

**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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## TABLE OF CONTENTS

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	Page
<b>CHAPTER 1: OVERVIEW OF GUARANTEED RURAL RENTAL HOUSING PROGRAM ORIGINATION AND SERVICING HANDBOOK.....</b>	<b>1-1</b>
1.1 Introduction.....	1-1
<b>SECTION 1: THE HANDBOOK.....</b>	<b>1-1</b>
1.2 Purpose.....	1-1
1.3 Using the Handbook .....	1-1
A. Handbook Symbols.....	1-2
B. Citations and Text Boxes.....	1-2
C. Attachments and Appendices.....	1-3
<b>SECTION 2: THE RURAL HOUSING SERVICE (RHS).....</b>	<b>1-3</b>
1.4 RHS Organization.....	1-3
<b>SECTION 3: OVERVIEW OF THE GUARANTEED RURAL RENTAL HOUSING PROGRAM.....</b>	<b>1-3</b>
1.5 Program Goals .....	1-3
1.6 Eligible Rural Area .....	1-4
1.7 Program Features .....	1-4
A. Risk Sharing with Lenders.....	1-4
B. Affordability Features.....	1-5
C. Combination Construction and Permanent Financing.....	1-5
D. Lender Origination, Servicing, and Disposition .....	1-5
E. The NOFA Process .....	1-5
1.8 Roles and Responsibilities of Agency, Lender and Borrower.....	1-5
1.9 Identity of Interests.....	1-6
1.10 Agency Exception Authority.....	1-7
1.11 Reviews and Appeals.....	1-8
<b>SECTION 4: FEDERAL REQUIREMENTS .....</b>	<b>1-9</b>
1.12 Intergovernmental Review .....	1-9
1.13 National Flood Insurance Program .....	1-9
1.14 Historic Preservation.....	1-9

1.15 Civil Rights ..... 1-9  
    A. Nondiscrimination..... 1-9  
    B. Reasonable Accommodations for Persons with Disabilities ..... 1-10  
1.16 Fair Housing..... 1-10  
1.17 Environmental Requirements..... 1-11

Attachment 1-A: Review and Appeals of Adverse Agency Decisions

**CHAPTER 2: LENDER ELIGIBILITY AND APPROVAL..... 2-1**

2.1 Purpose and Overview ..... 2-1

**SECTION 1: LENDER ELIGIBILITY ..... 2-2**

2.2 Purpose..... 2-2  
2.3 Requesting Lender Approval ..... 2-2  
2.4 Basic Eligibility Test Requirements ..... 2-2  
2.5 Demonstrated Eligibility Test Requirements ..... 2-3  
2.6 Approval Requirements ..... 2-3  
    A. Origination and Servicing Plan ..... 2-3  
    B. Demonstrate the Lender’s Financial Stability..... 2-5  
    C. The Lender’s Certification to Comply with Program Requirements ..... 2-5  
2.7 Additional Requirements for Approval to Originate and Service  
    Combination Construction/Permanent Loans..... 2-5  
2.8 Participation by Lenders without Demonstrated Ability..... 2-6

**SECTION 2: LENDER APPROVAL PROCESS..... 2-6**

2.9 Overview ..... 2-6  
2.10 Agency Assessment of the Request ..... 2-6  
2.11 Submission Requirements — Lender Application..... 2-6  
2.12 Issuance of Approved Lender Status..... 2-7

**SECTION 3: MAINTENANCE OF LENDER APPROVAL ..... 2-8**

2.13 Requirements for Retaining Approved Status ..... 2-8

**SECTION 4: OTHER ISSUES..... 2-9**

2.14 Substitution of Lender..... 2-9  
2.15 Use of Agents and Brokers by the Approved Lender ..... 2-9  
2.16 Loan Participations ..... 2-10  
2.17 Transfer of Servicing ..... 2-10

---

<b>CHAPTER 3: LENDER UNDERWRITING .....</b>	<b>3-1</b>
3.1 Introduction.....	3-1
<b>SECTION 1: LENDER UNDERWRITING RESPONSIBILITIES.....</b>	<b>3-1</b>
3.2 Overview.....	3-1
3.3 Summary of Lender Responsibilities.....	3-2
<b>SECTION 2: LENDER NARRATIVE .....</b>	<b>3-2</b>
3.4 Narrative Requirements .....	3-2
<b>SECTION 3: BORROWER ELIGIBILITY .....</b>	<b>3-3</b>
3.5 Overview.....	3-3
3.6 Eligible Borrowers.....	3-3
3.7 Ineligible Borrowers.....	3-4
3.8 Borrower Types.....	3-4
A. General or Limited Partnerships .....	3-5
B. Corporations.....	3-6
C. Limited Liability Companies .....	3-7
D. Trusts.....	3-7
E. Public Agencies .....	3-7
F. Indian Tribes .....	3-7
G. Individuals.....	3-8
3.9 Certification of Legal Eligibility.....	3-8
3.10 Borrower Experience and Capacity .....	3-8
A. Construction and Rehabilitation Experience .....	3-8
B. Property Management Experience .....	3-9
C. Financial Capacity.....	3-10
<b>SECTION 4: PROPERTY REQUIREMENTS .....</b>	<b>3-11</b>
3.11 Overview.....	3-11
3.12 Rural Area Designation.....	3-11
3.13 General Site Requirements .....	3-11
A. Public Facilities and Services .....	3-11
B. Less Desirable Areas.....	3-12
3.14 Site Standards.....	3-12
A. Applicable Codes.....	3-12
B. Adequate Utilities and Infrastructure.....	3-12
C. Grading and Drainage .....	3-12
D. Size and Shape.....	3-13
E. Undesirable Physical Conditions .....	3-13

3.15 Site Density.....	3-13
3.16 Non-Contiguous Sites.....	3-13
3.17 Site Control.....	3-14
A. Land Ownership.....	3-14
B. Land Lease.....	3-14
3.18 Environmental Requirements.....	3-15
A. Lender Responsibilities Prior to Requesting Guarantee.....	3-15
B. Agency Environmental Review.....	3-15
3.19 Civil Rights.....	3-16
3.20 Project Development.....	3-16
A. Project Size.....	3-16
B. Agency Construction Requirements.....	3-16
C. Federal Accessibility Requirements.....	3-17
<b>SECTION 5: FINANCING TERMS.....</b>	<b>3-20</b>
3.21 Overview.....	3-20
3.22 Occupancy and Rent Restrictions.....	3-20
3.23 Use of Loan Proceeds.....	3-20
A. Eligible Uses of Loan Proceeds.....	3-21
B. Ineligible Uses of Loan Funds.....	3-22
3.24 Applying Section 207(c) Loan Limits.....	3-23
3.25 Mortgage Terms.....	3-23
A. Maximum Loan Term.....	3-23
B. Maximum Interest Rate.....	3-23
C. Interest Reduction Credit.....	3-24
D. Maximum Loan Amount.....	3-24
<b>SECTION 6: DETERMINING PROPERTY VALUE.....</b>	<b>3-25</b>
3.26 Overview.....	3-25
3.27 Cash Flow Analysis.....	3-25
A. Operating and Maintenance Expense.....	3-25
B. Debt Service.....	3-26
3.28 Appraisal.....	3-28
A. Appraisal Requirements.....	3-28
B. Appraiser Qualifications.....	3-28
C. Appraisal Methods.....	3-28

---

D. Appraisal Report Guidelines.....	3-29
E. Market Study.....	3-29
<b>CHAPTER 4: LOAN GUARANTEE APPLICATION PROCESSING.....</b>	<b>4-1</b>
<b>SECTION 1: AN OVERVIEW OF THE PROCESS .....</b>	<b>4-1</b>
4.1 Purpose.....	4-1
<b>SECTION 2: NOTICE OF FUNDING AVAILABILITY (NOFA) .....</b>	<b>4-2</b>
4.2 Publication of GRRHP Requirements .....	4-2
4.3 Response to the NOFA .....	4-2
4.4 Information to be Included in Response to the NOFA .....	4-2
A. Descriptive Information .....	4-2
B. Lender Eligibility and Approval Status.....	4-4
C. Competitive Criteria.....	4-4
D. Lender Certification .....	4-4
4.5 Agency Review of NOFA Response.....	4-4
A. Was the Project Proposal on Time and Complete?.....	4-4
B. Is the Borrower An Eligible Entity?.....	4-4
C. Is the Lender Eligible? .....	4-5
D. Is the Proposed Project Eligible? .....	4-5
4.6 Scoring and Ranking.....	4-6
4.7 Notice to Proceed with Processing.....	4-6
<b>SECTION 3: APPLICATION FOR THE GUARANTEE.....</b>	<b>4-6</b>
4.8 Purpose of the Application.....	4-7
A. The Proposed Project Meets the GRRHP Threshold Requirements.....	4-7
B. The Proposed Project is Eligible to Receive a Conditional Commitment .....	4-7
4.9 Application Form and Documentation.....	4-8
A. The Lender’s Certification .....	4-8
B. Exhibits and Supporting Information to the Lender’s Certification .....	4-8
4.10 Interest Credit Request and Documentation .....	4-12
A. Amount of Interest Credit Subsidy .....	4-12
B. Demonstrated Need.....	4-12
C. Limits on Allocation of Interest Credit.....	4-13
D. Payment of Interest Credit .....	4-13
E. Cancellation of Interest Credit .....	4-14

4.11 Lender Review of the Borrower Submissions .....	4-14
A. Borrower Eligibility .....	4-14
B. Project Eligibility .....	4-15
C. Project Feasibility Analysis.....	4-15
4.12 Agency Review of the Loan Guarantee Application.....	4-16
A. Determination that the Loan Guarantee Application Package is Complete....	4-16
B. Environmental Review by Agency .....	4-16
C. Civil Rights Impact Analysis .....	4-17
D. Review of Other Federal Requirements.....	4-17
E. Review of Affirmative Fair Housing Marketing Plan (AFHMP) .....	4-17
F. Decision on Interest Credit Subsidy Request.....	4-19
G. Decision on the Guarantee Amount .....	4-19
H. Determination that the Loan is Acceptable for a Conditional Commitment .....	4-19
4.13 Agency Decision .....	4-20
<b>SECTION 4: ISSUANCE OF CONDITIONAL COMMITMENT .....</b>	<b>4-20</b>
4.14 General Requirements.....	4-20
4.15 Terms of Conditional Commitment.....	4-21
A. Subsidy Layering Review .....	4-21
B. Guarantee Fee .....	4-21
C. Termination of the Conditional Commitment .....	4-22
D. Substitution of Lender.....	4-22
E. Lender's Agreement.....	4-22
F. Loan Note Guarantee Agreement.....	4-22
<b>SECTION 5: RESPONSE TO THE CONDITIONAL COMMITMENT AND LOAN CLOSING.....</b>	<b>4-23</b>
4.16 General Conditions .....	4-23
4.17 Development of the Regulatory Agreement.....	4-23
4.18 Loan Closing.....	4-23
<b>SECTION 6: GUARANTEE DURING CONSTRUCTION.....</b>	<b>4-24</b>
4.19 Combination Construction and Permanent Loan .....	4-24
<b>SECTION 7: PERMANENT GUARANTEE.....</b>	<b>4-24</b>
4.20 Occupancy.....	4-24
4.21 Documentation Requirements.....	4-25

---

**SECTION 8: TERMINATION OF THE LOAN GUARANTEE ..... 4-25**

4.22 Reasons for Termination..... 4-25  
    A. Repayment of the Loan ..... 4-25  
    B. Payment of a Claim..... 4-26  
    C. Voluntary Termination of the Guarantee Agreement by the Lender ..... 4-26  
    D. Non-Compliance with Program Requirements ..... 4-26  
    E. Fraud ..... 4-26

Attachment 4-A: Sample -- Notice to Proceed with Processing  
                  Sample -- Letter to the State Director

Attachment 4-B: Suggested Format for the Opinion of the Lender's Legal Counsel

Attachment 4-C: Closing Documents to be Submitted as Part of the Final Application

**CHAPTER 5: CONSTRUCTION REQUIREMENTS ..... 5-1**

5.1 Introduction..... 5-1

**SECTION 1: PRE-CONSTRUCTION CONFERENCE ..... 5-2**

5.2 Conference Requirements..... 5-2

**SECTION 2: BASIC CONSTRUCTION REQUIREMENTS ..... 5-2**

5.3 Overview..... 5-2  
5.4 Construction Contractor Experience and Capacity..... 5-2  
5.5 Debarment and Suspension..... 5-2  
5.6 Architectural Services..... 5-3  
5.7 Plans, Specifications and Cost Estimates..... 5-4  
5.8 Environmental Requirements..... 5-5  
5.9 Construction..... 5-5  
5.10 Inspections ..... 5-6  
5.11 Warranty..... 5-9  
5.12 Construction Requirements Certification ..... 5-9

**SECTION 3: GUARANTEES OF CONSTRUCTION ADVANCES..... 5-9**

5.13 Overview..... 5-9  
5.14 Insurance ..... 5-10  
5.15 Sureties..... 5-10  
5.16 Letters of Credit ..... 5-10  
5.17 Payment Procedures..... 5-11  
5.18 Contract Change Orders..... 5-12  
5.19 Modification of Maximum Amount Guaranteed During Construction ..... 5-12



5.20 Reporting During Construction Period .....	5-13
5.21 Final Payment .....	5-13
5.22 Certification that Additional Requirements Have Been Met .....	5-14
<b>SECTION 4: APPLICATION PROCESSING FOR GUARANTEES ON CONSTRUCTION ADVANCES.....</b>	<b>5-14</b>
5.23 Overview of Process .....	5-14
<b>SECTION 5: CLAIMS PROCESSING FOR GUARANTEES ON CONSTRUCTION ADVANCES.....</b>	<b>5-15</b>
5.24 Overview of Process .....	5-15
<b>CHAPTER 6: PROGRAM FEES.....</b>	<b>6-1</b>
6.1 Overview .....	6-1
6.2 Fees Associated with the Loan Guarantee .....	6-2
A. Guarantee Fee .....	6-2
B. Annual Fee .....	6-2
C. Surcharge for Guarantees on Construction Advances .....	6-2
6.3 Additional Agency Fees .....	6-2
A. Application Fee .....	6-2
B. Extension and Reopening Fees .....	6-2
C. Transfer Fee .....	6-3
<b>CHAPTER 7: SERVICING PERMANENT LOANS.....</b>	<b>7-1</b>
7.1 Introduction .....	7-1
<b>SECTION 1: SERVICING GOALS AND OBJECTIVES .....</b>	<b>7-1</b>
7.2 Objectives .....	7-1
7.3 Protecting the Value of the Financial Asset.....	7-1
7.4 Protecting the Tenants' Rights.....	7-2
7.5 Protecting the Government's Interests .....	7-2
<b>SECTION 2: GENERAL SERVICING REQUIREMENTS.....</b>	<b>7-2</b>
7.6 Funds Management.....	7-2
A. Collecting and Processing Borrower Payments .....	7-2
B. Escrow and Reserve Account Management.....	7-2
C. Interest Credit.....	7-3
D. Approval of Reserve Releases .....	7-3
E. Approval of Surplus Cash Distribution to the Borrower .....	7-5

---

7.7	Addressing Defaults and Delinquencies .....	7-7
A.	Delinquencies.....	7-7
B.	Declaring a Default .....	7-7
C.	Initiating Special Servicing.....	7-7
7.8	Transfer of Ownership .....	7-8
A.	Changes in the Ownership Entity.....	7-8
B.	Transfers of Title/Transfers of Physical Assets .....	7-8
<b>SECTION 3: ASSET MANAGEMENT .....</b>		<b>7-9</b>
7.9	Overview.....	7-9
7.10	Financial Management.....	7-9
A.	Borrower Reports to the Lender.....	7-9
B.	Lender Reports to the Agency.....	7-12
7.11	Completing the Life Cycle Cost Analysis and Reserve Analysis .....	7-15
A.	The Life Cycle Cost Analysis .....	7-15
B.	Adjusting the Reserve Deposit Requirement.....	7-15
7.12	Physical Maintenance and Oversight .....	7-16
A.	Physical Standards and Inspections .....	7-16
B.	Capital Improvement Plans.....	7-17
7.13	Compliance with other Federal Requirements.....	7-17
A.	Affirmative Fair Housing Marketing Plan .....	7-17
B.	Annual Fair Housing Reporting Requirements.....	7-17
C.	Other Civil Rights Laws .....	7-17
7.14	Compliance with other Program Requirements .....	7-20
A.	Regulatory Agreement Compliance.....	7-20
B.	Preservation of Affordable Housing .....	7-21
<b>SECTION 4: SPECIAL SERVICING .....</b>		<b>7-21</b>
7.15	Overview.....	7-21
7.16	Roles and Responsibilities of the Servicing Lender .....	7-22
A.	Development of a Workout Plan.....	7-22
B.	Bankruptcy of Borrower .....	7-23
C.	Loss Claims During Bankruptcy.....	7-23

7.17 Roles and Responsibilities of the Borrower .....	7-23
A. Submission of Information to the Lender.....	7-23
B. Development and Execution of the Workout Plan .....	7-24
C. Compliance with the Workout Plan .....	7-24
7.18 Special Servicing Options.....	7-24
A. Loan Modifications .....	7-24
B. Partial Payment of Claim.....	7-24
C. Transfer of Physical Assets .....	7-25
D. Agency Approval of Reserve Releases.....	7-25
E. Lender Recommendation of Enforcement Action.....	7-25
<b>CHAPTER 8: PROPERTY MANAGEMENT.....</b>	<b>8-1</b>
8.1 Introduction.....	8-1
<b>SECTION 1: ROLE OF LENDER IN PROPERTY MANAGEMENT .....</b>	<b>8-1</b>
8.2 Responsibilities of the Lender.....	8-1
A. Management Plan.....	8-1
B. Property Manager Qualifications .....	8-2
C. Management Agreement .....	8-2
D. Site Visits.....	8-2
E. Occupancy and Rent .....	8-2
F. Affirmative Fair Housing Marketing Plan .....	8-2
G. Reporting.....	8-2
H. Relationship Reporting .....	8-3
<b>SECTION 2: MANAGEMENT PLAN .....</b>	<b>8-3</b>
8.3 Overview.....	8-3
8.4 Management Plan Requirements .....	8-4
A. Management Plan Contents .....	8-4
B. Agency Review .....	8-5
<b>SECTION 3: PROPERTY MANAGER.....</b>	<b>8-5</b>
8.5 Overview.....	8-5
8.6 Key Property Manager Issues.....	8-6
8.7 Property Manager Experience.....	8-7
8.8 Previous Participation and other Federal Requirements .....	8-7
<b>SECTION 4: MANAGEMENT AGREEMENT.....</b>	<b>8-7</b>
8.9 Overview.....	8-7
8.10 Terms and Conditions.....	8-8

---

8.11 Management Fee .....	8-8
<b>SECTION 5: OCCUPANCY REQUIREMENTS .....</b>	<b>8-8</b>
8.12 Occupancy Requirements and Lender Review .....	8-8
A. Income of Residents.....	8-9
B. Tenant Income Certifications.....	8-9
C. GRRHP Definition of Income.....	8-9
D. Reporting of Income .....	8-10
E. Restrictions on Rent.....	8-10
F. Use Restrictions .....	8-11
<b>SECTION 6: TENANT PROTECTION AND GRIEVANCE PROCEDURES .....</b>	<b>8-11</b>
8.13 Overview.....	8-11
8.14 Tenant Protection.....	8-11
8.15 Grievance Procedures .....	8-11
8.16 Civil Rights .....	8-13
A. Lender Obligations .....	8-13
B. Penalties.....	8-14
8.17 Housing Discrimination.....	8-14
Attachment 8-A: Management Plan Requirements for the Guaranteed Rural Rental Housing Program	
Attachment 8-B: The Hearing Process for Tenant Grievances and Appeals for the Guaranteed Rural Rental Housing Program	
<b>CHAPTER 9: INSURANCE REQUIREMENTS.....</b>	<b>9-1</b>
9.1 Introduction .....	9-1
<b>SECTION 1: OVERVIEW OF INSURANCE REQUIREMENTS .....</b>	<b>9-1</b>
9.2 Overview.....	9-1
<b>SECTION 2: TYPES OF INSURANCE.....</b>	<b>9-1</b>
9.3 Property Insurance .....	9-1
9.4 Fidelity Insurance.....	9-2
9.5 Mortgage’s Errors and Omissions (E&O) Insurance .....	9-2
9.6 Liability Insurance.....	9-2
9.7 Worker’s Compensation .....	9-3
9.8 Evidence of Insurance, Terms, and Coverage.....	9-3

<b>SECTION 3: AUTHORIZED INSURANCE PROVIDERS .....</b>	<b>9-3</b>
9.9 Overview.....	9-3
9.10 Acceptable Ratings for Insurance Providers.....	9-3
<b>CHAPTER 10: CLAIMS.....</b>	<b>10-1</b>
10.1 Purpose and Overview .....	10-1
<b>SECTION 1: PRE-LIQUIDATION REQUIREMENTS .....</b>	<b>10-2</b>
10.2 Overview.....	10-2
<b>SECTION 2: DECISION TO LIQUIDATE.....</b>	<b>10-2</b>
10.3 Overview.....	10-2
10.4 Notice of Liquidation and Potential Claim .....	10-3
10.5 Submission of a Liquidation Plan.....	10-3
10.6 Approval of Liquidation Plan .....	10-5
10.7 Filing an Estimated Loss Claim .....	10-5
10.8 Withdrawal of a Claim.....	10-5
<b>SECTION 3: PROPERTY LIQUIDATION .....</b>	<b>10-5</b>
10.9 Property Acquisition .....	10-5
10.10 Lender Liquidation.....	10-6
10.11 Failure to Comply with the Liquidation Plan.....	10-7
<b>SECTION 4: AGENCY ELECTION OF ASSIGNMENT OR CONVEYANCE.....</b>	<b>10-7</b>
10.12 Overview.....	10-7
10.13 Assignment of the Loan .....	10-8
10.14 Conveyance of Title to the Agency.....	10-8
<b>SECTION 5: DETERMINATION OF THE CLAIM AMOUNT .....</b>	<b>10-9</b>
10.15 Introduction.....	10-9
10.16 Determination of the Date of Loss.....	10-10
A. Lender Liquidation .....	10-10
B. Assignment or Conveyance of Title to the Agency.....	10-10
10.17 Calculation of Loss .....	10-10
A. Request for Estimated Loss Claim .....	10-10
B. Final Report of Loss .....	10-11
10.18 Protective Advances.....	10-11
10.19 Liquidation Expenses.....	10-11
10.20 Legal Expenses During Bankruptcy Proceedings .....	10-11

---

10.21 Maximum Guarantee Payment.....	10-12
<b>SECTION 6: PAYMENT OF THE FINAL CLAIM.....</b>	<b>10-12</b>
10.22 Overview.....	10-12
10.23 Submission of a Report of Final Loss.....	10-12
10.24 The Approved Claim Amount .....	10-13
<b>CHAPTER 11: ENVIRONMENTAL REQUIREMENTS .....</b>	<b>11-1</b>
11.1 Purpose and Overview .....	11-1
11.2 General Environmental Requirements.....	11-1
11.3 Environmental Risk Management.....	11-2
11.4 Responsibility for Environmental Reviews .....	11-3
11.5 Environmental Reviews During Loan Origination .....	11-4
A. The NOFA Submission Stage .....	11-4
B. The Application Submission Stage .....	11-4
11.6 Environmental Reviews During the Servicing Period .....	11-5
11.7 Other Environmental Requirements .....	11-6
A. Flood Hazard Determination .....	11-6
B. Clean Air Act and Water Pollution Control Act .....	11-7

**GLOSSARY**

**APPENDIX 1: 7 CFR PART 3565**

**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.
- **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.

**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>.



### **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 1944-30*.



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.

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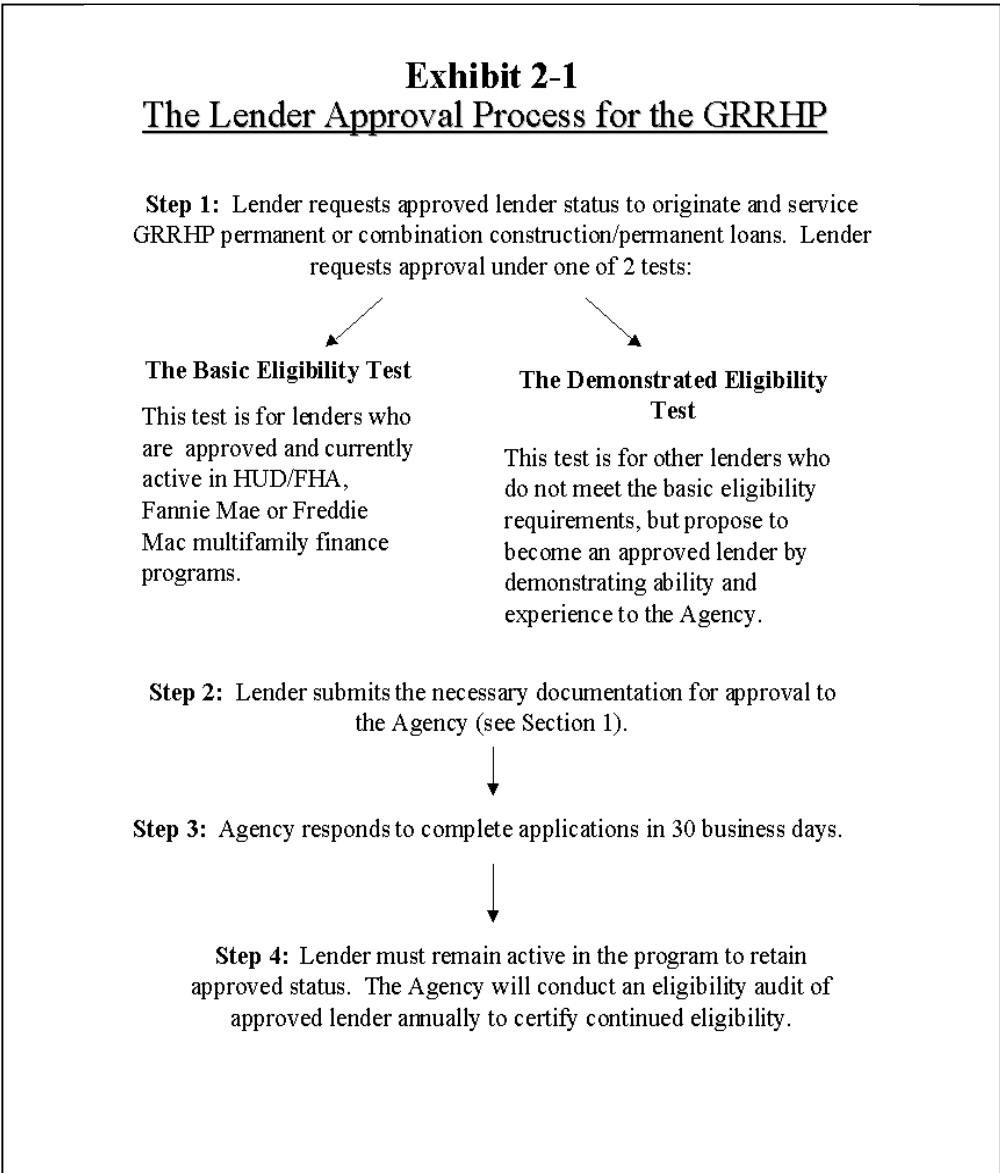
# CHAPTER 2: LENDER ELIGIBILITY AND APPROVAL

## 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; or
- Freddie Mac.

“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, or Freddie Mac 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, or Freddie Mac. 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, or Freddie Mac 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 or Freddie Mac 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, or Freddie Mac (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. 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, or Freddie Mac, 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.

**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.

### **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 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. A definition of "Indian tribe" is provided in the Glossary. To be eligible as an Indian tribe, this definition must be met.

## **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 are inadequate to the Agency, the loan will not be eligible for 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 must be financially stable and have sufficient resources to develop and operate the property. 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 requirements 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.

- **Working Capital.** 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. The Agency recommends that the construction contingency be set at 2 percent of the construction contract.

The O&M reserve will be at least 2 percent of the loan amount. 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 will 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 to the general operating account by the borrower, 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 (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 RHS State Office for rural area verification.

### **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.

**Examples of Less Desirable Areas**

Examples of less desirable areas include:

- 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.

**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.

**Technical Assistance on Site Standards**

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.

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 lender or the Agency are permitted to sublet the property and sell the leasehold for cash or credit if the leasehold is acquired through foreclosure, deed-in-lieu of foreclosure, or borrower abandonment;
- 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 may request assistance of the lender in conducting this review. 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 equal \$15,000 or more; and
- When completed, the rehabilitated building(s) must be energy efficient and in “like new” condition.

### C. Federal Accessibility Requirements

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. 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.



<b>Exhibit 3-2</b>
<b>Section 504 Requirements</b>
<b>Removal of Physical Barriers</b>
<p>For <b>new construction</b> 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"> <li>• The Section 504 definition of <b>substantial rehabilitation</b> 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.</li> <li>• When <b>rehabilitation less extensive than substantial rehabilitation</b> 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.</li> <li>• 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.</li> <li>• 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.</li> <li>• 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.</li> <li>• The usual standards for ensuring compliance with Section 504 are the Uniform Federal Accessibility Standards (UFAS), although deviations are permitted in specific circumstances.</li> </ul>
<b>Provide Program Accessibility</b>
<ul style="list-style-type: none"> <li>• Individuals with disabilities must be able to learn of, apply for, and participate in Federally-assisted programs or activities.</li> <li>• 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).</li> <li>• 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).</li> </ul>
<b>Make Employment Accessible</b>
<ul style="list-style-type: none"> <li>• Employers must not discriminate.</li> <li>• Employers must remove physical and administrative barriers to employment.</li> <li>• Employers must make reasonable accommodations for individuals with known disabilities (e.g., job restructuring, providing readers or sign interpreters, or making facilities accessible).</li> </ul>
<b>Administrative Requirements</b>
<p>If recipients or subrecipients have 15 or more employees, they must:</p> <ul style="list-style-type: none"> <li>• Designate a Section 504 Coordinator; and</li> <li>• Notify program participants and employees of non-discrimination policies.</li> </ul> <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 two distinct features with respect to affordability of units. Lenders must ensure that loans are underwritten and that mortgage documents adequately address these restrictions.

- **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. 

### 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 Agency staff 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.

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 must not exceed the maximum rate specified in the NOFA for the year the loan was obligated. The loan must bear a fixed rate of interest over the entire term.

### **C. Interest Reduction Credit**

The Agency will provide additional financial assistance for 20 percent of the loans by providing an interest credit to reduce the interest rate to the Applicable Federal Rate (AFR). In general, the interest credit will reduce the interest rate by 100 to 200 basis points. 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 a Final Loan Note 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 the 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 value.

Issues such as market conditions and borrower and property weaknesses should alter 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 3-3 outlines how the income side of a project budget is constructed.

**Exhibit 3-3**

**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, where possible. Exhibit 3-4 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 a 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 3-5.



**Exhibit 3-4****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;
- 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 the 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 3-5****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.



#### 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**

If a separate market study is conducted to support the appraisal it must include the material listed in Exhibit 3-6.

**Exhibit 3-6**

**Required Contents of a Market Study**

The market study must include:

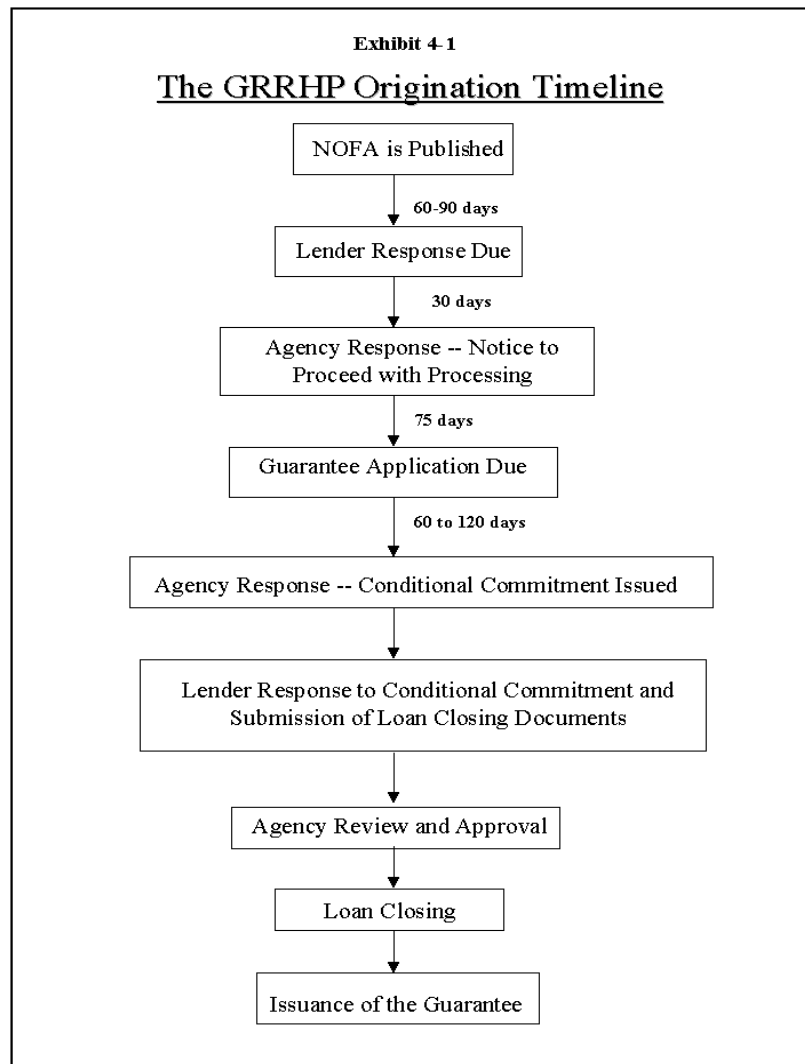
1. A complete description of the proposed site, including location of the land, location of services, and their distances from the site.
2. Major employment data including: the name, location, and date of establishment of any major employers within the community; the product or service of each employer, 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 request to the Agency for scoring and ranking a proposed GRRHP project. The lender must provide sufficient information 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 response period will generally extend for a 60-90 day period following publication of the NOFA. During the next 60-90 days, the Agency will determine the highest ranked responses. Lenders with top ranked proposals will receive a “Notice to Proceed with Processing” inviting them to submit a GRRHP application. Lenders that decide not to proceed must notify the Agency in writing within 90 days 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.

### 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.

**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 interest rate the lender will charge and the interest rate after applying the interest credit. This rate may be not lower than the published Applicable Federal Rate (AFR).
- 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-value ratio for 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 financial statements.
- Statement of borrower 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 must be submitted with the guarantee application.

**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 or certification by the lender that 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 must 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/epls/>. 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 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 borrower must be informed 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 that they are an approved lender under the GRRHP program or that they are eligible to apply for approved lender status. An application 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.)
- 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 an application is determined to be eligible after the review of the threshold criteria, then it will enter the ranking and scoring process as established in [7 CFR 3565.5]. In addition, specific ranking and scoring criteria will be determined annually and announced in the NOFA. This criteria will be used to determine project proposals that might receive a Notice to Proceed with Processing (see Attachment 4-A). When all other things are equal between two or more applications in the scoring and ranking process, the Agency will select applications submitted by a borrower who is a veteran of the United States armed services over applications submitted by a non-veteran borrower.

#### **4.7 NOTICE TO PROCEED WITH PROCESSING**

Once the proposal has been ranked by the Agency, a Notice to Proceed with Processing will be issued, in the order of ranking, until available funds have been reserved. This process will assure lenders that they can proceed to incur the costs associated with the preparation of a loan guarantee application.

After a Notice to Proceed has been issued, changes in the borrower entity or substitution of the lender with another approved lender, are permitted, with prior Agency approval, so long as the loan purpose, scope of project, location, and terms related to scoring and ranking are unchanged.

Proposals that are not ranked high enough to proceed will be retained at the National Office for reconsideration if higher ranking proposals choose not to proceed or fail to complete the loan guarantee application stage.

### **SECTION 3: APPLICATION FOR THE GUARANTEE**

#### **Key Activities in this Section**

- Invite Submission of an Application (Notice to Proceed with 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 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 lender 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 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.
- Evidence the loan is reasonable for the given borrower.

### 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 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 office stated in the NOFA. 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 Paragraphs 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 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.

Exhibit A-6 of RD Instruction 1944-E, 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.

*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).
  - ◇ Credit report for each principal 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 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.
- ◇ State Clearinghouse comments or recommendations.
- ◇ Certification that the lender has reviewed 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.
  - ◇ Lender's narrative.
  - ◇ SAUCE disc and hard copy (to be completed by RHS).
  - ◇ 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 submission.
  - ◇ Type of utilities and utility allowances (Exhibit A-6 of RD Instruction 1944-E), 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**

The application package must also include a request for interest credit if that is part of the proposed financing. An interest credit is a subsidy available to eligible borrowers that reduces the effective interest rate of the loan to the Applicable Federal Rate (AFR). The AFR is the interest rate set by the U.S. Treasury for federal financing programs. Twenty percent (20%) of the loans financed under the GRRHP will be given interest credit.

##### **A. Amount of Interest Credit Subsidy**

The interest rate on GRRHP loans may not exceed the Agency maximum interest rate, which will be announced each year in the NOFA. The spread between the interest rate the lender charges on the loan and the AFR (the effective interest rate after the interest credit is applied) determines the amount of interest credit subsidy. 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 application 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 negotiated rate of interest on the loan and the AFR. No project will receive interest credit on more than \$1,500,000 of the total amount guaranteed. 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 =  <b>Interest Payable</b></p>
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<p><b>To Obtain the                  Applicable Federal Rate                  (AFR)</b></p> 
<p>Check the Internet site:</p> <ul style="list-style-type: none"> <li>• <a href="http://ftp.fedworld.gov/pub/irs-utl/afrs.pdf">http://ftp.fedworld.gov/pub/irs-utl/afrs.pdf</a></li> </ul> <p style="text-align: center;">or</p> <ul style="list-style-type: none"> <li>• the <i>Wall Street Journal</i> which publishes the AFR rate on the third Wednesday of each month. Locate the "Long Term Monthly Rate."</li> </ul>

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.

### **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. Any unearned credit must be repaid to the Agency.

## **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 Agency 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 must be provided to the RHS State Architect who will review them to see that program design requirements will be met.

**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 Agency must conduct a feasibility analysis using SAUCE. If the projected income and costs do not match fairly evenly, the project costs and rent structure must be revised to bring the two in line or the project is not feasible.

**2. Adequacy of the Initial Operating Capital**

All borrowers must contribute from their own resources an amount equal to at least 2 percent of the loan amount as initial operating capital (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 Agency with a schedule of how these funds will be used.

The materials and equipment that are typically funded by the initial operating capital 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 lender must ensure that the items are necessary for the project, and the costs are similar to other comparable projects in the area.

### **3. *Management Systems***

The lender must evaluate whether the borrower has proposed 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 Agency 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 Agency will require information from the borrower and the lender to complete this review. The required information 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 Request**

The Agency will review any information justifying the request for interest credit and determine whether interest credit can be reserved for the project.

#### **G. Decision on the Guarantee Amount**

The guarantee amount will be negotiated between the lender and the Agency, 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 Agency 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. This determination must be confirmed by the issuance of a conditional commitment by the lender, subject to issuance of a loan guarantee by the Agency. 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 proposed loan amount does not exceed 207(c) limits;
- The proposed loan term is 40 years or less;
- 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 2 percent of the loan amount for initial operating capital (or provided the lender with a letter of credit, as provided by paragraph 3.10 C., in lieu of a cash contribution);
- 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 Applicable Federal Rate (AFR).

#### **4.13 AGENCY DECISION**

Decisions on applications will normally be rendered within 60-120 days of receipt of a completed application. In most cases, the Agency will be able to notify the lender of its decision in about 75 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; and
- The Agency has completed a satisfactory environmental review required under the National Environmental Policy Act, in accordance with RD Instruction 1940-G.

*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. Simultaneous with the issuance of a Conditional Commitment, the Agency will execute *Form RD 1940-3, Request for Obligation of Funds Guaranteed Loans* for the proposed project. This form will be faxed to:



USDA Finance Office  
 Guaranteed Loan Branch  
 Attention: FC 350  
 P.O. Box 200011  
 St. Louis, MO 63120-0011  
 Phone: (314) 539-3555  
 Fax: (314) 539-3041

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

**4.15 TERMS OF CONDITIONAL COMMITMENT**

The conditional commitment is valid for the length of time specified in the commitment letter. It is expected that the standard term will be 24 months, however, a longer term may be permitted in circumstances that warrant a longer term, such as unusual construction requirements. Up to two extensions of 60 to 90 days each may be requested prior to the expiration of the commitment. The Agency will normally charge a fee for any 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 RHS 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. 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 Agency immediately of its intention to withdraw an application. In this case, the Agency will retain the loan guarantee fee.
- **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 Agency may allow extensions of the loan commitment period. The lender must submit a written justification for the extension, which may be granted by the Agency 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 fee for this extension/reopening of the application.

### **D. 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 Agency and the substitute lender agrees to the underwriting terms approved in the conditional commitment. 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.

### **E. 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.

### **F. Loan Note Guarantee Agreement**

*Form RD 3565-4, Loan Note Guarantee* must be executed in order for the permanent loan guarantee to become effective.

## **SECTION 5: RESPONSE TO THE CONDITIONAL COMMITMENT AND LOAN CLOSING**

### **4.16 GENERAL CONDITIONS**

Once a lender receives a conditional commitment from the Agency, it must respond to the conditions detailed in that commitment. 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.

Among the conditions specified in the conditional commitment, the lender must submit the following for Agency approval before loan closing occurs.

- 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-B); and
- A copy of the proposed closing documents (See Attachment 4-C).

### **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 7.14. 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 Agency, the lender may schedule the closing date for the loan. All conditions of the conditional commitment must be fulfilled before the permanent guarantee is issued. If the loan is a combination construction and permanent loan, then the requirements of Section 6 will apply and the guarantee will be issued on the amount of outstanding advances. 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 Agency, and submitted to the Finance Office.

## **SECTION 6: GUARANTEE DURING CONSTRUCTION**

### **4.19 COMBINATION CONSTRUCTION AND PERMANENT LOAN**

In the case of a combination construction and permanent loan, the loan guarantee will go into effect as construction funds are drawn down (see Chapter 5).

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:

- Surety bonding or a performance and payment bond.
- 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 of a combination construction and permanent loan.

## **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 determined, with Agency concurrence, that a minimum level of occupancy to ensure financial feasibility has been attained. 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 a 2% operating reserve. 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 complete closing docket for the permanent loan closing (see Attachment 4-C for requirements).
- Lender's Agreement executed by the lender.
- An updated necessary assistance review by the Agency.
- Evidence that the annual guarantee fee has been paid.
- Loan Note Guarantee executed by the Agency.

### **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 Agency pursuant to Chapter 7.

**D. Non-Compliance with Program Requirements**

The loan guarantee may be terminated for non-compliance with the program requirements. If a lender fails to comply with program requirements, the Agency will make a declaration of default for non-compliance. If the lender fails to remedy the default, the Agency will terminate the guarantee. 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 may 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).

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

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

Thank you for participating in our recent funding round for the Section 538 Guaranteed Rural Rental Housing Program (GRRHP).

We are pleased to inform you that the proposal which you submitted for the Section 538 Guaranteed Rural Rental Housing Loan Program has been selected for further processing. We appreciate your hard work to date and look forward to a successful relationship.

The Rural Development State Director has been notified to proceed with the Environmental Assessment process. You should be contacted soon for additional information.

The proposal should now be processed through your full underwriting procedures in accordance with the GRRHP Handbook (HB-1-3565). Once you are comfortable with the proposal, the application docket should be provided to this office for review and the \$2,500 application fee will be due at this time. The Agency will attempt a quick turn around with any additional conditions for proceeding.

If you have any questions contact the Multi-Family Housing Processing Division on 202-720-1604 or Fax 202-690-3444.

Once again, congratulations on your selection as a pioneer participant in our Section 538 Guaranteed Rural Rental Housing Program.

HB-1-3565  
Attachment 4-A  
Page 2 of 2

**SAMPLE -- LETTER TO THE STATE DIRECTOR**

TO: \_\_\_\_\_  
State Director  
Rural Development  
Anywhere, USA

FROM: \_\_\_\_\_  
Administrator  
Rural Housing Service

SUBJECT: Section 538 Guaranteed Rural Rental Housing Program

We are pleased to inform you that the ABC LP and XYZ LP proposals were selected for inclusion in the Section 538 Guaranteed Rural Rental Housing Program. Because of the necessity to get the Environmental Assessments done as quickly as possible, we are asking for your assistance in providing the Environmental Coordinator for your State with the necessary resources to meet the \_\_\_\_\_, deadline for obligating the guarantee. Since we are unable to obligate Agency resources without an environmental review, **we need the copy of the published FONSI in this office by COB on \_\_\_\_\_.**

For your use, attached is a copy of the application(s) that was submitted to this office. Please ensure that the proper staff receives this information. If further information is needed to complete the Environmental Assessment(s), contact the lender.

**This is not a commitment for the projects. However, we have selected them for further processing.**

If you have any questions call the Multi-Family Housing Processing Division at 202-720-1604 or Fax 202-690-3444.

Attachments

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**ATTACHMENT 4-B  
SUGGESTED FORMAT FOR THE OPINION  
OF THE LENDER'S LEGAL COUNSEL  
(LEGAL OPINION TO BE RETYPED ON LENDER'S COUNSEL'S LETTERHEAD)**

To: (Name of Lender)

I/we have acted as counsel to (Lender) in connection with a \$ (amount) type loan by the (Lender) (hereinafter "the Lender") to (Borrower) (hereinafter "Borrower"), the terms of which loan are set forth in a certain Loan Agreement (hereinafter "the Loan Agreement") executed by the Lender and Borrower on (date). In connection with this loan, I/we have examined:

1. The corporate records of Borrower, including its organizational documents.
2. The Loan Agreement between the Lender and Borrower.
3. The Security Agreement executed by Borrower on (date).
4. The Guaranty (where applicable) executed on (date) by (personal guarantors).
5. Financing Statements executed by Borrower and the Lender.
6. Real Estate Mortgages dated (date) and executed by Borrower in favor of the Lender.
7. Real Estate Mortgages dated (date) and/or other security documents dated (date) executed by (personal guarantors) in favor of the Bank.
8. The appropriate title and/or lien searches relating to Borrower's property.
9. The pledge of stock and instruments related thereto.
10. Such other materials, including relevant provisions of the laws of this state as I/we have deemed pertinent as a basis for rendering the opinion hereafter set forth.

IN SOME CIRCUMSTANCES

11. Lease(s) between Borrower and     (lessor's name)     for the rental of     (property being rented)    , (if real property, give the address of the premises; if machinery equipment, etc., give brief, precise description of property for a     (length of lease)     term commencing on     (date)    ).

Based on the foregoing examinations, I am/we are of the opinion and advise you that:

1. Borrower is a duly organized                                      in good standing under the laws of the Commonwealth/State of     (State)    .
  2. Borrower has the necessary                                      power to authorize and has taken the necessary corporate action to authorize the Regulatory Agreement and to execute and deliver the Note, Security Agreement, Financing Statement, and Mortgage. Said instruments hereinafter collectively referred to as the "Loan Instruments."
  3. The Loan Instruments were all duly authorized, executed, and delivered and constitute the valid and legally binding obligation of the Borrower and collectively create a valid (first) lien upon or valid security interest in favor of the Lender, in the security covered thereby, and are enforceable in accordance with their 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. The restrictive-use provisions will be contained in the mortgage or deed of trust and the regulatory agreement signed by the borrower.
  4. The execution and delivery of the Loan Instruments and compliance with the provisions thereof under the circumstances contemplated thereby did not, do not and will not in any material respect conflict with, constitute default under, or contravene any contract or agreement or other instrument to which the Borrower is a Party or any existing law, regulation, court order, or consent decree or device to which the Borrower is subject.
  5. All applicable Federal, State and local tax returns and reports as required have been duly filed by Borrower and all Federal, State and local taxes, assessments and other governmental charges imposed upon Borrower or its respective assets, which are due and payable, have been paid.
  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.
-

## ATTACHMENT 4-C

### **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-B. 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 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-B);
- (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.

The Office of the General Counsel 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. The Office of the General Counsel at his/her option may attend the loan closing.



## 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.

#### Exhibit 5-1

#### Grrhp construction loan requirements

Construction loan closing

Pre-Construction Conference (Section 1)

Construction Begins

Draw Request

Inspection of Work Completed

Release of Funds

Request for a Modification of the  
Guarantee (Section 4)

Permanent Loan Closing

## **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. The construction when there is no guarantee requested for the construction loan must meet the state standards and will be discussed in full detail with Agency prior to the issuance of the guarantee. 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 manner. When the project is built the Agency should be able to access 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 on construction-permanent loans.



**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><b>Construction Requirements</b></p> <p>The construction requirements cover the following topics:</p> <ul style="list-style-type: none"> <li>• Contractor experience and capacity;</li> <li>• Debarment and suspension;</li> <li>• Architectural Services;</li> <li>• Plans, specifications and cost estimates;</li> <li>• Environmental requirements;</li> <li>• Construction;</li> <li>• Inspections; and</li> <li>• Warranty</li> </ul>
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**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. *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 (including a review of life cycle cost analyses, as discussed in Paragraph 5.9), 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 Exhibit 5-2.

### **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.

<b>Exhibit 5-2</b>		
<b>Construction Documents That Must Be Submitted for Any Loan Guarantee</b>		
<b>Document</b>	<b>When to Submit</b>	<b>Reference</b>
Preliminary plans, specs, and cost estimates	As soon as practicable	Paragraph 5.7
Final plans, specs, and cost estimates, and Plan Certification	Prior to issuance of construction loan guarantee	Paragraph 5.7
Deviations from approved plans and specifications	Final as built plans, after construction complete, prior to final contract of guarantee	Paragraph 5.10
Certification that basic construction requirements have been met	Prior to issuance of construction loan guarantee	Paragraph 5.12

**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." Life cycle cost analyses must be employed to compare materials and systems and determine which are most economical, considering the sum of all costs: initial, operation, and maintenance. In the case of minor cost items, the Agency may waive the life cycle cost analysis. An example of a life cycle cost analysis is provided in Exhibit 5-3.



## 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 either 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.



**Exhibit 5-3**

**Example of Life Cycle Cost Analysis**

Life cycle cost analyses will be reviewed by the Agency and will be used in the Agency's decision-making process.

The key to life cycle cost analysis is to calculate the present value of all current and estimated future costs associated with an item. Those costs can then be compared with the life cycle costs of alternative items to determine which would be most economical over time.

Calculating the present value to all current and estimated future costs is done by multiplying each year's estimated cost by a present value factor (PVF), which is represented by the formula  $[1/(1+I)]^N$ . "I" equals the discount rate and "N" equals the number of years in which costs will occur.

The following is an example of the costs for an electric water heater. These costs can be compared, for example, with the life cycle costs of a gas water heater.

Initial Installation Cost:	\$450
Operation Cost per Year:	\$120
Maintenance Cost (every 5 yrs.)	\$100
Life Expectancy:	14 years
Discount Rate:	5%

Year	Annual Cost	PVF	Present Value
Initial Cost	450.00	1.0000	450.00
1	120.00	0.9542	114.29
2	120.00	0.9070	108.84
3	120.00	0.8638	103.66
4	120.00	0.8227	98.72
5	220.00	0.7835	172.37
6	120.00	0.7462	89.55
7	120.00	0.7107	85.28
8	120.00	0.6768	81.22
9	120.00	0.6446	77.35
10	220.00	0.6139	135.06
11	120.00	0.5847	70.16
12	120.00	0.5568	66.82
13	120.00	0.5303	63.64
14	120.00	0.5051	60.61
<b>TOTAL</b>			<b>1,781.50</b>

- 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.

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.

<b>Exhibit 5-4</b>		
<b>Documents That Must Be Submitted for Guarantees of Construction Advances</b>		
<b>Document</b>	<b>When to Submit</b>	<b>Reference</b>
Construction change order	Before related work begins or costs are included in a payment request	Paragraph 5.18
Lender-approved payment estimates and related inspection reports	As soon as possible following payment, but prior to approval of subsequent payment	Paragraph 5.20
Final cost certification	Before final payment to contractor	Paragraph 5.21
Certification that additional construction requirements have been met	Prior to issuance of permanent loan guarantee	Paragraph 5.22
Form 1980-41	Monthly	Paragraph 5.20

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.

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.

**5.12 CONSTRUCTION REQUIREMENTS CERTIFICATION**

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

**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 work-in-place, or up to 90 percent of the amounts actually advanced by the lender, whichever is less. 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
Cost of work-in-place	=	\$60,000
Guarantee (\$60,000 x 90%)	=	\$54,000
First plus second loan advances	=	\$150,000
Cost of work-In-place	=	\$155,000
Guarantee (\$150,000 x 90%)	=	\$139,500

The Agency will convert the guarantee on the construction advance to a guarantee on the permanent loan once the underwriting and rent-up assumptions in the project pro forma have been met for a period of 90 consecutive days, or an escrow has been established in an amount that will equal pro forma rental income when combined with actual receipts from project operations. Proforma rental income may not be achieved through use of short-term leases or any type of rental concessions.



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

- Surety bonding or performance and payment bonding; or
- An irrevocable letter of credit acceptable to the Agency; or
- 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 the amount of the construction contract and must remain in effect until the date of final acceptance of work by the owner and the lender. 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 up to 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 5-5 for credit quality requirements) and be for 100 percent of the original principal amount of the combination loan.

<b>Exhibit 5-5</b>		
<b>Credit Quality Requirements for Letters of Credit</b>		
<b>Rating Agency</b>	<b>Type of Collateral</b>	<b>Rating</b>
Thomson’s Bankwatch	N/A	“B” or better
S&P	Long term senior debt, if rated, or long-term bank deposit	“A” or better
Moody’s	Long term senior debt, if rated, or long-term bank deposit	“A” or better

Further requirements for letters of credit include:

- 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 Rural Housing Service (RHS), USDA, must be named as the sole beneficiary.
- The term must be a minimum of one year or date of final acceptance of work.
- The form of the letter of credit and the sight draft must be reviewed and approved by the Agency.

**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 available upon request from the AIA. 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 substantial completion.

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 and that affect design, costs, or time must be documented as a contract change order, including the provision of financial assistance in connection with a change order, does not require the preparation ...etc. Changes that do not affect design, cost, or time are deemed minor and must be documented as field orders by the architect. 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.

### **5.19 MODIFICATION OF MAXIMUM AMOUNT GUARANTEED DURING CONSTRUCTION**

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.

**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. 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 Exhibit 5-4.

Exhibit 5-6 shows the notifications to the Agency required during the construction guarantee period.

<b>Exhibit 5-6</b>		
<b>Notifications Required During the Construction Guarantee Period</b>		
<b>Notification</b>	<b>When to Notify</b>	<b>Reference</b>
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.

- 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 this section, the lender must include a signed form certifying that each requirement has been met prior to the Agency issuance of a loan guarantee.

## **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 work in place. 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.

## 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 the fees should be collected and who is responsible for submitting the payment. Exhibit 6-1 provides an overview of each fee discussed in this chapter. None of the fees are refundable.

Fees are to be submitted to the multifamily housing staff in the State Office in which the project is located. The State Office staff will process the fee including a description of the reason for the fee, and forward it to the National Finance Office.

Thirty days prior to the due date of the fee the Finance Office will mail a reminder to the lender. If the renewal fee is not received by the due date, the guarantee will terminate.

<b>Exhibit 6-1</b>				
<b>Loan Guarantee Fees</b>				
<b>FEE</b>	<b>SUBMISSION</b>	<b>AMOUNT</b>	<b>EXAMPLE</b>	<b>TOTAL</b>
Guarantee Fee	When the loan guarantee is issued	1% of total guarantee amount x % guarantee	\$1,000,000 X .01 X 0.90 =	\$9,000
Annual Fee	This fee will be collected on January 1 of each calendar year	0.5% of the outstanding principal, and interest of the loan	\$1,000,000 X .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 of the 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 amount is the product of the percentage of the guarantee times the initial principal amount of the guaranteed loan.



The fee must be paid at the time the Agency issues a conditional commitment.

### B. Annual Fee

The annual fee is the amount that the lender must pay each year that the guarantee remains in effect. The lender will pay the annual fee of 0.5 percent 50 basis points of the outstanding principal and interest balance of the guaranteed portion of the loan on January 1 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 the time in which the 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 the 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 their 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 or Freddie Mac 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 Recommended Replacement Reserve Levels***

Required deposits to a replacement reserve account should be determined by the lender through a life cycle cost analysis and 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. 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. Any drop below that level, once it is reached, 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 and Freddie Mac 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 7.10 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;"><b>Exhibit 7-1</b></p> <p style="text-align: center;"><b>Examples of Reasons for Denial of a Year-End Surplus Cash Distribution</b></p> <ul style="list-style-type: none"><li>• Fair Housing violations</li><li>• Violations of State or local law</li><li>• Underfunded reserve accounts</li><li>• Failure to submit a budget or other reporting requirements to the lender in a timely manner</li><li>• Failure to properly maintain the property</li><li>• Failure to comply with the mortgage documents or regulatory agreement</li></ul>
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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 Agency in accordance with Paragraph 7.10 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**

**1<sup>st</sup> of the month** – The mortgage payment is due.

**15<sup>th</sup> 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 Agency by the end of the second month (60 days from the date of default).



Agency no later than 60 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><b>Approval of Ownership Changes</b></p> <ul style="list-style-type: none"><li>• The <b>lender</b> must approve all changes in general or limited partners, or a change that requires a modification to the title.</li><li>• The <b>Agency</b> must approve all transfers of the entire ownership entity.</li></ul>
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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 fundings.

## SECTION 3: ASSET MANAGEMENT

### 7.9 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.

### 7.10 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 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 lender may use the Freddie Mac *Form 506*, its current replacement, or an equivalent, and must highlight information on the following items:



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

**Exhibit 7-3**

**Classification System of RHS Projects**

**Class A**

No specific problems with project.

**Class B**

Approved workout agreement in place and on schedule.

**Class C**

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.

**Class D**

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.


- 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.

**7.11 COMPLETING THE LIFE CYCLE COST ANALYSIS AND RESERVE ANALYSIS**

The purpose of the life cycle cost analysis 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 Life Cycle Cost Analysis**

A life cycle cost analysis must be completed during the underwriting of the project 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 life cycle analysis to determine adjustments to the reserve level requirements 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 life cycle analysis 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.

## **7.12 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 7.12 A.3., to report them to the Agency.

#### ***3. Responding to Deficiencies***

Lenders may allow borrowers 90 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 Life Cycle Cost Analysis review process detailed in Paragraph 7.11 is no longer working. The Capital Improvement Plan (CIP) would then serve as the life cycle analysis 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.

**7.13 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. 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.

## 7.14 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 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**

### **7.15 OVERVIEW**

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

## 7.16 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



#### 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.)

regulatory agreement.

Once the lender has submitted the workout plan 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.

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**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.

**7.17 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.



HB-1-3565

Revised (10-19-01) SPECIAL PN

### **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 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.

## **7.18 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 Agency 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 Agency 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 Agency 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.

**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

- 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

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.

**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.

## **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/eplsl/> 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 rectification of tenant income is not required under the GRRHP, however, documentation of statutory compliance and information needed to fulfill fair housing reporting requirements will be required (as discussed in paragraph 8.12 D.). 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 (as discussed in Paragraph 8.12.B.).

**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<sup>th</sup> 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<sup>th</sup> 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] 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.

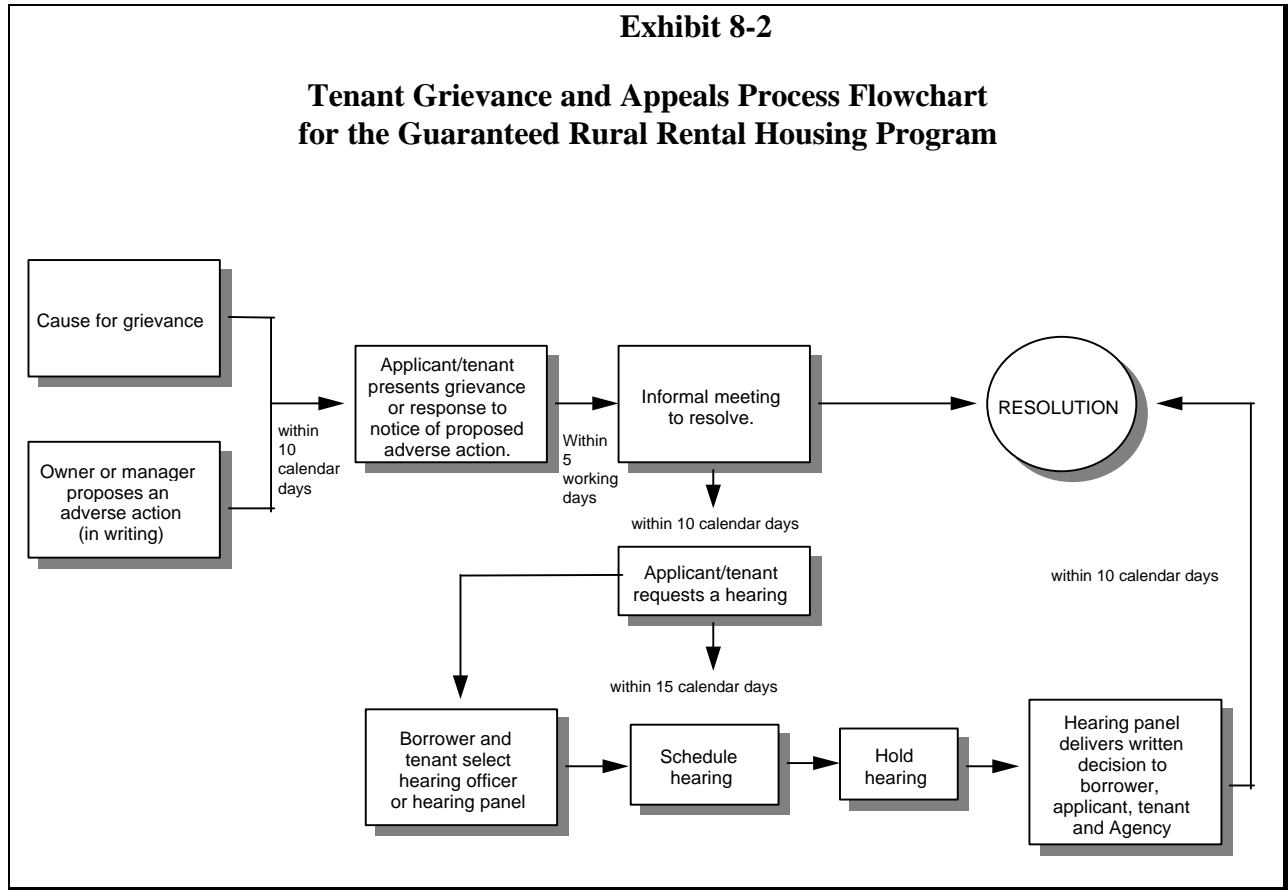
When there is a grievance, it is important to determine whether the grievance is appropriate for the Agency’s grievance process. Often the grievance is more properly addressed in other venues, such as a civil court in the case of personal disputes between tenants, or by the Secretary of HUD or the Secretary 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.

<b>Exhibit 8-1</b>	
<b>Tenant Grievances – Allowable Circumstances</b>	
<b><i>A complaint may not be filed if:</i></b>	<b><i>A complaint may be filed if:</i></b>
<ul style="list-style-type: none"> <li>• There is a proposed rent change that is authorized by the Agency.</li> <li>• 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.</li> <li>• A project has formed a tenants’ association and all parties involved have agreed to use this association as a method of settling grievances.</li> <li>• There are changes in the rules that are required by the Agency and proper notice has been given.</li> <li>• The tenant is in violation of the lease and those violations result in termination of tenancy.</li> <li>• Disputes between tenants that do not involve the borrower or management agent.</li> <li>• The grievance is related to displacement or other effects as a result of Agency-approved prepayment of a guaranteed loan.</li> </ul>	<ul style="list-style-type: none"> <li>• There is a modification of the lease; change in the rules; or changes in the rent that are not authorized by the Agency.</li> <li>• The borrower or management agent fails to maintain the property in a manner that is decent, safe, and sanitary.</li> </ul>

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.



**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:

<b>Examples of Unit Features That May Be Modified to Accommodate Tenants</b>
<ul style="list-style-type: none"><li>• Doorknobs/handles</li><li>• Bathroom fixtures</li><li>• Light switches</li><li>• Appliance handles/knobs</li><li>• The size of doorways</li></ul>

- 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.

## 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.
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## 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 cannot 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.

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## 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 or Freddie Mac.

#### 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 or Freddie Mac. 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 MORTGAGES 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 WORKERS 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**

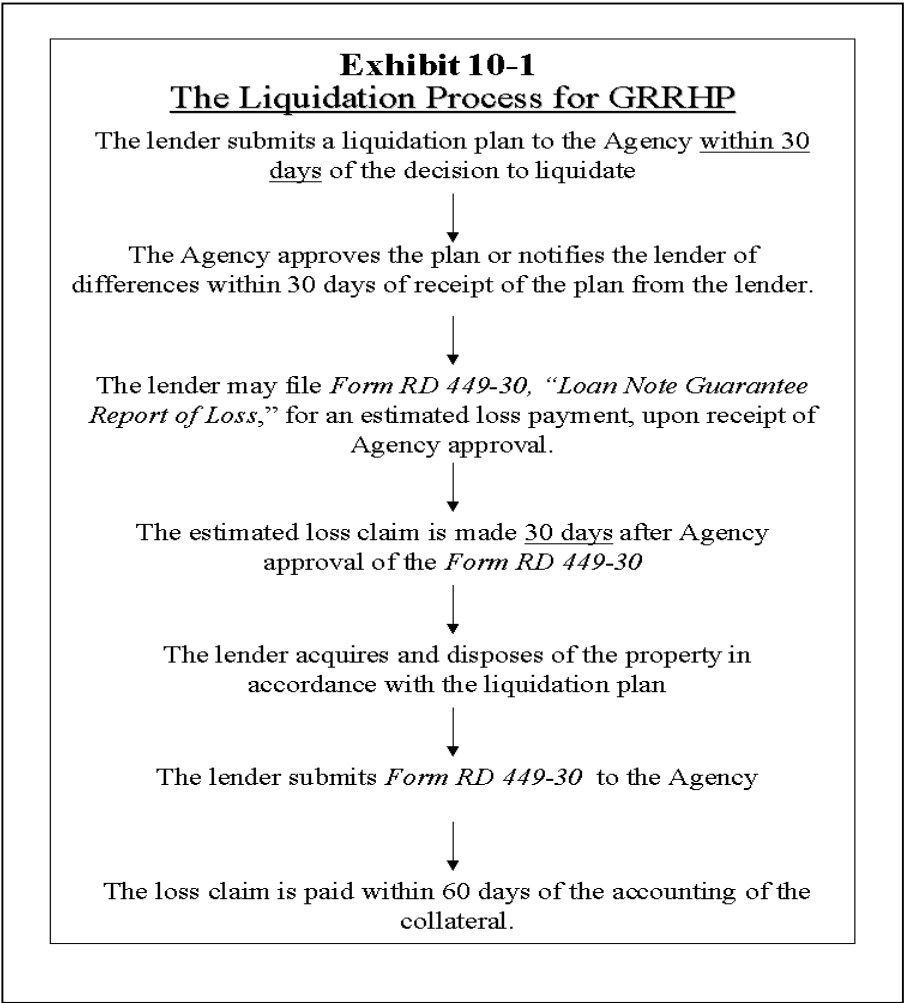
A hazard or property insurance provider needs to meet one of the acceptable rating categories established by one of the rating agencies approved by Fannie Mae or Freddie Mac.

# 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



## **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 at 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 exist:

- A loan has been delinquent for 90 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
- Complete the entire liquidation process within 9 months of the liquidation decision (see Paragraph 10.5).

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 notice to Agency, the lender must submit in writing its proposed method of liquidation. Upon approval by the Agency, the lender will commence liquidation.



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, if available, reflecting 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. This date must be within 9 months of the date of decision to liquidate, unless the Agency approves an alternate date due to special circumstances.
- Steps to be taken to preserve the collateral.
- 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 along with justification for each expense.
- A schedule of reports to be provided to the Agency on the progress of liquidation.
- An estimate and justification of protective advances.
- Proposed protective bid amounts on the security property 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.
- Any relevant legal opinions, including, for example, opinions on environmental issues, title search, and bankruptcy.





## **10.6 APPROVAL OF LIQUIDATION PLAN**

In most cases, the Agency will accept or reject the lender's liquidation plan within 30 days after receipt. If the Agency needs additional time to respond to a liquidation plan, it will advise the lender of a definite time for such response. 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 may request an estimated loss payment by submitting to the Agency an estimate of the loss that is expected to occur in connection with liquidation of the loan. 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, Loan Note Guarantee Report of Loss*, using the basic loss formula as provided on the report. A copy of the approved liquidation plan must be attached to the form. The loss claim will be promptly processed. Payment of the estimated loss amount will be made to the lender approximately 30 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**

## HB-1-3565

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 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. Modification of this date will be subject to Agency approval. Failure to inform the Agency of the unforeseen circumstance could result in the denial of payments to the lender under the guarantee. Liquidation must be completed within 9 months of the date of decision to liquidate [7 CFR Part 3565, subpart J], unless otherwise approved by the Agency due to circumstances beyond the lenders control.



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 1944, subpart L 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 lender liquidation will occur in almost every case, the Agency reserves the right to require the lender to assign the loan or convey the property 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 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 figures on *Form RD 449-30* must be calculated based on the date of loss as explained in Paragraph 10.16 A.

**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 *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.



HB-1-3565

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 days of liquidation of the property, the lender must submit a report of final loss to the Agency using *Form RD 449-30, Loan Note Guarantee Report of Loss*.

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, plus interest at the note rate from the date of payment, 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, as provided in the Agency-approved 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 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.

<b>Exhibit 11-1</b>	
<b>Major Protected Resources</b>	
Wetlands	Natural Landmarks
Floodplains	Important Farmland
Wilderness Areas	Prime Forestland
Wild and Scenic Rivers	Pine Rangeland
Historical and Archeological Sites	Coastal Zone Management Area
Critical Habitat or Endangered or Threatened Species	Sole Source Aquifer Recharge Area
Coastal Barriers	State Water Quality Standards

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 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.

### **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 Exclusion* 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 ORIGINATION**

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.



## 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. 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 this 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.

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 of the guarantee. A lender or other party possessing a right to the benefits payable under the guarantee agreement.

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 applicable Federal rate (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.

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 loan that becomes effective upon Agency acceptance of a lender certification of an acceptable minimum level of occupancy.

Prepayment. The payment of the outstanding balance on a loan prior to the note's original 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 with Regulatory agreement.

Program requirements. Any requirements set forth in any pertinent loan document, guarantee agreement, statute, regulation, handbook, or administrative notice.

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 lender. A lender or other entity approved to service a permanent guaranteed loan.

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 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.

Appendix 1  
7 CFR PART 3565--Guaranteed Rural Rental Housing Program

TABLE OF CONTENTS

Sec.

Subpart A--General Provisions

- 3565.1 Purpose.
- 3565.2 Applicability and authority.
- 3565.3 Definitions.
- 3565.4 Availability of assistance.
- 3565.5 Ranking and selection criteria.
- 3565.6 Inclusion of tax-exempt debt.
- 3565.7 Agency environmental requirements.
- 3565.8 Civil rights compliance.
- 3565.9 Compliance with federal requirements.
- 3565.10 Conflict of interest.
- 3565.11-3565.12 [Reserved]
- 3565.13 Exception authority.
- 3565.14 Review and appeals.
- 3565.15 Oversight and monitoring.
- 3565.16 [Reserved]
- 3565.17 Demonstration programs.
- 3565.18-3565.49 [Reserved]
- 3565.50 OMB control number.

Subpart B--Guarantee Requirements

- 3565.51 Eligible loans and advances.
- 3565.52 Extent of the guarantee.
- 3565.53 Guarantee fees.
- 3565.54 Transferability of the guarantee.
- 3565.55 Participation loans.
- 3565.56 Suspension or termination of loan guarantee agreement.
- 3565.57 Modification, extension, reinstatement of loan guarantee.
- 3565.58-3565.99 [Reserved]
- 3565.100 OMB control number.

7 CFR Part 3565  
Table of Contents

Sec.

Subpart C--Lender Requirements

- 3565.101 Responsibility of lenders.
- 3565.102 Lender eligibility.
- 3565.103 Approval requirements.
- 3565.104 Application requirements.
- 3565.105 Lender compliance.
- 3565.106 Construction lender requirements.
- 3565.107 [Reserved]
- 3565.108 Responsibility for actions of agents and mortgage brokers.
- 3565.109 Minimum loan prohibition.
- 3565.110 Insolvency of lender.
- 3565.111 Lobbying activities.
- 3565.112-3565.149 [Reserved]
- 3565.150 OMB control number.

Subpart D--Borrower Eligibility Requirements

- 3565.151 Eligible borrowers.
- 3565.152 Control of land.
- 3565.153 Experience and capacity of borrower.
- 3565.154 Previous participation in state and federal programs.
- 3565.155 Identity of interest.
- 3565.156 Certification of compliance with federal, state, and local laws and with Agency requirements.
- 3565.157-3565.199 [Reserved]
- 3565.200 OMB control number.

Subpart E--Loan Requirements

- 3565.201 General.
- 3565.202 Tenant eligibility.
- 3565.203 Restrictions on rents.
- 3565.204 Maximum loan amount.
- 3565.205 Eligible uses of loan proceeds.
- 3565.206 Ineligible uses of loan proceeds.
- 3565.207 Form of lien.
- 3565.208 Maximum loan term.
- 3565.209 Loan amortization.



Sec.

Subpart E--Loan Requirements

3565.210 Maximum interest rate.  
3565.211 Interest credit.  
3565.212 Multiple guaranteed loans.  
3565.213 Geographic distribution.  
3565.214 [Reserved]  
3565.215 Special conditions.  
3565.216-3565.249 [Reserved]  
3565.250 OMB control number.

Subpart F--Property Requirements

3565.251 Eligible property.  
3565.252 Housing types.  
3565.253 Form of ownership.  
3565.254 Property standards.  
3565.255 Environmental requirements.  
3565.256 Architectural services.  
3565.257 Procurement actions.  
3565.258-3565.299 [Reserved]  
3565.300 OMB control number.

Subpart G--Processing Requirements

3565.301 Loan standards.  
3565.302 Allowable fees.  
3565.303 Issuance of loan guarantee.  
3565.304 Lender loan processing responsibilities.  
3565.305 Mortgage and closing requirements.  
3565.306-3565.349 [Reserved]  
3565.350 OMB control number.

7 CFR Part 3565  
Table of Contents

Sec.

Subpart H--Project Management

3565.351 Project management.  
3565.352 Preservation of affordable housing.  
3565.353 Affirmative fair housing marketing.  
3565.354 Fair housing accommodations.  
3565.355 Changes in ownership.  
3565.356-3565.399 [Reserved]  
3565.400 OMB control number.

Subpart I--Servicing Requirements

3565.401 Servicing objectives.  
3565.402 Servicing responsibilities.  
3565.403 Special servicing.  
3565.404 Transfer of mortgage servicing.  
3565.405-3565.449 [Reserved]  
3565.450 OMB control number.

Subpart J--Assignment, Conveyance, and Claims

3565.451 Preclaim requirements.  
3565.452 Decision to liquidate.  
3565.453 Disposition of the property.  
3565.454 [Reserved]  
3565.455 Alternative disposition methods.  
3565.456 Filing a claim.  
3565.457 Determination of claim amount.  
3565.458 Withdrawal of claim.  
3565.459-3565.499 [Reserved]  
3565.500 OMB control number.

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.

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.

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.

Sec. 3565.3 (Con.)

(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.

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.

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 loan that becomes effective upon Agency acceptance of a lender certification of an acceptable minimum level of occupancy.

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.

Sec. 3565.3 (Con.)

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.

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.

(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.

(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.

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.

Sec. 3565.10 (Con.)

(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 Extent of the guarantee.

A guarantee of a permanent loan will be made once the project has attained a minimum level of acceptable occupancy as determined by the lender with Agency concurrence. The required occupancy level must be reached before the commitment for a loan guarantee, including any extensions, expires. For combination construction and permanent loans, the Agency will guarantee advances during the construction loan period (which can not exceed 24 months). The guarantee of construction loan advances will convert to a permanent loan guarantee once the required level of occupancy has been reached.

## Sec. 3565.52 (Con.)

(a) Maximum guarantee amount. The maximum guarantee for a permanent loan will be 90 percent of the unpaid principal and interest 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 guarantee document. The Agency will guarantee construction contracts not to exceed 90 percent of the work in place which have credit enhancements to protect the Government's guarantee. Acceptable credit enhancements include:

(1) Surety bonding or performance and payment bonding are the preferred credit enhancement;

(2) An irrevocable letter of credit acceptable to the Agency; and

(3) A pledge by the lender of acceptable collateral.

(b) Lesser guarantee amount. The Agency may provide a lesser guarantee based upon its evaluation of the credit quality of the loan.

(c) Cancellation or reduction to the guarantee amount. In cases of fraud, misrepresentation, abuse, negligence, or failure to follow the terms of the guarantee or the note, the Agency may cancel the guarantee.

## 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.

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 guarantee 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 or Freddie Mac to make multifamily housing loans that are to be sold to 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

7 CFR Part 3565  
Sec. 3565.102 (Con.)

(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 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;

(4) A positive record of past performance when participating in RHS or other federal loan programs;



Sec. 3565.103 (Con.)

(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 Sec. Sec. 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.

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:

7 CFR Part 3565  
Sec. 3565.204 (Con.)

(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.

(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;

Sec. 3565.205 (Con.)

- (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;
- (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:

7 CFR Part 3565  
Sec. 3565.205 (Con.)

(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.



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;

(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; and

(d) The loans do not contain tax exempt financing.

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.

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 substantially rehabilitated 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 proposes to guarantee proposals for new construction or acquisition with rehabilitation of at least \$15,000 per unit. The portion of the guaranteed funds for acquisition with rehabilitation is limited to 25 percent of the program authority.

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:

- (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;
- (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.

(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;

7 CFR Part 3565  
Sec. 3565.303 (Con.)

- (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.

(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;

(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.

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) Responsibility of 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.

(b) 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.

(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.

(c) 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.

(d) Displacement prevention. The actions of the lender must not harm the property's tenants through displacement.

Sec. 3565.404 Transfer of 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. 3565.450 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 Sec. 3565.403 of subpart I or it has been determined that it is in the best interest of the Agency and the lender to liquidate.

(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) Liquidation plan. The lender will, within 30 days after a decision to liquidate, submit to the Agency in writing its proposed detailed plan of liquidation. Upon approval by the Agency of the liquidation plan, the lender will proceed to liquidate. At a minimum, this plan must contain the following information:

(1) Such proof as the Agency requires to establish the lender's ownership of the guaranteed loan promissory note and related security instruments and a copy of the payment ledger if available which reflects the current loan balance and accrued interest to date and the method of computing the interest.

(2) A full and complete list of all collateral including any personal and corporate guarantees.

(3) The recommended liquidation methods for making the maximum collection possible on the indebtedness and the justification for such methods, including recommended actions for:

- (i) Acquiring and disposing of all collateral;
- (ii) Collecting from guarantors;
- (iii) Obtaining an appraisal of the collateral;
- (iv) Setting the proposed date of foreclosure; and
- (v) Setting the proposed date of liquidation.

(4) Necessary steps for protection of the tenants and preservation of the collateral.



Sec. 3565.453 (Con.)

(5) Copies of the borrower's latest available financial statements.

(6) Copies of the guarantor's latest available financial statements.

(7) An itemized list of estimated liquidation expenses expected to be incurred along with justification for each expense.

(8) A schedule to periodically report to the Agency on the progress of liquidation. (9) Estimated protective advance amounts with justification.

(b) Filing an estimated loss claim. Upon Agency concurrence in the liquidation plan and when the lender owns any or all of the guaranteed portion of the loan, the Agency may, in accordance with program guidance, pay an estimated loss payment based on an Agency determined percentage of the approved estimate of the loss. The estimated loss payment will be based in the liquidation value of the collateral. If such payment is made, it will be applied to the outstanding principal balance owed on the guaranteed debt. The lender will discontinue interest accrual on the defaulted loan in accordance with Agency procedures.

(c) 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 contained in 7 CFR part 1944, subpart L or successor regulation. This liquidation process must be completed within 9 months from the lender's decision to liquidate, unless otherwise approved by the Agency.

(d) 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.

7 CFR Part 3565  
Sec. 3565.455 (Con.)

(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

(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.

(a) 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.

(b) Date of loss. The date of loss is the earliest of the date on which the property is foreclosed or acquired or the proposed date of foreclosure or acquisition 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.

Sec. 3565.457 (Con.)

(c) 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 on the property;

(iv) Loan guarantee fees paid after default; and

(v) 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.

(d) 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]

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.

## 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 Loan Funds, Guaranteed Loans*  
*Form RD 1940-20, Request for Environmental Information*  
*Form RD 1940-21, Environmental Assessment for Class Action; or Exhibit H, RD Instruction 1940-G, Environmental Assessment for Class II Actions*  
*Form RD 1940-22, Environmental Checklist for Categorical Exclusion*  
*Form RD 1944-8, Rural Housing Service Tenant Certification*  
*Form RD 1944-30, Identify of Interest (IOI) Disclosure Certificate*  
*Form RD 1944-31, Identity of Interest (IOI) Qualification*  
*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 1980-41, 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 3565-1, Application for Loan and Guarantee*  
*Form RD 3565-2, Conditional Commitment*  
*Form RD 3565-3, Lender's Agreement*  
*Form RD 3565-4, Loan Note Guarantee*  
*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*

*HB-1-3565*

*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*

*Freddie Mac Form 506*