender's receipt thereof. The holder must concurrently send a copy of the demand letter to the Agency. The lender will notify the holder and the Agency of its decision to repurchase within 10 business days from the date of the written demand letter by the holder. The lender may agree to repurchase the unpaid portion of the entire loan from the Holder, even though the guarantee will not cover the unguaranteed portion of the loan. If the lender decides to repurchase, the lender has 30 calendar days from the date of the holder's written demand letter to do so. The guarantee will not cover the unguaranteed portion of the loan or the note interest to the holder on the guaranteed loan accruing after 90 calendar days from the date of the demand letter to the lender requesting the repurchase. The lender may deduct the lender's servicing fee from the repurchase amount. The lender will accept an assignment without recourse from the holder upon repurchase. The lender is encouraged to repurchase the loan to facilitate the accounting of funds, resolve the problem, and prevent default where and when reasonable.

(b) Repurchase by Agency.

(1) If the lender does not repurchase the loan as provided in paragraph (a) of this section, the Agency will purchase from the holder the unpaid principal balance of the guaranteed portion together with accrued interest to date of repurchase, less the lender's servicing fee, within 30 calendar days after written demand to the Agency from the holder. This demand notice is in addition to the copy of the written demand on the lender. The guarantee will not cover the note interest to the holder on the guaranteed loan accruing after 90 calendar days from the date of the original demand letter of the holder to the lender requesting the repurchase.

Holders of Loan Note Guarantees that have been issued prior to the effective date of this final rule may opt to adhere to the terms and conditions of the Loan Note Guarantee then in effect. In case of loan default, the holder of a Loan Note Guarantee issued prior to the effective date of this final rule will stipulate, in a written demand for repurchase, its preference for repurchase in accordance with the Loan Note Guarantee issued prior to the effective date of this final rule. If the demand for repurchase does not stipulate a preference for repurchase in accordance with the Loan Note Guarantee issued prior to the effective date of this final rule, the Agency will process the demand for repurchase as stated in this final rule. The holder must stipulate a preference for repurchase in accordance with the Loan Note Guarantee issued prior to the effective date of this final rule in the first demand for repurchase. The holder of the Loan Note Guarantee issued prior to the effective date of this final rule cannot make a subsequent demand for repurchase changing the preference stipulated in the original demand for repurchase.

(2) The holder's demand to the Agency must include a copy of the written demand made to the lender. The holder must also include evidence of its right to require payment from the Agency. Such evidence will consist of either the original of the Loan Note Guarantee properly endorsed to the Agency or the original of the Assignment Guarantee Agreement, or an Agency approved assignment guarantee agreement, properly assigned to the Agency without recourse including all rights, title, and interest in the loan. The holder must include in its demand the amount due including unpaid principal, unpaid interest to date of demand, and interest subsequently accruing from date of demand to proposed payment date. The Agency will be subrogated to all rights of the holder.

(3) The Agency will notify the lender of its receipt of the holder's demand for payment. The lender must provide the Agency with the information necessary for the Agency to determine the appropriate amount due the holder within 10 business days from the date of the written demand letter to the lender from the holder requesting repurchase of the guaranteed portion. The lender will furnish a current statement certified by an appropriate authorized officer of the lender stating the unpaid principal and interest then owed by the borrower on the loan and the amount then owed to any holder. Any discrepancy between the amount claimed by the holder and the information submitted by the lender must be resolved between the lender and the holder before payment will be approved. The Agency will coordinate the resolution of the discrepancy. Such conflict will suspend the running of the 30 calendar day payment requirement.

(4) Purchase by the Agency neither changes, alters, nor modifies any of the lender's obligations to the Agency arising from the loan or guarantee nor does it waive any of the Agency's rights against the lender. As holder, the Agency will have the right to set-off against any payments the Agency owes the lender.

Sec. 3565.450 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart J-Assignment, Conveyance, and Claims

Sec. 3565.451 Preclaim requirements.

(a) Lender certifications. After borrower default and before filing a claim or assignment of the loan to the Agency, the lender must make every reasonable and prudent effort to resolve the default. The lender must provide the Agency with an accounting of all proposed and actual actions taken to cure the default. The lender must certify that all reasonable efforts to cure the default have been exhausted. Where the lender fails to comply with the terms of the loan guarantee agreement and the corresponding regulations and guidance with regard to liquidating the property, the Agency, at its option, may take possession of the security collateral and dispose of the property.

(b) Due diligence by lender. For all loan servicing actions where a market, net recovery or liquidation value determination is required, guaranteed lenders shall perform due diligence in conjunction with the appraisal and submit it to the Agency for review.

The Phase I Environmental Site Assessment published by the American Society of Testing and Materials is considered an acceptable format for due diligence.

(c) Environmental review. The Agency is required to complete an environmental review under the National Environmental Policy Act, in accordance with 7 CFR part 1940, subpart G or a successor regulation, prior to disposition of inventory property, if title is held by the Agency, and prior to any authorization to the guaranteed lender to foreclose and dispose of property, and for any other servicing action requiring Agency approval or consent.

Sec. 3565.452 Decision to liquidate.

(a) A decision to liquidate shall be made when it is determined that the default cannot be cured through actions contained in § 3565.403 or it has been determined that it is in the best interest of the Agency and the lender to liquidate. For interest accrual purposes, interest will accrue for 90 calendar days after the date the liquidation plan is approved by the Agency. If within 20 calendar days of the Agency's receipt of the liquidation plan, the Agency fails to respond to the lender's proposal or advise the lender to make revisions to the plan that was submitted, the liquidation plan will be approved by default, and the 90 calendar day period for interest accrual will commence.

(b) In the event of a default involving a loan to an Indian tribe or tribal corporation made under this section which is secured by an interest in land within such tribe's reservation (as determined by the Secretary of the Interior), including a community in Alaska incorporated by the Secretary of the Interior pursuant to the Indian Reorganization Act (25 U.S.C. 461 et seq.), the lender shall only pursue liquidation after offering to transfer the account to an eligible tribal member, the tribe, or the Indian housing authority serving the tribe. If the lender subsequently proceeds to liquidate the account, the lender shall not sell, transfer, or otherwise dispose of or alienate the property except to one of the entities described in the preceding sentence.

Sec. 3565.453 Disposition of the property.

(a) Submission of the liquidation plan. The lender will, within 30 calendar days after a decision to liquidate, submit to the Agency in writing, its proposed detailed plan of liquidation. The Agency will inform the lender, in writing, whether the Agency concurs in the lender's liquidation plan. Should the Agency and the lender not agree on the liquidation plan, negotiations will take place between the Agency and the lender to resolve the disagreement. When the liquidation plan is approved by the Agency, the lender will proceed expeditiously with liquidation. The liquidation plan submitted to the Agency by the lender shall include:

(1) Satisfactory proof of the lender's ownership of the guaranteed loan promissory note and related security instruments.

(2) A copy of the payment ledger or equivalent which reflects the current loan balance and accrued interest to date and the method of computing the interest.

(3) A full and complete list of all collateral including any personal and corporate guarantees.

(4) The recommended liquidation methods for making the maximum collection possible on the indebtedness and the justification for such methods, including recommended actions for:

(i) Obtaining an appraisal of the collateral;

(ii) Acquiring and disposing of all collateral;

(iii) Collecting from guarantors;

(iv) Setting the proposed date of foreclosure; and

(v) Setting the proposed date of liquidation.

(5) Necessary steps for protection of the tenants and preservation of the collateral.

(6) Copies of the borrower's latest available financial statements.

(7) Copies of the guarantor's latest available financial statements.

(8) An itemized list of estimated liquidation expenses expected to be incurred along with justification for each expense.

(9) A schedule to periodically report to the Agency on the progress of liquidation.

(10) Estimated protective advance amounts with justification.

(11) Proposed protective bid amounts on collateral to be sold at auction and a breakdown to show how the amounts were determined.

(12) If a voluntary conveyance is considered, the proposed amount to be credited to the guaranteed debt.

(13) Any legal opinions supporting the decision to liquidate.

(14) The lender will obtain a complete appraisal report on all collateral securing the loan, which will reflect the fair market value and potential liquidation value, and an examination of the title on the collateral. In order to formulate a liquidation plan, which maximizes recovery, collateral must be evaluated for hazardous substances, petroleum products, or other environmental hazards, which may adversely impact the market value of the collateral.

(b) A transfer and assumption of the borrower's operation can be accomplished before or after the loan goes into liquidation. However, if the collateral has been purchased through foreclosure or the borrower has conveyed title to the lender, no transfer and assumption is permitted.

Sec. 3565.453 (Cont.)

(c) A protective bid may be made by the lender, with prior Agency written approval, at a foreclosure sale to protect the lender's and the Agency's interest. The protective bid will not exceed the amount of the loan, including expenses of foreclosure, and should be based on the liquidation value considering estimated expenses for holding and reselling the property. These expenses include, but are not limited to, expenses for resale, interest accrual, length of weatherization, and prior liens.

(d) Filing an estimated loss claim. When the lender is conducting the liquidation and owns any or all of the guaranteed portion of the loan, the lender will file an estimated loss claim with the liquidation plan if the lender expects liquidation to exceed 90 calendar days. The estimated loss payment will be based on the outstanding loan amount minus the liquidation value of the collateral. For the purpose of reporting and loss claim computation, the loss claim will be promptly processed in accordance with applicable Agency regulations, as set forth in this section.

The loss claim calculation will include 90 calendar days of interest accrual on the defaulted loan at the time the estimated loss claim is paid by the Agency. If the lender estimates that there will be no loss after considering the costs of liquidation, the lender submits an estimated loss claim of zero. Interest accrual will cease 90 calendar days after the date the liquidation plan is approved by the Agency.

(e) Property disposition. Once the liquidation plan has Agency approval, the lender must make every effort to liquidate the property in a manner that will yield the highest market value consistent with the protections afforded to tenants in 7 CFR part 1944, subpart L or successor regulation.

(f) Accounting and reports. When the lender conducts liquidation, the lender will account for funds during the period of liquidation and provide the Agency with reports at least quarterly on the progress of liquidation, including disposition of collateral, resulting costs, and additional procedures necessary for successful completion of the liquidation.

(g) Transmitting payments and proceeds to the Agency. When the Agency is the holder of a portion of the guaranteed loan, the lender will transmit to the Agency its pro rata share of any payments received from the borrower, liquidation, or other proceeds.

Sec. 3565.454 [Reserved]

Sec. 3565.455 Alternative disposition methods.

The Agency, in its sole discretion, may choose to obtain an assignment of the loan from the lender or conveyance of title obtained by the lender through foreclosure or a deed-in-lieu of foreclosure.

(a) Assignment. In the case of an assignment of the loan, the assignment of the security instruments or the security must be in written and recordable form. Completion of the assignment will occur once the following transactions are completed to the Agency's satisfaction.

(1) Conveyance to the Agency of all the lender's rights and interests arising under the loan.

(2) Assignment to the Agency of all claims against the borrower or others arising out of the loan transactions, including:

(i) All collateral agreements affecting financing, construction, use or operation of the property; and

7 CFR Part 3565

Sec. 3565.455 (Cont.)

(ii) All insurance or surety bonds, or other guarantees, and all claims under them.

(3) Certification that the collateral has been evaluated for the presence of contamination from the release of hazardous substances, petroleum products or other environmental hazards which may adversely impact the market value of the property and the results of that evaluation.

(b) Conveyance of title. In the case of a conveyance of title to the property, the lender must inform the Agency in advance of how it plans to acquire title and a timetable for doing so. The Agency will accept the conveyance upon receipt of an assignment to the Agency of all claims of the lender against the property and assignment of the lender's rights to any operating funds and any reserves or escrows established for the maintenance of the property or the payment of property taxes and insurance.

Sec. 3565.456 Filing a claim.

Once the lender has disposed of the property or the Agency has agreed to accept an assignment of the loan or conveyance of title to the property, the lender may file a claim for the guaranteed portion of allowable losses. All claim amounts must be calculated in accordance with this subpart and be approved by the Agency.

Sec. 3565.457 Determination of claim amount.

In all liquidation cases, final settlement will be made with the lender after the collateral is liquidated, unless otherwise designated as a future recovery or after settlement and compromise of all parties has been completed. The Agency will have the right to recover losses paid under the guarantee from any party, which may be liable.

(a) Report of loss form. An Agency approved form will be used for calculations of all estimated and final loss determinations. Estimated loss payments may only be approved by the Agency after the Agency has approved a liquidation plan.

(b) Estimated loss. An estimated loss claim based on liquidation appraisal value will be prepared and submitted by the lender.

(1) The estimated loss payment shall be applied as of the date of such payment. The total amount of the loss payment remitted by the Agency will be applied by the lender on the loan debt. Such application does not release the borrower from liability.

(2) The Government's written authorization is required for all protective advances in excess of \$5,000. Protective advances include, but are not limited to, advances made for property taxes, annual assessments, ground rent, hazard or flood insurance premiums affecting the collateral, and other expenses necessary to preserve or protect the security. Attorney fees are not a protective advance. A protective advance claim will be paid only at the time of the final report of loss payment except in certain transfer and assumption situations with Agency approval.

(c) Final loss. Within 30 calendar days after liquidation of all collateral, except for certain unsecured personal or corporate guarantees (as provided for in this section) is completed, a final report of loss must be prepared and submitted by the lender to the Agency. Before approval by

Sec. 3565.457 (Cont.)

the Agency of any final loss report, the lender must account for all funds during the period of liquidation, disposition of the collateral, all costs incurred, and any other information necessary for the successful completion of liquidation. Upon receipt of the final accounting and report of loss, the Agency may audit all applicable documentation to determine the final loss. The lender will make its records available and otherwise assist the Agency in making any investigation. The documentation accompanying the report of loss must support the amounts shown on the report of loss form.

(1) A determination must be made regarding the collectibility of unsecured personal and corporate guarantees. If reasonably possible, such guarantees should be promptly collected or otherwise disposed of prior to completion of the final loss report. However, in the event that collection from the guarantors appears unlikely or will require a prolonged period of time, the report of loss will be filed when all other collateral has been liquidated, and unsecured personal or corporate guarantees will be treated as a future recovery with the net proceeds to be shared on a pro rata basis by the lender and the Agency.

(2) The lender must document that all of the collateral has been accounted for and properly liquidated and that liquidation proceeds have been properly accounted for and applied correctly to the loan.

(3) The lender will show a breakdown of any protective advance amount as to the payee, purpose of the expenditure, date paid, and evidence that the amount expended was proper and that payment was actually made.

(4) The lender will show a breakdown of liquidation expenses as to the payee, purpose of the expenditure, date paid, and evidence that the amount expended was proper and that payment was actually made. Liquidation expenses are recoverable only from collateral proceeds.

(5) Accrued interest will be supported by documentation as to how the amount was accrued.

(6) Loss payments will be paid by the Agency within 60 calendar days after the receipt of the final loss report and accounting of the collateral.

(7) Should there be a circumstance where the lender cannot or will not sign a final report of loss, the State Director may complete the final report of loss and submit it to the Finance Office without the lender's signature. Before this action can be taken, all collateral must be disposed of or accounted for; there must be no evidence of fraud, misrepresentation, or negligent servicing by the lender; and all efforts to obtain the cooperation of the lender must have been exhausted and documented.

(d) Maximum guarantee payment. The maximum guarantee payment will not exceed the amount of guarantee percentage as contained in the guarantee agreement (but in no event more than 90%) times the allowable loss amount.

(e) Rent. Any net rental or other income that has been received by the lender from the collateral will be applied on the guaranteed loan debt after paying operating expenses of the property.

(f) Liquidation costs. Liquidation costs will be deducted from the proceeds of the disposition of primary collateral. If changed circumstances after submission of the liquidation plan require a substantial revision of liquidation costs, the lender will procure the Agency's written concurrence prior to proceeding with the proposed changes.

7 CFR Part 3565

Sec. 3565.457 (Cont.)

(g) Payment. When the Agency finds the final report of loss to be proper in all respects, it will approve the form and proceed as follows:

(1) If the loss is greater than any estimated loss payment, the Agency will pay the additional amount owed by the Agency to the lender.

(2) If the loss is less than the estimated loss payment, the lender will reimburse the Agency for the overpayment.

(3) If the Agency determines that it is in the Government's best interest to take assignment of the loan and conduct liquidation, as stipulated in 42 U.S.C. 1490 (i)(3), Assignment by Secretary, the Agency will pay the lender in accordance with the Loan Note Guarantee.

(h) Date of loss. The date of loss is the date on which the collateral will be liquidated in the liquidation plan, unless an alternative date is approved by the Agency. Where the Agency chooses to accept an assignment of the loan or conveyance of title, the date of loss will be the date on which the Agency accepts assignment of the loan or conveyance of title.

(i) Allowable claim amount. The allowable claim amount must be calculated by:

(1) Adding to the unpaid principal and interest on the date of loss, an amount approved by the Agency for payments made by the lender for amounts due and owing on the property, including:

(i) Property taxes and other protective advances as approved by the Agency;

(ii) Water and sewer charges and other special assessments that are liens prior to the guaranteed loan;

(iii) Insurance of the property; and

(iv) Reasonable liquidation expenses.

(2) And by deducting the following items:

(i) Any amount received by the lender on the account of the guaranteed loan after the date of default;

(ii) Any net income received by the lender from the secured property after the date of default; and

(iii) Any cash items retained by the lender, except any amount representing a balance of the guaranteed loan not advanced to the borrower. Any loan amount not advanced will be applied by the lender to reduce the outstanding principal on the loan.

(j) Lender certification. The lender must certify that all possibilities of collection have been exhausted and that all of the items specified in paragraph (c) of this section have been identified and reported to the Agency as a condition for payment of claim.

Sec. 3565.458 Withdrawal of claim.

If the lender provides timely written notice to the Agency of withdrawal of the claim, the guarantee will continue as if the default had not occurred if the borrower cures the default prior to foreclosure or prior to acceptance of a deed-in-lieu of foreclosure.

Secs. 3565.459-3565.499 [Reserved]

7 CFR Part 3565

Sec. 3565.500 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart K - Agency Guaranteed Loans that Back Ginnie Mae Guaranteed Securities

§ 3565.501 Applicability.

The provisions of this subpart apply when Agency guaranteed loans are used to back Ginnie Mae securities. In instances where this subpart applies, the provisions of this subpart prevail over any other provisions of this part.

§ 3565.502 Incontestability.

In the case of loans that back Ginnie Mae securities or loans that are acquired by Ginnie Mae as a consequence of its guaranty, the Agency guarantee under this part is incontestable except that the guarantee may not be enforced by a lender who commits fraud or misrepresentation or by a lender who had knowledge of the fraud or misrepresentation at the time such a lender acquired the guarantee or was assigned the loan.

§ 3565.503 Repurchase.

Lenders and security holders must comply with Ginnie Mae requirements regarding the repurchase of loans from pools backing Ginnie Mae guaranteed securities.

§ 3565.504 Transfers.

(a) Loans and/or mortgage servicing on loans backing Ginnie Mae guaranteed securities may only be transferred to a Ginnie Mae issuer and may only be transferred with prior Ginnie Mae approval.

(b) Agency approval shall not be required for transfer of the servicing on the guaranteed mortgages to Ginnie Mae.

§ 3565.505 Liability.

(a) Ginnie Mae shall not be liable for the actions of the lender including, but not limited to, negligence, fraud, abuse, misrepresentation or misuse of funds, property condition, or violations of usury laws.

(b) Ginnie Mae's rights under the guarantee shall be fully enforceable notwithstanding the actions of the lender.

§§ 3565.506-3565.549 [Reserved]

§ 3565.550 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information is 0575-0174.

APPENDIX 2 LIST OF FORMS

Below is a list of forms that are mentioned in the text of this handbook. Since these forms may change more frequently than the handbook, users are encouraged to obtain the most updated copy of these forms from the Rural Development Instructions home page (<http://rdinit.usda.gov/regs>) for their own reference.

AIA Document A-101

AIA Document 702

ASTM Standard E-1527

Form RD 449-30, Loan Note Guarantee Report of Loss

Form RD 451-2, Schedule of Remittances

Form RD 1910-11, Applicant Certification, Federal Collection Policies for Consumer or Commercial Debts

Form RD 1924-13, Estimate and Certificate of Actual Cost

Form RD 1924-16, Record of Pre-Construction Conference

Form RD 1924-25, Plan Certification

Form RD 1940-3, Request for Obligation of Funds, Guaranteed Loans

Form RD 1940-20, Request for Environmental Information

Form RD 1940-21, Environmental Assessment for Class I Action; or Exhibit H, RD Instruction 1940-G, Environmental Assessment for Class II Actions

Form RD 1940-22, Environmental Checklist for Categorical Exclusions

Form RD 1944-37, Previous Participation Certification

Form RD 1980-11, Guaranteed Rural Housing Lender Record Change

Form RD 1980-19, Guaranteed Loan Closing Report

Form RD 1980-24, Request Interest Assistance/Interest Rate Buydown/Subsidy Payment to Guaranteed Loan Lender

Form RD 1980-37, Purchase of a Guaranteed Loan Portion

Form RD 1980-41, Guaranteed Loan Status Report

Form RD 1980-43, Lender's Guaranteed Loan Payment to USDA

Form RD 1980-44, Guaranteed Loan Borrower Default Status

Form RD 2006-38, Civil Rights Impact Analysis Certification

Form RD 3550-6, Notice of Special Flood Hazards, Flood Insurance Purchase Requirements, and Availability of Federal Disaster Relief Assistance

Form RD 3560-8, Tenant Certification

Form RD 3560-9, Multi-Family Housing Interest Credit Agreement

Form RD 3560-30, Certification of NO Identify of Interest (IOI)

Form RD 3560-31, Identity of Interest Disclosure/Qualification Certificate

Form RD 3565-1, Application for Loan and Guarantee

Form RD 3565-2, Conditional Commitment

Form RD 3565-3, Lender's Agreement

HB-1-3565

Form RD 3565-4, Loan Note Guarantee

Form RD 3565-5, Assignment Guarantee Agreement

*Form AD 1047, Certification Regarding Debarment, Suspension, and Other
Responsibility Matters – Primary Covered Transactions*

*Form AD 1048, Certification Regarding Debarment, Suspension, Ineligibility and
Voluntary Exclusion – Lower Tier Covered Transactions*

FEMA Form 81-93, Standard Flood Hazard Determination

Form HUD 935.2, Affirmative Fair Housing Market Plan

Form HUD 9822, Physical Inspection Report

Form HUD 9832, Management Entity Profile

Form I-94, Arrival-Departure Record

Form I-551 (or I-151), Alien Registration Card

*RD Instruction 1940-Q Exhibit A-2, Statement of Loan
Guarantees*