

UNNUMBERED LETTERS ISSUED FOR THE JULY OF 2015

Dated	Subject	Distribution
07-02-15	Management of Rental Assistance	S/D
07-14-15	Guidance on the Use of Section 538 Guaranteed Rural Rental Housing Program with Section 515 Properties	S/D
07-30-15	Guidance on Loan Modifications in the Section 538 Guaranteed Rural Rental Housing Program (GRRHP)	S/D

July 2, 2015

TO: State Directors
Rural Development

FROM: Tony Hernandez /s/ *Tony Hernandez*
Administrator
Housing and Community Facilities Programs

SUBJECT: Management of Rental Assistance

The purpose of this Unnumbered Letter (UL) is to reiterate for Rural Development State Directors and Multi-Family Housing (MFH) program staff about the requirements for management of the Rental Assistance (RA) program. A similar UL was issued in May 2013. RA outlays in Fiscal Year (FY) 2015 are projected to exceed \$1.2 billion. Annual program appropriations are expected to be at a similar level for the foreseeable future. It is, therefore, incumbent upon the Agency to utilize the RA program to its maximum potential Nationwide.

Continuing the procedure outlined in the prior UL, the transfer of all RA must be approved by the National Office prior to the transfer. This includes situations where it is appropriate under the regulations to transfer RA in conjunction with new construction projects, rehabilitation, ownership transfers, equity loans, Multifamily Preservation and Restructuring (MPR) demonstration program transactions or temporarily transfer RA due to natural disasters such as fire at a project. The National Office intends to recover unliquidated RA units in accordance with 7 CFR §3560.259 and any transfer of RA will be done from the National Office level. The unliquidated balances remaining on RA units available for transfer pursuant to 7 CFR §3560.259 may be used for RA contract renewals in the current FY.

MFH had previously established the policy of prior National Office approval for the transfer of RA units from properties where the Agency mortgage was paid off before the natural maturity date, due to prepayment or foreclosure. Prior National Office approval is also required for actions under 7 CFR Section 3560.259(c), which provides a 4-month period in which a tenant receiving RA may move to another Rural Development property, with the RA, in cases of prepayment, disaster, and foreclosure.

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RA will be recovered by the National Office in the situations provided for in 7 CFR §3560.259. Please note for Section 515 properties, MFH will follow the guidance established in 7 CFR §3560.259(a)(4).

For Section 514 properties, where RA has been unused for 12 months or more, actions will be taken in accordance with the Consolidated and Further continuing Appropriations Act, 2015, 2014, Public Law 113-235 (December 16, 2014). The language is as follows:

Provided further, That Rental Assistance provided under agreements entered into prior to fiscal year 2015 for a Farm-Labor Multi-Family Housing project financed under Section 514 or Section 516 of the Act may not be recaptured for use in another project until such assistance has remained unused for a period of 12 consecutive months, if such project has a waiting list of tenants seeking such assistance or the project has Rental Assistance eligible tenants who are not receiving such assistance: Provided further, That such recaptured Rental Assistance shall, to the extent practicable, be applied to another Farm-Labor Multi-Family Housing project financed under Section 514 or Section 516 of the Act.

For Section 514 properties, if such recaptured RA cannot be transferred to another Farm-Labor Housing property, the National Office intends to recover the RA units.

Determinations regarding the availability and transfer of unused RA will be made by the National Office through use of the MFIS Report PRJS 4200 “Occupancy Trend”. This report identifies unused RA units as of the first day of the month. *State Offices should pay particular attention to those situations where unused RA units are in turnover status (i.e. one tenant has left and another one will soon move in).* It is important for State Officials to identify turnover units as these will not be recovered if they are to be assigned to another tenant in the same property imminently. The National Office intends to recover all eligible unused RA on a semi-annual basis and will advise State Officials, who must prepare Form RD 3560-55, “*MFH Transfer of RA*”, as directed. Unused RA will be aggregated and distributed for RA contract renewal purposes Nationwide.

When legal action or a National Appeals Division (NAD) appeal is involved, unused RA units will be swept only after the legal action [in the case of acceleration or foreclosure] is completed, or NAD makes a final determination on any RA units in an appeal. Unused RA units associated with a property undergoing rehabilitation will be allowed to remain at the property; the property’s unused RA will not be evaluated for recovery until at least six months after the rehabilitation is complete.

The management of unused RA is established in MFH's Handbook, HB-2-3560, Chapter 9, section 9.15 "Unused Rental Assistance". As a reminder, Attachment 9-B, of HB-2-3560, "Report of Status of Unused RA Units" should be completed on the SharePoint website. The next report is due November 1, 2015.

If you have any questions regarding this UL, please contact Stephanie White, Director of the Multi-Family Housing Portfolio Management Division, at (202) 720-1615.

July 14, 2015

TO: State Directors
Rural Development

ATTN: Program Directors
Multi-Family Housing

FROM: Tony Hernandez /s/ *Tony Hernandez*
Administrator
Housing and Community Facilities Programs

SUBJECT: Guidance on the Use of Section 538 Guaranteed Rural Rental Housing
Program with Section 515 Properties

The intent of this Unnumbered Letter (UL) is to clarify issues concerning the use of Section 538 loan guarantees in transactions involving the revitalization and preservation efforts of existing affordable housing properties financed with Section 515 direct loans. It is written for the sole use of the Rural Development State Office staff and area offices involved in processing Section 538 guaranteed loan applications received in conjunction with existing Section 515 property transfers and MPR.

The use of the Section 538 program enhances Rural Development's capacity to attract private capital to support the revitalization of the Section 515 portfolio. The Section 515 Rural Rental Housing program and the Section 538 Guaranteed Rural Rental Housing program have different regulatory frameworks. This UL intends to reconcile the procedural differences between the two programs.

The attachment to this UL is titled "SECTION 538/515 PROGRAM REQUIREMENTS MATRIX". Column A contains several program requirements that are addressed in this UL. Column B contains an overview of the program requirement from the Section 538 perspective. Column C contains an overview of the program requirement from the Section 515 perspective. It should be noted that both Column B and Column C are only summary statements. Reviewers should rely on the respective regulations and handbooks for each program for detailed program

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guidance. Column D outlines the program requirements Rural Development staff should utilize for each program requirement contained in Column A. The guidance provided generally directs the user to utilize the most restrictive guidance from either the Section 538 or the Section 515 program.

If you have any questions regarding this UL, please contact Tammy S. Daniels of the Multi-Family Housing Guaranteed Loan Division at (202) 720-0021 or tammy.daniels@wdc.usda.gov.

Attachments

COLUMN A Program Requirements	COLUMN B Section 538 Requirements	COLUMN C Section 515 Requirements	COLUMN D Sections 538/515 Projects Recommended Approach
1. Equity Contribution	<p>For-profit – the greatest of 10% of the Total Development Cost (TDC) or of the appraised value.</p> <p>Non-Profit – the greatest of 3% of the TDC or of the appraised value.</p> <p>Cash or/and land value meet the equity requirement (other Agency approved sources may be considered).</p>	<p>For-profit – 3% of the Agency loan not receiving LIHTC For-profit – 5% of the Agency loan if receiving LIHTC</p> <p>Non-Profit - 0%; can loan 100%.</p> <p>Not required for properties in the MPR using MPR tools, however still required for MPR properties using Section 515 loan funds.</p>	<p>Prior to the issuance of the Agency’s Conditional Commitment, the lender certifies in its application that Section 538 program’s equity requirements were met and Agency personnel verify lender’s calculations. Prior to the issuance of a permanent guarantee, an appraisal (unless waived) of the project once construction is completed must confirm the borrower’s equity contribution certification.</p>
2. Lease-Up Reserve	<p>Lease-up reserve in lieu of 90/90</p> <ul style="list-style-type: none"> • Required only if the permanent guarantee is to be issued prior to achievement of 90% occupancy for 90 continuous days in the 120-day period immediately prior to the issuance of the permanent guarantee. • Lender and/or developer must elect to use a lease-up reserve prior to the start of construction. • Borrower funded with a non-mortgageable cash contribution. • Reserve must be fully funded prior to issuance of permanent guarantee. • For Option 3 Continuous Guarantees, the lease-up reserve is fully funded on or before the issuance of the guarantee. • Reserve must be at least 2% of the greater of appraised value or TDC. <p>Unused funds are transferred to the Section 538 O&M reserve account and may be returned to the borrower as a cash distribution at the end of the year and if the requirements of HB-1-3565, Paragraph 7.7 E have been met.</p>	<p>No published standard: Discuss individual transactions with a National Office Review Underwriter.</p>	<p>When the lender and/or developer opt to use the lease-up reserve in lieu of the 90/90 requirement, the lease up reserve will be managed pursuant to Section 538 requirements. The lender will control the account and its distributions.</p> <p>If the lender, borrower and Agency choose not to fund a lease-up reserve during the construction period, documentation for the basis of the decision must be in the file. There must be evidence that the project will not expect to lose tenants due to displacement or due to increased rents.</p> <p>If a Section 538 lease up reserve is not used, the project must meet the 90/90 test in the 120-day period immediately prior to the issuance of the permanent guarantee.</p> <p>Unused funds are transferred to the Section 538 O&M reserve account and may be returned to the borrower as a cash distribution at the end of the year if the requirements of HB-1-3565, Paragraph 7.7 E have been met</p>

COLUMN A Program Requirements	COLUMN B Section 538 Requirements	COLUMN C Section 515 Requirements	COLUMN D Sections 538/515 Projects Recommended Approach
3. Construction Contingency Reserve	<ul style="list-style-type: none"> At least 2% of total construction costs. Borrower funds reserve with a non-mortgagable cash contribution. The lender may release unused construction contingency reserves to the borrower anytime after completion of construction and achievement of the 90/90 test. All other reserve accounts must be fully funded prior to the release of any unused construction contingency funds. May accept letter of credit (LOC) in lieu of cash. 	<ul style="list-style-type: none"> 7% -10% and may be funded with Section 515/MPR funds or other third-party financing as authorized in the transfer approval. Upon final inspection and acceptance by Rural Development any remaining unused funds will be deposited into project's Rural Development capital reserve account. 	<p>For projects using the Section 538 construction guarantee, Section 538 requirements apply.</p> <p>State Offices must approve all change orders for Sections 515/538 construction contracts.</p>
4. Occupancy & Rent Restrictions	<ul style="list-style-type: none"> At initial occupancy, tenancy restricted to individuals and families whose incomes do not exceed 115% of area median income. 	<ul style="list-style-type: none"> At initial occupancy, and at least annually, must qualify as a very low- low or moderate income household meeting Rural Development definitions. Rural Development Section 515 rent levels must reflect realistic operating and maintenance expenses and expectations in accordance with Section 515 program policy. Overly optimistic or unjustifiable expenses will be rejected under Section 515 underwriting principles. 	<p>The most restrictive occupancy and rent restrictions (typically Section 515) will be used.</p> <p>In the event that Section 515 income requirements and/or rent levels exceed the Section 538 levels, the State Office will refer the matter to the National Office for resolution.</p>
5. Operating Costs and Rent Levels	<ul style="list-style-type: none"> Operating costs and rent levels must be adequate to meet program and NOFA requirements on a sustainable basis in the budget analysis. 	<ul style="list-style-type: none"> Rural Development Section 515 rent levels must reflect realistic operating and maintenance expenses and expectations in accordance with Section 515 program policy. Overly optimistic or unjustifiable expenses will be rejected under Section 515 underwriting principles. Projects must be sustainable and will be underwritten with expenses, costs and incomes that can typically be supported in the market area. 	<p>Underwriters will review both Section 538 and Section 515 anticipated income and expense projects to reconcile the operating projections. If LIHTCs are also included, such projections will also be considered in determining feasibility projections and sustainability determinations.</p>
	<ul style="list-style-type: none"> At rent up and on a continuing basis, rents including tenant utility allowances may not exceed 30 percent of 115 percent of area median income adjusted for family size. Average rent for all units in a project cannot exceed 30% of 100% of area median income adjusted for family size. 	<ul style="list-style-type: none"> At approval of new loans and servicing actions, transfers, prepayments, etc., rents cannot exceed the Conventional Rents for Comparable Units (CRCU) standard, unless waived by the National Office Ongoing basis, rents remain budget-based. CRCU standard does not apply to annual budget submissions. 	

COLUMN A Program Requirements	COLUMN B Section 538 Requirements	COLUMN C Section 515 Requirements	COLUMN D Sections 538/515 Projects Recommended Approach
6. Construction Monitoring, Inspections, Payouts	<ul style="list-style-type: none"> • New construction, rehabilitation, modular and manufactured structures must meet RD Instruction 1924-A. • Actual work inspected by, or on behalf of, the lender. • Minimum three inspections. • In addition to the three inspections; lender inspections must be done prior to each payment to the contractor. • Lender must coordinate final inspection. • Agency must approve all change orders. 	<ul style="list-style-type: none"> • Agency to inspect all work completed and materials suitably stored on site. • Minimum three inspections at key times • In addition to the three required inspections; Agency encouraged to make monthly inspections if time and resources permit. • Prior Agency concurrence in each pay request and proposed change order. • MPR projects are subject to project-specific requirements under the terms of the MPR Conditional Commitment. • Follow RD Instruction 1924-A requirements 	For Sections 515/538 projects financed with a Section 538 construction guarantee, follow the applicable provisions of HB-1-3565 for construction monitoring. If time and resources permit, State Offices are encouraged to monitor the construction through on-site reviews/inspections. State Office staff should review, but not sign, the contractor's payment requests.
7. Mortgage Terms	Term of not less than 25 years and not more than 40 years.	Third-party loans must: <ul style="list-style-type: none"> • be fully amortized; or • have a maturity date that is after the Rural Development/Section 515 debt matures; or • include a written agreement with third-party lender to extend scheduled maturity through re-amortization or whatever means available to them on terms that do not require rents to exceed CRCU. 	In Section 515 transactions the Section 538 loan term must exceed the term of the Section 515 subordinate financing. The minimum term of the Section 538 loan will be 25 years or the term of the Section 515 subordinate debt whichever is greater. The maximum term of the Section 538 loan is 40 years.
8. Debt Service Coverage Ratio (DSCR)	Requires DSC of at least 1.15 unless Agency approves lower DSCR.	No published standard: Discuss individual transactions with a National Office Review Underwriter.	All transactions will be underwritten with a minimum DSCR of 1.15 or the Agency approved DSCR, whichever is higher. The combined DSCR for the 538 and the 515 debt will be at least 1.0 every year. Rents that exceed CRCU to achieve the 1.15 DSCR, must have a National Office waiver.
9. Interest Credit	If available, generally limited as to basis points and loan amount.	Reduction in the effective interest rate for the Agency's entire loan down as low as 1% with Interest Credit Agreement.	Interest credit eligibility, availability and limitations for Sections 515/538 transactions will be published in the annual NOFA.

COLUMN A Program Requirements	COLUMN B Section 538 Requirements	COLUMN C Section 515 Requirements	COLUMN D Sections 538/515 Projects Recommended Approach
10. O&M Reserve/ Initial Operating Capital (IOC)	<p>O&M Reserve</p> <ul style="list-style-type: none"> All borrowers must contribute from their own resources at least 2% of the loan amount. Funds may be provided in cash or LOC. For Options 1 and 2 Guarantees, the O&M Reserve is funded on or before the closing of the permanent loan. For Option 3 Continuous Guarantee, the O&M Reserve is funded no later than 30 days before the issuance of the first certificate of occupancy is anticipated. 	<p>Initial Operating Capital</p> <p>To provide a source of capital for start-up costs, such as the purchase of equipment, and paying operating, maintenance, and debt service expenses. Borrowers are required to make an initial operating capital contribution to the general operating account as described in §3560.64.</p>	<p>O&M Reserve for a Guaranteed Loan is not required when State Office MFH staff concurs that the Section 515 General Operating Account (GOA) is sufficient to cover projected expenses.</p> <p>When Section 538 O&M Reserve is required (i.e. when the Section 515 GOA is not sufficient to cover projected expenses) the O&M will be managed in accordance with Section 538 requirements. The Section 538 lender will control the account and its distributions.</p>
11. Credit Enhancements During Construction	<p>Per 3565.303 (c) (2) acceptable credit enhancements include:</p> <ul style="list-style-type: none"> Surety bonding or performance and payment bonding acceptable to the Agency; An irrevocable letter of credit acceptable to the Agency; or A pledge to the lender of collateral that is acceptable to the Agency. 	<p>Acceptable credit enhancements include:</p> <ul style="list-style-type: none"> Surety bonding or a P&P Bond (preferred). An irrevocable LOC, Rural Development is named as Beneficiary – 100% of contract. Cash deposit in amount of contract. All construction must adhere to RD Instruction 1924-A. MPR projects must also comply with the terms of the MPR Conditional Commitment. 	<p>For projects financed with a Section 538 construction guarantee, follow the applicable provisions of 3565.303 (c) (2) to the extent that it does not conflict with Section 515 conditions, including surety, bonding and final acceptance.</p>
12. Developer Fee	<ul style="list-style-type: none"> Developer fee is an eligible use of Section 538 loan proceeds. Deferred developer fee can be repaid from surplus cash at year end. 	<ul style="list-style-type: none"> Allow reasonable developer fee when the only other funding source is a Section 538 loan that is being used with existing Section 515 property transfers and MPRs. Deferred developer fees cannot be repaid except as part of the approved annual Return on Investment. 	<p>Developer fee will be an allowed cost with Section 538 loan proceeds. The developer fee will be disbursed at closing.</p> <p>The disbursement of a deferred developer fee will be subject to Section 515 limitations on annual distributions.</p>

COLUMN A Program Requirements	COLUMN B Section 538 Requirements	COLUMN C Section 515 Requirements	COLUMN D Sections 538/515 Projects Recommended Approach
13. Reserve Accounts including CNA requirements	<ul style="list-style-type: none"> • Lender holds funds. • Lender approves all release of funds. • Deposits based on Capital Needs Assessment (CNA). CNAs on Section 538 properties should follow 538 Program Requirements. • At least every five years- but no later than each seventh year, the lender must review the CNA as part of adjusting the replacement reserve deposit. The reserve account must be adjusted accordingly. If the reserve deposits as determined by the CNA are not adjusted, the lender must provide a justification to the Agency. The lender must continue to do an evaluation of the property during the annual physical inspection to ensure that the reserve account has acceptable funding levels. • 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. 	<ul style="list-style-type: none"> • Section 515 reserve account funds required to be held in a supervised account. • Requires prior Rural Development concurrence to release funds. • Emergency situation may request post approval. • Minimum two bids required when costs are more than \$3,500 or when IOI-involved bid is submitted directly to State Office prior to requesting bids from other firms. • Reserve account sized to meet the 20-year inflated needs of the property as determined by an approved CNA. • Rural Development may require frontend loading in MPRs. • A new CNA be commissioned at five years or later. • Reserve accounts established under an approved CNA may only be used for approved capital needs or purposes specifically authorized in the Section 515 transfer authorization or MPR Conditional Commitment. <p>MPR uses are restricted to those items shown on the approved CNA but withdrawals for transfers must follow HB 2-3560.</p>	<p>Requirements of the Reserve Account will be handled in accordance with 7 CFR 3560, section 3560.306 (e).</p> <p>The Section 538 guaranteed lender will hold the funds. Release of funds will require approval of Agency, lender and borrower.</p> <p>The project will maintain initial and ongoing reserve levels at the greater of the Section 515 or Section 538 requirements.</p> <p>**The Section 515 Requirements will be followed in regards for CNA.</p> <p>Reserve account funds will not be used to pay fees associated with the Section 538 guarantee.</p> <p>Follow 7 CFR 3560, for minimum two bids required when costs are more than \$3,500 or when IOI-involved bid is submitted directly to State Office prior to requesting bids from other firms.</p>

COLUMN A Program Requirements	COLUMN B Section 538 Requirements	COLUMN C Section 515 Requirements	COLUMN D Sections 538/515 Projects Recommended Approach
14. Surplus Cash Distribution/ Return to Owner	Lender may release surplus cash to borrowers annually with no restrictions on the amount. All requirements (HB 3565-1, 7.6 E) must be met prior to release of surplus cash.	There is no statutory authority in the Section 515 program to allow for a distribution of surplus cash.	<p>Use Section 515 program requirements to define amount of the annual distributions. Lender will maintain any surplus funds from owner funded reserves (construction contingency, lease up and O&M reserve) in a Section 538 Surplus Reserve Account separate from the Section 515 GOA.</p> <p>Lender may release unused funds in this Surplus Reserve Account only if the requirements of HB-1-3565 Paragraph 7.6 E. have been met.</p> <p>Appraisals are required in ALL cases prior to approval to determine allowable equity payments and RTO.</p>
15. Definition of Total Development Cost	Total cost of project construction cost, financing fees, professional fees and profit.	The cost of construction, purchasing, improving, altering or repairing MFH and related facilities, and purchasing or improving the necessary land, including architectural, engineering, or legal fees and charges and other technical and professional fees and charges, but excluding fees, charges or commissions such as payments to brokers, negotiators or other persons for the referral of prospective applicants or solicitations of loans.	Use the Section 515 definition.
16. Use-Restrictions	The property must remain as affordable rental housing for the original loan term. The restriction use covenants must be recorded.	Mandated Section 515 extended use restrictions apply to all program loans and may be extended for the full term of the loan for transfers and MPRs on project-by-project basis. Use restrictions are not liens and cannot be subordinated except to the applicable State Agency LIHTC LURAs when necessary.	<p>Both the Section 515 and Section 538 use restrictions will be recorded. In general, Section 515 use restrictions are more restrictive than the Section 538 restrictions and will control during the term of the Section 515 loan.</p> <p>When the term of the Section 538 use restrictions are greater than the term of the Section 515 restrictions, they will survive the Section 515 restrictions.</p> <p>The period of the Restrictive Use Covenant (RUC) in Section 515 transfers utilizing Section 538 funds to pay equity pursuant to 7 CFR 3560.406 will be for a term of 30-years from the closing date of the Rural Development transfer.</p>

COLUMN A Program Requirements	COLUMN B Section 538 Requirements	COLUMN C Section 515 Requirements	COLUMN D Sections 538/515 Projects Recommended Approach
17. Subordination of Section 515 Loan		Section 515 properties selected into the MPR Program must use the Restrictive Use Subordination Agreement approved by OMB No. 0575-0190 which is posted to the MPR Website. Subordinations of existing Section 515 loans in transfer authorization must comply with the Section 515 program transfer conditions currently published in HB-3-3560, Chapter 7.	For Sections 515/538 properties participating in the MPR program, both the Subordination Agreement in HB-3-3560 dated December 17, 2008 PN 425 and any updates will be used along with the Restrictive Use Subordination Agreement approved by OMB No. 0575-0190. A 515 loans may only subordinate to a 538 loan used for eligible 515 purposes.
18. Appraisal	Appraisal must be completed within the 12 months prior to the issuance of the loan guarantee. Refer to 3565.303 (d) (4) for appraisal exemption guidance.	In Section 515 transfers and MPR Program transactions, any required appraisal must be completed as required by the transaction approval conditions. Acceptable appraisals for Section 515 property transactions must comply with HB-1-3560, Chapter 7 and 7CFR 3560 Subpart P.	Appraisals will be completed in accordance with Section 538's 3565.303 for Section 538 loan approval and 7CFR 3560 Subpart P for Section 515.
19. Market Study	A market study is required to support the appraisal.	Either a market study or a market survey, as appropriate is required to establish feasibility for any Section 515 transaction as required by the respective Section 515 HB or NOFA.	For Section 515 projects that have been 90% or more occupied for the 3 consecutive years prior to submitting an application, a market study is not necessary unless specifically required as a condition of the Section 515 transfer or MPR approval.
20. Cost Certification	A cost certification is required that 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 LIHTC) then a copy of that cost certification is acceptable. An audited cost certification is required from identify of interest (IOI) contractors.	Actual construction costs must be reported. In the instance of an IOI contractor the costs must be certified and audited as outlined on Form RD 1924-13, "Estimate and Certificate of Actual Cost" if required.	For projects with any Section 538 guarantee, use the Section 538 program cost certification requirements. However if there is an IOI contractor the certified and audited costs will be presented in the format contained on Form RD 1924-13, "Estimate and Certificate of Actual Cost".
21. Single Asset Entity	Borrowers must operate as a single asset ownership entity.	There is no restriction that borrowers must operate as a single asset ownership entity however all transfers and MPRs approvals provide project-specific conditions.	For Section 515 projects using Section 538 guaranteed loan funds, the Single Asset Entity restriction is waived.
22. Rural Area Designation (Grandfathering)	A Section 538 project for which a subsequent loan will be used to make necessary repairs or improvements to the property or to avert prepayment may be located in an area that has changed from rural to non-rural.	A project for which a subsequent loan will be used to make necessary repairs or improvements to the property or to avert prepayment may be located in an area that has changed from rural to non-rural.	For subsequent loans in a Section 515 project whose acquisition and/or repair are financed by the Section 538 program, the "grandfathered" rule applies.

COLUMN A Program Requirements	COLUMN B Section 538 Requirements	COLUMN C Section 515 Requirements	COLUMN D Sections 538/515 Projects Recommended Approach
23. Underwriting Requirements		Section 515 transfers and MPR must comply with program HB and specific NOFA requirements and generally require review of the Section 538 and any other third-party funding underwriting summaries to accurately complete the UWT for approval.	Lenders are required to submit a matrix summarizing any differences between Section 515 underwriting and Section 538 underwriting.
24. Reporting Requirements: a) Annual Financial Reports b) Affirmative Fair Housing Marketing Plan c). Management Plan	<p>a) The lender must obtain from the borrower, on an annual basis, an audited annual financial statement conducted in accordance with generally accepted government auditing standards. The audit must be sent to the Agency within 90 days of the end of the property's fiscal year.</p> <p>b) The borrower must prepare and comply with the Affirmative Fair Housing Marketing Plan and all other Fair Housing requirements. AFHMP submitted with the NOFA Response and/or application must be reviewed, approved and signed by the Agency. If the property has interest credit, the AFHMP must be approved and signed by the Agency at least every three years when the agency's compliance review is conducted. Annually, the lender must review and certify that the AFHMP is in compliance with the Agency's regulation. This certification and a copy of the AFHMP will be included in the Annual Audit of the property.</p>	<p>a) Borrowers must submit annual financial reports in the form of the MFH Project Budget (with actual expenditures) and the MFH Balance Sheet.</p> <p>b) Borrowers with housing projects that have four or more rental units must prepare and maintain an Affirmative Fair Housing Marketing Plan (AFHMP) as defined in 24 CFR part 200, subpart M.</p>	<p>The lender must obtain from the borrower, on an annual basis, an audited annual financial statement conducted in accordance with generally accepted government auditing standards.</p> <p>Lenders may use the same approved AFHMP that the borrower is currently using for the project. The annual reporting requirements for the Section 538 must remain in place.</p> <p>The same Management Plan may be used for Section 515 and Section 538, lender must ensure that the 538 program requirements are included in the Management Plan. In instances where the requirements may differ, the most stringent requirement must be met.</p>

COLUMN A Program Requirements	COLUMN B Section 538 Requirements	COLUMN C Section 515 Requirements	COLUMN D Sections 538/515 Projects Recommended Approach
25. Portfolio vs. Consolidation	<p>If projects are located in different market areas, the deal must be structured as portfolio sale with all projects underwritten as separate properties.</p> <p>If projects are located in the same market area, the deal may be structured as consolidation.</p> <p>Consolidation- all buildings will operate as one project, under one management plan and one NOFA response/application will be submitted.</p> <p>For areas in which separate counties or cities are considered the same market area, the Fair Market Rents must be the same.</p>	<p>If there are 2 or more projects located in different market areas, the deal must be structured as portfolio sale</p> <p>If there are 2 or more projects located in the same market area, the deal may be structured as a project consolidation.</p> <p>For areas in which separate counties or cities are considered the same market area, the Fair Market Rents must be the same.</p>	<p>If projects are located in different market areas, the deal must be structured as portfolio.</p> <p>If projects are located in the same market area, the deal may be structured as consolidation.</p> <p>For areas in which separate counties or cities are considered the same market area, the Fair Market Rents must be the same.</p>
26. Favorable Financing.	The lender determines the favorable financing in accordance with industry practices.	Section 538 loan may be included as favorable financing	Section 515 interest credit subsidy is not considered as favorable financing for the Section 538 program.
27. Rent Increases	Rent goes into effect with issuance of the guarantee.	Rent increase begins after construction or the rehabilitation is complete.	Follow the guidelines for Section 515, rent increases will not go into effect until the construction or the rehabilitation is complete.

July 30, 2015

TO: State Directors
Rural Development

ATTN: Program Directors
Multi-Family Housing

FROM: Tony Hernandez
Administrator
Housing and Community Facilities Programs

SUBJECT: Guidance on Loan Modifications in the Section 538 Guaranteed Rural Rental Housing Program (GRRHP)

The intent of this Unnumbered Letter (UL) is to provide guidance on loan modifications to reduce the interest rate of existing Section 538 GRRHP loan guarantees. It is written for the sole use of the Rural Development State Office staff and area offices involved in processing Section 538 guaranteed loan modifications.

Section 538 GRRHP borrowers and lenders may agree to a loan modification when the action will improve the financial viability of the project and its operations.

To request a loan modification, the incumbent Lender will submit to the Agency:

- A summary of the transaction detailing the projected change in interest rate (interest rate must be fixed), pro forma debt service coverage (after modification, must be equal to or greater than 1.15) and benefits to the property and borrower, including a projected debt service savings.
- Certification that the original term (maturity date and guarantee term) of the guaranteed loan will not be modified.
- Certification that the outstanding principal balance will not be modified.
- Certification that there will not be a negative impact to the tenants.
- Certification that the borrower is in compliance with all program requirements. If the borrower is not in compliance, the lender must submit documentation to show how the modification will bring the borrower into compliance.

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- Certification that there are no asset management issues.
- Most recent and interim financial statements and lender analysis.
- Sources and Uses statement. Any third party lender costs such as attorney fees, processing fees, title and recording cost must be disclosed.
- Lender's attorney will attest that the modification meets state law requirements
- If approved, the lender will be responsible for closing the transaction. Agency will review, verify and approve all closing documents, if applicable (Mortgage Note, Deed of Trust, amended Promissory Note, Loan Note Guarantee).
- Certification that third party lender costs may not be added to the principal of the guaranteed loan.
- Any out-of-pocket costs incurred by the lender or the owner related to the modification cannot be from project funds or loan proceeds.

If the loan guarantee is deemed eligible for the loan modification, new or revised lockout and prepayment terms may be added to allow the mortgage to be re-securitized with Ginnie Mae. Prepayment penalties may not be added to the loan balance.

The Agency shall do the following in response to the request for a loan modification:

- Review all documentation and provide an approval or denial response to the lender in writing within 30 business days of receipt of the request. Requests that are approved by the State Office must receive National Office concurrence.
- If the modification is approved, the Finance Office must be contacted to update GLS with the lower interest rate.

If you have any questions regarding this UL, please contact Tammy S. Daniels of the Multi-Family Housing Guaranteed Loan Division at (202) 720-0021 or tammy.daniels@wdc.usda.gov.