CHAPTER 6: LOAN PURPOSES
7 CFR 3555.101

6.1 INTRODUCTION

SFHGLP loan funds can be used to acquire new or existing housing that will be the applicant's principal residence, and, with some restrictions, to pay costs associated with such a purchase. This section describes loan purposes, restrictions, and supplemental loans. The lender is responsible to ensure that loan funds are used only for eligible purposes.

6.2 ELIGIBLE LOAN PURPOSES

Guaranteed loan funds must be used to acquire a new or existing dwelling to be used as a permanent residence and may be used to pay costs associated with such an acquisition. Properties must be residential in use, character and appearance. Loan funds may be used for the following purposes:

- Acquiring a site with a new or existing dwelling;
- Repairs and rehabilitation when associated with the purchase of an existing dwelling;
- Reasonable and customary expenses associated with purchasing a dwelling; and
- Refinancing under specific situations.

A. Acquiring a Site and Dwelling

Loan funds may be used to acquire a site with a new or existing dwelling that meets the Agency's site, dwelling, and environmental requirements, or will meet the Agency's requirements once planned rehabilitation or repair work is completed. These requirements are addressed in Chapter 12 of this Handbook.

B. Repairs and Rehabilitation

If repairs or rehabilitation are involved, the lender must not request that the loan guarantee be issued until all work is complete with the exception of minor exterior work or minor interior work when funds have been escrowed in accordance with Chapter 12 of this Handbook. Additional requirements for repairs and rehabilitation are addressed in Chapter 12 of this Handbook.

C. Reasonable and Customary Expenses Associated With Purchasing a Dwelling

The program allows loan funds to be used for expenses associated with purchasing a dwelling as long as they are reasonable and customary for the area. These expenses may include the following items:

- **Loan Acquisition Expenses**. These include legal, architectural, and engineering fees, title clearance costs, and insurance costs. The guarantee fee and fees for appraisal, surveying, tax monitoring, expenses for homeownership education counseling, and other technical services associated with obtaining the loan may also be included. Paragraph 16.4 B of Chapter 16 of this Handbook provides information on the guarantee fee structure.

- **Reasonable Lender Fees**. Reasonable lender fees, which are financed, may include an origination fee and other fees and charges. Lender fees and charges must meet the points and fees limits published by the Consumer Financial Protection Bureau (CFPB) in the Federal Register at 12 CFR 1026.43(e)(3) and cannot exceed those charged other applicants by the lender for similar transactions such as FHA-insured or VA-guaranteed first mortgage loans. It is the lender's responsibility to ensure CFPB requirements are met. Payment of finder's fees or placement fees for the referral of an applicant to the lender may not be included in the loan amount. Discount points may be financed as described in Paragraph 6.3 of this Chapter. The SFHGLP up-front guarantee and annual fee are not included in the lender fees and charges calculation.

- **Closing Costs**. Closing costs that are reasonable and customary for the area can be paid for with loan funds. Closing costs cannot exceed those charged other applicants by the lender for similar transactions such as FHA-insured or VA-guaranteed first mortgage loans. If the lender does not participate in such programs, the loan closing costs may not exceed those charged other applicants by the lender for a similar program that requires conventional mortgage insurance or a guarantee. Seller contributions (or other interested parties) are limited to six percent of the loan amount and must represent an eligible loan purpose in accordance with this Paragraph. Closings costs and/or prepaid items paid by the lender through premium pricing are not included in the seller contribution limitation. In addition, closing costs, including lender fees, may not exceed the total loan amount as described in this section under "Reasonable Lender Fees." The SFHGLP up-front guarantee fee is not included in the lender fees calculation. The approved lender is responsible to ensure applicable limitations and eligible loan purposes are met.

- **Design Features or Equipment for Physical Disabilities.** Special design features or permanently installed equipment to accommodate a household member who has a physical disability is an eligible loan purpose. The purchase of personal items for such individuals, such as wheelchairs, is not an eligible loan purpose.

- **Connection, Assessment and Installment Fees.** Reasonable and customary connection fees, assessments, or the pro rata installment costs for utilities such as water, sewer, electricity, and gas for which the buyer is liable are eligible costs.

- **Taxes and Escrow Accounts**. A pro rata share of real estate taxes that are due and payable on the property at the time of closing and funds for the establishment of escrow accounts for real estate taxes, hazard and flood insurance premiums, and related costs are eligible costs.

- **Essential Household Equipment.** Loan funds can be used to pay for essential household equipment such as wall-to-wall carpeting, ovens, ranges, refrigerators, washers, dryers, and heating and cooling equipment as long as the equipment is conveyed with the dwelling, and such items are normally sold with dwellings in the area.

- **Energy Efficiency Measures**. Loan funds can be used for purchase and installation of measures to promote energy efficiency, such as insulation, double-paned glass, and solar panels.

- **Broadband**. Loan funds may be used to install fixed broadband service to the household, as long as the equipment is conveyed with the dwelling.

- **Site Preparation.** Site preparation activities, including grading, foundation plantings, seeding or sod installation, trees, walks, fences, and driveways, are eligible costs.

D. Refinance [7 CFR 3555.101(d)]

Refinances under the SFHGLP are permissible under the following conditions.

1. Construction Financing

A refinance is allowed for “take out”/interim financing to construct a new dwelling, or to improve an existing dwelling. The guarantee fee structure for this type of financing will be considered a purchase loan.

- This transaction utilizes two separate loan closings with two separate sets of legal documents.
- A modification may not be used to update the original note. A new note will be signed by the borrowers.
- The first transaction will obtain the interim construction financing. The second closing obtains the permanent financing when improvements are completed.
- The lender is responsible to ensure all costs involved in both transactions represent an eligible loan purpose in accordance with Section 6.2 of this Chapter. Documentation could represent a draw and disbursement ledger validating the builder’s price to build, cost of the land (if applicable), closing costs and any out-of-pocket expenses (supported by canceled checks, paid receipts for construction costs) paid by the applicants.
- The construction period is limited to no greater than 12-months. The 12-month period must have occurred directly prior to permanent financing.
- The borrower must meet credit requirements as outlined in Chapter 10 of this Handbook.
- New construction documentation (certified plans and specifications, inspections and warranty) must be obtained as outlined in Chapter 12 applies.
- The Loan Note Guarantee will be issued on the second transaction, permanent financing, once construction is complete.

2. Site without a Dwelling

In the case of loans for a building site without a dwelling, a refinance is permitted if:

- The debt to be refinanced was incurred for the sole purpose of purchasing the site;
- The applicant is unable to acquire adequate housing without a refinance;
- An eligible dwelling will be constructed on the site prior to issuance of the loan note guarantee; and
- The lender is responsible to ensure all costs involved in the construction financing represent an eligible loan purpose in accordance with Section 6.2 of this Chapter. Documentation could represent a draw and disbursement ledger validating the builder's price to build, cost of the land, closing costs and any out-of-pocket expenses (supported by canceled checks, paid receipts for construction costs) paid by the applicants.
- The construction period is limited to 12-months. The 12-month period must have occurred directly prior to permanent financing.
- The borrower must meet credit requirements as outlined in Chapter 10 of this Handbook.
- New construction documentation (certified plans and specifications, inspections and warranty) must be obtained as outlined in Chapter 12 applies.
- This transaction will represent a two-closing transaction with two sets of legal documents.
- A modification may not be used to update the original note.
- The guarantee fee structure for this type of financing will be considered a purchase transaction loan.

See Section 7 of Chapter 12 for combination construction to permanent financing involving a single-closing transaction.

3. Existing Section 502 Direct and Guaranteed Loans

The intent of the refinance feature of the SFHGLP is to give existing guaranteed and direct borrowers, with satisfactory payment histories, the opportunity to benefit from a lower interest rate and increase their ability to be successful homeowners. The interest rate of the new guaranteed loan must not exceed the interest rate of the existing loan that will be refinanced. Applicants must meet all eligibility requirements as outlined in this Handbook except where noted. SFHGLP refinance loans may **not** be used as a loss mitigation tool for loans that are non-performing. Delinquent loans should be reviewed and evaluated with applicable loan servicing and loss mitigation guidelines.

Three refinance options are available:

i. Non-streamlined refinance.

- A new appraisal is required.

- The maximum loan amount may not exceed the new appraised value, with the exception of the upfront guarantee fee. The following items are eligible to be financed up to the new appraised value: the principal and interest balance of the existing loan, reasonable and customary closing costs, and funds necessary to establish a new tax and insurance escrow account.

- Direct loan borrowers that owe subsidy recapture have the option of financing or deferring the amount of recapture that is due. If the borrower choose to finance the subsidy recapture, they may be eligible for a discount on the amount that is due. If the direct borrower elects to defer their recapture or is unable to include this subsidy within the new appraised value, a second lien will apply and no discount will be available. The upfront guarantee fee may be financed above the new appraised value.

- Additional borrowers may be added to the new guaranteed loan. Existing borrowers on the current mortgage note may be removed, however, at least one of the original borrowers must be an applicant for the new refinance loan.

- The existing loan must have closed 12 months prior to request for a refinance and must be current for the 180 day period prior to the Agency's receipt of a Conditional Commitment request.

- The borrower must meet credit requirements as outlined in Chapter 10 of this Handbook.

- Monthly housing expense to income ratio may not exceed 29 percent. The monthly total debt to income ratio may not exceed 41 percent. Lenders may request a debt ratio exception when documentation of strong compensating factors in accordance with Chapter 11 of this Handbook are met. A satisfactory payment history for the existing mortgage is a strong compensating factor.

- The Guaranteed Underwriting System (GUS) may be utilized to request a non-streamlined refinance.

ii. Streamlined refinance.

- A new appraisal is not required for existing guaranteed loan borrowers. A direct loan borrower will be required to obtain a new appraisal if they have received payment subsidy in order to determine the amount of subsidy recapture due. If subsidy recapture is due, the amount cannot be included in the newly refinanced loan. Subsidy recapture must be paid with other funds or subordinated to the new guaranteed loan.

- The maximum loan amount may not exceed the original loan amount at the time of purchase. The following items are eligible to be financed up to the original purchase price: the principal and interest balance of the existing loan and a reasonable fee for re conveyance of the existing USDA mortgage. The upfront guarantee fee may be financed above the original purchase price.

- Additional borrowers may be added to the new guaranteed loan. Existing borrowers on the current mortgage note may be removed, however, at least one of the original borrowers must remain on the new refinance loan.

- The existing loan must have closed 12 months prior to request for a refinance and must be current for the 180 day period prior to the Agency's receipt of a Conditional Commitment request.

- The borrower must meet credit requirements as outlined in Chapter 10 of this Handbook.

- Monthly housing expense to income ratio may not exceed 29 percent. The monthly total debt to income ratio may not exceed 41 percent.

Lenders may request a debt ratio exception when documentation of strong compensating factors in accordance with Chapter 11 of this Handbook is met. A satisfactory payment history for the existing mortgage is a strong compensating factor.

- GUS may be utilized to request a streamlined refinance.

iii. Streamlined-assist refinance

- A new appraisal is not required for existing guaranteed loan borrowers. A direct loan borrower will be required to obtain a new appraisal if they have received payment subsidy to determine the amount of subsidy recapture due. If subsidy recapture is due, the amount cannot be included in the newly refinanced loan. Subsidy recapture must be paid with other funds or subordinated to the new guaranteed loan.

- The maximum loan amount may include the principal and interest balance of the existing loan, eligible loan closing costs, funds necessary to establish a new tax and insurance escrow account, and the upfront guarantee fee.

- The borrower must receive a tangible benefit to refinance under this option. A tangible benefit is defined as a $50 or greater reduction in their principal, interest, and annual fee monthly payment compared to the existing principal, interest and annual fee monthly payment.

- The existing loan must have closed 12 months prior to request for a refinance.

- The borrower is not required to meet all of the credit requirements as outlined in Chapter 10 of this Handbook. However, the existing mortgage must be paid as agreed for the 12 months prior to application for a streamlined-assist refinance. Lenders may verify mortgage payment history through: 1. A Verification of Mortgage obtained directly from the servicing lender or 2. A credit report. If a credit report is ordered to determine timely mortgage payments, other credit accounts will not be reviewed.

- Borrowers may be added but not removed from the current loan.

- The borrower is not required to meet the repayment provisions as outlined in Chapter 9 of this Handbook.

- GUS may not be utilized and all loans must be manually underwritten.

Obtaining a "Statement of Loan Balance" letter for direct loan borrowers:

Lenders may determine an applicant has direct loan when the credit report reflects "USDA" as the mortgage creditor, or the applicant informs the lender they applied and received their mortgage loan through a USDA Service Center. Direct loans are serviced by the Customer Servicing Center (CSC) located in St. Louis, Missouri. Obtaining a "Statement of Loan Balance" letter will assist lenders to determine if subsidy recapture is due.

1. Submit a request on lender letterhead suitable for fax transmission which includes the borrower's name, account number, address, and the date for which the payoff should be valid. If available at the time of payoff request, also include a copy of the Loan Estimate or Closing Disclosure and a recent appraisal of the direct loan property. If a current appraisal is not remitted at the time of the loan payoff request, the "Statement of Loan Balance" will reflect the maximum amount of subsidy recapture that may be due. When a current appraisal is submitted to the CSC, the payoff will reflect the actual amount of subsidy recapture due. Requests can be faxed to (314)457-4433.

2. The "Statement of Loan Balance" will also include instructions for the lender to follow regardless of information submitted at the time of payoff request.

   The CSC will not provide payoff quotes verbally or over the phone. The CSC also assists lenders with subordination agreements when direct loan borrowers elect to subordinate subsidy recapture due. Lenders and direct loan borrowers that have questions regarding a direct loan account may contact the CSC at (800) 414-1226.

a. Loan Terms and Conditions

- Loan terms are fixed at 30 years.
- The interest rate of the new loan must be fixed and not exceed the interest rate of the loan refinanced.
- The loan security must include the same property as the original loan. The security property must be owned and occupied by the applicants as their principal residence.

- Total adjusted annual income for the household cannot exceed the moderate level for the area.

- Subordinate financing such as home equity seconds and down payment assistance “silent” seconds cannot be included in the new loan amount. The SFHGLP **may not** be used to refinance a leveraged loan from a non-Rural Development source that was closed simultaneously with a Section 502 Direct Loan. Any existing secondary financing must be subordinate to the new first lien.

- Applicants are not eligible to receive “cash out” from the refinance transaction. However, for non-streamlined and streamlined-assist refinance loans applicants may receive reimbursement from loan proceeds at settlement for their personal funds advanced for eligible loan purposes that are part of the refinance transaction, such as an appraisal fee or credit report fee. At loan closing, a nominal amount of “cash out” to the applicants may occasionally result due to final escrow and interest calculations.

- Unpaid fees, past-due interest, and late fees/penalties due the servicer cannot be included in the new loan amount.

- Properties located in areas since determined by the Agency to be non-rural are eligible.

b. Loan Application Documentation

The following items must be addressed or documented in the lender’s loan file in order for the application to be considered complete:

- A Uniform Residential Loan Application (URLA).

- A credit report, as applicable.

- Lender verification of applicant’s current employment and income.

- Lender verification that the total adjusted income for the household does not exceed the current moderate income level established for the area.

- Lender’s underwriting analysis, including applicant’s qualifying ratios for the loan being refinanced, as applicable.

- Applicants and lenders will sign *Form RD 3555-21, "Request for Single Family Housing Loan Guarantee"*.
- A complete Uniform Residential Appraisal Report (URAR), as applicable.
- Property inspections as outlined in Chapter 12 of this Handbook are not required. However, the lender may require completion of repairs as a condition of loan approval. Expenses related to property inspections and repairs may not be financed into the new loan amount.

c. Submission Process

- **Lender:** After underwriting and approving the loan, the application package will be submitted to the Agency for review in accordance with Chapter 15 of this Handbook. The Agency will review applications to determine if all program requirements have been met.
- **Agency:** Funding for the refinance type will be requested by the Agency through the usual channels outlined in Chapter 14 of this Handbook.
- The Agency will establish an application in GLS. Streamlined and non-streamlined refinance transactions submitted through GUS will be uploaded to GLS from the USDA Administration page in GUS.
- The Agency will code refinances with the appropriate type of assistance code (TOA).
- Following Rural Development approval, funds will be obligated in GLS and a Conditional Commitment issued to the lender.
- For streamlined-assist, due to the unique features of this option, the additional processing steps need to be completed by the field staff:

1. Deduct the upfront guarantee fee from the total loan amount and enter that figure as the appraised value in GLS
2. Review the previous 12-month mortgage payment history. If a credit report is submitted, only review the 12-month mortgage payment history. If the mortgage account is currently delinquent or has been reported delinquent in the previous 12 months, the borrower is not eligible.

Agency staff should use the "Borrower ID" with GLS Report *"GLSST01: Status of a GRH Loan Account"* to ensure the loan is currently active and not in default

3. Enter 1 in the "FICO Score" data field when processing a Streamlined-assist application in GLS

4. Enter the repayment income calculation in GLS, but do not include any "Additional Liabilities" amounts. If the new mortgage payment results in ratios above 29 and/or 41 percent, check the box that indicates a debt ratio waiver has been issued by the Agency.

5. If the new Streamlined-assist loan amount exceeds the original loan amount enter the new loan amount into the "Original USDA Purchase Loan Amt." field in GLS (Loan Purposes section). (This is a system override to allow for the loan amount provisions of the streamlined-assist loans).

6. On the "Update Application" GLS loan screen under "Agency Information," select the "Servicing Office" named "STREAM-ASSIST REFI".

d. Closing Costs and Lender Fees

The lender may establish charges and fees for the refinance loan, provided they are the same as those they charge other applicants for similar types of transactions. Lenders and the Agency should make every effort to ensure that applicants are not being charged excessive fees as part of the new loan. Discount points are eligible to be financed to permanently "buy-down" the interest rate. In such cases, discount points financed will not exceed two percentage points of the loan amount and must represent a reduction to the interest rate.

e. Up-Front Guarantee Fee

The guarantee fee for SFHGLP refinances will be established by the Agency. The entire up-front guarantee fee may be financed into the new refinance loan. The amount of the up-front fee will be published in Exhibit K, of RD Instruction 440.1, available in any Rural Development office or on the Rural Development website as follows: http://www.rd.usda.gov/publications/regulations-guidelines.

f. Annual Fee

An annual fee may be charged by the Agency for refinance transactions. The amount of annual fee will be established by the Agency. Refer to Exhibit K of RD Instruction 440.1, available in any Rural Development office or on the Rural Development website as follows: http://www.rd.usda.gov/publications/regulations-guidelines.

g. Loan Note Guarantee Issuance Requirements

Once the lender has closed the loan, closing documentation should be submitted to the Agency. Provided the lender's loan closing documentation is adequate, and the loan documentation represents the loan was closed in accordance with the terms of the Conditional Commitment, a Loan Note Guarantee will be issued. The Agency will process loan closings for SFHGLP refinance loans using the same procedures used for SFHGLP purchase loans. Once the Agency's loan closing has processed and the new Loan Note Guarantee has been issued, the Agency should notify the Finance Office to terminate the original guarantee due to the loan being refinanced through the SFHGLP. Notifications should be made to the National Finance and Accounting Operations Center, Housing Services Branch, Attn: FC-350 by Fax at (314) 457-4279 or by email at NFAOC.HSB@STL.USDA.GOV.

h. Guaranteed Loan System (GLS) Reporting

All SFHGLP refinance loans should be coded with the type of assistance code as referenced in Chapter 14 of this Handbook.

i. Funding Limitations

There will be no limit placed on the number of refinance loans made from the allocation at this time. Refer to Chapter 14 of this Handbook for additional information regarding funding.

4. Additional Criteria for Existing Section 502 Direct Loans

When the Agency has determined that a 502 direct borrower may be eligible to refinance with private credit, the option to attempt a refinance with a SFHGLP loan may be offered to the borrower. It will be the option of the borrower to contact a SFHGLP lender or pursue other refinance credit. If the borrower elects to refinance with a SFHGLP loan, the same process described above for Section 502 Guaranteed loans will apply, with the following exceptions:

a. Section 502 Leveraged Loans

The SFHGLP may not be used to refinance Leveraged Loans. Leveraged Loans are loans from a non-Rural Development source closed simultaneously with a 502 direct loan. The private sector lender takes a first lien; Rural Development takes a second lien on the same property. Because the first lien is not funded or guaranteed by Rural Development, it is statutorily prohibited to refinance Leveraged Loans.

b. Recapture

As part of the direct loan refinance, arrangements must be made to either pay off or defer repayment of any subsidy recapture due. Any recapture amount owed as part of the 502 direct loan pay off may be included into the amount being financed with the SFHGLP loan subject to maximum loan of refinance. Alternatively, any 502 direct recapture amount owed at the time of refinance may be deferred if the recapture amount takes a lien position subordinate to the new SFHGLP loan. A discount on recapture may be offered if the customer does not defer recapture or includes the recapture amount being refinanced with the SFHGLP loans.

E. Supplemental Loans

When an existing SFHGLP loan is assumed, a supplemental loan can be provided if funds are needed for seller equity, closing costs, or essential repairs. See Chapter 17 of this Handbook for a detailed discussion of transfers and assumptions in the SFHGLP.

6.3 PROHIBITED LOAN PURPOSES

Guaranteed loan funds cannot be used for any of the following purposes.

- **Loan Discount Points**. Loan discount points, other than to reduce the effective interest rate, cannot be financed as part of the loan. Discount points must be reasonable and customary for the area and cannot be more than those charged other applicants for comparable transactions. Permissible discount points financed may not exceed two percentage points of the loan amount for a non-streamlined refinance. Loan discount points and loan origination fees must be itemized separately on the settlement statement so that the Agency can accurately identify the amount of the loan used for loan discount points. Loan discount points representing fees other than to reduce the effective interest rate, such as to compensate for a low credit score or low loan amount are ineligible. The lender must begin with an eligible interest rate per 7 CFR Part 3555, 3555.104 prior to reducing the effective interest rate.

- **Income Producing Property**. Purchase or improvement of income-producing land or buildings that will be used principally for income producing purposes is not allowed. Vacant land or properties used primarily for agricultural, farming or commercial enterprise are ineligible. A minimal income-producing activity, such as maintaining a garden that generates a small amount of additional income, does not violate this requirement. A qualified property must be predominantly residential in use, character and appearance. Refer to Chapter 12 of this Handbook for additional information on qualifying a property.

- **Manufactured Homes.** Purchase of an existing manufactured home is not permitted, unless it is a purchase of an existing Rural Development Section 502 direct loan or guarantee, as provided in Section 2 of Chapter 13 of this Handbook.

- **Lease Payments.** Payment on any lease agreement associated with the proposed real estate transaction is prohibited.

- **Seller contributions**. Seller or other interested party contributions towards closing costs in excess of six percentage points are prohibited. Closing costs and/or prepaid items paid by the lender by premium pricing are not included in the seller contribution limitation. Fees towards the applicant's cost to close such as real estate commission or other typical fees paid by the seller or other interested party under local, state law, or local custom are not considered in the maximum contribution calculation. Lenders are responsible to ensure this requirement is met.

- **Closing costs.** Closing costs, including lender fees, may not exceed three percent of the total loan amount, unless flexibility is provided through guidance published by the CFPB's Ability to Repay and Qualified Mortgage (ATR/QM) standards. The SFHGLP up-front guarantee fee and annual fee is not included in the three percent lender fee calculation. Lenders are responsible to ensure this requirement is met.

6.4 AGENCY REVIEW OF LOAN PURPOSES

The Agency will review the purposes for which guaranteed loan funds are being used before issuing a Conditional Commitment for loan guarantee. If the Agency discovers loan funds are to be used for an ineligible purpose, the Agency will contact the lender and attempt to resolve the situation prior to making a determination on the loan guarantee. Loan purposes also will be reviewed during the Agency's on-site monitoring process to ensure that the lender has an accurate understanding of allowable and prohibited loan purposes. See Chapter 20 of this Handbook for a detailed discussion of how the Agency handles loss claims for loan funds that were used for an ineligible purpose.