CHAPTER 3: ESCROW, TAXES, AND INSURANCE

3.1 INTRODUCTION

To protect the Agency's interest in the security property, the Customer Service Center (CSC) must ensure that real estate taxes and any other local assessments are paid and that the property remains adequately insured. To ensure that funds are available for these purposes, the Agency requires most borrowers who receive new loans to deposit funds to an escrow account. Borrowers who are not required to establish an escrow account may do so voluntarily. If an escrow account has been established, payments for insurance, taxes, and other assessments are made by the Agency. If an escrow account has not been established, the borrower is responsible for making timely payments.

Section 1 of this chapter describes basic requirements for paying taxes and maintaining insurance coverage; Section 2 provides procedure for establishing and maintaining the escrow account; and Section 3 discusses procedures for addressing insured and uninsured losses to the security property.

SECTION 1: TAX AND INSURANCE REQUIREMENTS *[7 CFR 3550.60 and 3550.61]*

3.2 TAXES AND OTHER LOCAL ASSESSMENTS

The Agency contracts with a tax service to secure tax information for all borrowers. The tax service obtains tax bills due for payment, determines the optimal time to pay the taxes in order to take advantage of any discounts, and provides delinquent tax status on the portfolio.

A. Tax Service Fee

All borrowers are charged a tax service fee. Borrowers who obtain a subsequent loan are not required to pay a second tax service fee. Refer to the tax service fee schedule shown in Attachment 3-B to determine the fee charged for new loans and new rates and terms assumptions.

B. Borrowers Failure to Pay Taxes

Borrowers not on escrow are responsible for paying their real estate taxes each year and submitting proof of payment to CSC. When the Agency is notified that a borrower has not paid real estate taxes on the property or other local assessments, CSC must notify the borrower that proof of payment must be submitted to CSC within 60 days. If the borrower fails to submit proof of payment, CSC may pay the taxes and any penalties and charge the cost as an advance to the borrower's account. CSC will not generally pay taxes and penalties in cases where there is another known lien holder, the security property also includes a farm, or net recovery is not anticipated unless it is determined to be in the best interest of the Agency. If the Agency advances funds to pay taxes or insurance, the borrower will be required to convert to escrow. When an escrow account is established, the advance will be repaid over the remaining term of the loan minus ten years. If the loan has less than 10 years remaining, the fee will be spread over 2 years or the remaining term, whichever is less.

C. Recapture Receivable Accounts

Delinquent tax notices/pending tax sale notices from taxing authorities on recapture receivable accounts should be forwarded to the Tax Unit at the CSC for handling. The notices can be faxed to (314)457-4535. Upon receipt of a notice of pending tax sale, the CSC will review the recapture receivable account to determine if it is in the best interest of the Agency to pay the taxes to avoid the tax sale and protect the Government's interest in the property. If the taxes are paid the CSC will demand payment from the borrower. If payment is not made a foreclosure action will pursue.

3.3 INSURANCE REQUIREMENTS

Borrowers are responsible for obtaining and continuously maintaining insurance on the security property until the loan is paid in full. Evidence of insurance coverage for the first year of a loan must be provided at closing. In subsequent years, borrowers not on escrow are required

> **Insurance on Acquired Property**
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> Insurance will not be carried on properties that the Agency has acquired. After a foreclosure sale has been held or after a deed in lieu of foreclosure has been filed for record, insurance will not be canceled but will not be renewed. If the property becomes uninsured between the time when the borrower defaults on the loan and the time when the Agency obtains title, the Agency will force place insurance to protect its interests.

to pay insurance premiums and send proof of premium payment to CSC annually. For borrowers on escrow, CSC makes the premium payments.

A. Policy Requirements

Borrowers must purchase policies from approved insurance companies. Attachment 3-A provides the minimum standards insurance policies must meet. When a loan is made, Field Staff are responsible for reviewing the applicant's proposed insurance coverage to determine whether it is adequate. CSC also reviews these policies for adequacy when closing documents are forwarded from the Field Office and approves any subsequent changes to borrower insurance policies. Borrowers may need to obtain three types of insurance.

1. Hazard Insurance

Most borrowers are required to maintain hazard insurance to protect the property against fire, wind, and weather-related damage. These policies may also be called "Fire and Extended Coverage," "Homeowner's," "All Physical Loss," or "Broad Form" policies.

Any borrower with a secured indebtedness in excess of $15,000 at the time of loan approval must furnish and continually maintain hazard insurance on the security property, with companies, in amounts, and on terms and conditions acceptable to RHS and include a "loss payable clause" payable to RHS to protect the Government's interest.".

For borrowers initially required to maintain hazard insurance, CSC may force place coverage for the benefit of the Agency and charge the cost to the borrower's account.

2. Flood Insurance

Flood insurance is required for all properties located in a Special Flood Hazard Area (SFHA), as identified by the Federal Emergency Management Agency (FEMA) and described in RD Instruction 426.2, except for loans and grants with an original principal balance of $5,000 or less.

FEMA's Standard Flood Hazard Determination is used to document whether a property is in a SFHA and whether flood insurance is available under FEMA's National Flood Insurance Program. If the property is in a SFHA, the borrower should be notified using *Form RD 3550-6, Notice of Special Flood Hazards, Flood Insurance Purchase Requirements, and Availability of Federal Disaster Relief Assistance*. The borrower must sign and return the form. If the borrower in a SFHA cannot secure flood insurance through FEMA's National Flood Insurance Program, the property is not eligible for Federal financial assistance.

Dwellings located in the 100 year flood plain have additional requirements that must be met in regards to elevation levels, public utilities or on-site water supply and waste disposal systems requirements, and completion of the eight step decision making process for alternative consideration. (see RD Instruction 1970-F, section 1970.256 for further requirements).

3. Builder's Risk Policies

The borrower may elect to obtain a builder's risk policy that meets the Agency's requirements while the dwelling is under construction. An acceptable policy either: (1) names the borrower as the insured; or (2) contains a builder's risk endorsement for a policy issued to the borrower. A policy issued only to a contractor is not an acceptable substitute for the property insurance a borrower is required to provide.

CSC should ensure that the builder's risk policy automatically converts to full coverage when the dwelling is completed. Otherwise, acceptable insurance must be obtained to coincide with the expiration of the builder's risk provisions of the policy.

B. Acceptable Evidence of Insurance

For loans secured by a first lien, the borrower must provide the original policy or declaration page. For loans secured by other than a first lien, a copy of the policy or declaration page, or other evidence of insurance, is acceptable. At loan closing the applicant may submit a written binder in lieu of the policy or declaration page, as long as the policy will be submitted to CSC within 60 days of closing.

C. Force Placed Insurance

Force placed insurance is insurance coverage the Agency obtains for a security property when the borrower is unable or unwilling to provide adequate and acceptable insurance coverage. If the Agency force places insurance, CSC will make an advance to pay for the coverage and will inform the borrower of the new insurance. Borrowers must submit acceptable evidence of other insurance before the force placed insurance can be removed.

3.4 SERVICING ACTIONS RELATED TO INSURANCE

A. Reviewing Policies for Acceptability

After loan closing, Field Staff will send the borrower's policy to CSC along with other closing documents. CSC should review the policy to ensure that it meets the Agency's requirements as described in Attachment 3-A. If the policy is acceptable, CSC should image the policy and enter the policy information into LoanServ. If the borrower's policy is not acceptable, CSC should notify the borrower, explain why the policy is unacceptable, and request that the borrower submit an acceptable policy.

B. Annual Payments

For borrowers on escrow, CSC will pay annual insurance premiums from the escrow account. The borrower's insurance company must submit a renewal notice to CSC indicating the amount of the next year's insurance premium. CSC must pay the required premium before the expiration date in order to prevent any lapse in insurance.

Borrowers not on escrow are responsible for paying insurance premiums and sending CSC evidence of payment and the declaration page. If CSC does not receive evidence of insurance coverage they will advise the borrower within 10 days after the policy's expiration date that the Agency will force place insurance if they fail to provide the necessary documentation within 60 days after the date of notification (45 days for flood insurance). Cost of the insurance will be charged to the borrower's account and the borrower will be required to escrow for taxes and insurance.

C. Reviewing Changes in Insurance Coverage

Borrowers who wish to change insurance policies must submit a replacement policy and evidence of payment to CSC at least 60 days before the current policy expires. If the replacement policy is received with less than 60 days notice and CSC has already disbursed a payment for the existing policy from the escrow account, the borrower is responsible for obtaining reimbursement of the paid premium.

CSC must review the replacement policy to ensure that it meets the Agency's requirements outlined in Attachment 3-A and may contact the applicable State Office to verify whether the insurance carrier is authorized to conduct business in the State. If the borrower's policy is not acceptable, CSC should inform the borrower of the reason (for example, there is not an adequate amount of coverage, it is not in the correct name, or the premium has not been paid) and request that the borrower submit an acceptable policy. If necessary, CSC will force place insurance.

D. Cancellation of Insurance

For borrowers on escrow, the borrower's insurance company must send to CSC any notice of cancellation or nonrenewal. Within 3 days of receiving the notification, CSC must notify the borrower of the need to get new insurance coverage before the existing policy expires.

The borrower must send an invoice to CSC for payment and should include a copy of the policy, if it is available. If the borrower does not submit a new hazard or flood policy and invoice within 10 days of the old policy's cancellation CSC will initiate action to force place insurance coverage on the property. If the borrower does not submit a new hazard or flood insurance policy and invoice within 70 days of the previous policy's expiration date (45 days for flood insurance), CSC will force place insurance.

If a borrower not on escrow receives a notice of cancellation or nonrenewal, the borrower must secure new insurance coverage before the current policy expires. The borrower must submit proof of insurance coverage and evidence of payment to CSC before the policy expires. Borrowers who cannot secure new insurance coverage should contact CSC immediately. CSC will then force place insurance for the security property.

E. Vacant or Leased Units

If the Agency becomes aware that a security property is vacant or leased, CSC should review the policy to determine if it permits such conditions. If it does not, CSC should immediately notify the insurance carrier in writing. If the insurance carrier requires an additional premium because of the vacancy, tenant occupancy, or other increased hazard, CSC will pay the additional premium from the borrower's escrow account, if one exists. Borrowers not on escrow are responsible for paying the increased premiums. If the borrower is unable to pay the increased premium, the Agency may pay the additional premium and charge the cost to the borrower's account.

F. Transfer of Property

1. Assumptions

In a transfer with assumption, insurance will be required in the same amount and according to the same provisions as for an initial loan of the same type. The new owner may obtain a new policy or have the current insurance company issue an endorsement to the current insurance policy, changing the name of the insured to that of the new owner.

2. Payment in Full

When a borrower pays off the Agency's debt in full, the Agency releases its insurance interest in the security property. CSC should notify the insurance agency of record to remove the Agency's interests from the mortgagee or loss payable clause.

3. Transfers Without Satisfying Agency Debt

If the Agency becomes aware that the borrower has transferred title to the property without satisfying the Agency's debt, CSC should immediately notify the new owner that the mortgage requires the owner to provide and maintain adequate, acceptable insurance with the Agency listed as the mortgagee. In addition, the new owner should be informed that evidence of coverage and payment must be received by CSC within <u>30 days</u>. If the evidence is not received in that time frame, CSC will force place insurance. The Agency will notify the borrower and new owner that acceptance of the new policy or endorsement will not constitute consent by the Government to the transfer.

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SECTION 2: ESCROW REQUIREMENTS

3.5 OVERVIEW OF ESCROW REQUIREMENTS

A. Requirement to escrow

The Agency requires most borrowers who receive new loans to escrow funds for taxes and insurance.

> **Escrow Statutes**
>
> The Agency administers escrow accounts in accordance with the Real Estate Settlement and Procedures Act of 1974 (RESPA) and section 501(e) of the Housing Act of 1949.

Borrowers are exempt from escrow requirements if they:

- Are current on an annual payment plan;
- Have a leveraged loan and the escrow is maintained by the primary lending institution;
- Have received only a Section 504 grant;
- Have Section 504 loans with a total outstanding balance of $15,000 or less, and the Agency determines there is no risk to the Government's security interest in the property;
- Have a Section 504 loan and the Agency does not hold a mortgage interest in the property; or
- Assume a current loan (not past due) on same rates and terms; or
- Have security property which includes a farm and the property is not subdivided between farm and non-farm tract. In these cases, the Agency may still elect to require escrow where the housing represents the majority of the value of the security property or it is in the Agency's best interest to require escrow.

Existing borrowers who do not have escrow accounts may voluntarily establish an escrow account. Existing borrowers who pay on a monthly basis and annual-pay borrowers with monthly income must establish escrow accounts if:

- The borrower obtains a subsequent loan;
- The borrower requests a Delinquency Workout Agreement;
- The borrower's loan is reamortized as a servicing action; or
- Because of borrower failure to pay, the Agency must advance funds to pay for insurance, taxes, or other local assessments. The advance will be repaid over the remaining term of the loan minus ten years. If the loan has less than 10 years remaining, the fee will be spread over 2 years or the remaining term, whichever is less.

B. Sources of Escrow Funding

At the time the escrow account is established an initial deposit to the account is required. Once the escrow account is established, a portion of the borrower's monthly payment continues to fund the escrow account. Exhibit 3-1 illustrates the calculation of the initial deposit and monthly escrow payment.

3.6 ESTABLISHING ESCROW ACCOUNTS FOR NEW LOANS

A. Field Office Responsibilities

No later than loan closing, the borrower must provide proof of insurance coverage. Field Staff will enter the borrower's estimated taxes and insurance premiums into UniFi, which automatically calculates the initial deposit and the monthly payment. The Closing Agent/Attorney collects escrow funds at closing and, in most cases, provides the funds to the CSC along with the closing documents. If real estate taxes are due within 60 days of the date of closing, the Closing Agent/Attorney will pay the real estate taxes and submit the remaining amount to the CSC.

Exhibit 3-2 lists the closing documents related to taxes and insurance and provides processing instructions for each.

Exhibit 3-1

Escrow Account Funding

The initial escrow balance and the escrow payment amount are calculated in accordance with RESPA. UniFi prepares *Form RD 3550-9, Initial Escrow Account Disclosure Statement* described in Paragraph 3.6 B.2. The following example is intended to show how escrow accounts are funded each year.

Assumptions:

(1) The loan closing occurs on February 12, 1996 with the first payment due April 1, 1996.
(2) Taxes of $214.88 are paid in July and December.
(3) Hazard insurance of $319.00 is paid in January.
(4) The Agency requires a cushion equal to 2 months of payments.

Monthly Payment Calculation:

$214.88
$214.88
$319.00
$748.76 Total anticipated escrow disbursements divided by 12 equals
$ 62.39 per month escrow payment

Month	Payments to Escrow	Disbursements	Balance
Loan Closing	$249.64	$ 0.00	$249.64
April	$ 62.39	$ 0.00	$312.03
May	$ 62.39	$ 0.00	$374.42
June	$ 62.39	$ 0.00	$436.81
July	$ 62.39	$214.88	$284.32
August	$ 62.39	$ 0.00	$346.71
September	$ 62.39	$ 0.00	$409.10
October	$ 62.39	$ 0.00	$471.49
November	$ 62.39	$ 0.00	$533.88
December	$ 62.39	$214.88	$381.39
January	$ 62.39	$319.00	$124.78
February	$ 62.39	$ 0.00	$187.17
March	$ 62.39	$ 0.00	$249.56

The borrower will be required to pay $62.39 per month and will also be required to fund the escrow account at closing in the amount of $249.64. Part of the tax payment component of the initial escrow deposit will be contributed by the seller for the period from January 1st to the closing on February 12th.

According to RESPA, the lending institution at some time during the year must achieve an escrow balance that serves as a cushion but does not exceed 2 monthly escrow payments. In this example, the balance equal to 2 monthly payments ($124.78), occurs in January after the payment for hazard insurance.

CSC is required to perform an escrow analysis within 12 months of the first payment and every year thereafter. The actual running escrow balance from the prior year will become the basis for projecting the necessary escrow payment for the next year. The low point achieved will be compared to the projected minimum of $124.78. If the low point is below $124.78, the loan will be deemed to have a shortage. If the low point is greater than $50.00, the loan will have a surplus, which will be refunded to the borrower, if the surplus is less than $50.00, it will be or credited to the next year's escrow.

Exhibit 3-2

Closing Documents Related to Tax and Insurance

- ***Form RD 3550-19, Initial Escrow Account Disclosure Statement,*** shows the amount of the initial escrow deposit.
- **Closing Disclosure.** CSC must verify that the real estate taxes have been properly pro rated between the buyer and seller by reviewing the Closing Disclosure.
- **Tax information.** CSC must enter into LoanServ the information on taxing authorities, parcel number, due dates, and tax information from *Form RD 3550-15 Tax Information*.
- **Title insurance policy**. CSC must verify that the legal description of the property is consistent with the closing documents.
- **Insurance documentation**. CSC must review the insurance documentation (either a policy, declaration page, or binder) and enter into LoanServ information such as the cost, coverage period, coverage amount, company, and beneficiaries.

B. CSC Responsibilities

After reviewing the information sent by the Field Staff, CSC deposits the escrow funds and verifies the information on *Form RD 3550-15*.

1. Notification to Tax Service

Within 30 days of establishing the escrow account, CSC should send the completed tax worksheet to the tax service, along with the loan identification number, the parcel number, a legal description of the borrower's property, and the tax service fee. The tax service will set up the borrower's information in its system and generate a unique tax service contract number. The tax service will then send the borrower's contract number to CSC. This number will be entered into LoanServ to help identify the borrower's account.

2. Initial Escrow Account Disclosure Statement

The field office is responsible for completing the *Form RD 3550-9* "Initial Escrow Account Disclosure Statement". The statement will be initialed by the borrower at closing and the borrower will be provided a copy of the statement. The signed statement will be forwarded to CSC with the closing documents.

The initial disclosure statement should include the amount of the borrower's monthly mortgage payment and the portion of the payment going into the escrow account. It should itemize the estimated taxes and insurance premiums to be paid from the account during the upcoming year. It also should show the cushion and a trial running balance for the account. (A trial running balance is a projected escrow balance for each month during the computation year.)

3. Construction Loans

When a borrower receives a construction loan, an escrow account is not established until after construction is complete. In addition, since loan payments are deferred during the construction period, monthly escrow payments are not paid. Two options are provided to loan applicants to handle taxes and insurance. One option is to include in the loan amount, subject to loan underwriting requirements, taxes which come due during construction and the amount to fund the initial escrow deposit. The other option is for the borrower to use personal funds to pay taxes when due and for the initial escrow deposit to be paid by the borrower in a lump sum when the construction loan is converted to a permanent loan. If the borrower does not pay tax bills or insurance bills which become due during construction or there are insufficient funds to establish the escrow account when the loan is converted, the Field Office will cue CSC and provide the estimated amount of the shortage, and the facts in the case. CSC will generally increase the monthly payment scheduled for the remainder of the escrow cycle to compensate for the shortage. CSC may also elect to charge the borrower's account for any shortage and reamortize the loan.

Borrowers must be counseled that they are ultimately responsible for payment of insurance premiums and while the costs may be included in the loan, the borrower is responsible to cover any shortage which may occur.

If construction is completed as planned, the course of construction (Builder's Risk) policy should remain in effect without an additional premium due during construction. However, if a second premium is due during construction, the borrower is responsible for this payment. Within 30 days of the anticipated construction completion date, the borrower will provide the Field Office with a copy of the binder for a hazard insurance policy and a receipt showing it has been paid in full for one year, OR a request for a draw from the construction loan to pay one year's hazard insurance premium in full, as applicable.

3.7 ESTABLISHING ESCROW ACCOUNTS FOR EXISTING LOANS

A. Determining the Escrow Amount

To establish an escrow account for a borrower with an existing loan, CSC must gather the information discussed in the following paragraphs.

1. Insurance Information

Current information on insurance coverage should be available in CSC records. If current information is not available, CSC should contact the borrower at least 30 days prior to establishing an escrow account, notifying them that they must provide proof of insurance coverage.

When the policy information is received, CSC must review it to ensure that it meets the Agency's requirements, as described in Attachment 3-A, and enter information about the insurance into LoanServ. If the borrower cannot or will not obtain insurance coverage, CSC will force place insurance.

2. Tax Information

CSC will confirm with the borrower the taxing authorities to which taxes are due, the amount of taxes paid by the borrower last year, and the due dates. CSC will verify this information, enter it into LoanServ, and establish an escrow account.

Once the necessary information is entered into LoanServ, the escrow analysis unit will calculate the escrow amount (both the initial deposit and the monthly amount). CSC should change the tax service code in LoanServ to reflect that the borrower is now on escrow and within 30 days of setting up the escrow account, inform the tax service that the borrower has been converted to escrow. The tax service will then be changed to escrow.

B. Obtain Funds for the Escrow Account

Once the escrow account is set up, CSC must deposit the specified escrow funds into the borrower's escrow account. If the escrow account contains insufficient funds to pay the insurance and taxes when due, CSC will advance an amount equal to the difference between the amount due and the escrow balance. At the time of the annual escrow analysis, any negative balances or shortage will be spread over 12 months and collected with the escrow portion of the borrower's mortgage payments.

C. Notify the Borrower

Once the escrow account has been established, CSC must send written notification to the borrower which includes an explanation of the establishment and function of the escrow account and *Form RD 3550-9*. See Paragraph 3.6 B.2 for a description of this document. The disclosure statement must be sent within 45 days after creating the escrow account.

3.8 ESCROW PAYMENTS

> **Termination of Escrow Payments**
>
> Escrow disbursements will stop immediately upon debt settlement or release of security.

CSC will disburse funds as necessary to pay tax and insurance bills, as well as other appropriate expenses. CSC will be responsible for ensuring that all escrow payments are made at the optimal time to take advantage of any discounts and avoid penalties.

3.9 ANNUAL ESCROW ANALYSIS

RESPA requires CSC to conduct an annual escrow account analysis for each borrower that has an escrow account. RESPA also requires CSC to provide borrowers with an Annual Escrow Disclosure Statement that shows the account history and projects activity for the coming year. A borrower’s monthly payment to the escrow account may increase or decrease as a result of the analysis. CSC must mail the disclosure statement at least 30 days prior to the new payment effective date.

A. Surpluses

Surpluses arise when the account balance does not reach the expected low point of two monthly escrow payments during the year. When a surplus for an escrow account is greater than or equal to $50 and the borrower is current on the loan, CSC will generate a check and return the surplus to the borrower with the Annual Escrow Disclosure Statement.

B. Shortages

Shortages arise when the escrow balance is less than the expected low point during the year. Generally, CSC can recover shortages by adjusting the monthly payment to the escrow account and spreading the amount equally over the next 12 month period. If the borrower cannot make the resulting required payment, CSC may spread it out over a longer period. If a risk analysis reveals that the borrower is unlikely to be able to repay the amount, CSC may require payment within 30 days. CSC should consider special servicing options if the borrower is unable to repay the amount within 30 days.

C. Account History

> **Accelerated Accounts**
>
> If a borrower's account is currently accelerated, CSC does not provide a disclosure statement.

In general, the account history should include a description of the borrower's monthly mortgage payment and the portion going into the escrow account, the total amounts paid into and disbursed from the account, an explanation of how any surpluses or shortages will be handled, and the balance of the escrow account at the end of the year. Any differences in actual disbursements from amounts previously projected should be marked with an asterisk.

D. Projection

CSC should base its projection on last year's disbursement amount unless last year's statement includes items that are not paid annually such as flood insurance that is due every 3 years or quarterly tax assessments.

A projection statement should cover 12 months unless the loan will mature within the next 12 months. In this case, the projection need only cover the months through the maturity date.

3.10 DISCLOSURE STATEMENTS FOR PROPERTY TRANSFERS AND PAYOFFS

A. Loan Assumptions

Loan assumptions require the preparation of a statement for both the buyer and the seller.

1. Disclosure to the New Borrower

For assumptions on the same rates and terms, CSC should provide the new borrower with *Form RD 3550-9* within <u>45 days</u> of completing the name change on LoanServ. The disclosure for new purchasers who assume a loan on new rates and terms is handled the same as for any new loan as described in Paragraph 3.6 B.2.

2. Disclosure to the Previous Owner

For either kind of assumption, a disclosure statement covering the period from the last disclosure until property transfer must be sent to the prior borrower within <u>60 days</u> of completing the assumption.

B. Loans Paid in Full

A disclosure statement that shows the account history from the date of the last disclosure to the date of payoff must be sent to a borrower who pays a loan in full.

SECTION 3: LOSSES *[7 CFR 3550.61(d)]*

3.11 OVERVIEW

When CSC learns of a loss to a security property, the actions to be taken depend upon whether the property is insured, whether the Agency is named as the mortgagee in the insurance policy, and the lien position of the Agency's loan. This section provides servicing instructions for dealing with both insured and uninsured losses.

A. Reporting the Loss

The borrower is responsible for immediately notifying CSC of any loss or damage to the security property and for collecting covered losses from the insurance company. CSC may ask the Field Office to inspect the property to verify that the borrower has taken the necessary steps to protect the property against further damage. If the borrower is unable to arrange for adequate protection, the Field Staff may recommend to CSC that a protective advance be used to arrange for emergency protection.

B. Losses on Properties with Accelerated Loans

Losses on properties in the process of foreclosure or deed in lieu of foreclosure will be handled in accordance with advice from the Office of the General Counsel (OGC). All loss payments should be applied to the borrower's real estate indebtedness before title to the property is taken by the Government, unless absolute assignment has been made by the borrower to the Government of all loss funds due from the insurance company.

If a borrower has improperly disposed of loss proceeds, CSC's escrow branch should consult with its risk management branch and OGC to determine what further action should be taken.

C. Agency Subrogation of Its Rights

Whenever a borrower willfully destroys a security property, the insurance company is not liable to the borrower but is still liable to the Agency (as the mortgagee). In such circumstances, the insurance company may ask the Agency to subrogate and assign some of its legal rights in the property to the insurance company. CSC will consult with OGC to determine whether subrogation is appropriate.

3.12 FILING THE INSURANCE CLAIM

The borrower is responsible for submitting a claim to the insurance company. The insurance company will send an adjuster to evaluate the borrower's loss, establish the work to be completed, and develop an estimated cost to complete the work (by individual work item). To document the information, the adjuster will complete an adjuster's worksheet.

The borrower must negotiate the adjustment of the loss with the insurance company. The borrower may consult with the Agency, but the Agency will not enter into the negotiations with the insurance adjusters, make commitments, or sign any forms in connection with the adjustment. The Agency will not waive any rights that it may have against the company, except when the borrower's claim has been settled.

If, after the borrower has settled the claim, CSC determines that the adjustment agreed to by the borrower is significantly less than the amount to which the borrower is entitled under the terms of the policy, the Agency may consider reopening negotiations with the insurance company.

3.13 ADMINISTERING INSURANCE PROCEEDS

The mortgagee or loss payable clause of borrower insurance policies ensures that the Agency's interest is protected. Checks for insurance proceeds (also called "loss drafts") are made payable jointly to the borrower and the Agency. Other lien holders also may be parties to the loss draft.

Borrowers with insurance claims must contact CSC to establish a plan to repair or rehabilitate the security property. If the insurance claim proceeds will not be used to redevelop the security property, the amount received must be applied to the account. Depending upon the amount of the loss, the Agency may require that the expenditure of insurance payments be supervised by a local Field Office. It is important that CSC and the Field Office work together to assure that any repairs are completed to protect the government's interest. The amount of Field Office involvement is dependent upon the amount of the insurance claim and the risk to the government.

A. Loans Secured by a First Lien

Once insurance proceeds are received, the borrower should endorse the loss draft and send it, along with the adjuster's worksheet, to CSC. CSC generally places the funds into a managed escrow account. However, when the amount of the loss claim is $7,500 or less and the borrower's account is current, Field Offices are authorized to endorse the insurance claim check without recourse provided the borrower submits the adjuster's worksheet along with documentation that the repairs will be made or have been completed. **Note**: Field offices should first review the adjuster's worksheet to ensure that the check is the total claim disbursement. If it is a partial disbursement, the check should be forwarded to CSC and not endorsed in the field.

For significant rehabilitation (having a total cost of more than $30,000) all development will be completed under the supervision of the local Field Office. The insurance proceeds may be provided to the Field Office to establish a supervised bank account or retained for disbursement at CSC. Development will be managed by the Field Office in a like manner as development funded by loan proceeds. This could include *Form RD 1924-2, Description of Materials,* and *Form RD 1924-25, Plan Certification* or a building permit issued by the local jurisdiction. As noted in Paragraph 3.14, all repairs and replacements will be planned, performed, inspected, and paid for in accordance with RD Instruction 1924-A. Payment schedules will be established in the individual repair plan.

Written contracts, using *Form RD 1924-6, Construction Contract* are strongly recommended for all rehabilitation-related construction, and are required if there is construction involved that would affect the dwelling's structural integrity. Otherwise, a *Form RD-1924-1*, *Development Plan* or similar form, with cost estimates and specifications may be used. Unless the borrower method is used, funds will not be advanced for materials or other purposes until work is completed.

In summary, there are three different ways development with insurance claim proceeds is managed by CSC and Field Staff, depending on the amount and risk involved. Exhibit 3-3 presents a matrix summarizing these procedures.

- **Total claim of $7,500 or less and the borrower's account is current:** Field Staff endorses the check to the borrower after reviewing the adjuster's worksheet;

- **Total claim exceeding $7,500 but less than $30,000, or claims of $7,500 or less and the borrower's account is not current:** Field Staff forwards insurance proceeds to CSC's insurance escrow, and inspects the work as requested by CSC;

- **Total claim of more than $30,000:** Field Staff establishes a supervised bank account or forwards insurance proceeds to CSC's escrow, and manages all steps of construction planning and performance in a like manner as development funded by loan proceeds.

Exhibit 3-3

Administration of Insurance Proceeds when Redevelopment Work is to be Performed

Total Claims	Account Status	Rehab Components	Insurance Claims Administration Procedure
$7,500 or less	Current	Not considered	Field Staff endorses check to borrower after reviewing the adjuster's worksheet.
$7,500 or less	Not current	Not considered	Field Staff forwards insurance proceeds to CSC's insurance escrow, and inspects the work as requested by CSC.
More than $7,500 but less than $30,000	All accounts regardless of status	Single component	
More than $7,500 but less than $30,000	All accounts regardless of status	More than one component	Field Staff establishes a supervised bank account or forwards insurance proceeds to CSC's escrow, and manages all steps of construction planning and performance in a like manner as development funded by loan proceeds. Work is inspected work prior to any disbursements.
More than $30,000	All accounts regardless of status	All rehab work	

Paragraph 3.13 Administering Insurance Proceeds

For construction contracts exceeding $10,000, Department of Labor requirements also apply. Refer to RD Instruction 1924-A.

B. Loans Secured by Other Than a First Lien

If the loss draft does not include the interest of the prior mortgagee or if all other payees have endorsed the draft, CSC administers the claim as described above for loans secured by a first lien.

When the loss draft includes the interest of the prior mortgagee, oversight of repairs of any supervised account may be conducted by the prior mortgagee.

1. When Proceeds Will Be Used to Repair or Replace the Property

CSC should endorse the loss draft without recourse once the prior mortgagee has agreed to the use of the loss funds to repair or replace the damaged property and the borrower has provided satisfactory proof that the repairs have been made or satisfactory assurance that the work will be performed. Satisfactory assurance includes a signed construction contract, a final inspection report, or a contractor's release of liens.

If funds remain after the repairs are complete and the prior lien holder has agreed in writing that it will apply the funds as a payment on the borrower's prior lien indebtedness, the loss draft should be endorsed without recourse.

2. When Proceeds Will be Used to Reduce Debt on the Property

When the amount of the loss draft is less than the amount of the indebtedness secured by the prior lien and the holder of the prior lien has agreed in writing that it will apply such funds as a payment on the borrower's prior lien indebtedness, CSC may endorse the loss draft without recourse.

When the amount of the loss draft exceeds the amount of the indebtedness secured by the prior lien and the borrower has agreed in writing to pay such indebtedness from the loss funds, the loss draft should be endorsed without recourse only after all parties named as payees in the draft have signed an agreement to deliver the draft "in escrow" to a bank acceptable to the named parties. The agreement will specify the manner in which the funds will be disbursed by the escrow agent to the mortgagees named in the draft.

C. If the Agency is Not Listed as a Mortgagee

The Agency must always be listed in the mortgagee or loss payable clause. However, if through some oversight the Agency is not listed as mortgagee, CSC must contact the borrower to determine if loss proceeds have been received. If the borrower has not yet received the funds, CSC should contact the insurance carrier to request that the loss proceeds be made payable jointly to the Agency and the borrower.

If the borrower already has received the proceeds but has not yet paid for repairs, CSC should notify the borrower that the loss proceeds must be used for repairs or other uses as required by the Agency. If the borrower fails to make required repairs, the account should be accelerated as soon as practical if the Government's security interest is threatened.

D. When the Agency has No Claim on Insurance Proceeds

If the indebtedness secured by the insured property has been paid in full, or the draft is in payment for a loss of property on which the Agency has no claim, any loss draft which includes the Agency as a payee may be endorsed and released without recourse and delivered to the borrower.

3.14 INSPECTING REPAIRS AND AUTHORIZING PAYMENTS

All repairs and replacements will be planned, performed, inspected, and paid for in accordance with RD Instruction 1924-A. Payment schedules will be established in the individual repair plan and the construction contract.

A. Progress Inspections and Payments

When the loss claim is under the purview of CSC, CSC should request that the Field Office inspect the repair work and complete *Form RD 1924-12, Inspection Report.* Before each inspection related to a progress payment, Field Staff should request a check from CSC. The check should be made payable to the borrower and the contractor. If work has been satisfactorily completed, Field Staff will instruct the borrower to endorse the check and give it to the contractor. If the inspection reveals that the work was not completed satisfactorily, Field Staff will void the check and return it to CSC. After each periodic inspection, Field Staff will send the inspection report to CSC and maintain a copy in the borrower's case file. Field Staff will follow up on the adjustment of all losses until satisfactory settlement has been made.

B. Final Payment

When all work has been satisfactorily completed, Field Staff will release the final check to the borrower and submit to CSC all documents completed as required in RD Instruction 1924-A, including: a final *Form RD 1924-12, Inspection Report; Form RD 1924-9, Certificate of Contractor's Release; Form RD 1924-10, Release By Claimants;* and *Form RD 1924-19, Builder's Warranty*.

3.15 POST REPAIR ACTIVITIES

A. If Insurance Funds Remain

If insurance funds remain after all repairs, replacements, or other authorized corrections have been made, the funds will be applied in the following order of priority:

- Prior liens, including delinquent property taxes;
- Any delinquency on the account; and
- Advances for recoverable cost items.

If funds still remain after being applied in the above order and the Agency's debt is adequately secured, CSC should release the funds to the borrower.

B. Reinstatement After Loss

In cases where insurance in the amount of the loss is not reinstated automatically under the provisions of the policy, the Agency should ensure that the borrower reinstates the full amount of the coverage required by the Agency.

3.16 PRESIDENTIAL DECLARED DISASTERS

After a presidential declared major disaster, borrowers may need quick access to all or a portion of the insurance proceeds.

A. Repairs That Will Be Completed Within 30 Days

If the insurance proceeds are $10,000 or less and the repairs can be completed within 30 days, the Agency may endorse the entire check and the proceeds can be released to the borrower for repairs to the property. Before this is done, the borrower must provide a copy of the contractor's estimate of the repair costs.

If the insurance proceeds are more than $10,000 and the repairs can be completed within 30 days, the Agency may release $20,000 to the borrower for the repairs. The borrower must provide a copy of the contractor's estimate of the cost of repairs. The Agency will retain the balance of the proceeds for disbursement according to the borrower's individual plan.

B. Repairs That Require More than 30 Days to Complete

If the repairs cannot be completed within 30 days and the insurance proceeds exceed the outstanding debt against the property, the CSC may release to the borrower an amount equal to the difference between the amount of the insurance proceeds and the debt against the property. The Agency will retain the balance of the proceeds for disbursement according to the borrower's individual plan.

3.17 LOSSES NOT COVERED BY INSURANCE

If a loss occurs while insurance is not in force, CSC should notify the borrower that failure to maintain insurance is a violation of the security agreement and instruct the borrower to make the needed repairs or replacements.

If the borrower is unable or unwilling to make needed repairs or replacements, the Servicer will prepare a problem case report and make recommendations on the following items:

- The advisability and possibility of making a subsequent loan to pay for needed repairs;
- Subordination of the Agency's real estate lien to permit the borrower to obtain funds from another source for needed repairs;
- The possibility of the borrower obtaining funds secured by a junior lien from another lender; and
- Whether a protective advance is necessary to protect the Government's interest.

When preparing the report, the CSC Servicer should consider such factors as the borrower's previous repayment history, the amount of the loss, the nature of the repairs, and the threat to the Agency's security interest.

Recommendations to accelerate the loan should be processed in accordance with Chapter 6.

ATTACHMENT 3-A
INSURANCE POLICY REQUIREMENTS

A. Authorized Insurance Providers

Borrowers must purchase their policies from approved insurance companies licensed to do business in the State where the property is located. If the required insurance is not available at comparable rates from a State-licensed insurance company, insurance from another company may be accepted if:

- The Office of the General Counsel (OGC) confirms that policies issued by the company are enforceable despite the fact that the company is not licensed to conduct business in the State, and the company is a legal entity that may be sued in the State where the property is located; and

- The State Director determines that the company is reputable and financially sound based on the company's financial statements, industry rating standards, or information available from the State insurance authority or other lending institutions.

CSC Servicers may contact the applicable State Office to verify whether the insurance carrier is authorized to do business in the state.

B. Loss or Damage Covered

Hazard insurance policies must insure buildings against loss or damage by fire, lightning, windstorm, hail, explosion, riot, civil commotion, aircraft, vehicles, and smoke. The flood insurance, if applicable, must cover any damage due to water or flooding conditions.

C. Amount

The borrower is required to insure the dwelling and any other essential buildings in an amount equal to the insurable values of the dwelling and other essential buildings. However, in cases where the borrower's outstanding secured indebtedness is less than the insurable value of the dwelling and other essential buildings, the borrower may elect a lower coverage provided it is not less than the outstanding secured indebtedness. If the borrower fails, or is unable to insure the secured property, RHS will force place insurance. The amount of the lender-placed coverage will generally be the last known insured value.

The policy must state whether or not the building is on a leasehold. State Supplements provide guidance on specific State insurance requirements pertaining to leasehold interests. CSC Servicers may contact the applicable State Office for further guidance.

D. Borrower's Deductible

The borrower's deductible must not exceed the generally accepted minimum based on the current industry standards and local market conditions. For flood insurance these deductibles apply unless the insurance carrier requires a higher amount.

E. Term

The policy must have a term of at least 1 year, with evidence that 1 year's premium has been paid.

F. Effective Date

If there are insurable buildings on the property (as opposed to vacant land to be built upon), the policy must be in force at the time the loan is closed. When a dwelling is to be constructed, the insurance coverage must be effective as of the date the materials are delivered to the property. No payments from loan funds for labor or materials can be made unless insurance coverage is in place.

G. Construction Specifications and Use Conditions

If the insurance policy specifies certain standards of construction or prescribes certain uses of the property, the policy will be acceptable only if the property meets the specifications or conditions.

H. Names and Location

The policy must include the legal names of all parties being insured. It also must contain a description of the property's location, although a legal metes and bounds description is not required.

I. Mortgagee Clause

A mortgagee clause ensures that the Agency will be reimbursed in the event of a loss by identifying the Agency as the secured party on the lien (the "mortgagee"). The standard mortgagee clause adopted by the State must be attached to or printed in the policy. It also must identify the Agency as the mortgagee. Specifically, the Agency must be identified as the "United

States of America, acting through the Rural Housing Service or its successor agency." The Agency, and all other mortgagees whose interests are insured under the policy, must be shown in either the mortgagee clause or on the declaration page in the order of priority of their mortgages. The address should be:

United State of America
acting through the Rural Housing Service
or its successor agency
Attn: Insurance Department
P.O. Box 66876
St. Louis, Missouri 63166

Whenever a new mortgagee clause is issued after the policy has been in force, the new mortgagee clause must be signed by an authorized agent or officer of the company that issued the policy.

When an approved mortgagee clause is not printed in the policy, a "loss payable clause" which lists all the parties that would receive payment in case of a loss is acceptable, provided the Agency will receive payment in case of loss, even in circumstances in which the company would not be liable to the borrower. The closing agent must verify that an authorized official of the insurance company has sent a signed letter to the State Director stating that all insurance policies issued by the company in the State incorporate all the provisions of the standard mortgagee clause and that the Agency is named in the loss payable clause (a State Supplement will be issued offering guidance on the requirements of this letter).

Master Policies

A master policy is one containing substantially the same standard provisions adopted or recommended by legislative action or by order of the State's insurance authority. A master policy is required, unless State statutes exempt the company from the regulations requiring its use.

If a State has adopted a master policy, the State Director will submit a copy to CSC. CSC will compare individual policies to the master policy to determine whether they are sufficient to protect the Agency's interest.

ATTACHMENT 3-B

TAX SERVICE FEE SCHEDULE

The tax service fee will be charged according to the timetable listed below:

Tax Service Fee:	New Rates and Terms Assumptions *	$10
New Loans Approved	July 17, 2017 - July 16, 2018	$79
	July 17, 2018 - July 16, 2019	$82
	July 17, 2019 - July 16, 2020	$85
	July 17, 2020 - July 16, 2021	$88
	July 17, 2021 - July 16, 2022	$91
	(This fee remains in effect until further notice)	

* The charge for Tax Service on a New Rates & Terms assumption will remain $10 unless otherwise notified.