RD AN No. 4404 (1980-D)
December 3, 2008

TO: All State Directors
Rural Development

ATTENTION: Rural Housing Program Directors, Guaranteed Rural Housing Coordinators, Area Managers and Specialists

FROM: Russell T. Davis ***(Signed by Russell T. Davis)***
Administrator
Housing and Community Facilities Programs

SUBJECT: Single Family Housing Guaranteed Loan Program (SFHGLP)
Temporary Interest Rate Buydowns

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice is to clarify and provide additional guidance regarding temporary interest rate buydowns. These policies are effective with all mortgage applications signed on or after the effective date of this Administrative Notice and are applicable to manual and automated underwriting.

COMPARISON WITH PREVIOUS AN:

No previous AN has been issued on this subject.

EXPIRATION DATE:
November 30, 2009

FILING INSTRUCTIONS:
Preceding RD Instruction 1980-D

BACKGROUND:

Temporary interest rate buydowns are a financing tool designed to reduce the borrower's monthly mortgage payment during the early years of repayment. The most familiar temporary interest rate buydown is the 2-1-0 buydown. It is a temporary reduction in the interest rate paid by the borrower, resulting in a reduction below note rate of two percent during the first year, a reduction below note rate of one percent the second year of the loan, after which the interest rate reverts to the note rate for the remainder of the life of the loan.

To cover the shortfall between the reduced payments made by the borrower and the regular payments received by the lender, cash is withdrawn from a special escrow account set up for that purpose. The total payment received by the lender, consisting of the payment made by the borrower plus the withdrawal from the escrow account is the same as it would be in the absence of the buydown.

The table below illustrates the mortgage payment for a 2-1-0 temporary interest rate buydown.

2-1-0 Buydown
Payments by Borrowers and Payments From Escrow
$100,000 loan; 30 Year Fixed 7% Mortgage

Year	Payment Received by Lender	Payment by Borrower	Payment From Escrow
1	$665.31	$536.83	$128.48
2	$665.31	$499.56	$65.75
3 – 30	$665.31	$665.31	$0
Total Escrow			$2331

IMPLEMENTATION RESPONSIBILITIES:

In accordance with Section 1980.392(b) of RD Instruction 1980-D, the use of a funded buydown is permitted when the Lender obtains prior Rural Development approval.

The following outlines underwriting requirements for temporary interest rate buydowns:

- The mortgage loan must be underwritten at the note rate.
- Buydown funds may come from the seller, lender or other third party.
- Buydown funds may not come from the borrower.
- The initial interest rate is temporarily reduced no more than two percent below the note rate *and* increased by no more than one percent annually for no more than two years.

- The lender must establish that the eventual increase in mortgage payments will not affect the borrower adversely and lead to default. The underwriter must document the compensating factors which indicate the borrower's ability to meet the expected increases in loan payment, such as:
  - The borrower has a potential for increased income that would offset the scheduled payment increases, as indicated by job training or education in the borrower's profession or by a history of advancement in the borrower's career with increases in earnings.
  - The borrower has demonstrated ability to devote a greater portion of income towards housing expenses.
  - The borrower has substantial assets available to cushion the effect of the increased payments.
- Funds for a temporary interest rate buydown must be escrowed with a state or federally supervised Lender and fully funded for the buydown period.

Questions regarding this AN can be directed to Debbie Terrell at 918.534.3254 or debra.terrell@wdc.usda.gov or Joaquín Tremols at 202.720.1452 or joaquin.tremols@wdc.usda.gov.