TABLE OF CONTENTS

Page

CHAPTER 1: OVERVIEW OF GUARANTEED RURAL RENTAL HOUSING PROGRAM ORIGINATION AND SERVICING HANDBOOK 1-1

1.1 Introduction 1-1

SECTION 1: THE HANDBOOK 1-1

1.2 Purpose 1-1
1.3 Using the Handbook 1-2
A. Handbook Symbols 1-2
B. Citations and Text Boxes 1-2
C. Attachments and Appendices 1-3

SECTION 2: THE RURAL HOUSING SERVICE (RHS) 1-3

1.4 RHS Organization 1-3

SECTION 3: OVERVIEW OF THE GUARANTEED RURAL RENTAL HOUSING PROGRAM 1-3

1.5 Program Goals 1-3
1.6 Eligible Rural Area 1-4
1.7 Program Features 1-4
A. Risk Sharing with Lenders 1-5
B. Affordability Features 1-5
C. Construction and Permanent Financing 1-5
D. Lender Origination, Servicing, and Disposition 1-5
E. The NOFA Process 1-6

1.8 Roles and Responsibilities of Agency, Lender and Borrower 1-6
1.9 Identity of Interests 1-7
1.10 Agency Exception Authority 1-8
1.11 Reviews and Appeals 1-9

SECTION 4: FEDERAL REQUIREMENTS 1-10

1.12 Intergovernmental Review 1-10
1.13 National Flood Insurance Program 1-10
1.14 Historic Preservation 1-10

1.15 Civil Rights 1-10
A. Nondiscrimination 1-10
B. Reasonable Accommodations for Persons with Disabilities 1-11

1.16 Fair Housing 1-12
1.17 Environmental Requirements 1-12

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

CHAPTER 2: LENDER ELIGIBILITY AND APPROVAL 2-1

2.1 Purpose and Overview 2-1

SECTION 1: LENDER ELIGIBILITY 2-2

2.2 Purpose 2-2
2.3 Requesting Lender Eligibility 2-2
2.4 Basic Eligibility Test Requirements 2-2
2.5 Demonstrated Eligibility Test Requirements 2-3
2.6 Eligibility Requirements 2-3
A. Origination and Servicing Plan 2-3
B. Demonstrate the Lender's Financial Stability 2-5
C. The Lender's Certification to Comply with Program Requirements 2-5

2.7 Additional Requirements for Approval to Originate and Service Option Two and Option Three Loan Guarantees 2-5
2.8 Participation by Lenders without Demonstrated Ability 2-6

SECTION 2: ELIGIBILITY APPLICATION PROCESSING 2-6

2.9 Overview 2-6
2.10 Agency Assessment of the Request 2-6
2.11 Submission Requirements — Lender Application 2-7
2.12 Issuance of Approved Lender Status 2-8

SECTION 3: MAINTENANCE OF LENDER APPROVAL 2-8

2.13 Requirements for Retaining Approved Status 2-8

SECTION 4: OTHER ISSUES 2-9

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

CHAPTER 3: LENDER UNDERWRITING 3-1

3.1 Introduction 3-1

SECTION 1: LENDER UNDERWRITING RESPONSIBILITIES 3-1

3.2 Overview 3-1
3.3 Summary of Lender Responsibilities 3-2

SECTION 2: LENDER NARRATIVE 3-2

3.4 Narrative Requirements 3-2

SECTION 3: BORROWER ELIGIBILITY 3-3

3.5 Overview 3-3
3.6 Eligible Borrowers 3-3
3.7 Ineligible Borrowers 3-4
3.8 Borrower Types 3-4
A. General or Limited Partnerships 3-5
B. Corporations 3-6
C. Limited Liability Companies 3-7
D. Trusts 3-7
E. Public Agencies 3-7
F. Indian Tribes 3-7
G. Individuals 3-8

3.9 Certification of Legal Eligibility 3-8
3.10 Borrower Experience and Capacity 3-8
A. Construction and Rehabilitation Experience 3-8
B. Property Management Experience 3-9
C. Financial Capacity 3-10

SECTION 4: PROPERTY REQUIREMENTS 3-13

3.11 Overview 3-13
3.12 Rural Area Designation 3-14
3.13 General Site Requirements 3-14
A. Public Facilities and Services 3-14
B. Less Desirable Areas 3-14

3.14 Site Standards 3-15
A. Applicable Codes 3-15
B. Adequate Utilities and Infrastructure 3-15

C. Grading and Drainage 3-15
D. Size and Shape 3-15
E. Undesirable Physical Conditions 3-15

3.15 Site Density 3-16
3.16 Non-Contiguous Sites 3-16
3.17 Site Control 3-16
A. Land Ownership 3-16
B. Land Lease 3-14

3.18 Environmental Requirements 3-17
A. Lender Responsibilities Prior to Requesting Guarantee 3-18
B. Agency Environmental Review 3-18

3.19 Civil Rights 3-18
3.20 Project Development 3-19
A. Project Size 3-19
B. Agency Construction Requirements 3-19
C. Federal Accessibility Requirements 3-19

SECTION 5: FINANCING TERMS 3-22

3.21 Overview 3-22
3.22 Occupancy and Rent Restrictions 3-22
3.23 Use of Loan Proceeds 3-24
A. Eligible Uses of Loan Proceeds 3-24
B. Ineligible Uses of Loan Funds 3-25

3.24 Applying Section 207(c) Loan Limits 3-26
3.25 Mortgage Terms 3-26
A. Maximum Loan Term 3-26
B. Maximum Interest Rate 3-27
C. Interest Reduction Credit 3-27
D. Maximum Loan Amount 3-28

SECTION 6: DETERMINING PROPERTY VALUE 3-29

3.26 Overview 3-29
3.27 Cash Flow Analysis 3-29
A. Operating and Maintenance Expense 3-29
B. Debt Service 3-30

3.28 Appraisal 3-32
A. Appraisal Requirements 3-32
B. Appraiser Qualifications 3-32
C. Appraisal Methods 3-32
D. Appraisal Report Guidelines 3-33
E. Market Study 3-33

CHAPTER 4: LOAN GUARANTEE APPLICATION PROCESSING 4-1

SECTION 1: AN OVERVIEW OF THE PROCESS 4-1

4.1 Purpose 4-1

SECTION 2: NOTICE OF FUNDING AVAILABILITY (NOFA) 4-1

4.2 Publication of GRRHP Requirements 4-1
4.3 Response to the NOFA 4-1
4.4 Information to be Included in Response to the NOFA 4-2
A. Descriptive Information 4-2
B. Lender Eligibility and Approval Status 4-3
C. Competitive Criteria 4-3
D. Lender Commitment Letter 4-4

4.5 Agency Review of NOFA Response 4-4
A. Was the Project Proposal on Time and Complete? 4-4
B. Is the Borrower An Eligible Entity? 4-4
C. Is the Lender Eligible? 4-5
D. Is the Proposed Project Eligible? 4-5

4.6 Notice to Proceed with Application Processing 4-6

SECTION 3: APPLICATION FOR THE GUARANTEE 4-7

4.7 Purpose of the Application 4-7
A. The Proposed Project Meets the GRRHP Threshold Requirements 4-7
B. The Proposed Project is Eligible to Receive a Conditional Commitment 4-8

4.8 Application Form and Documentation 4-8
A. The Lender's Certification 4-8
B. Exhibits and Supporting Information to the Lender's Certification 4-8

4.9 Interest Credit Request and Documentation 4-13
A. Amount of Interest Credit Subsidy 4-13
B. Demonstrated Need 4-13

C. Limits on Allocation of Interest Credit 4-13
D. Payment of Interest Credit 4-14
E. Cancellation of Interest Credit 4-15
F. Closing a Loan with Interest Credit 4-15

4.10 Lender Review of the Borrower Submissions 4-16
A. Borrower Eligibility 4-16
B. Project Eligibility 4-17
C. Project Feasibility Analysis 4-17

4.11 Agency Review of the Loan Guarantee Application 4-19
A. Determination that the Loan Guarantee Application Package is Complete ... 4-19
B. Environmental Review by Agency 4-19
C. Civil Rights Impact Analysis 4-19
D. Review of Other Federal Requirements 4-20
E. Review of Affirmative Fair Housing Marketing Plan (AFHMP) 4-20
F. Decision on Interest Credit Subsidy Request 4-22
G. Decision on the Guarantee Amount 4-22
H. Determination that the Loan is Acceptable for a Conditional Commitment .. 4-22
4.12 Agency Decision 4-23

SECTION 4: ISSUANCE OF CONDITIONAL COMMITMENT 4-24

4.13 General Requirements 4-24
4.14 Terms of Conditional Commitment 4-24
A. Subsidy Layering Review 4-25
B. Guarantee Fee 4-25
C. Transactions Backed by Ginnie Mae 4-26
D. Termination of the Conditional Commitment 4-26
E. Substitution of Lender 4-27
F. Lender's Agreement 4-27
G. Loan Note Guarantee Agreement 4-27

SECTION 5: RESPONSE TO THE CONDITIONAL COMMITMENT AND LOAN CLOSING 4-28

4.15 General Conditions 4-28
4.16 Development of the Regulatory Agreement 4-28
4.17 Loan Closing 4-29

SECTION 6: GUARANTEE DURING CONSTRUCTION 4-29

4.18 Combination Construction and Permanent Loan 4-29

SECTION 7: PERMANENT GUARANTEE 4-31

4.19 Occupancy 4-31
4.20 Documentation Requirements 4-32

SECTION 8: TERMINATION OF THE LOAN GUARANTEE 4-35

4.21 Reasons for Termination 4-35
A. Repayment of the Loan 4-35
B. Payment of a Claim 4-35
C. Voluntary Termination of the Guarantee Agreement by the Lender 4-35
D. Non-Compliance with Program Requirements 4-36
E. Fraud 4-37

Attachment 4-A: Section 538 GRRHP Application Checklist
Attachment 4-B: Suggested Format for the Opinion of the Lender's Legal Counsel
Attachment 4-C: Closing Documents to be Submitted as Part of the Final Application
Attachment 4-D: Housing Allowances for Utilities and Other Public Services
Attachment 4-E: Planning Meeting Agenda

CHAPTER 5: CONSTRUCTION REQUIREMENTS 5-1

5.1 Introduction 5-1

SECTION 1: PRE-CONSTRUCTION CONFERENCE 5-2

5.2 Conference Requirements 5-2

SECTION 2: BASIC CONSTRUCTION REQUIREMENTS 5-2

5.3 Overview 5-2
5.4 Construction Contractor Experience and Capacity 5-3
5.5 Debarment and Suspension 5-3
5.6 Architectural Services and Capital Needs Assessments 5-3
5.7 Plans, Specifications and Cost Estimates 5-4
5.8 Environmental Requirements 5-5
5.9 Construction 5-6
5.10 Inspections 5-6
5.11 Warranty 5-8
5.12 Construction Requirements Certification 5-8

SECTION 3: GUARANTEES OF CONSTRUCTION ADVANCES 5-9

5.13 Overview 5-9

5.14 Insurance 5-10
5.15 Sureties 5-10
5.16 Letters of Credit 5-10
5.17 Payment Procedures 5-11
5.18 Contract Change Orders 5-12
5.19 Modification of Maximum Amount Guaranteed During Construction 5-12
5.20 Reporting During Construction Period 5-13
5.21 Final Payment 5-14
5.22 Certification that Additional Requirements Have Been Met 5-14

SECTION 4: APPLICATION PROCESSING FOR GUARANTEES ON CONSTRUCTION ADVANCES 5-15

5.23 Overview of Process 5-15

SECTION 5: CLAIMS PROCESSING FOR GUARANTEES ON CONSTRUCTION ADVANCES 5-15

5.24 Overview of Process 5-15

CHAPTER 6: PROGRAM FEES 6-1

6.1 Overview 6-1
6.2 Fees Associated with the Loan Guarantee 6-2
A. Guarantee Fee 6-2
B. Annual Guarantee Renewal Fee 6-2
C. Surcharge for Guarantees on Construction Advances 6-2

6.3 Additional Agency Fees 6-2
A. Application Fee 6-2
B. Extension and Reopening Fees 6-3
C. Transfer of Ownership Fee 6-3

CHAPTER 7: SERVICING PERMANENT LOANS 7-1

7.1 Introduction 7-1

SECTION 1: SERVICING GOALS AND OBJECTIVES 7-1

7.2 Objectives 7-1
7.3 Protecting the Value of the Financial Asset 7-1
7.4 Ensuring the Program Compliance 7-2
7.5 Protecting the Tenants' Rights 7-2
7.6 Protecting the Government's Interests 7-2

SECTION 2: GENERAL SERVICING REQUIREMENTS 7-3

7.7 Funds Management 7-3
A. Collecting and Processing Borrower Payments 7-3
B. Escrow and Reserve Account Management 7-3
C. Interest Credit, if Applicable 7-3
D. Approval of Reserve Releases 7-3
E. Approval of Surplus Cash Distribution to the Borrower 7-6

7.8 Addressing Defaults and Delinquencies 7-7
A. Delinquencies 7-8
B. Default 7-8
C. Declaring a Default 7-8
D. Initiating Special Servicing 7-8

7.9 Transfer of Ownership 7-9
A. Changes in the Ownership Entity 7-9
B. Transfers of Title/Transfers of Physical Assets 7-9
7.10 Transfer of Loans or Mortgage Servicing 7-10

SECTION 3: ASSET MANAGEMENT 7-10

7.11 Overview 7-10
7.12 Financial Management 7-10
A. Borrower Reports to the Lender 7-10
B. Lender Reports to the Agency 7-11

7.13 Completing the Capital Needs Assessment and Reserve Analysis 7-14

A. The Capital Needs Assessment 7-14
B. Adjusting the Reserve Deposit Requirement 7-15

7.14 Physical Maintenance and Program Compliance and Oversight 7-15
A. Physical Standards and Inspections 7-15
B. Capital Improvement Plans 7-16
C. Compliance with other Federal Requirements 7-16
D. Compliance with other Program Requirements 7-19

SECTION 4: SPECIAL SERVICING 7-21

7.15 Overview 7-21
7.16 Roles and Responsibilities of the Servicing Lender 7-21
A. Development of a Workout Plan 7-21
B. Bankruptcy of Borrower 7-22
C. Loss Claims During Bankruptcy… 7-22

7.17 Roles and Responsibilities of the Borrower 7-22
A. Submission of Information to the Lender 7-22
B. Development and Execution of the Workout Plan 7-23
C. Compliance with the Workout Plan 7-23

7.18 Special Servicing Options 7-23
A. Loan Modifications 7-23
B. Partial Payment of Claim 7-23
C. Transfer of Physical Assets (TPA) 7-24
D. Agency Approval of Reserve Releases 7-24
E. Lender Recommendation of Enforcement Action 7-24
7.19 Loan Modification (Interest Rate Reduction) 7-24
Attachment 7-A: GRRHP Lender Servicing Compliance Checklist
Attachment 7-B: Supplemental Government Auditing Standards Guide

CHAPTER 8: PROPERTY MANAGEMENT 8-1

8.1 Introduction 8-1

SECTION 1: ROLE OF LENDER IN PROPERTY MANAGEMENT 8-1

8.2 Responsibilities of the Lender 8-1
A. Management Plan 8-2
B. Property Manager Qualifications 8-2
C. Management Agreement 8-2
D. Site Visits 8-2
E. Occupancy and Rent 8-2
F. Affirmative Fair Housing Marketing Plan 8-2
G. Reporting 8-2
H. Relationship Reporting 8-3
I. Pre-Rent Up Instructions 8-3

SECTION 2: MANAGEMENT PLAN 8-4

8.3 Overview 8-4

8.4 Management Plan Requirements 8-4
A. Management Plan Contents 8-4
B. Agency Review 8-5

SECTION 3: PROPERTY MANAGER 8-6

8.5 Overview 8-6
8.6 Key Property Manager Issues 8-7
8.7 Property Manager Experience 8-7
8.8 Previous Participation and other Federal Requirements 8-8

SECTION 4: MANAGEMENT AGREEMENT 8-8

8.9 Overview 8-8
8.10 Terms and Conditions 8-8
8.11 Management Fee 8-9

SECTION 5: OCCUPANCY REQUIREMENTS 8-9

8.12 Occupancy Requirements and Lender Review 8-9
A. Income of Residents 8-9
B. Tenant Income Certifications 8-9
C. GRRHP Definition of Income 8-10
D. Reporting of Income 8-10
E. Restrictions on Rent 8-11
F. Use Restrictions 8-11

SECTION 6: TENANT PROTECTION AND GRIEVANCE PROCEDURES 8-12

8.13 Overview 8-12
8.14 Tenant Protection 8-12
8.15 Grievance Procedures 8-12
8.16 Civil Rights 8-14
A. Lender Obligations 8-14
B. Penalties 8-15

8.17 Housing Discrimination 8-15

Attachment 8-A: Management Plan Requirements for the Guaranteed Rural Rental Housing Program

Attachment 8-B: The Hearing Process for Tenant Grievances and Appeals for the Guaranteed Rural Rental Housing Program

CHAPTER 9: INSURANCE REQUIREMENTS 9-1

9.1 Introduction 9-1

SECTION 1: OVERVIEW OF INSURANCE REQUIREMENTS 9-1

9.2 Overview 9-1

SECTION 2: TYPES OF INSURANCE 9-1

9.3 Property Insurance 9-1
9.4 Fidelity Insurance 9-2
9.5 Mortgage's Errors and Omissions (E&O) Insurance 9-2
9.6 Liability Insurance 9-3
9.7 Worker's Compensation 9-3
9.8 Evidence of Insurance, Terms, and Coverage 9-3

SECTION 3: AUTHORIZED INSURANCE PROVIDERS 9-3

9.9 Overview 9-3
9.10 Acceptable Ratings for Insurance Providers 9-3

CHAPTER 10: CLAIMS 10-1

10.1 Purpose and Overview 10-1

SECTION 1: PRE-LIQUIDATION REQUIREMENTS 10-2

10.2 Overview 10-2

SECTION 2: DECISION TO LIQUIDATE 10-2

10.3 Overview 10-2
10.4 Notice of Liquidation and Potential Claim 10-3
10.5 Submission of a Liquidation Plan 10-3
10.6 Approval of Liquidation Plan 10-5
10.7 Filing an Estimated Loss Claim 10-5
10.8 Withdrawal of a Claim 10-6

SECTION 3: PROPERTY LIQUIDATION 10-6

10.9 Property Acquisition 10-6
10.10 Lender Liquidation 10-7
10.11 Failure to Comply with the Liquidation Plan 10-7

SECTION 4: AGENCY ELECTION OF ASSIGNMENT OR CONVEYANCE 10-7

10.12 Overview 10-7
10.13 Assignment of the Loan 10-8
10.14 Conveyance of Title to the Agency 10-8

SECTION 5: DETERMINATION OF THE CLAIM AMOUNT 10-9

10.15 Introduction 10-9
10.16 Determination of the Date of Loss 10-10
A. Lender Liquidation 10-10
B. Assignment or Conveyance of Title to the Agency 10-10

10.17 Calculation of Loss 10-10
A. Request for Estimated Loss Claim 10-10
B. Final Report of Loss 10-11

10.18 Protective Advances 10-11
10.19 Liquidation Expenses 10-11
10.20 Legal Expenses During Bankruptcy Proceedings 10-11
10.21 Maximum Guarantee Payment 10-12

SECTION 6: PAYMENT OF THE FINAL CLAIM 10-12

10.22 Overview 10-12
10.23 Submission of a Report of Final Loss 10-12
10.24 The Approved Claim Amount 10-13

CHAPTER 11: ENVIRONMENTAL REQUIREMENTS 11-1

11.1 Purpose and Overview 11-1
11.2 General Environmental Requirements 11-1
11.3 Environmental Risk Management 11-2
11.4 Responsibility for Environmental Reviews 11-4
11.5 Environmental Reviews During Loan Origination 11-4
A. The NOFA Submission Stage 11-5
B. The Application Submission Stage 11-5

11.6 Environmental Reviews During the Servicing Period 11-6
11.7 Other Environmental Requirements 11-7
A. Flood Hazard Determination 11-7
B. Clean Air Act and Water Pollution Control Act 11-7

CHAPTER 12: SECONDARY MARKET 12-1

12.1 Purpose and Overview 12-1

SECTION 1: TRANSFER TO SECONDARY MARKETS 12-1

12.2 Holder Versus Participant 12-1

12.3 Transfer to the Secondary Market 12-2
A. Loan Requirements for Sale on the Secondary Market 12-2
B. Agency Execution of Form RD 3565-5, Assignment Guarantee Agreement .. 12-3
C. Loans Involving Ginnie Mae, Freddie Mac and Fannie Mae 12-4

SECTION 2: REPURCHASE FROM A SECONDARY MARKET HOLDER 12-4

12.4 Holder Demand Repurchase 12-4
12.5 Lender Initiated Repurchase 12-5
12.6 Demand Repurchase of Loans Contained in a Ginnie Mae Pool 12-5
12.7 Purchase of the Loan or Note by the Agency 12-5
A. Agency Purchase from the Holder 12-5
B. Agency Purchase of Loans Contained in Ginnie Mae Pools 12-7
12.8 Servicing Fees 12-8

GLOSSARY

APPENDIX 1: 7 CFR PART 3565

APPENDIX 2: LIST OF FORMS

CHAPTER 1: OVERVIEW OF GUARANTEED RURAL RENTAL HOUSING PROGRAM ORIGINATION AND SERVICING HANDBOOK

1.1 INTRODUCTION

This chapter provides an overview of the Guaranteed Rural Rental Housing Program (GRRHP) Handbook and key program features. It includes the following sections:

Key Topics in this Chapter

Section 1: The Handbook
Section 2: The Rural Housing Service (RHS)
Section 3: Program Overview
Section 4: Federal Requirements

SECTION 1: THE HANDBOOK

1.2 PURPOSE

This handbook provides lenders and Rural Housing Service (hereinafter referred to as RHS or the Agency) staff with guidance on the origination and servicing of GRRHP loans and the approval of qualified lenders. Lenders will use this handbook as a guide for carrying out the activities and procedures required by the regulation. Agency staff will use the handbook as a reference to monitor and evaluate a lender's performance in the program.

These instructions are intended to be consistent with all applicable laws, civil rights laws, Executive Orders, and U.S. Department of Agriculture (USDA) regulations. Nothing in this handbook should be construed to supersede, rescind, or otherwise amend such laws, Executive Orders, and regulations.

This handbook and any additions or revisions to this handbook will be distributed to approved lenders and are available to other interested parties at www.rurdev.usda.gov/regs/hblist.html#hbw6.

1.3 USING THE HANDBOOK

This handbook has been organized for ease in looking up information. Several graphic tools and conventions have been used to make information easier to find and understand.

A. Handbook Symbols

- **References**. The book symbol directs the reader to additional information sources, such as laws, regulations, or instructions.

- **Civil rights**. A modified fair housing logotype highlights processing procedures with significant fair housing or civil rights implications.

- **Deadlines**. Time frames for completing required actions are highlighted by a small clock to make them easier to locate. Deadlines are also underlined in the text. Deadlines are generally expressed in terms of calendar days unless otherwise noted.

- **Helpful hints.** Helpful hints, cautions, or important facts are included in text boxes throughout the handbook and display this hand symbol.

B. Citations and Text Boxes

- **Regulatory citations.** The text of the GRRHP regulation *[7 CFR part 3565]* is provided in Appendix 1. All references to this regulation appear in italicized brackets. Other referenced regulations or Rural Development (RD) Instructions may be found on the USDA/RD website at http://www.rurdev.usda.gov/RegulationsAndGuidance.html

The Code of Federal Regulations

What is the CFR? The Code of Federal Regulations (CFR) is published in volumes and is numbered according to the Agency or subject. The part pertaining to USDA can be found in Title 7 of the CFR.

Where do I find Federal regulations? Some sources for the CFR are:

- Purchase it from the U.S. Government Printing Office, Superintendent of Documents, Washington, DC 20402-9328.
- View the e-CFR on the Internet at: http://www.gpoaccess.gov/cfr/index.html.

- **Form references.** Agency forms, guides, and system letters are shown in italics. Appendix 2 lists all forms used in this handbook.

- **Examples and exhibits.** Text boxes labeled as examples or exhibits provide a specific illustration of a concept described in the text or provide additional detailed

information. Exhibits are numbered in sequence, using the chapter number. For example, Exhibit 2-1 is the first exhibit in Chapter 2. Examples are not numbered.

C. Attachments and Appendices

- **Attachments.** Attachments at the end of each chapter contain technical information that is specific to the topics covered in the chapter. Attachments are referenced in sequence, using the chapter number and a letter; for example, Attachment 4-A is the first attachment in Chapter 4.
- **Glossary and acronyms lists.** Key words and terms are defined in the glossary. The glossary and list of acronyms can be found immediately before Appendix 1.
- **Appendices.** Appendices at the end of the handbook include forms and other reference materials that relate to multiple chapters or the entire handbook.

SECTION 2: THE RURAL HOUSING SERVICE (RHS)

1.4 RHS ORGANIZATION

RHS is a credit agency within USDA for rural housing and community development. The Agency's purpose is to increase the availability of affordable housing and community facilities for rural residents.

The GRRHP will be administered jointly by the RHS National Office and State Offices. The National Office will allocate guarantee authority to the States. National Office staff will also approve lenders and allocate interest credit, if applicable.

All applications will be sent to the State Offices initially. State Offices will score applications and submit them to the National Office for its concurrence, when applicable, and funding.

SECTION 3: PROGRAM OVERVIEW

1.5 PROGRAM GOALS

The GRRHP was established to:

- Increase the supply of affordable rental housing in rural areas;
- Ensure that housing is affordable to rural residents whose incomes are 115 percent or less of area median income (AMI);

- Provide housing that is decent, safe, sanitary, and competitive in the market; and
- Foster risk-sharing partnerships with public and private lenders.

Under the program, the Agency will provide credit enhancements through Government guarantees to encourage private and public lenders to make new loans for the construction and preservation of affordable rural rental properties. The Agency will review lender qualifications and approve eligible lenders to participate in the program. Approved, lenders will underwrite and service the loans guaranteed by the Agency. The Agency will monitor lender performance to ensure it meets program requirements.

1.6 ELIGIBLE RURAL AREA

Loans under this program may only be made in an eligible rural area. An eligible rural area is:

- Open country which is not a part of or associated with an urban area.
- Any town, village, city, or place, including the immediate, adjacent, densely-settled area which is not part of or associated with an urban area and which has:
  - ◊ An area with a population of 10,000 or less if it is rural in character, or
  - ◊ An area with a population in excess of 10,000, but not in excess of 20,000, that is not contained within a Metropolitan Statistical Area and has a serious lack of mortgage credit for low and moderate income households, as determined by the Secretary of Agriculture and the Secretary of the Department of Housing and Urban Development (HUD), or
  - ◊ An area classified as a rural area prior to October 1, 1990, (even if within a Metropolitan Statistical Area), with a population exceeding 10,000, but not in excess of 25,000, which is rural in character and has a serious lack of mortgage credit for low and moderate income families. (This definition is effective through the receipt of the most current decennial census data.)
- A Section 515 revitalization property that will use Section 538 Guaranteed Rural Rental Housing loan funds. (This is permissible in areas that are no longer rural.)

1.7 PROGRAM FEATURES

The GRRHP program offers the following types of loan guarantees *[7 CFR 3565.52 (c)(1), (c)(2), and (c)(3)]*:

- The Agency may guarantee permanent loans (Option One).

- The Agency may guarantee advances during construction and [when eligible] the permanent loan (Option Two).

- The Agency may provide a single continuous guarantee for construction and permanent loans (Option Three).

Key features of the program include:

A. Risk Sharing With Lenders

The Agency will provide a guarantee in the event of loss of up to 90 percent of the loan amount; lenders will retain the remaining 10 percent of any loss. The Agency and lender risk sharing percentages will be applied equally to every dollar of the Agency-approved loss amount. While this type of lending presents additional risks to lenders, the Agency believes that lender performance will be improved if lenders have a financial interest in preventing losses.

B. Affordability Features

The program restricts both tenant income and unit rents. The program is designed to provide housing for low- or moderate-income families or individuals whose incomes at initial occupancy do not exceed 115 percent of the AMI adjusted for family size. Monthly rent for a unit may not exceed 30 percent of 115 percent of adjusted AMI. Average project rent may not exceed 30 percent of 100 percent of AMI.

C. Construction and Permanent Financing

The program may provide credit enhancement for construction lending as part of a construction and permanent loan. This feature is intended to encourage greater construction lending in rural areas and make it easier for lenders to make one loan to finance a project.

D. Lender Origination, Servicing, and Disposition

To be approved to participate in the program lenders must be experienced in affordable rental housing loan origination and servicing. Lenders will be responsible for underwriting the loan in a prudent manner and for servicing the loan to ensure repayment and protection of the property. In the event of default by the borrower, lenders must dispose of properties prior to submitting a claim to the Agency.

When a borrower defaults on a loan, the lender must submit a liquidation plan for the Agency's approval. When the property is liquidated, the lender will be able to submit a claim and receive payment for the Agency's share of any loss if the lender has complied with all program requirements.

E. The Notice of Funding Availability (NOFA) Process

The availability of GRRHP guarantee and interest credit authority under all three options and the criteria for allocating this assistance will be made public through a NOFA. Once a NOFA has been published, lenders may submit a summary of proposed projects for scoring and ranking. All responses will be reviewed and ranked in accordance with selection criteria included in the NOFA. Applicants selected will be issued a Notice to Proceed with Processing (Notice to Proceed) of an application for a loan guarantee.

1.8 ROLES AND RESPONSIBILITIES OF AGENCY, LENDER, AND BORROWER

Each participant in the guarantee program has responsibilities that must be met if the program is to achieve its goals. Agency staff, participating lenders, and borrowers should understand the range of tasks for which they are responsible. The responsibilities are summarized below.

The Agency will:

- Approve qualified lenders and monitor lenders for compliance;
- Conduct the National Environmental Policy Act (NEPA) environmental review;
- Approve the loan guarantee application; and
- Process and pay claims.

The Lender must:

- Originate and service loans;
- Monitor the borrower and property for compliance with program requirements;
- Manage the mortgage asset through regular monitoring; and
- Provide reports to the Agency on loans in their portfolio.

The Borrower must:

- Develop and maintain property that is decent, safe, and sanitary;
- Ensure that the occupancy and rent requirements are met;

- Comply with all other program rules and regulations; and
- Comply with the loan requirements.

1.9 IDENTITY OF INTERESTS

Hidden identity of interest relationships may undermine the confidence of participants and the public that the program is fair and open. The lender is responsible for properly addressing any identity of interest situations and for disclosing their existence to the Agency using *Forms RD 3560-30* "Certification of No Identity of Interest (IOI)" or 3560-31 "Identity of Interest Disclosure/Qualification Certificate".

Identity of interest may exist between the borrower and another party, such as a general contractor, architect, engineer, attorney, subcontractor, material supplier, or equipment lessor (hereafter called "other entities") in circumstances such as the following:

- When there is any financial interest of the borrower in any other entity, except provisions of normal professional services by architects, engineers, attorneys, or accountants with a client-professional relationship (these situations will not constitute an identity of interest);
- When one or more of the officers, directors, stockholders, or partners of the borrower is also an officer, director, stockholder, or partner of any other entity;
- When any officer, director, stockholder, or partner of the borrower has any financial interest, whatsoever, in any other entity;
- When any spouse or relative (such as grandmother, aunt, daughter, granddaughter, grandfather, uncle, son, grandson, mother, sister, niece, cousin, father, brother, nephew) or step-relatives of the borrower, on its principals, has any significant financial interest in any other entity;
- When any other entity advances any funds to the borrower;
- When any other entity provides and pays, on behalf of the borrower, the cost of any legal services, architectural services, engineering services, or other development costs, other than those of a surveyor, general superintendent, or engineer employed by a general contractor, in connection with obligations under the construction contract;
- When any other entity takes significant stock or any interest in the borrower as part of the consideration to be paid;

- When there exists or comes into being any side deals, agreements, contracts, or undertakings that alter, amend, or cancel any of the required loan or construction closing documents; or

- When another party can significantly influence the management or operating policies of the transacting parties, or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

When considering whether a lender's relationship in an entity that purchased the low income housing tax credits generated by a project may be an inappropriate identity of interest, the Agency will determine whether the lender's interest in the entity controlling the tax credits conflicts with the lender's responsibilities under the program. From to time to time affordable housing lenders, in addition to providing loan funds on affordable housing projects may purchase an interest in an entity that purchased the low income housing tax credits on that project. The Agency does not want to discourage this practice however the Agency must be sure that its interest as a guarantor is not compromised by the lender's interest in the tax credit ownership entity. The Agency will look to several factors during its review;

- The lender's ownership interest in the entity owning the tax credits;

- The lender's ability to effect action within the entity that owns the tax credits;

- The connection and interaction between the subsidiary of the lender that owns the interest in the entity owning the subsidiary of the lender that originates and services the loan guaranteed by the Agency; and

- The loan to cost ratio of the guaranteed loan for the project.

1.10 AGENCY EXCEPTION AUTHORITY

Exceptions to any requirement of this handbook or *[7 CFR part 3565]*, which are not inconsistent with any applicable law, may be approved by the Administrator or a designee, on an individual basis, if the application of the requirement or failure to take action would adversely affect the government's interest, adversely affect the accomplishment of the purposes of the program, or result in undue hardship. The Administrator may exercise such authority independently or at the request of the State Director. A request for an exception to any requirement may also be initiated by the Deputy Administrator for Multifamily Housing. The exception request must provide clear and convincing evidence of the need for the exception. At a minimum, the request must include:

- A full explanation of the circumstances, including an explanation of the adverse effect on the government's interest or on the accomplishment of program purposes, or any undue hardship that may result if an exception is not granted;

- A discussion of proposed alternatives considered; and

- A discussion of how the adverse effect will be eliminated or minimized if the exception is granted.

State Office requests for exceptions regarding architectural and engineering, environmental, or civil rights issues must be accompanied by the review and comments of the appropriate State Office technical staff and will be referred to the appropriate National Office technical staff for further comment before a decision is made. Likewise, when exception requests on such issues are generated by the Administrator or National Office staff, such requests will be referred to the appropriate National Office technical staff for further comment before a decision is made.

1.11 REVIEWS AND APPEALS

Only the borrower and/or lender can appeal an Agency decision. The borrower and lender must jointly execute the written request for review of an alleged adverse decision made by the Agency and both must participate in the appeal. In cases where the Agency has denied or reduced the amount of final loss payment to the lender, the adverse decision may be appealed by the lender only. A decision by a lender adverse to the interest of the borrower is not a decision by the Agency, whether or not concurred in by the Agency. Appeals will be handled in accordance with 7 CFR part 11.

An Agency decision that is not made in favor of the lender may be considered an adverse decision. Agency decisions may include administrative actions taken by Agency officials or the Agency's failure to take required actions within required or reasonable timeframes. The lender may request a review of adverse Agency decisions by the next-level supervisor except those decisions made by the Secretary. In addition, most adverse decisions may be appealed to the National Appeals Division (NAD). The Agency review and appeals policy for all programs can be found in Attachment 1-A.

SECTION 4: FEDERAL REQUIREMENTS

1.12 INTERGOVERNMENTAL REVIEW

The Agency is responsible for ensuring that intergovernmental review and comment is obtained on all proposals in accordance with RD Instruction 1970-I. The intergovernmental review process must be initiated by the lender or the borrower. This process should be completed as early as possible since all comments must be submitted to the Agency for consideration as part of the environmental review.

1.13 NATIONAL FLOOD INSURANCE PROGRAM

Property located in a Special Flood Hazard Area (SFHA) designated by the Federal Emergency Management Agency (FEMA) is not eligible for Federal financial assistance, including loan guarantees, unless flood insurance through the National Flood Insurance Program (NFIP) is available. Flood insurance through NFIP must be purchased prior to loan closing and issuance of the guarantee, in accordance with the National Flood Insurance Act, as amended, and RD Instruction 426.2. These requirements are also addressed in Chapter 11.

1.14 HISTORIC PRESERVATION

The Agency is responsible for compliance with historic preservation statutes, regulations, and related directives, in accordance with RD Instruction 1940-G and RD Instruction 1901-F.

1.15 CIVIL RIGHTS

A. Nondiscrimination

Federal civil rights laws ensure that no person will, exclude from participation in, deny the benefits of, or subject to discrimination, any person in the United States under program activity conducted by Rural Development, on the basis of race, color, religion, sex, age, national origin, familial status, physical or mental disability, or because all or part of an individual income is derived from any public assistance program. Discrimination in employment practices also is prohibited. Exhibit 7-5 lists the applicable Federal laws and Executive Orders and highlights key aspects of these requirements.

Key Civil Rights Issues

Equal Housing Opportunity

- Access
- Consistency and fairness of treatment
- Disparate impacts -- intended or unintended
- Record keeping

The rules of nondiscrimination apply to all parties involved in this process. The lender is responsible for upholding the laws pertaining to nondiscrimination in selecting, assisting, and monitoring a borrower. Borrowers are held accountable for any discrimination resulting from

development and management tasks, from the hiring of construction firms, and from the selection of tenants.

Effective program management and consistent policies and procedures are essential to ensure that all applicants are treated fairly. Poor program implementation, whether or not discrimination is intended, may have possible civil rights consequences. Attention to consistent procedures is especially important in several key areas listed below.

- **Outreach.** Information about the availability of GRRHP rental units and how to apply for tenancy must be broadly disseminated, and the information, assistance, and courtesy extended to those who make inquiries must be equal and consistent.

- **Application-taking procedures.** Application-taking procedures must be fair and equally accessible to all potential tenant applicants.

- **Determining eligibility.** Lenders, borrowers, and property managers must use equal rigor for all applicants when verifying income, conducting credit checks, and allowing applicants to clarify information.

- **Making exceptions.** Standards for offering exceptions to policies and procedures must be applied equally and consistently.

- **Loan terms and subsidies.** Opportunities for subsidies and favorable loan terms must be made available equally and consistently.

- **Hearings and appeals.** Avenues for remedies when problems arise must be equally accessible to all applicants.

B. Reasonable Accommodations for Persons with Disabilities

It is unlawful for owners or managers to refuse to make reasonable accommodations in rules, policies, practices, or services, when such accommodations may be necessary to afford a qualified person with a disability equal opportunity to use and enjoy a dwelling unit, including public and common use areas. It is also unlawful for owners or managers to refuse to permit, at the expense of a qualified person with a disability, reasonable modifications of existing premises, occupied or to be occupied by a disabled person so that they may have full enjoyment of the premises of a dwelling.

1.16 FAIR HOUSING

Federal fair housing regulations provide the specific framework to ensure that Federal housing assistance is available to all individuals qualified by income and residence in rural areas, without regard to race, color, religion, sex, familial status, national origin, or disability. This includes any actions in the financing, sale, rental, or advertising of the dwellings or in the provision of brokerage services that involve Federal assistance.

All participating lenders and borrowers must comply with the requirements of Title VIII of the Civil Rights Act of 1968, as amended by the Fair Housing Amendments Act of 1988 (the Fair Housing Act). Any lender or borrower that refuses to comply with the regulations is liable for sanctions as authorized by law.

If a resident or prospective resident believes that their denial of occupancy was based on discrimination, they may file a complaint with HUD.

1.17 ENVIRONMENTAL REQUIREMENTS

It is the Agency's policy to give environmental quality equal consideration with economic, social, and other factors in its program development and decision-making processes. The Agency is concerned with the impact of the project on important environmental resources, as well as the quality of life for residents and the long-term viability of the project as an investment. It is the responsibility of the Agency to effectively integrate the environmental policies and procedures, described in RD Instruction 1940-G and Executive Order 12898 "Federal Actions to Address Environmental Justice in Minority Populations and Low – Income Populations" and the Departmental Regulation 5600-002 which implements the Executive Order", into loan guarantee origination and servicing activities.

Lenders and borrowers must cooperate fully with the Agency and provide such information as the Agency needs to complete its environmental review. Lenders must become familiar with the requirements so they can help advise borrowers and reduce the probability of unacceptable applications being submitted to the Agency and so they can speed Agency approval or consent to certain servicing actions.

The responsibilities of the lender and the Agency to address environmental issues are discussed in more detail in Chapter 11.

ATTACHMENT 1-A

REVIEW AND APPEALS OF ADVERSE AGENCY DECISIONS

A. INFORMING LENDERS OF THEIR RIGHTS

Whenever the Agency makes a decision that will adversely affect a lender, the Agency must inform the lender in writing that a review by the next-level supervisor may be requested. The Agency must also inform the lender whether or not the decision can be appealed to the National Appeals Division (NAD).

The lender and/or borrower can appeal an Agency decision made under this program. In cases where the Agency has denied or reduced the amount of final loss payment to the lender, the adverse decision may be appealed by the lender only. A decision made by a lender adverse to the interest of the borrower is not a decision made by the Agency, whether or not concurred in by the Agency. Appeals will be handled in accordance with 7 CFR part 11. Any lender adversely affected by an Agency decision under this subpart may request a determination of appealability from the Director, NAD, USDA, within 30 days of the adverse decision.

Review Requests. Lenders who want to request a review by the next-level supervisor must do so within 15 days of the date of the Agency's letter notifying the applicant of an adverse decision. The lender shall have the option to make the request in writing or verbally. Copies of written requests should be retained in the lender's files. If the lender chooses to make a verbal request, it should be carefully documented. The review must be completed within 45 days of the request.

Appeal Requests. Lenders who wish to appeal an adverse decision must submit a written request to NAD within 30 days of receiving notice of an adverse decision. The request must be personally signed by the participant and include a copy of the adverse decision to be appealed and a brief statement describing why the participant believes the decision is wrong.

NAD will notify the participant and the Agency once it has made a final determination. If NAD reverses the Agency's decision, the next loan processing action that would have occurred (had no adverse decision been made) must be taken within 30 days after the effective date of the notice from NAD.

B. DECISIONS THAT CANNOT BE APPEALED

Decisions that cannot be appealed by the lender include:

- Interest rates set by the Agency's procedures, unless the participant alleges that an incorrect interest rate was applied;
- Decisions made in accordance with the statute;
- Denials of credit due to lack of funds; and
- Decisions made by the lender.

Participants may submit a written request to NAD to confirm that the decision cannot be appealed. Even though a decision is not appealable, Agency staff must provide the participant an opportunity for a review and explanation of the decision.

CHAPTER 2: LENDER ELIGIBILITY AND APPROVAL

2.1 PURPOSE AND OVERVIEW

For a lender to originate and service GRRHP loans, the Agency must determine that the lender meets the eligibility criteria set forth in the statute and corresponding regulations. The purpose of this chapter is to assist the lender in understanding these requirements and requesting and obtaining approved lender status from the Agency. An overview of the lender approval process is shown in Exhibit 2-1.

Key Topics in this Chapter

- Determining Lender Eligibility
- Approving Lenders
- Maintaining Approved Status
- Working with Other Lenders

EXHIBIT 2-1

The Lender Approval Process for the GRRHP

Step 1: Lender requests approved lender status to originate and service GRRHP permanent, construction/permanent loans, or continuous guarantee loans. Lender requests approval under one of two tests:

The Basic Eligibility Test

This test is for lenders who are approved and currently active in HUD/FHA, Fannie Mae, Freddie Mac, or Ginnie Mae multifamily finance programs.

The Demonstrated Eligibility Test

This test is for other lenders who do not meet the basic eligibility requirements but propose to become an approved lender by demonstrating the ability to originate and service multifamily housing loans.

Step 2: Lender submits the necessary documentation for approval to the Agency (see Section 2 of this chapter).

Step 3: The Agency normally responds no later than 30 business days after receiving a complete application.

Step 4: Lender must remain active in the program to retain approved status. The Agency will conduct an eligibility audit of approved lenders annually to confirm continued eligibility.

SECTION 1: LENDER ELIGIBILITY

2.2 PURPOSE

The purpose of the GRRHP is to attract credit to develop multifamily housing opportunities in rural areas where the supply of credit is not adequate. A goal of the program is to use the knowledge and expertise of eligible private sector lenders to originate and service GRRHP loans.

Lender preliminary eligibility is determined by meeting one of two tests:

- The basic eligibility test (see Paragraph 2.4); or
- The demonstrated eligibility test (see Paragraph 2.5).

Eligible lenders must be able to originate and/or service construction and permanent GRRHP loans. To become eligible to participate in the GRRHP, a lender must meet the approval requirements as detailed in Paragraphs 2.6 and 2.7.

2.3 REQUESTING LENDER ELIGIBILITY CONSIDERATION

The application for lender eligibility may be made at the same time as the first loan application. The first loan application means:

- The first application for a loan guarantee for a new loan; or
- The first application before ownership of any GRRHP loan is transferred to that lender.

A lender will obtain approved status when it issues a loan guarantee or it acquires a program guaranteed loan.

2.4 PRELIMINARY ELIGIBILITY- BASIC ELIGIBILITY TEST REQUIREMENTS

One of two preliminary eligibility tests must be met before a lender is deemed eligible to participate in the program. Under the basic eligibility test, a lender must be an approved and currently active lender who has originated at least one multifamily loan in the last 24 months and / or is currently servicing at least one multifamily loan in one of the following multifamily housing programs:

- HUD/Federal Housing Administration (FHA) insurance programs;
- Fannie Mae;
- Freddie Mac; or
- Ginnie Mae.

A letter or other verification of HUD/FHA, Fannie Mae, Freddie Mac, or Ginnie Mae current program approval and participation dated within 12 months of the application must be provided to the Agency as evidence that the lender meets the basic eligibility requirements.

2.5 PRELIMINARY ELIGIBILITY-DEMONSTRATED ELIGIBILITY TEST REQUIREMENTS

If a lender does not meet the basic eligibility test, they may still apply to become an eligible lender by demonstrating the ability to originate and service GRRHP loans. A lender applying to make loans under Options Two or Three must also have experience in underwriting and servicing construction loans and have experience in the construction to permanent conversion process.

A State or local housing finance agency (HFA), a member of the Federal Home Loan Bank (FHLB) System, or other lender may be eligible to participate if they can demonstrate satisfactory experience with multifamily lending and servicing.

A lender can meet the demonstrated eligibility test if they demonstrate to the Agency's satisfaction that they have:

- A thorough knowledge of multifamily lending and the capacity to underwrite, originate, process, close, service, manage, and dispose of multifamily housing loans in a reasonable and prudent manner; and
- A track record of making at least three multifamily loans, including at least one loan in the past two years.

2.6 ELIGIBILITY REQUIREMENTS

A. Origination and Servicing Plan

As part of their application for eligibility, lenders must develop and submit an origination and servicing plan to be approved by the Agency. The plan must include the following information:

1. Policies and Procedures

The lender must provide a summary of their in-house policies and procedures from applicant screening through loan origination, processing, construction and/or permanent servicing, and termination.

2. Portfolio Performance Data

Lenders must verify their track record in servicing construction and/or permanent loans. A lender applying under the basic eligibility test may document the ability to service multifamily loans by verifying current approved servicer status with HUD/FHA, Fannie Mae, Freddie Mac, or Ginnie Mae. Verification can be provided in the form of a letter or other verification of participation with any of these multifamily finance programs within 12 months of the application.

Lenders who are not approved by HUD/FHA, Fannie Mae, Freddie Mac, or Ginnie Mae and are applying under the demonstrated eligibility test must provide a summary of multifamily servicing activity. At a minimum, the summary must include the dollar amount, number, and type of loans in the lender's portfolio and information on delinquencies and losses over the past three years. Delinquent multifamily loans must not exceed three percent of all multifamily loans outstanding as of the application date, and historic losses must not exceed three percent of total dollars loaned. In the case of a new or reorganized servicing operation, the principal staff of the lender must demonstrate experience consistent with these benchmarks.

For the purpose of this plan, a delinquency will be any loan where the borrower has failed to make the full amount of a required payment on the due date or within any grace period.

3. Standard Documents to be used in Processing GRRHP Loans

To the extent that the lender has developed standard documents that will be used in originating, monitoring, or servicing construction and/or permanent GRRHP loans, samples of these documents must be included as part of the origination and servicing plan. These documents may include, but are not limited to:

- The loan note,
- The mortgage,
- The security agreement,
- The regulatory agreement, and
- All loan closing documents.

If the lender does not submit a sample set of standard documents as part of the origination and servicing plan, the Office of the General Counsel (OGC) must review these documents for each GRRHP loan unless OGC has directed otherwise.

4. Key Personnel Involved in GRRHP Loan Program

This section should detail qualifications of the lender's key personnel responsible for administering and monitoring the GRRHP loans, as well as any third party relationships. Resumés of all personnel to be involved in underwriting, construction management, servicing, and property disposition of GRRHP loans, regardless of whether they are in-house staff or a third party, must be submitted as part of this section. Resumes must document multi-family housing experience including, but not limited, to underwriting.

5. Specific Areas Where the Lender's Policies and Procedures Will Deviate from Agency Standards

To the extent that the lender intends to use standards that are different from the Agency standards prescribed throughout this handbook, the lender must detail the proposed process or standard and obtain Agency approval prior to its use.

B. Demonstrate the Lender's Financial Stability

Lenders meeting the basic eligibility test will be considered financially stable. All other private lenders must be rated BBB (or equivalent rating) or better by a nationally recognized rating agency. A state or local housing finance government instrumentality authorized to issue housing bonds or otherwise provide financing for rural rental multi-family housing must have an investment grade long-term obligation rating from a rating agency such as Standard and Poor's or Moody's. Lenders that are not rated must submit data to the Agency to show they have sufficient capital and liquidity to meet any potential losses in their portfolio. Lenders must also submit an audited copy of the most recent annual financial statement prepared in accordance with Generally Accepted Accounting Practices (GAAP).

C. Lender's Certification to Comply with Program Requirements

As a part of the origination and servicing plan, lenders are required to certify their commitment to comply with all Agency policies and procedures, including, but not limited to, standards for underwriting, servicing, and property disposition.

2.7 ADDITIONAL REQUIREMENTS FOR APPROVAL TO ORIGINATE AND SERVICE OPTION TWO AND OPTION THREE LOAN GUARANTEES

A construction and permanent loan provides advances during the construction period and remains in place as a permanent loan at the completion of construction. The Agency will guarantee such loans but requires additional information to determine that lenders are qualified to originate and service both the construction and permanent loan. The Agency cannot guarantee construction only loans due to statutory restrictions.

The request to originate and service construction and permanent loans must be made when the lender first applies to the program or when an approved lender first submits its first construction loan for a guarantee.

Under Options Two and Three a lender who originates and services construction and permanent loans and continuous guarantee loans must agree to manage the construction and draw activities in the manner described in Chapter 5.

Lenders must meet either the basic or the demonstrated eligibility test described in Paragraphs 2.4 and 2.5, and the lender eligibility requirements set forth in Paragraph 2.6. Lenders must clearly identify policies and procedures for multifamily construction lending. Lenders must also provide a summary of their multifamily construction lending activity in the same form as non-construction lending activity specified in Paragraph 2.5. The Agency may, at its discretion, consider other types of construction loans — such as those for commercial development — as a substitute for multifamily construction experience.

2.8 PARTICIPATION BY LENDERS WITHOUT DEMONSTRATED ABILITY

Lenders that do not meet the requirements for approval may participate in the loan or may act as an agent of an approved lender. These arrangements are discussed in Section 4 of this chapter.

SECTION 2: ELIGIBILITY APPLICATION PROCESSING

2.9 OVERVIEW

There are two ways an applicant may submit an application for lender eligibility:

- Applications may be submitted to the National Office when the lender submits its first loan application to the RHS State Office.
- Applications may be submitted directly to the National Office any time prior to submission of the first loan application.

There is no standard application form for lender approval. Prospective lenders must submit a request on their letterhead and include all of the items listed in Paragraph 2.11.

2.10 AGENCY ASSESSMENT OF THE REQUEST

The Agency normally will respond to complete applications within 30 business days. Incomplete applications, especially those that do not include the submission requirements listed in Paragraph 2.11, will generally be returned automatically to the lender. Information required from third parties, such as the eligibility letter from HUD/FHA, Fannie Mae, Freddie Mac, or Ginnie Mae or lender credit ratings, must accompany the application.

The Agency will review completed applications and determine if the applicant meets all of the requirements for eligibility. The Agency may request additional information as necessary to evaluate the lender's qualifications.

As a part of the lender application, the Agency may collect a non-refundable fee, if applicable. The application fee and other program fees are discussed in Chapter 6.

2.11 SUBMISSION REQUIREMENTS — LENDER APPLICATION

The following are submission requirements for lender eligibility applications.

- Lender legal name and legal address.
- Identification of contact person responsible for coordinating with the Agency including phone number, fax number, and email address.
- List of principal officers and their responsibilities.
- Certification that the lender has not been debarred or suspended from Federal programs. Lenders must complete *Form AD-1047, "Certification Regarding Debarment, Suspension, and Other Responsibility Matters - Primary Covered Transactions"*.
- Certification that the officers or principals of the lender have not been debarred or suspended from any Federal programs.
- Certification that the lender is not in default or delinquent on any Federal debt or loan.
- A recent letter, or other proof, verifying participation as a currently active, approved multifamily lender in good standing with HUD/FHA, Fannie Mae, Freddie Mac, or Ginnie Mae (see Paragraph 2.4); or evidence that the lender is a State HFA, a member of the FHLB system, or other lender experienced in multifamily lending who can meet the requirements of the Agency.
- A copy of the lender's origination and servicing plan for construction and/or permanent multifamily loans.
- Verification of lender credit rating or evidence of financial stability as discussed in Paragraph 2.6 B.
- A certification by the lender that they will:
  - ◊ Comply with all Agency policies and procedures, including all monitoring requirements of the Agency;
  - ◊ Maintain all original eligibility and approval conditions; and
  - ◊ Inform the State Office in writing <u>within 60 days</u> if there are any substantive changes in corporate structure or business practices, such as a change in management or in the size or scope of business operations.

2.12 ISSUANCE OF APPROVED LENDER STATUS

Lenders determined eligible, will be informed in writing of their approval to participate in the program. Those lenders deemed not eligible will be informed of the reasons for their denial to participate in the program.

Lenders not approved may appeal the decision by following an informal appeals procedure, through mediation or alternative dispute resolution, or by following the formal appeals procedures referenced in Attachment 1-A.

SECTION 3: MAINTENANCE OF LENDER APPROVAL

2.13 REQUIREMENTS FOR RETAINING APPROVED STATUS

Lenders participating in the program are expected to maintain compliance with all of the requirements for participation. If a change in the lender's operations or financial status results in the lender becoming ineligible to participate in the program, the Agency must be notified immediately. Lender approval under the program is automatically maintained until one of the following occurs:

- The lender is inactive for three consecutive years;
- The lender fails to maintain requirements for eligibility;
- The lender voluntarily withdraws from participation in the program; or
- The Agency removes a lender's approval.

Example: Lender Z has not participated in the program in any way (originating or owning a loan) in the past three years. Lender Z's approval lapses. Lender Z may reapply for approval in the program when Lender Z obtains another loan under the program.

Example: Lender Y originates loans guaranteed under the program and then promptly sells them. Lender Y does this continuously, never going more than two years between originating loans under the program. Lender Y remains in the program in good standing and is considered an active participant.

The definition of an active lender is a lender who does at least one of the following:

- Has originated at least one loan under the program in the last 24 months; or
- Holds in their portfolio at least one loan guaranteed under the program.

All active lenders must have an "eligibility audit" annually that must be sent to the National Office for review within 120 days of the end of their fiscal year. The audit will consist of a financial and program performance audit conducted by a certified public accountant in

accordance with Generally Accepted Government Accounting Standards (GAGAS). In addition, the Agency will periodically visit the lender's business office to conduct an on-site review. The lender must also certify that all eligibility requirements are being maintained.

Lenders who have lost approval status must reapply to regain approved status. Their past performance under the program may count as demonstrated ability during the pre-application process. In the event of loss of approval either through Agency action or voluntary termination by the lender, the Agency may require the transfer of servicing of loans to an approved lender. If the loss of approval is due to non-compliance, the Agency may pursue other actions against the lender, including, but not limited to, debarment, criminal and/or civil proceedings.

SECTION 4: OTHER ISSUES

2.14 SUBSTITUTION OF LENDER

The Agency recognizes that lenders may wish to sell loans that they originate, but the Agency has a duty to ensure that the Government is not placed at higher risk as a result of this action. The Agency requires that each loan sale, other than sales to Fannie Mae, Freddie Mac, or through Ginnie Mae, be approved in advance.

The Agency requires that only approved lenders can take ownership of a guaranteed loan. This policy is to ensure that loans are properly serviced at all times. Therefore, after the issuance of a Loan Note Guarantee, the lender must not sell or transfer the loan, or any portion, without the prior written approval of the Agency. The Agency will not pay any loss if a loan or portion of a loan is transferred without Agency approval.

To be approved, a substitute lender must:

- Be an approved lender or be eligible to become an approved lender in accordance with Section 1 of this chapter.
- Be able to service the loan in accordance with the original loan documents;
- Agree in writing to assume all original loan requirements, including liabilities and servicing responsibilities; and
- Submit a signed *Form RD 3555-11, "Guaranteed Rural Housing Lender Record Change*, to the State Office".

The Office of the General Counsel (OGC) Regional Attorney must review the proposed substitution documents to ensure that the substitution meets all legal requirements unless OGC has directed otherwise.

Following the approval of the substitution, the State Office will submit *Form RD 3555-11* to the USDA Finance Office.

2.15 USE OF AGENTS BY THE APPROVED LENDER

An approved lender may use agents such as brokers to carry out their duties. However, the approved lender bears full and complete responsibility for all of the actions of these agents. For experienced lenders, the use of an agent gives them the opportunity to reach out to other geographic areas where they might not do business.

Use of agents provides the opportunity for inexperienced lenders to develop experience under the tutelage of experienced lenders. One example of use of a lender's agent would be the use of a mortgage broker to underwrite and originate a loan for an approved lender. The loan must be closed in the name of the approved lender, who retains ownership and responsibility for the loan. Lenders can use the experience gained acting as the agent for another lender as evidence of their demonstrated ability for multifamily lending should they wish to become approved in the future.

If an agent originates or services a GRHHP loan, the lender must identify the agent on the loan guarantee application. If the lender proposes to use an agent on a consistent basis, the Agency must be informed of this relationship but does not need to approve the arrangement unless the lender is delinquent or in default under the Lender Agreement.

Lenders who are currently not eligible to participate in the program may do so through a correspondent relationship with a lender who is approved. A correspondent relationship is a contractual relationship between an approved lender and a non-approved lender or mortgage broker in which the correspondent performs certain origination, underwriting, or servicing functions for the approved lender. The correspondent must be an entity or individual eligible to conduct business with the Agency.

2.16 LOAN PARTICIPATIONS

A participated loan is a loan that is funded by two or more lenders. Loan participations are permitted, subject to Agency review. In every case, a lead lender must be designated, and that lead lender must be an approved GRRHP lender. The lead lender will execute the Lender Agreement with the Agency and assume full responsibility for compliance with program requirements. The lead lender is responsible for establishing an intercreditor agreement with each participating lender and ensuring that the GRRHP loan is a first lien or a parity lien, if a parity lien is approved by the Agency. The lead lender will be, in most cases, the sole point of contact with the Agency for the loan.

2.17 TRANSFER OF SERVICING

The Agency requires that the originating lender services the entire loan and remains as the mortgagee or secured party of record. In cases where the originating lender cannot service the

loan, the Agency may permit the transfer of servicing responsibility to another lender, subject to Agency concurrence prior to the transfer as provided in Paragraph 2.14.

Agency approval is not required for the transfer of servicing on guaranteed mortgages to Ginnie Mae.

Loans and/or mortgage servicing on loans backing Ginnie Mae guaranteed securities may only be transferred to a Ginnie Mae issuer and may only be transferred with prior Ginnie Mae approval.

CHAPTER 3: LENDER UNDERWRITING

3.1 INTRODUCTION

Key Topics in this Chapter

- Lender Responsibilities
- Lender's Underwriting Conclusions
- Borrower Eligibility Requirements
- Property Requirements
- Financing Terms and Lender Commitment
- Determining Property Value

The underwriting of a loan is the process by which the lender determines whether the loan is a good investment of capital. The process involves a simultaneous analysis of the creditworthiness of the borrower and the economic value of the property as an income-producing investment. If the borrower is creditworthy and the property has sufficient value under existing market conditions, the lender can enter into the loan with reasonable confidence that the investment will be a good one. The underwriting of a loan guaranteed by the GRRHP involves the same feasibility analysis that the lender uses for any other loan. The only difference is that the GRRHP guaranteed loan will have property use restrictions that must be factored into the underwriting analysis.

This chapter brings together the borrower eligibility, property, and loan requirements of the GRRHP that must be a part of the lender underwriting analysis. In evaluating each transaction, the lender must use prudent underwriting standards, consistent with the best industry practices and with the requirements set forth in this chapter.

SECTION 1: LENDER UNDERWRITING RESPONSIBILITIES

3.2 OVERVIEW

Prior to requesting a loan guarantee, the lender must underwrite and approve the loan. The underwriting analysis is a detailed evaluation of key elements of borrower experience and creditworthiness, market conditions, the value of improvements, and the ability of the property to attract the rents needed to generate sufficient cash flow to support the loan's debt service. The lender underwriting must identify and evaluate all of the factors that could affect loan performance. Such factors must be reflected in the underwriter's conclusions detailed in the lender's narrative. The lender will underwrite the GRRHP guaranteed loan as prudently as any other loan in their portfolio.

3.3 SUMMARY OF LENDER RESPONSIBILITIES

The lender's underwriting responsibilities can be summarized as follows:

- Review borrower's qualifications and capacity to own and operate the property in accordance with the loan terms and program requirements;
- Approve the plans and specifications for the construction of the property;
- Approve the construction and lease-up schedules for the property;
- Determine that there is a market for the project – that is, that there is demand for additional rental units of the type proposed at market rents or at the proposed rents, if higher;
- Determine the expense amounts and the amount of replacement reserves;
- Determine the appropriate debt service coverage ratio;
- Review the management plan and management agreement for the management of the property;
- Ensure that all materials prepared by outside parties such as appraisers, architects, attorneys, environmental consultants, engineers, or cost estimators are adequate for their intended purpose and comply with Agency requirements; and
- Determine the value of the property.

SECTION 2: LENDER NARRATIVE

3.4 NARRATIVE REQUIREMENTS

The lender must submit a complete narrative summary of all of the factors affecting the transaction and provide supporting documentation for all decisions made in underwriting the loan. This will be submitted as part of the loan guarantee application (see Section 3 of Chapter 4). The lender is expected to identify those factors that may impact the performance of the loan. The lender's underwriting narrative must include the following elements:

Outline of Lender's Narrative

- Summary of Loan Request
- Financing Terms/Commitment
- Borrower/Sponsor's Qualifications
- Management Review
- Property History
- Site/Area/Neighborhood Analysis
- Improvements/Physical Needs
- Environmental Issues
- Market Analysis/Appraisal
- Income/Expense Proforma
- Valuation

- A summary of the loan guarantee request, including under which option the loan is being guaranteed, the amount of the loan, guaranteed portion, and any subordinate financing;
- Conclusions about the borrower, including eligibility, financial capacity, and management review;
- Property history and loan purpose, including prior ownership and any outstanding financing;
- Conclusions about the property, including site and neighborhood analysis;
- A summary of any needed or planned improvements or physical needs.
- A summary of known or potential environmental concerns; and
- A determination of the project's value, including market analysis, appraisal, income and expense analysis, and valuation.

While the lender is expected to use their experienced judgment in making a determination of value and developing financing terms, lenders must consider their own loan policy processes and procedures in addition to the Agency underwriting guidelines contained in the following sections of this chapter in making loans for Agency guarantee.

SECTION 3: BORROWER ELIGIBILITY

3.5 OVERVIEW

The borrower's intentions, qualifications, and capabilities are crucial to maintaining housing that is decent, affordable, and financially sound. Lenders must determine that the borrower is an eligible borrower for the Guaranteed Rural Rental Housing Program. Lenders must determine that the borrower is financially and legally capable of meeting all program requirements and has a good record of compliance with Agency and other Federal program requirements and financial obligations. In reviewing borrower eligibility, the lender must examine the background and capabilities of all of the principals of the ownership group.

3.6 ELIGIBLE BORROWERS

Eligible borrowers include individuals, corporations, state or local public agencies or an instrumentality thereof, partnerships, limited liability companies, trusts, Indian tribes, or any organization deemed eligible by the Agency.

To be considered eligible, the borrower must:

- Be a creditworthy entity. Borrowers who own any other business or engage in other business activities are eligible to participate in the program. However, the borrower must operate as a single asset entity, unless otherwise approved by the Agency.

- Be able to maintain and operate rental housing in accordance with program objectives and requirements.

- Be in compliance with all legal and regulatory requirements with respect to any Agency program and any other Federal debt.

- Be a U.S. citizen(s) or permanent legal resident(s), a U.S. owned corporation, a limited liability company, or a partnership in which the principals are U.S. citizens or permanent legal residents.

The lender can establish the citizenship or permanent legal residency of a borrower by examining a birth certificate, passport or by any other method. If the borrower is not a U.S. citizen, the borrower must provide acceptable evidence of eligible status as a permanent legal resident, as listed in Exhibit 3-1.

3.7 INELIGIBLE BORROWERS

Borrowers are not eligible to receive Agency loan guarantees if:

- The borrowing entity or any one of its principals has been debarred by the Agency from future participation in any federal credit program; or

- The borrowing entity or any one of its principals has defaulted on any Federal debt.

- The borrowing entity or any of its principals has a relationship with the lender that violates the GRHHP's Lender's Agreement.

The State Office will verify that the borrower does not appear on the debarment/suspension list by reviewing the "List of Parties Excluded from the Federal Procurement and Nonprocurement Programs" available on the Internet at http://www.epls.gov and filing a copy of the print out of the Excluded Parties List System (EPLS) page in the application file. The State Office will also verify that the borrower does not appear on the Credit Alert Verification Reporting System (CAIVRS) or any other list the agency uses from time to time to determine borrower eligibility.

3.8 BORROWER TYPES

The lender must determine that the type of borrower is appropriate to carry out the obligations under the loan and GRRHP requirements. Other than public agencies, Indian tribes, and individuals, borrowers must provide documentary evidence that they are valid legal entities, licensed to do business in the state in which the property is located and able to enter into agreements governing the loan and guarantee. The following are examples of eligible borrower types and the documentation, including any amendments that they must provide to prove their legal status for a GRRHP loan.

Exhibit 3-1

Acceptable Evidence of Permanent Legal Residency

- *Form I-551," Alien Registration Card"* or prior to 1979, *Form I-151* "Alien Registration Receipt Card" (for permanent resident aliens).
- *Form I-94, "Arrival-Departure Record"*, with one of the following annotations:
  - ◊ "Admitted as Refugee Pursuant to Section 207";
  - ◊ "Section 208" or "Asylum";
  - ◊ "Section 243(h)" or "Deportation stayed by Attorney General"; or
  - ◊ "Paroled Pursuant to Section 212(d)(5) of the Immigration and Nationality Act (INA)" for a period of at least a year.
- If *Form I-94* is not annotated, it should be accompanied by one of the following documents:
  - ◊ A final court decision granting asylum (but only if no appeal is taken);
  - ◊ A letter from an asylum officer of the U.S. Immigration and Naturalization Service (INS) granting asylum (if application is filed on or after October 1, 1990) or from an INS district director granting asylum (if application filed before October 1, 1990);
  - ◊ A court decision granting withholding of deportation; or
  - ◊ A letter from an INS asylum officer granting withholding of deportation (if application filed on or after October 1, 1990).
- An alien who is granted conditional entry pursuant to section 203(a)(7) of the INA as in effect prior to April 1, 1980, is a qualified alien.
- A receipt issued by the INS indicating that an application for issuance of a replacement document in one of the above-listed categories has been made, and the applicant's entitlement to the document has been verified.
- If other documents are determined by the INS to constitute acceptable evidence of eligible immigration status, they will be announced by a notice published in the Federal Register.

A. General or Limited Partnerships

A partnership is a business agreement between one or more managing or general partners and one or more limited or equity partners, organized to carry out the activities related to ownership and operation of rental housing, or similar purposes. Partnerships must provide evidence of legal status in the form of a partnership agreement setting forth the terms of the business relationship. The partnership must be for a term at least equal to the term of the loan.

Lenders must verify that the partnership structure will ensure the sound ownership and management of the project over the life of the loan. Lenders must review and approve any changes in the partnership structure.

- The terms of any limited partnership agreement must require that the general partners maintain a minimum of five percent financial interest in the residual or refinancing proceeds of the partnership.

- Any limited partnership agreement must contain a clause that provides for obtaining prior consent from the lender when any of the following actions are taken:

  ◊ Withdrawing a general partner;

  ◊ Adding a general partner;

  ◊ Substituting a general partner;

  ◊ Amending the Limited Partnership Agreement or the Partnership's Certificate of Limited Partnership;

  ◊ Selling all or substantially all of the assets of the partnership;

  ◊ Dissolving or terminating the partnership; and

  ◊ Borrowing funds from the general partners or third parties.

B. Corporations

A corporation is a for-profit or non-profit organization created for the purpose of owning and operating rental housing or similar purposes. Corporations must provide evidence of legal status in the form of Articles of Incorporation. Corporate owners must clearly identify the officer(s) responsible for managing the ownership responsibilities of the GRRHP project and must be in good standing with state of incorporation and where the project will be built.

Non-profit corporations may receive preference in ranking and are not subject to the same equity requirement as for-profit entities. Non-profits must provide evidence of their status in the form of:

- A tax-exempt ruling from the Internal Revenue Service (IRS) designating the non-profit as a 501(c) or 501(c)(4) organization; and

- A purpose statement in their Articles of Incorporation which includes a provision to provide decent housing that is affordable to low- and moderate-income persons.

C. Limited Liability Companies (LLC)

An LLC is a legal entity created to own and operate rental housing, or for a similar purpose, and that is structured to provide limited liability in the ownership of real property. LLCs must provide evidence of legal status in the form of Articles of Organization and Operating Agreements. These documents must show that:

- The authority of the members of the LLC is limited, and an authorized member who will act on the LLC's behalf has been appointed;
- The management functions of the LLC are the responsibility of a member who holds at least a five percent financial interest in the LLC;
- The LLC has agreed that any new members may only be brought into the organization with prior consent of the lender; and
- At least one member has committed to meet the equity contribution requirements if the LLC partnership is not able to do so at the time of loan request.

D. Trusts

A trust is an entity formed by a legal agreement for the purpose of owning and operating rental housing or for a similar purpose. Organizational documents of legal status should be submitted as evidence.

E. Public Agencies

Public agencies are organizations, including State or local housing finance agencies (HFAs) or public housing authorities or agencies (PHAs), organized to finance and/or own and operate affordable rental housing, or similar purposes. Public agencies must provide evidence of legal status in the form of State or local enabling or implementing legislation or a resolution of an official public body authorizing the creation of the agency.

F. Indian Tribes

Indian tribes are legal entities recognized by the Federal government as representing the legal interests of tribal members. Indian tribes must provide evidence of legal status in the form of a certificate or other official document of recognition from the Interior Department or other authorized agency of the Federal government. Only those entities that meet the definition of "Indian tribe" as provided in the Glossary are considered eligible.

G. Individuals

An individual borrower is any citizen or permanent legal resident of the United States aged 18 years of age or older who has the capacity to enter into a legal agreement to own and operate rental housing. Citizenship status of individuals is addressed in Paragraph 3.6.

3.9 CERTIFICATION OF LEGAL ELIGIBILITY

The borrower's attorney must review the organizational documents of the borrower, each principal that is an entity, and the organizational documents of any entity that has an ownership interest in a principal and certify that the borrower meets Agency and program requirements. The lender must review this certification for compliance with program requirements.

3.10 BORROWER EXPERIENCE AND CAPACITY

Lenders must verify that borrowers have the experience and capacity to develop and operate the property to the standards established by the lender and the program.

Areas to be reviewed by the lender:

- The number and types of projects that the borrower has previously undertaken.
- The experience of the borrower in completing projects.
- The borrower's financial resources and management capacity to undertake the project and resolve problems that arise over the course of the loan.

The lender must be able to verify that:

- The borrower can construct or rehabilitate rental housing;
- The borrower can provide for the financially sound operation of the property over the life of the loan; and
- The borrower is legally able to enter into the necessary contracts with the builder, lender, and other parties involved in the development, financing, and operation of the property.

A. Construction and Rehabilitation Experience

The development team includes the people who will build or rehabilitate the real estate. The development team must have experience with the type of construction involved and a history of sound performance. The lender must review and certify as acceptable each member of the development team. The core development team usually consists of the developer, architect, and contractor.

- The developer is the owner or borrower entity and the party with ultimate responsibility for getting the project completed. The developer coordinates or directs an agent to coordinate the work of other members of the development team. To demonstrate qualifications, the developer must provide a narrative description of its organization, including its history, approximate annual operating budget, staff size, resumes of key staff members, and if applicable, information about the board of directors. This narrative should also include a factual description of the developer's experience in residential real estate activities (i.e., the number and type of projects and units built, total square footage, the total cost of the projects and source of financing, and pending litigation or mechanic's lien claims or contingent liabilities).

- The architect is responsible for the design of the project and for monitoring construction to ensure that it meets Agency requirements. The architect must provide a narrative about his/her firm that includes the history of the firm, professional staff, annual revenue, and experience designing similar projects.

- The contractor is responsible for construction of the project. The contractor must provide a narrative about his/her construction company including the history of the company, annual revenue, and track record in building projects of this type and size and pending litigation or mechanic's lien claims or contingent liabilities.

B. Property Management Experience

The property manager and the management plan are crucial to the financial viability of rental housing projects. The lender must thoroughly evaluate the experience of the property manager, whether the borrower or a management agent. Particular attention should be given to:

- Knowledge of property management and marketing practices;
- Experience managing rental housing properties, with emphasis on similar properties and those managed in the same geographic area as the subject property; and
- Submission of an appropriate and comprehensive management plan and clear procedures for meeting the objectives of the plan.

If the borrower does not manage the property, a written management agreement must be executed with a qualified management company. The management agreement must clearly state the responsibilities of the management agent, the amount of management fees to be paid, and how fees are determined. If the property management agent or management plan is inadequate to the Agency, the loan will not be eligible for a guarantee by the Agency.

Additional information about the elements of an acceptable management plan and an acceptable management agreement are included in Chapter 8.

C. Financial Capacity

The borrower and its principals must be financially stable and have sufficient resources to develop and operate the property. Credit reports will assist in determining the financial stability of the borrower and will be ordered for the borrower as well as any guarantors. Newly formed entities will not be subject to credit report reviews. The borrower must demonstrate the financial resources to meet the specific requirements of the transaction.

The lender is responsible for verifying that the borrower has the cash and other marketable securities needed to close the loan and meet working capital requirements.

The borrower must meet the following equity and reserve requirements.

- **Equity Requirement**. In the case of a for-profit entity, the borrower must commit equity capital in an amount equal to at least 10 percent of the total development cost. In general, total development cost includes the cost of constructing, purchasing, improving, altering, or repairing new or existing housing and related facilities and purchasing and improving the necessary land. Other items may be approved on a case-by-case basis by the State Office. In the case of a non-profit entity, the borrower must have equity capital in the amount of at least 3 percent of the total development cost. In either case, a deferred developer's fee cannot be used to fulfill the equity requirement. Equity must be in place prior to closing the construction loan note guarantee or the permanent loan note guarantee. Equity will be in the form of cash or value in the land being developed. On a case by case basis, the Agency at its sole discretion may consider and approve alternative financial instruments to meet equity requirements.

- **Program Reserve Requirements.** In addition to equity capital, the borrower must commit working capital to meet the program requires for these reserves: an Operating and Maintenance Reserve (O&M Reserve), a Lease-Up Reserve, a Contingency Reserve during construction, an initial deposit to the Replacement Reserve, and an Interest Credit Reserve (if applicable) to be established prior to closing or conversion to permanent depending on the Option. None of these reserve requirements are mortgageable costs.

  ◊ **O&M Reserve**

  The O&M reserve is applicable under Guarantee Options One (permanent financing only guarantee), Two (construction advances and permanent financing guarantee), and Three (continuous guarantee). The O&M reserve will be at least two percent of the loan amount. The Agency may request additional O&M reserves if rent-up assumptions indicate the need for more reserves. The sources of the O&M reserve must be shown in the construction budget with a schedule of when the funds will be disbursed in the case of a construction loan note guarantee

or will be funded prior to the closing of the permanent loan in the case of a permanent loan note guarantee. Funds contributed as O&M reserve funds will be contributed from the borrower's own resources and are not to be included as part of the total development cost calculation.

Under guarantee Options One (permanent financing only guarantee) and Two (construction advances and permanent financing guarantee), funds for the O&M reserve may be contributed to the project upon the closing of a permanent loan. Under Option Three (continuous guarantee), the O&M reserve will be set up and fully funded prior to or at the closing of the construction loan. The funds will be deposited to the project's general operating account and lose their identity as O&M funds. The funds will not be returned except as a "surplus cash distribution" at the end of the year and only if the requirements of Paragraph 7.6 E. have been met.

The items that are typically funded by the original O&M reserve amount include, but are not limited to, property and liability insurance premiums, fidelity bond premiums when the borrower is also the property management organization, utility installation charges and deposits, maintenance equipment, lease forms, loan payments that may become due during construction, purchase of office equipment and furniture, community room furnishing, other movable equipment and furnishing, congregate items, advertising expenses, management fees, etc. State Office staff should verify that the initial payment for O&M reserves has been made in accordance with the Reserve Account Agreement or any other mortgage document governing O&M reserve accounts.

In lieu of a cash contribution for the O&M reserve, the lender may accept an unconditional and irrevocable letter of credit that is issued by another lending institution in an amount that is at least equal to the required O&M contribution level (at least two percent of the loan amount). The letter of credit must remain in effect until the borrower has submitted an annual audited financial statement of the property to the lender (covering at least a six-month period), and the lender has determined that the property is in good financial and physical condition and in compliance with the regulatory agreement. If these requirements are not met, the letter of credit must be extended for an additional year and until the requirements can be met.

◊ **Lease-Up Reserve**

The GRRHP offers the option of establishing a lease-up reserve in lieu of the 90% occupancy for 90 continuous days. 90% occupancy for 90 continuous days must occur within the 120 days immediately preceding the issuance of the permanent guarantee at pre-rent-up assumptions before the Agency issues to the lender written confirmation of the effective date of the guarantee on the permanent loan. The lease-up reserve in lieu of 90% occupancy for 90 continuous

days is not available after the closing of the construction loan. In the case where the Agency has been requested to provide a construction guarantee and a permanent guarantee or a continuous guarantee (Options Two or Three), the lender has the option to establish a lease-up reserve and provide a schedule for funding the lease-up reserve prior to closing on the construction loan. The lease-up reserve must be equal to or greater than an amount established by the Agency in a written notice. The lease-up reserve will be at least two percent of the appraised value of the project or two percent of the total development cost, whichever is greater. The lease-up reserve will be based on the projected operations deficit until the project is stabilized if the calculated projected operations deficit amount is greater than the reserve amount calculated using the aforementioned two percent formula. This cash contribution is an additional amount, over and above the required initial O&M reserve contribution.

Under Option Two if the lender opts to set up the lease-up reserve, the Agency will guarantee the permanent loan after all conditions for the permanent guarantee are fulfilled. The guarantee on the permanent loan will become effective when the Agency provides the lender with written confirmation of that date. If the lender does not establish and provide a schedule for funding the additional two percent lease-up reserve prior to closing the construction loan with the borrower and/or does not fund the lease-up reserve in accordance with the schedule, then the project must meet the "90% occupancy for 90 continuous days…" requirement. In this case, the guarantee will cease to be enforceable once construction is completed unless and until the requirements for the continuation of the guarantee contained in the Conditional Commitment and this part are completed and approved by the Agency by the date stated in the Conditional Commitment and any Agency approved extension(s) *(7 CFR 3565.303 (d))*.

Under Option Three the lease-up reserve must be established prior to the closing of the construction loan and funded 30 days before the first Certificate of Occupancy is anticipated (*7 CFR 3565.52(e)(3)*).

◊ **Contingency Reserve**

When the Agency is guaranteeing the construction draws [as well as the permanent loan], the Agency requires the construction contingency reserve to be set at a minimum of two percent of the construction contract, inclusive of the contractor's fee and hard and soft costs. This reserve is required under Options Two and Three.

The construction contingency reserve will be set up and fully funded as a cash contribution prior to or at the closing of the construction loan. The construction contingency reserve will be held and managed by the lender. The disbursement of funds from the construction contingency reserve will be made by the lender only for change order requests approved by the lender and an Agency representative.

Unused funds from the construction contingency reserve transferred to the O&M reserve cannot be released until the project reaches occupancy of 90% for 90 days at the underwritten NOI and all reserves remain fully funded. This requirement remains in effect notwithstanding that the lender has established an additional Lease-Up/Conversion reserve in lieu of the occupancy requirement as provided in Chapter 4.19.

The lender at its own discretion, may release unused funds in the construction contingency reserve to the borrower after all other reserve accounts are fully funded, construction/punch list items are complete, certificates of occupancy have been issued, all lien releases have been obtained, and the Agency's final inspections have taken place and are satisfactory. If the lender decides not to release the unused funds to the borrower then it must transfer those funds to the O&M account and inform the State Office.

◊ **Interest Credit Reserve (if Applicable)**

The interest credit reserve is to be established in order to pay the interest credit to the project in its first year of operations in lieu of the actual interest credit payments which are made in January of each year. The interest credit is payable annually in arrears after the first day of January following the project's first amortization payment. The interest credit reserve will be reimbursed to the borrower within 60 days of receipt of the interest credit payment to the lender.

◊ **Initial Deposit to the Replacement Reserve**

The Capital Needs Assessment and Capital Improvement Plan may call for a replacement reserve escrow that requires an initial deposit to the replacement reserve. The reserve account balance must meet or exceed a $1,000/unit threshold by year three. Such an initial deposit is typically associated with a rehabilitation project and not with new construction. See Paragraph 7.13 for further details.

SECTION 4: PROPERTY REQUIREMENTS

3.11 OVERVIEW

To achieve long term success, GRRHP projects must be competitive with other rental properties in their market area. Property characteristics such as location, size, amenities, and environmental conditions are important to the success of a rental housing project. Each of these characteristics affects a property's marketability, financial success, and value.

Ensuring that certain minimum property standards are met is important to maintaining the ability to remain competitive and financially viable over the long term. In evaluating property, lenders are expected to evaluate the site conditions as well as the buildings which will be constructed or rehabilitated on the site.

3.12 RURAL AREA DESIGNATION

Lenders must verify that projects are located in an area that meets the Agency's definition of a rural area (see Paragraph 1.6). Lenders must contact the State Office to verify eligibility.

3.13 GENERAL SITE REQUIREMENTS

Multifamily housing properties must be located in areas that are appropriate for residential housing and represent reasonable real estate investments. To meet this requirement, the area where the site is located must be a residential area that provides adequate services and facilities and is free from undesirable conditions. The requirements for an appropriate location are detailed below.

A. Public Facilities and Services

Sites must have necessary public facilities and services to support the needs of the tenants. The lender must ensure that necessary facilities and services exist and that they are close and convenient to the site, including:

- Central water and sewer systems;
- Schools and hospitals; and
- Shopping, medical, and pharmaceutical services.

The "close and convenient" standard may differ by area based on local transportation and population density. Factors to consider include available transportation, traffic patterns, road conditions, and terrain.

B. Less Desirable Areas

The Agency's requirements for site development prohibit development in "less desirable" areas unless more attractive alternatives are not available. Such areas create unpleasant living conditions for residents and depress the value of the investment.

Examples of Less Desirable Areas

Examples of less desirable areas include:

- Sites adjacent to train tracks;
- Industrial areas;
- Sites with environmental concerns;
- Grain elevators and grain storage bins;
- Mobile home courts;
- Older, declining neighborhoods;
- Gas stations; and
- Car lots.

3.14 SITE STANDARDS

Planning for development must take into consideration topography, soils, climate, adjacent land use, environmental impacts, energy efficiency, local economy, aesthetic and cultural values, public and private services, housing and social conditions, and a degree of flexibility to accommodate changes in local needs.

Technical Assistance on Site Standards

Technical services such as architectural, engineering, land survey, or site planning services must be performed by professionals who are qualified and authorized to provide such services in the State where the project is developed.

Lenders must review site plans for compliance with Agency site standards.

A. Applicable Codes

All multifamily housing projects must observe all applicable Federal, State, and local codes, laws, local ordinances, and zoning requirements, and regulations on health and safety standards.

B. Adequate Utilities and Infrastructure

Sites must have infrastructure and utilities that are adequate for the needs of the site and that meet all local requirements. Ideally, the utilities should be publicly owned and have adequate capacity for the proposed development. If the project will operate its own system, lenders must approve the justification for private ownership.

C. Grading and Drainage

Soil and geological conditions must be suitable for the type of construction proposed. In questionable and unserved areas, the lender must obtain an engineering report with supporting data to identify all pertinent subsurface conditions that could adversely affect the structure and show proposed solutions.

D. Size and Shape

The size and shape of a site must be adequate for the proposed units as well as walks, parking, any onsite septic system, and other site improvements.

E. Undesirable Physical Conditions

Sites must not have undesirable physical conditions that create hazards or unnecessary development costs, such as:

- Rocks or soil conditions that increase development costs;
- Noise from nearby roads, railroad tracks, airports, or factories that create unacceptable residential conditions; and
- Pollution from nearby sources that create hazardous health conditions.

3.15 SITE DENSITY

Acceptable density standards will vary by market area and local codes. Because of these differences, program rules do not provide specific density standards. Instead, project density should be evaluated based on:

- Compatibility and consistency with the market and neighborhood.
- Sufficient size to accommodate necessary site features.
- Impact on total development costs and project budget.

3.16 NON-CONTIGUOUS SITES

The Agency prefers to guarantee loans for single and contiguous site projects, since projects on single sites or contiguous sites are generally easier to manage and monitor than non-contiguous sites. Non-contiguous sites may be eligible for guarantees if the lender certifies that the parcels of land are:

- Located in one market area (a neighborhood or similar area where the property competes for tenants);
- Managed under one management plan and one management agreement; and
- In sufficiently close proximity to permit convenient and efficient management of the property.

3.17 SITE CONTROL

At the time of closing, the borrower must have control of the housing and related land. Control means either current ownership rights to a long-term lease or a valid option to purchase or lease the land. After closing, the borrower must have a fully marketable title (fee interest) or land lease.

A. Land Ownership

The only form of ownership acceptable to the Agency is fee-simple ownership. Under this form of ownership the borrower holds a fully marketable title, which is evidenced by a deed unless received from an estate. The deed vests full interest in the property to the borrower. If proof of site control is in the form of a land purchase contract, full ownership interest must be converted to a deed prior to closing the loan.

B. Land Lease

A land lease is acceptable if the lease meets the following requirements:

- The lessor owns the land fee-simple;
- Neither the title nor the leasehold are subject to prior liens other than taxes not due and payable;

- The amount of the guaranteed loan does not exceed the market value of the property, including the value of the leasehold;
- The unexpired term of the lease exceeds the term of the mortgage by at least 25 percent;
- Rent charged for the lease does not exceed the rate being paid for similar leases in the area; and
- It is recorded in the location necessary to give notice to the public of its existence.

The lease must be in writing and must contain the following provisions:

- The lessor must authorize the proposed improvements required by the guaranteed mortgage;
- The lessor must authorize the lender and Agency the right to foreclose the guaranteed mortgage or to transfer the lease if the borrower defaults;
- The lender or the Agency are permitted to bid at a foreclosure sale or to accept deed in lieu of foreclosure;
- The borrower is permitted to transfer the leasehold as part of an ownership transfer of the property, in the event of default or inability to continue with the lease; and
- The lessor gives the Agency and the lender notice of lease default and a 60-day period of time for the Agency or lender to cure the default.

The lender must submit a copy of the leasehold agreement to the State Office for approval prior to loan closing. Any subsequent changes in the leasehold agreement must be approved by the Agency.

3.18 ENVIRONMENTAL REQUIREMENTS

To protect the environment and to ensure the value of a guaranteed loan, the Agency must undertake an environmental review. The Agency will request assistance of the lender in conducting this review. State Office staff will initiate the governmental review process after the lender submits *Form RD 1940-20, "Request for Environmental Information"*, and supporting documentation. The environmental review entails the publication of a public notice regarding the project and written feedback from different State and local offices concerned with environmental issues. The environmental review is complete only after the publication period of the public notice has expired, and the State Environmental Coordinator signs the appropriate documents. The environmental review takes at least 45 days to complete. More time will be needed if State and local environmental authorities have any findings. Delays in the environmental review process are certain if the project location is on an archaeological burial site, in flood plains, or protected areas. Properties must meet the Agency environmental standards in Chapter 11 and in RD Instruction 1940-G, Executive Order 12898 and Departmental Regulation 5600-002.

A. Lender Responsibilities Prior to Requesting Guarantee

The Agency and the lender will incorporate into their lending practices an environmental risk management program. A major component of the environmental risk management program is the conduct of due diligence in the context of real estate transactions. The lender will ensure that due diligence is performed and the results taken into consideration through an appraisal as further detailed in Chapter 11.

B. Agency Environmental Review

The National Environmental Policy Act (NEPA) requires Federal agencies to take into consideration the potential impacts of a proposed project on the human environment and on any protected environmental resources in the vicinity of the proposed site. Therefore, prior to loan approval, obligation of loan funds, issuance of a conditional commitment, or other commitment of Agency resources, whichever occurs first, the Agency must complete a NEPA environmental review. The environmental review examines the environmental consequences of the proposed action and ensures that alternatives are developed and incorporated into the proposal to either avoid environmental impacts or to mitigate adverse effects to the environment. Further information is found in Chapter 11. The Agency conducts the environmental review process in accordance with RD Instruction 1940-G.

3.19 CIVIL RIGHTS

Residents of housing projects benefiting from Federal assistance have the right to live in their homes free from the burden of discrimination. Consequently, for every GRRHP project, the State Office staff will conduct a civil rights impact analysis to determine whether the proposed project would negatively or disproportionately affect tenants by virtue of their race, color, sex, national origin, religion, age, disability, or familial status.

The civil rights impact analysis will address two areas in particular:

- The extent to which the project serves all eligible members of the community. The Agency will examine applicant plans to market the project affirmatively and to implement non-discriminatory occupancy policies and procedures.
- The extent to which the project creates disproportionately high and adverse human health or environmental effects on minority and low income populations. The State Office will examine the project proposal to ensure that there are no factors that create adverse environmental impacts. Examples of such factors include locating the project near a sewage treatment facility, train tracks, or a farm that routinely sprays or dusts crops.

Guidance on the civil rights impact analysis can be found in RD Instruction 2006-P.

3.20 PROJECT DEVELOPMENT

All construction, rehabilitation, and use of the property must comply with applicable governmental statutes, codes, rules, and regulations.

A. Project Size

Rental housing properties with less than five dwelling units are ineligible for guarantee. There is no maximum number of dwelling units that renders a project ineligible. However, the market analysis, which is a part of the underwriting process, takes into account market demand and could limit project size.

B. Agency Construction Requirements

New construction, rehabilitation, modular, and manufactured structures must meet the standards contained in RD Instruction 1924-A and the site development standards found in RD Instruction 1924-C. Unless an exception is granted for special housing needs as referenced in Paragraph 3.23, refinancing of existing housing and indebtedness is not an authorized use of guaranteed loan funds.

The lender is responsible for inspection of the project to ensure compliance with contract documents and State and local building requirements.

Acquisition with rehabilitation is permitted, subject to the following conditions:

- The portion of the program authority guaranteed funds for acquisition with rehabilitation may be limited depending on program goals;
- Rehabilitation requires replacement or alteration of building spaces, mechanical systems, or project facilities;
- Existing structures must be structurally sound and functionally adequate prior to the start of repair work;
- Per unit rehab costs must be at least $6,500 or more; and
- When completed, the rehabilitated building(s) must be energy efficient and in “like new” condition.

C. Federal Accessibility Requirements

All GRRHP loans are subject to the Americans with Disabilities Act and the Fair Housing Act. Projects receiving interest credit, if applicable or other Federal financial assistance are also subject to Section 504 of the Rehabilitation Act of 1973. These regulations must be addressed in the proposed construction plans and specifications.

- **The Americans with Disabilities Act (ADA)** (42 U.S.C. 12131; 47 U.S.C. 155, 201, 218, and 225) addresses the civil rights of individuals with disabilities in the areas of employment, public accommodations, State and local government services, and telecommunications. The ADA states that discrimination includes the failure to design and construct facilities (built for first occupancy after January 26, 1993) that are accessible to and usable by persons with disabilities. The ADA also requires the removal of architectural and communication barriers that are structural in nature in existing facilities, if the removal is readily achievable, easily accomplishable, and able to be carried out without much difficulty or expense.

- **The Fair Housing Act** (42 U.S.C. 3601-19) requires that multifamily dwellings meet the design and construction requirements at 24 CFR 100.205 that implements the Fair Housing Act.

- **Section 504 of the Rehabilitation Act of 1973** prohibits discrimination in Federally-assisted programs on the basis of disability. Section 504 imposes requirements to ensure that "qualified individuals with disabilities" have access to programs and activities that receive Federal funds. GRRHP lenders and borrowers are considered recipients and subrecipients under the Act if interest credit is awarded. The specific requirements under Section 504 are summarized in Exhibit 3-2. Under Section 504, recipients are *not* required to take actions that create undue financial and administrative burdens or alter the fundamental nature of the program. Contractors and vendors are subject to Section 504 requirements only in the work they do on behalf of a recipient or subrecipient.

Exhibit 3-2

Section 504 Requirements

Removal of Physical Barriers

For **new construction** of multifamily projects, five percent of the units in the project (but not less than one unit) must be accessible to individuals with mobility impairments, and an additional two percent of the units (but not less than one unit) must be accessible to individuals with sensory impairments.

- The Section 504 definition of **substantial rehabilitation** multifamily projects includes construction in a project with 15 or more units for which the rehabilitation costs will be 75 percent or more of the replacement cost. In such developments, five percent of the units in the project (but not less than one unit) must be accessible to individuals with mobility impairments, and an additional two percent (but not less than one unit) must be accessible to individuals with sensory impairments.
- When **rehabilitation less extensive than substantial rehabilitation** is undertaken, alterations must, to the maximum extent feasible, make the unit accessible to and usable by individuals with disabilities until five percent of the units are accessible to people with mobility impairments. Alterations to common spaces must, to the maximum extent feasible, make the project accessible.
- Accessible units must be, to the maximum extent feasible, distributed throughout projects and sites and must be available in a sufficient range of sizes and amenities so as not to limit choice.
- Owners and managers of projects with accessible units must adopt suitable means to ensure that information regarding the availability of accessible units reaches eligible individuals with disabilities. They also must take reasonable non-discriminatory steps to maximize use of such units by eligible individuals.
- When an accessible unit becomes vacant, before offering the unit to a non-disabled individual, the owner/manager should offer the unit, first to a current occupant of the project requiring the accessibility feature and second to an eligible qualified applicant on the waiting list requiring the accessibility features.
- The usual standards for ensuring compliance with Section 504 are the Uniform Federal Accessibility Standards (UFAS), although deviations are permitted in specific circumstances.

Provide Program Accessibility

- Individuals with disabilities must be able to learn of, apply for, and participate in Federally-assisted programs or activities.
- Special communication systems may be needed for outreach and ongoing communication (e.g., Telecommunications Devices for the Deaf (TDD), materials on tape or in Braille, or disabled-accessible locations for activities and meetings).
- Policies and procedures must be non-discriminatory (e.g., housing providers may not ask people with disabilities questions not asked of all applicants, screen individuals with disabilities differently, or assess an individual's ability to live independently).

Make Employment Accessible

- Employers must not discriminate.
- Employers must remove physical and administrative barriers to employment.
- Employers must make reasonable accommodations for individuals with known disabilities (e.g., job restructuring, providing readers or sign interpreters, or making facilities accessible).

Administrative Requirements

If recipients or subrecipients have 15 or more employees, they must:

- Designate a Section 504 Coordinator; and
- Notify program participants and employees of non-discrimination policies.

All recipients and subrecipients must conduct self-evaluations of compliance with Section 504.

SECTION 5: FINANCING TERMS

3.21 OVERVIEW

The lender must ensure that the loan submitted for Agency guarantee meets specific loan requirements established in the regulation and the NOFA. The lender must follow statutory, regulatory and Agency policy on eligible use of proceeds, maximum loan amounts, maximum loan-to-value ratio, and loan terms and interest rates. In addition, lenders must observe Agency guidance on parity loans and participation loans with other lenders. These requirements apply to all GRRHP guarantees.

3.22 OCCUPANCY AND RENT RESTRICTIONS

The guaranteed loan program contains three distinct features with respect to affordability of units. Lenders must ensure that loans are underwritten and that mortgage documents adequately address these restrictions. GRRHP income limits can be found in Appendix 5 of HB-1-3555.

- **Tenant Income Restrictions**. At initial occupancy, tenancy is restricted to individuals and families whose incomes do not exceed 115 percent of AMI (adjusted for family size). The tenant income restriction must be supported by a deed restriction for each GRRHP loan guarantee.

- **Rent Restrictions**. At rent up and on a continuing basis thereafter, rents on any GRRHP unit, including tenant paid utility allowances, may not exceed 30 percent of 115 percent of AMI (adjusted for family size). In addition, the average rent for the entire project, including any tenant paid utilities, may not exceed 30 percent of 100 percent of AMI (adjusted for family size). For this purpose, AMIs can be found at http://www.rurdev.usda.gov/HSF-Guar_Income_Limits.html.

- **Deed Restrictions.** The property must remain as affordable rental housing for the original loan term. To ensure compliance with this requirement even if the loan is prepaid, restrictive language must be recorded in the deed or any other instrument that conveys with the property if the mortgage is prepaid. Sample language is provided in Exhibit 3-3.

Exhibit 3-3
Sample Restrictive Language for Deeds

Example I: If the guaranteed loan is being used to finance the purchase of the property and the construction of the affordable rental housing, the following restriction would be placed on the deed:

"The owner(s), for themselves and their successors in interest, agree that until (insert date), the property can only be utilized as rental housing (not homeownership) and can only be leased to low or moderate income families or persons, whose incomes at the time of initial occupancy do not exceed 115 percent of the median income of the area (Eligible Tenants), as determined by the United States Department of Agriculture in accordance with 42 U.S.C. 1490p-2. No Eligible Tenant occupying the housing will be required to vacate nor any Eligible Tenant denied occupancy in violation of this provision. This restriction is enforceable by Eligible Tenants or the United States Department of Agriculture. For further questions, contact the United States Department of Agriculture, Rural Housing Service, Director of Multi-Family Housing Guaranteed Loan Division, 1400 Independence Avenue, SW, STOP 0781, Washington, DC 20250."

Example II: If the applicant already owns the property, the lender will need to create and file a deed declaration in the suggested format:

"The owner(s), for themselves and their successors in interest, agree that until (insert date), the property can only be utilized as rental housing (not homeownership). The following property

[Legal description of property]

can only be leased to low or moderate income families or persons, whose incomes at the time of initial occupancy do not exceed 115 percent of the median income of the area (Eligible Tenants), as determined by the United States Department of Agriculture in accordance with 42 U.S.C. 1490p-2. No Eligible Tenant occupying the housing will be required to vacate nor any Eligible Tenant denied occupancy in violation of this provision. This restriction is enforceable by Eligible Tenants or the United States Department of Agriculture. For further questions, contact the United States Department of Agriculture, Rural Housing Service, Director of Multi-Family Housing Guaranteed Loan Division, 1400 Independence Avenue, SW, STOP 0781, Washington, DC 20250."

3.23 USE OF LOAN PROCEEDS

As a first step in determining the financing terms, lenders must determine that all of the proceeds of the guaranteed loan will be used for eligible purposes as set forth in *[7 CFR 3565.205]*. The use of Agency guaranteed loan proceeds must comply with the standards and conditions for housing and facilities in RD Instruction 1924-A and the standards for site development in RD Instruction 1924-C. To be competitive in the market, the housing developed in this program may require additional features such as dishwashers, garbage disposals, or wall-to-wall carpeting. The Agency may approve a higher level of amenities, construction, or fees if the lender certifies that such costs and features are reasonable and customary for similar housing in the market area.

A. Eligible Uses of Loan Proceeds

The proceeds of a guaranteed loan may be used for the following purposes:

- New construction;
- Rehabilitation of buildings and acquisition costs when related to the rehabilitation;
- Acquisition of existing buildings, when approved by the Agency, for projects that serve a special housing need;
- Acquisition and improvement of land on which housing will be located;
- Development of on-site and off-site improvements essential to the use of the property;
- Development of related facilities such as community space, recreation, storage, or maintenance structures, except that any high cost recreational facility, such as swimming pools and exercise clubs or similar facilities, must be specifically approved by the Agency;
- Construction of on-site management or maintenance offices and living quarters for operating personnel for the property being financed;
- Purchase and installation of appliances and certain approved decorating items, such as window blinds;
- Development of the surrounding grounds, including parking, landscaping, and fencing;
- Costs associated with commercial space provided that:
  - ◊ The project is designed primarily for residential use;
  - ◊ The commercial use consists of facilities such as laundry rooms, that are considered essential and not conveniently available; and

- ◊ The commercial space does not exceed 10 percent of the gross floor area of the residential units and common areas, and the commercial income does not exceed 10 percent of total project income, unless a higher level is specifically approved by the Agency.

- Costs for feasibility determination, loan application fees, appraisals, environmental studies, professional fees or other fees determined by the Agency to be necessary to the development of the project;
- Technical assistance to and by non-profit entities to assist in the formation, development, and packaging of a project or formation or incorporation of a non-profit borrower entity;
- Education programs for a board of directors, both before and after incorporation of a borrower entity that will serve as the borrower;
- Construction interest;
- Relocation assistance, in the case of rehabilitation projects;
- Developers' fees; or
- Repaying applicant debts when:

  - ◊ The Agency authorizes the use of loan funds to pay debts for work, materials, land purchase, or other fees and charges before the loan closed; or

  - ◊ The Agency concurs with a determination by the lender that costs of work, fees, and charges incurred prior to loan application are integral to development of the guarantee application and project.

B. Ineligible Uses of Loan Proceeds

Loan proceeds must not be used for the following:

- Specialized equipment for training or therapy;
- Student housing;
- Housing in military impact areas;
- Housing that serves primarily temporary and transient residents, such as students;
- Special care facilities and institutional type homes that require licensing as a medical care facility;

- Operating capital for central dining facilities or for any items not affixed to the real estate, such as special portable equipment, furnishings, kitchenware, dinnerware, eating utensils, movable tables and chairs, etc.;

- Payment of fees, salaries, and commissions or compensation to borrowers, with the exception of developers' fees; or

- Refinancing of an outstanding debt, except in the case of an existing GRRHP guaranteed loan where the Agency determines that the refinancing is in the best interest of the government or the program. The term and amount of any refinanced loan must not exceed the maximum loan amount or term limits.

3.24 APPLYING SECTION 207(c) LOAN LIMITS

The loan amount must not exceed the applicable maximum per dwelling unit limitations amended by H.R. 1629, dated April 26, 2001, of Section 207(c)(3) of the National Housing Act. The limits are published by HUD, but the lender should contact the local HUD Multifamily Hub or Program Center Office as adjustments to the limits are made for different locales. The Secretary of HUD may increase these limits up to an amount not to exceed 110 percent in any geographical area where the Secretary finds that cost levels so require, and up to 140 percent on a project-by-project basis where the Secretary determines it is necessary. The amount also may be increased by up to 20 percent, if necessary, to account for the cost of installation of certain energy improvements. Prior to closing, lenders must also certify that the limits under 207(c) (3) have not been exceeded. Lenders should refer to HUD Notice H2001-10. The Notice, available at http://portal.hud.gov/portal/page/portal/HUD/program_offices/administration/hudclips/notices/hsg, contains the methodology used to determine costs not attributable under Section 207 (c)(3).

3.25 MORTGAGE TERMS

A. Maximum Loan Term

Where the transaction includes a construction loan guarantee under Option Two or a continuous guarantee under Option Three, the lender is expected to determine the construction loan term, which cannot exceed 24 months.

The Agency must review the construction period and determine that it is appropriate.

The lender is expected to determine the loan's repayment term. However, the repayment term cannot exceed 40 years (including the construction period) or the remaining economic life of the project, whichever is less. Where interest rates available on shorter term loans result in lower unit rents, lenders are encouraged to make shorter, fully amortizing loans. The Agency will not permit negative amortization during the term of the loan.

Loans guaranteed by the GRRHP must have a term of not less than 25 and not more than 40 years from the date of the loan. The loan amortization period cannot be less than 25 years or more than 40 years. The final payment of the balance is due at the end of the loan term. State Offices may accept requests from lenders to restructure the loan terms of prior NOFA awards accordingly

B. Maximum Interest Rate

The interest rate on the loan will be the negotiated rate between the lender and the borrower. If a maximum rate is established by the Secretary, the negotiated rate aforementioned cannot exceed the maximum allowable rate. The loan must bear a fixed rate of interest over the entire term.

C. Interest Rate Reduction, if Applicable

When authorized by Congress, the Agency may provide additional financial assistance by providing an interest credit to reduce the interest rate. The interest rate was previously reduced to the Long Term Monthly Applicable Federal Rate (AFR). However, the use of the AFR was eliminated by the enactment of the Housing and Economic Recovery Act of 2008.

The lender and borrower have two options for calculating the rate to the borrower:

- Option 1 – Apply the interest credit amount to a new loan note guarantee's interest rate negotiated between the borrower and the lender. The lender may change the previously calculated effective interest rate to the borrower. The new effective rate may be higher than the previously negotiated rate.
- Option 2 – Continue to process these deals with the existing loan note guarantee's interest rate under the program guidance in effect at the time the conditional commitment was issued, thereby not changing the effective interest rate to the borrower.

The interest credit is payable annually in arrears after the first day of January following the project's first amortization payment.

Interest credit awards are competitive. They are based on criteria and a scoring threshold established in each NOFA. No more than the amount established by the Agency in a written notice published in the Federal Register will receive interest credit. Lenders must separately amortize the loan amount that receives interest credit from the loan amount that is not eligible for the interest credit award. The interest credit will be payable the following January 1 of the year in which the project has reached occupancy standards, and/or the construction guarantee has converted to a permanent guarantee.

D. Maximum Loan Amount

The lender is responsible for determining the appropriate maximum loan amount based on, among other things, market demand, absorption period, loan-to-value limits, other sources of financing, and total project development costs. Development costs include housing and related facilities. Lenders must determine the total development cost of the property by reviewing proposed plans and specifications and the construction bids presented by the borrower and the builder.

1. Determining Maximum Loan-to-Value

For borrower entities that are not State, local, or tribal government bodies, or non-profit organizations, the guaranteed loan cannot exceed 90 percent of the total development cost or property value (as determined by the lender), whichever is less. Non-profit entities, public agencies, and Indian tribes may borrow up to 97 percent of the lesser of total development cost or appraised value. In order to mitigate the Government's exposure on high loan-to-value (LTV) loan guarantees, 75% and higher LTV loans guarantees may be required to pay down a portion (i.e., 10%) of the guaranteed loan's principal before any distributions of excess cash flow to borrower/owners are allowed.

Issues such as market conditions and borrower and property weaknesses should affect the loan-to-value limit. For example, if the area in which the property is to be located is experiencing an economic downturn that is not yet reflected in comparable sales, the lender should consider a lower loan-to-value to hedge against the expected drop in property values.

2. Other Financing Sources

Projects may need additional financing to be feasible in a given market. Many GRRHP projects will include equity financing from Low Income Housing Tax Credits (LIHTC) or will involve grants or loans from Home Investment Partnership (HOME) funds or State or local housing assistance. In addition, some projects may involve secondary bank financing to cover costs not eligible or feasible under the guaranteed loan program. This additional capital should result in a lower loan-to-value ratio on the GRRHP loan.

SECTION 6: DETERMINING PROPERTY VALUE

3.26 OVERVIEW

The lender is ultimately responsible for determining the value of a property. In doing so, the lender must take into account the appraisal and all of the factors related to the borrower, property, and financing. There is not a formula that can be applied in every case, but rather a weighing of multiple factors and the unique circumstances of each property. The experience and knowledge of the lender's underwriter is critical to making an appropriate determination. The underwriter determination must be clearly supported and accepted by the lender's loan committee.

The following is a discussion of the information that must be examined by the lender in determining property value.

3.27 CASH FLOW ANALYSIS

The lender must analyze the proposed cash flow for the property to be sure that it is reasonable and supported by information on income and expenses for similar properties. Any unique factors in the analysis must be explained. The lender must also review the borrower's estimate of future income and expenses for the property. This review should include a cash flow analysis over a 15-year period.

A. Operating and Maintenance Expenses

The operating budget is used to project the income and expenses for the project and the net operating income (NOI) the project will have available for debt service. The operating budget must reflect the following:

- **Income Analysis**. The borrower must provide a schedule of proposed rents (exclusive of utility allowances) and any other project income. Supporting documentation must include rents, tenant paid utilities, and vacancy levels at comparable properties. Exhibit 3-4 outlines how the income side of a project budget is constructed.

- **Operating Cost Projections**. These are estimated operating expenses, including costs of maintenance, repairs, utilities, and taxes. These estimates must be based upon the specific requirements of the subject property. Borrowers should support estimates with written documentation, when possible. Exhibit 3-5 outlines how the expense side of the projected budget is constructed.

Exhibit 3-4

The Income Projection

The income projection estimates rental and other income (revenue) and occupancy rates.

The project's **Effective Gross Revenue** is a function of:

- Gross Rent Potential (rents that would be collected if all units are rented and all tenants paid their rent).
- Less rent not collected due to vacancies, delays in lease-up, and bad debt.
- Plus other income from parking, laundry, commercial space, etc.

Sources of information for the development of this part of the proforma include:

- The Rent Roll (for existing properties and comparable properties) is the source document for information on units occupied and vacant, rents charged and collected, bad debt, move-in and move-out dates, and so on.
- A Market Analysis (for newly constructed and substantially rehabilitated properties).

B. Debt Service

In determining value, lenders must consider whether the property will generate sufficient NOI to pay debt service and provide a return to the owner. A rule of thumb for rental properties is that properties must have sufficient net income to provide a reasonable cash surplus after expenses, or "debt service coverage." Debt service coverage (DSC) is the ratio of annual NOI to the annual mortgage principal and interest payment. The Agency requires lenders to use DSC of at least 1.15, unless the lender justifies a lower ratio and receives Agency approval. The NOI and DSC calculations are shown in Exhibit 3-6.

Exhibit 3-5

The Expense Projection

The expense projection estimates the cost of operating the property. The project's total expenses are a function of:

- Rental expenses (marketing, promotions, rent concessions);
- Management costs or fees;
- Financing costs such as bond financing expenses;
- Annual renewal and one-time guarantee fees (if applicable);
- Inspection fees;
- Utility and maintenance costs; and
- Taxes and insurance.

Sources of information for this part of the pro-forma include:

- Local and State tax offices;
- Property management companies;
- Utility companies; and
- Historical records on subject or comparable properties.

The proforma also includes the Reserve for Replacement Account. Projects must set aside a reserve to cover the costs of non-routine repairs and replacements, such as roofs, appliances, and other capital improvements. The amount of the reserve depends upon local fixture costs, age, and conditions.

Exhibit 3-6

NOI and DSC Calculations

NOI and DSC are important terms used in underwriting a loan. NOI is total project income minus expenses.

Total income - Total expenses = NOI

DSC is the ratio of NOI to the annual principal and interest (P&I) payments on the mortgage.

DSC = Annual NOI ÷ Annual P&I Mortgage Payment

The DSC must always be greater than 1, since cash flow needs to be more than the mortgage payment in order for the project to be feasible. For GRRHP loans, the minimum acceptable ratio is 1.15, or 115 percent. Lenders may set a higher requirement.

Example: A project is estimated to have an annual NOI of $103,500 and annual mortgage payments of $90,000. The DSC is $103,500 ÷ $90,000, or 1.15.

3.28 APPRAISAL

The appraisal provides a complete, accurate description of the property and the market and an estimate of the property's market value. The appraiser's conclusions must be based upon and supported by market data, logical analysis, and sound professional judgment.

A. Appraisal Requirements

All real property appraisals associated with Agency guaranteed loan making and servicing transactions must meet the requirements contained in the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 and the appropriate guidelines contained in Standards 1 and 2 of the Uniform Standards of Professional Appraisal Practices (USPAP). All appraisals must include consideration of the effect of a potential contamination from hazardous wastes and from the release of nearby hazardous substances and petroleum products on the security value of real property. This information will be made available to the appraiser through the due diligence report. Chapter 11 contains further details.

Appraisals used for Agency decision-making must be *current*. A *current appraisal* is an appraisal with a report date that is not more than one year old. A current appraisal is required before the loan guarantee is issued.

B. Appraiser Qualifications

The lender is responsible for selecting qualified appraisers. To be considered qualified, appraisers must:

- Be qualified to appraise rental housing;
- Be familiar with the market in which the properties are located; and
- Be licensed and certified in the State in which the property is located.

C. Appraisal Methods

The appraiser must provide a complete summary report, which considers the three generally accepted appraisal methods, and follow the standards identified in USPAP. Accepted appraisal methods include the Market or Comparable Approach, the Cost Replacement Approach and the Income Approach. The following is a brief description of each approach.

- The **Market or Comparable Approach** compares the property to sale prices of comparable properties in the area. Adjustments are made for differences in amenities, size, and other factors between the comparables and the subject property.
- The **Cost Replacement Approach** determines the cost of building the project on the basis of current prices and using current standards of material and design.

- The **Income Approach** determines the current value of the property based on the present value of a stream of future income.

For program purposes, the appraiser must rely most heavily on the Income Approach to assess the value of the property because the property being considered for the guarantee is an income-producing property. The other appraisal methods, such as the Market or Comparable Approach and the Cost Replacement Approach, cannot substitute the Income Approach for determining the value of the property.

D. Appraisal Report Guidelines

The appraisal report must include a market analysis and a narrative attachment that supports the appraiser's conclusions. Any facts or issues about the property or the market that the appraiser thinks are important to the value determination must be addressed in the appraisal report. The lender must thoroughly review the appraisal report and note any circumstances or factors that, in the lender's view, would modify the appraiser's conclusions.

E. Market Study

A separate market study will be conducted to support the appraisal, and it must include the material listed in Exhibit 3-7.

Exhibit 3-7

Required Contents of a Market Study

The market study must include:

1. A complete description of the proposed site, including location of the land, location of services, and their distances from the site.
2. Major employment data including: the name, location, and date of establishment of any major employers within the community; the product or service of each employer; the number of employees and salary range for each employer; and business permits issued per year for the last three years.
3. Population by year, number, and total, plus the annual increase/decrease and percentage.
4. Population characteristics by age.
5. Household data by number, year, and number of persons per household.
6. Breakdown of households by owners and renters.
7. Households by income group.
8. Building permits issued per year for single and multiple unit dwellings.
9. Housing stock as defined by total number of units: one unit buildings, two or more unit buildings, mobile homes, and the number of these lacking some, or all, plumbing facilities (substandard housing).
10. A survey of existing rental housing including: name, number of units, bedroom mix, family or elderly type, year built, rent, vacancies, location, and amenities.
11. Number of rent-overburdened households.
12. A projection of housing demand based on:
    (a) Household growth.
    (b) Units constructed since the last census.
    (c) Number of owned and rented units.
    (d) Number of replacements.
    (e) Number of persons in the eligible income range.
13. For proposals where the applicant is requesting low income housing tax credits (LIHTC), the applicant must provide the number of LIHTC units and the maximum LIHTC incomes and rents by unit size. This information will determine the levels of incomes in the market area which will support the basic rents while also qualifying the borrower for tax credits.

CHAPTER 4: LOAN GUARANTEE APPLICATION PROCESSING

SECTION 1: AN OVERVIEW OF THE PROCESS

4.1 PURPOSE

This chapter describes the process to obtain a guarantee.

SECTION 2: THE NOTICE OF FUNDING AVAILABILITY (NOFA) PROCESS

Key Topics in this Section

- NOFA is Published
- Project Proposals [a.k.a. NOFA responses] are Accepted by the Agency
- Proposals are Reviewed by the Agency for Fundamental Eligibility
- Selected Borrowers Receive a Notice to Proceed with Processing

4.2 PUBLICATION OF GRRHP REQUIREMENTS

On an annual basis, the Agency will publish a NOFA in the Federal Register. The NOFA will state the amount of GRRHP funding available and the period it will be available.

4.3 RESPONSE TO THE NOFA

In response to the NOFA, lenders must submit a NOFA response to the State Office in the state where the proposed project will be located. The State Office reviews, scores and ranks the NOFA response. Lenders state in their NOFA responses the type of guarantee sought; Option One, the permanent financing guarantee; Option Two, the construction advances and permanent financing guarantee; or Option Three, the continuous guarantee. The lender must provide information that includes the project's purpose, its location, and how it meets the established funding priorities. Lenders must submit their response to the NOFA in accordance with Paragraph 4.4.

Lenders must submit responses during the prescribed period specified in the NOFA. The Agency will determine the highest ranked responses based on priority criteria and a threshold score. Lenders with top ranked proposals will receive a "Notice to Proceed with Application Processing," inviting them to submit a GRRHP application to the State Office where the project is located. Once the "Notice to Proceed with Application Processing" is issued, lenders have 90 calendar days from its receipt to respond with an application. Lenders withdrawing their requests for a guarantee must notify the State Office in writing. All lenders who submit a NOFA response will receive a written response from the Agency within 30 calendar days of the receipt of the response.

4.4 INFORMATION TO BE INCLUDED IN RESPONSE TO THE NOFA

4. **Descriptive Information**

4. ***The Project***

- A brief description of the proposed location of the project, including town, county, state, and congressional district.
- A description of the property and improvements, including lot size, number of units, building type, type of construction, etc., including preliminary drawings, if available.
- The proposed development schedule.
- Total project development cost.
- The proposed rent structure and area median income (HUD published AMIs can be found online at http://www.huduser.org).
- Evidence of site control by the proposed borrower or a purchase option.
- Description of any environmental issues that may affect the project.
- Amount of loan to be guaranteed.
- Type of project (e.g. elderly or family).

2. The Proposed Financing

- Proposed loan amount and the proposed borrower's equity.
- Proposed financing option: Option One, permanent financing guarantee only; Option Two, construction advances and permanent financing guarantee; or Option Three, a single continuous loan guarantee.
- Proposed use of interest credit, if applicable. If the lender proposes to use interest credit, this section should include the maximum basis points the lender will charge the borrower for the project. Selection and scoring criteria that the project must meet to receive interest credit will be published in the NOFA.
- Estimated development budget (total and cost/unit) and the proposed sources and uses of funds. This information should include all proposed financing sources – the amount, type, rates and terms of loans, tax credits, or grant funds. Letters of application and commitment letters should be included, if available.
- Estimated loan-to-development cost ratio for the guaranteed loan.
- Proposed Agency guarantee percentage for guaranteed loan (under no condition can the percentage exceed 90 percent of the loan amount).
- Collateral. This is all the security, in addition to the real property, proposed to secure the loan.

3. *The Proposed Borrower*

- The name of the borrower and the type of ownership entity. List the general partners if a limited partnership, officers if a corporation, or members if an LLC.
- Borrower's contact name, mailing address, phone and fax numbers, and email address.
- Evidence that the borrower or principals of the ownership are not barred from participating in Federal housing programs and not delinquent on any Federal debt.
- Borrower's unaudited or audited financial statements.
- Statement of borrower's housing development experience.

B. Lender Eligibility and Approval Status

The response must include evidence that the lender is either an approved lender in the GRRHP or that the lender is eligible to become an approved lender. If not approved, the lender can submit its application with the NOFA response. The application must be received by the National Office no later than 30 calendar days of the lender's receipt of the "Notice to Proceed with Application Processing."

C. Competitive Criteria

Information that shows how the proposal is responsive to the selection criteria specified in the NOFA.

D. Lender's Commitment Letter

The lender submits its signed commitment letter on its organization's letterhead, indicating that it will make a loan to the borrower for the proposed project, under specified terms and conditions subject only to the issuance of a guarantee by the Agency.

4.5 AGENCY REVIEW OF NOFA RESPONSE

The Agency review of the NOFA response is designed to assess preliminary eligibility and feasibility. A good project proposal is one that clearly and completely responds to the criteria set forth in the NOFA. Project proposals will be returned if preliminary eligibility cannot be established. Preliminary eligibility means that the project meets the following criteria.

A. Was the Project Proposal on Time and Complete?

Project proposals will be date stamped when first received by the Agency. The reviewer can refer to the date stamp on the project proposal to determine whether the proposal was received by the submission deadline specified in the NOFA. Late and/or incomplete proposals will not be considered and will be returned to the lender.

B. Is the Borrower An Eligible Entity?

Eligible borrowers shall include individuals, corporations, State or local public agencies or an instrumentality thereof, partnerships, LLCs, trusts, Indian tribes, or any organization deemed eligible by the Agency. The ownership entity must be a valid entity in good standing under the laws of the jurisdiction in which it is organized. Borrowers must be U.S. citizens or permanent legal residents, a U.S. owned corporation, an LLC, or a partnership in which the principals are U.S. citizens or permanent legal residents. Borrowers and principals must not be delinquent on any other Federal debt. The Agency reviewer will determine whether these conditions are met. If these conditions are not met or are unclear, additional steps must be taken as outlined below.

The following resources are available to establish the borrower's good standing with the Federal Government:

- The publication, "List of Parties Excluded from Federal Procurement and Nonprocurement Programs," provides a monthly listing of all suspended and debarred individuals and is available on the Internet at http://www.epls.gov.

  Once the site is entered, there are easy-to-follow user instructions that will guide the user through the EPLS and main menu. A hard copy of this publication can be mailed to lenders without Internet access upon request to the Agency. The Agency shall verify that the borrower does not appear on the list and provide evidence in the file such as a print out of the EPLS page with the date the list was checked or a copy of the AD-1047.

- HUD's Credit Alert Interactive Voice Response System (CAIVRS) identifies all individuals with delinquent Federal debt. If CAIVRS indicates that the borrower has a delinquent Federal debt, the reviewer must verify with the point of contact that the information regarding the borrower is current. If the information is current and the borrower is delinquent, the borrower is ineligible. The State Office will inform the borrower of the reason for their rejection and provide the CAIVRS list's point of contact telephone number.

  The Agency reviewer will verify that there is satisfactory evidence that the borrower meets the other requirements of Paragraph 3.6.

C. Is the Lender Eligible?

Lenders requesting eligibility consideration per Paragraph 2.3 must submit an application to the National Office with supporting documentation within 30 calendar days of receiving the "Notice to Proceed with Application Processing" for the proposed GRRHP project. Information on the contents of an application for lender approval can be found in the NOFA and Chapter 2. If a lender is deemed not eligible, the application will be rejected and returned to the lender.

D. Is the Proposed Project Eligible?

The Agency will review the following evidence that the project meets basic program requirements.

- Is the proposed project located in a designated rural area as defined for all RHS programs? (See Paragraph 1.6 for the definition.) Prior to submitting a NOFA response, lenders should contact the

- State Office where the project is located to determine whether the project site is located within a designated rural area in that state.
- Are the proposed uses of funds for eligible purposes?
- Does the proposed financing comply with the requirements set forth in Chapter 3, Section 5 (including occupancy and rent limits, 207(c) limits, maximum loan term, interest rate, and loan-to-value ratios)?

4.6 NOTICE TO PROCEED WITH APPLICATION PROCESSING

Complete NOFA responses deemed eligible after the preliminary review for program requirements will be issued a Notice to Proceed with Application Processing (Notice to Proceed). The State Office will fax a copy of the Notice to Proceed to the lender and follow up with a hard copy of the letter.

The Notice to Proceed will instruct the lender to contact the State Office staff to complete the application process. Once the lender contacts the State Office concerning the project, State Office staff will schedule a meeting with the lender, borrower, and other interested parties to review important programmatic, environmental, and civil rights requirements, using Attachment 4-E as a guide.

The Agency will continue to accept NOFA responses and issue Notices to Proceed until all available funds have been obligated or until the deadline announced in the NOFA.

After the Notice to Proceed has been issued, changes in the borrower entity or substitution of the lender with another approved lender are permitted with prior State Office approval, so long as the loan purpose, scope of project, location, and terms related to scoring and ranking remain unchanged. The original lender must transfer the Notice to Proceed to the substituting lender, and the new lender must issue a commitment letter for the project.

Any costs incurred in the transfer of a Notice to Proceed from one lender to another approved lender cannot be charged to the project. The original lender may charge a fee to the borrower or the substituting lender for its work on the project that is being transferred to another approved lender. However, in no way will this cost be charged to the project. If the original lender is unwilling to transfer the Notice to Proceed, then the new lender must submit a new NOFA response. Incomplete NOFA responses will be sent to the lender with a letter notifying the lender of the incompleteness of the proposal. Lenders may resubmit the NOFA response for consideration in the same fiscal year if the submission date for Agency review of NOFA responses has not expired. A NOFA response that has been resubmitted will be treated as a new NOFA response and will receive a new Agency receipt date.

SECTION 3: APPLICATION FOR THE GUARANTEE

Key Activities Discussed in this Section

- Purpose of the Application
- Interest Credit, if Applicable
- Receive and Process Applications
- Agency Review and Decision

4.7 PURPOSE OF THE APPLICATION

In submitting an application for a loan guarantee, the lender is seeking a conditional commitment from the Agency. Before a conditional commitment can be issued, the Agency must determine if the project meets threshold requirements and is eligible for a commitment.

A. The Proposed Project Meets the GRRHP Threshold Requirements

To be approved for a guaranteed loan, proposed projects must be able to meet the threshold criteria. The application for a loan guarantee must clearly demonstrate that the following criteria are or can be met before the Agency issues a guarantee:

- Evidence that the owner and development team have the qualifications and experience sufficient to carry out development, management, and ownership responsibilities.
- Evidence that the property is located in an eligible rural area.
- Evidence of readiness to proceed, including submission of a complete application for a guarantee, with evidence of at least a proposed conditional commitment from the lender for financing.
- Evidence of market and financial feasibility.
- Evidence the loan is reasonable for the given borrower.
- Evidence that the loan risk is reasonable, taking conventional lending practices into account.
- Evidence that the loan risk is reasonable given factors related to concentration of risk in a given market.

B. The Proposed Project is Eligible to Receive a Conditional Commitment

In addition to the threshold requirements, the following conditions must be met before a conditional commitment can be issued to the lender:

- The borrower and the lender are both eligible to receive a guarantee under the option selected.

The lender has conducted its due diligence, and the results have been taken into consideration in the appraisal.

- The application fee is paid, if applicable
- The Agency has completed a satisfactory environmental review required under NEPA in accordance with RD Instruction 1940-G.

4.8 APPLICATION FORM AND DOCUMENTATION

The lender is responsible for preparing an application that is complete and accurate. The lender must submit the application to the State Office where the project is located. The Section 538 GRRHP Application Checklist is Attachment 4-A. The application is comprised of two components: (1) the lender's certification and (2) exhibits and supporting information to the lender's certification.

A. The Lender's Certification

The lender's certification will serve as assurance to the Agency that the borrower, the project, and the proposed financing meet the lender's standards for making the loan. The lender must certify that:

- The information contained in the exhibits is consistent with the lender's underwriting and loan making standards;
- The lender has completed its review as required by Paragraph 4.10 and has identified any significant findings in a narrative attached to this certification; and
- The lender agrees to make a loan to the borrower for the proposed project, subject to the Agency's issuance of a guarantee.

B. Exhibits and Supporting Information to the Lender's Certification

In addition to the submission of the certification, the lender must submit the supporting documentation outlined in this paragraph.

Because the application, in many cases, will be prepared before working drawings and an appraisal are complete, the lender must submit proforma estimates at the application stage. Once the State Office issues a conditional commitment, the lender must submit complete documented information, as specified in that conditional commitment.

For more information about the complete requirements and documentation, see Chapter 3.

1. Forms Included in the Application Package

Form RD 400-4 "Assurance Agreement" (under Title VI Civil Rights Act of 1964). This form assures the U.S. Department of Agriculture that the Recipient is in compliance with and will continue to comply with Title Vi of the Civil Rights Act of 1964, 7 CFR Part 15 and Rural Housing Service regulations.

Form 400-1,-"Equal Opportunity Agreement".

Form RD 3565-1, "Application for Loan and Guarantee". This form is to provide information needed for the analysis and loan determination process.

Form RD 1940-20, "Request for Environmental Information". This form will provide an understanding of the environmental conditions of the proposed site and the project's potential impact on the environment and will provide information to be used by the Agency to complete its environmental review under the National Environmental Policy Act.

Attachment 4-D, "Housing Allowances for Utilities and Other Public Services". This attachment shows the utility allowance for the proposed project and how it was developed.

Form RD 1944-37,"Previous Participation Certification". This document describes a borrower's prior experience with Federal assistance programs.

Form RD 3560-30," Certification of No Identity of Interest (IOI)". This document describes the IOI relationships between the borrower and other businesses with whom the borrower may contract for goods or services.

RD Instruction 1940-Q, "Exhibit A-2, Statement for Loan Guarantees". The lender certifies that no funds have been or will be used in lobbying activities.

Form RD 3560-31, "Identity of Interest Disclosure/Qualification Certification". This document provides information on organizations listed in the *Form RD 3560-30*.

Form RD 1910-11, "Applicant Certification, Federal Collection Policies for Consumer or Commercial Debts". This document is a certification by the borrower that they are not delinquent on Federal debt.

Form HUD 9832, "Management Entity Profile". This form outlines the proposed management agent and their organizational structure and discloses any IOI relationships the management agent may have.

Form HUD 935.2A, "Affirmative Fair Housing Marketing Plan (AFHMP) Multifamily Housing". This document is required of all federally guaranteed and assisted housing (except when the borrower is a federally recognized Indian tribe and the housing units will be located on land over which the tribe has sovereignty/civil jurisdiction). It describes the process borrowers will use to assure that marketing and outreach efforts are targeted at all persons, regardless of race or disability, who are eligible for admission to the available housing.

AD 1047, "Certification Regarding Debarment, Suspension, and Other Responsibility Matters – Primary Covered Transactions". This document certifies that the borrower entity is not debarred from participating in Federal housing programs.

AD 1048, "Certification Regarding Debarment, Suspension, Ineligibility and Voluntary Exclusion – Lower Tier Covered Transactions". This form is required of the general contractor and each subcontractor when the Agency is guaranteeing the construction loan.

2. Other Information Requested in the Application Package

- Borrower information:

◊ Financial statements with certification(s) (newly formed entities applying for an Option Two or Option Three guarantees do not need to provide financial statements at the time of application).

◊ Credit report for the entity and any guarantor.

◊ For any type of partnership, all organizational documents, including but not limited to the partnership agreement. Agency requirements should be contained in one section of the agreement and their location identified by the borrower or their attorney in a cover sheet.

◊ For any type of corporation, all organizational documents, including but not limited to the Articles of Organization and its Operating Agreement.

- If the borrower is a nonprofit organization:

◊ Tax-exempt ruling from the IRS designating them as a 501(c)(3) or 501(c)(4) organization. If the designation is pending, a copy of the designation request must be submitted.

◊ Evidence of organization under State law or copies of pending applications.

◊ A list of board members.

- If the borrower is a public body:

◊ The enabling statute or the State law of organization.

- Project information:

◊ Project name, location, number and type of units, the development team, property manager, lawyer, and syndicator. The development team includes the developer (including all principals), architect, and contractor.

◊ Appraisal or market study.

◊ Capital Needs Assessment (for rehabilitation loans only).

◊ State Clearinghouse comments or recommendations.

◊ Certification that the lender has reviewed and approved the management plan and agreement and confirmed that they are consistent with Agency requirements.

◊

Site plan, including contour lines.

- ◊ Plot plan.
- ◊ Floor plan of each living unit type and other type spaces.
- ◊ Building exterior elevations.
- ◊ Typical building exterior wall section.
- ◊ Description and justification of any related facilities and schedule of separate charges for related facilities, if any.
- ◊ Design development/working plans/construction specifications.
- ◊ Management plan and proposed management agreement.

- Project financing information:

- ◊ Lender's conditional commitment on the lender's letterhead with lender's signature specifying the GRRHP option under which the project loan is to be guaranteed.
- ◊ Lender's narrative.
- ◊ Sources and Uses Comprehensive Evaluation (SAUCE) disc and hard copy (to be completed by the State Office).
- ◊ A copy of the proforma budget detailing the first year and a typical year's operation.
- ◊ *Form RD 1924-13, "Estimate and Certificate of Actual Cost"*.
- ◊ Disclosure of any change in financing since NOFA response submission.
- ◊ Type of utilities and utility allowances (Attachment 4-D), if applicable.
- ◊ Interest Credit Request, if applicable.

- Required environmental information:

- ◊ *Form RD 1940-20* to be completed by the lender or the lender's client.
- ◊ Phase I Environmental Site Assessment Report, as prescribed by the American Society for Testing and Materials.
- ◊ Compliance with historic and architectural laws, if applicable.
- ◊ Comments regarding relevant off-site conditions.

◊ Land survey.

◊ *FEMA Form 81-93, "Standard Flood Hazard Determination"*.

4.9 INTEREST CREDIT REQUEST AND DOCUMENTATION – IF APPLICABLE

Interest credit (when available) requests must be made in the NOFA response if interest credit is part of the proposed financing. Interest credit awards will be based on a numerical value earned on the scoring of priority criteria identified in the NOFA. Lenders will be notified of interest credit awards in the Notice to Proceed with Processing. Lenders must justify the need for the interest credit award in the application package submitted to the State Office. Proformas with and without the interest credit award will serve as justification for the interest credit award.

The Agency will not accept the resubmission of a project proposal with an interest credit request if the project has been previously submitted without an interest credit request and demonstrated financial feasibility.

A. Amount of Interest Credit Subsidy

The Agency may choose to regulate the maximum interest rate charged on GRRHP loans; if it does it will be announced in a notice published in the Federal Register. The process for allocating interest credit, when available, may be competitive in years when there are more requests than credits available. The Agency may give preference to proposals that require less interest credit subsidy.

B. Demonstrated Need

The interest credit justification must demonstrate why the interest credit subsidy is needed. The Agency will review the proposed rents and operating budget and give preference to applications that demonstrate that the interest credit will result in lower rents or in a higher level of services for tenants in the event that demand for interest credit exceeds available funds.

C. Limits on Allocation of Interest Credit

In order to fairly distribute the amount of credit available in a given year, the Agency may set a limit on the amount of interest credit allocated to a single project. The Agency expects to accomplish this by limiting the size of loans eligible for interest credit to an amount published in a written notice in the Federal Register. For highly ranked projects, the Agency may guarantee two parity loans -- one with interest credit (up to the maximum amount) and one without interest credit.

D. Payment of Interest Credit

Lenders may only request and receive interest credit payments once a project is in its permanent financing phase and a permanent guarantee is issued. For Option Three guarantees, before the lender is eligible to request and receive interest credit, it must document and receive the Agency's written concurrence, that the project met all of the requirements for a permanent guarantee.

The Agency is not obligated to fund the maximum allowable amount of interest credit. The use of the applicable federal rate to determine the interest rate has been eliminated by the enactment of the Housing and Economic Recovery Act of 2008. The lender and borrower have two alternatives for calculating the rate to the borrower:

Alternative 1 – Apply the interest credit amount to a new loan note guarantee's interest rate negotiated between the borrower and the lender. The lender may change the previously calculated effective interest rate to the borrower. The new effective rate may be higher than the previously negotiated rate.

Alternative 2 – Continue to process these deals with the existing loan note guarantee's interest rate under the program guidance in effect at the time the conditional commitment was issued, thereby not changing the effective interest rate to the borrower.

The amount of the interest credit and the loan note rate are not locked until the closing of the loan. The interest credit is not used to reduce the rate on a loan until the date that amortization commences.

Of the total amount guaranteed, no project will receive interest credit on more than the amount established by the Agency in a notice published in the Federal Register. If the loan amount exceeds the amount established by the Agency in a notice published in the Federal Register, the lender is required to separate the loan amount that will receive interest credit from the loan amount that is not eligible for the interest credit award. A separate amortization schedule is necessary for each loan amount. Yearly payments of the interest credit award will be based on the declining balance of the amount established by the Agency in a notice published in the Federal Register.

Interest credit is established in accordance with *Form RD 1980-24*, "*Request Interest Assistance/Interest Rate Buydown/Subsidy Payment to Guaranteed Loan Lender*". *Form RD 1980-24* is due to the State Office no later than February 28 of each year. The calculation will be done in accordance with item 17, "Interest Payable." The interest credit will be paid upon receipt and Agency approval of the form. The interest credit calculation and the request will be part of the project's annual report (per Paragraph 7.6 C.) provided to the State Office. The interest will be calculated from the effective date of the permanent loan note guarantee until the end of the year, so interest credit will always be paid in arrears for interest credit accrued for the previous calendar year. The State Office will review the calculation for accuracy and then forward the document on to the Finance Office for processing. The formula for calculation is:

Interest Payments Received **+**
Accrued Interest at the End of the Period **-**
Accrued Interest at the Beginning of the Period **x**
Interest Assistance Rate ÷
Effective Interest Assistance Rate **=**
Interest Payable

Interest credit will be paid to the lender. It is anticipated that the lender will use the interest credit to reduce the interest rate on the loan and therefore, enable the borrower to pass the savings on to the tenant in the form of reduced rents.

Due to the deferred nature of interest credit, an interest credit reserve must be established by the borrower prior to closing of the permanent loan (Option One), or the construction loan (Options Two and Three). See Paragraph 3.10.C.

E. Cancellation of Interest Credit

The interest credit is tied to a specific loan. If a loan guarantee application is rejected or withdrawn, the interest credit application is similarly terminated. If the borrower defaults on a GRRHP guaranteed loan, the interest credit contract will be canceled no later than when the liquidation plan is approved by the Agency. Any unearned interest credit must be repaid to the Agency.

F. Closing of a Loan with Interest Credit

In order to assist the Finance Office in timely and accurate payments of interest credit, the State Office will complete only Blocks 1, 4, 7, 8, and 9 of Form *RD 3560-9*, "*Multiple Family Housing Interest Credit Agreement"*, as described below. The State Office should complete *Form RD 3560-9* as follows:

Block 1: Enter Borrower's Case Number.

Block 4: Enter 241.

Block 7: Enter the Promissory Note Rate.

Block 8: Enter the Interest Credit Rate/ Reduced Loan Payment.

Block 9: Enter the difference between Blocks 7 and 8.

This form will be completed for the sole purpose of assisting the Finance Office in the tracking of interest credit and will, therefore, not be completed in accordance with the *FMI* or signed by the borrower. This form will be submitted to the Finance Office when the *Form RD 1980-19, "Guaranteed Loan Closing Report"*, is submitted as described in Paragraph 4.17.

4.10 LENDER REVIEW OF THE BORROWER SUBMISSIONS

The lender must review all elements of the proposed project prior to submission of an application to the State Office for review. The lender must certify to the Agency that program requirements have been met and highlight significant information for Agency review.

A. Borrower Eligibility

The lender will review the following documents submitted by the borrower and assess whether they adequately establish that the borrower meets the eligibility criteria of Chapter 3, Section 3.

1. Acceptable Borrower Entity

The lender will determine whether the borrower is an acceptable borrower entity by reviewing the following documents.

- **Draft organizational documents**. This includes the organizational documents or a Certificate of Good Standing if the borrower is an existing organization.

- **Certification Regarding Debarment**. The lender will have already checked the list of debarred individuals against the applicant's *Form RD 1944-37* when the project proposal was first submitted. This certificate by the borrower on *Form AD-1047* or *AD-1048* must confirm the borrower's status as an entity in good standing with the Federal Government. The website to confirm this information is http://www.epls.gov.

2. IOI Disclosure

The lender will review the IOI disclosures in order to understand the borrower entity. *Form RD 3560-30* and/or *Form RD 3560-31* will be used.

3. Certification Regarding Debt Collection

The borrower must sign *Form RD 1910-11* to certify to their understanding of the collection policies that will be taken by the government to recover delinquent or defaulted debts. The lender must ensure that this form is included in the application and signed.

B. Project Eligibility

The lender must ensure that the property meets all program requirements.

1. Property Requirements

In reviewing the application, the lender must determine that any site or design issues and any issues raised by the due diligence report (relating to potential contamination from hazardous substances, hazardous wastes, and petroleum products) have been identified and resolved in a manner consistent with Agency requirements. If they cannot be resolved at the time of application, the lender must notify the Agency and propose an appropriate remedy.

The lender must submit the design development or final plans and construction documents to the State Office Architect who will review them for compliance with program design requirements. The State Architect must approve the plans prior to issuance of an Agency obligation of funds.

2. Clear Title and Necessary Local Approval

The preliminary title report is a part of the application. The lender must make sure that it does not show any encumbrances to the title that would affect the lender's ability to obtain a first lien.

The lender must ensure that all the necessary State or local approvals have been obtained, including proper zoning and necessary utility rights.

C. Project Feasibility Analysis

The lender must carefully review the borrowers proposed cost estimates to ensure that project costs are reasonable and customary for the type of project.

1. Sources and Uses Comprehensive Evaluation (SAUCE)

The Agency SAUCE program is a software tool to help underwriters determine whether the projected income stream will match projected costs. The lender must conduct a feasibility analysis using SAUCE that the Agency will review. If the projected income and costs do not closely match, the lender or borrower must revise the project costs and rent structure to bring the two in line; otherwise, the project is not feasible.

2. Adequacy of the Operating & Maintenance (O&M) Reserve

All borrowers must contribute cash from their own resources prior to loan closing in an amount equal to at least two percent of the loan amount as O&M reserve (or provide the lender with a letter of credit, as provided by Paragraph 3.10 C., in lieu of a cash contribution). The lender must provide the State Office with proof of deposit for the initial payment into the O&M reserve account, or proof of the letter of credit prior to or at closing. State Office staff should verify that the initial payment for O&M reserves has been made in accordance with the Reserve Account Agreement or any other mortgage document governing O&M reserve accounts. State Office staff will monitor the balance in the O&M reserve account on an annual basis, or monitor the continued existence of the letter of credit from the lender's annually audited financial statements to verify consistency with the Reserve Account Agreement or other relevant mortgage documents.

The items that are typically funded by the O&M reserve amount include, but are not limited to, property and liability insurance premiums, fidelity bond premiums when the borrower is also the management agent, utility installation charges and deposits, maintenance equipment, lease forms, loan payments that may become due during construction, purchase of office equipment and furniture, community room furnishings, other movable equipment and furnishings, congregate items, advertising expenses, management fees, etc.

The O&M reserve funds will be kept in a separate account and held by the lender. The lender must ensure that the items are necessary for the project, and the costs are similar to other comparable projects in the area. The lender will authorize all disbursement of funds from the O&M reserve account as needed prior to utilization. The lender may release any remaining funds from the O&M reserve account only in accordance with Paragraph 3.10 C.

3. Management Systems

The lender must certify that the borrower has adequate systems to manage the property successfully in accordance with Agency requirements. In order for an application to be approved, borrowers must show that they will provide professional management to ensure the successful operation of the project. The lender must evaluate the acceptability of the management proposed for the project by analyzing *Form HUD 9832* and the proposed management plan. Chapter 8 provides details on how to evaluate the management profile information.

4.11 AGENCY REVIEW OF THE LOAN GUARANTEE APPLICATION

The analysis conducted at this stage is intended to verify and document feasibility and eligibility. Any changes to the proposal submitted in response to the NOFA must be carefully considered to ensure that the project continues to meet the selection and priority criteria. The application review consists of eight parts as listed below.

A. Determination that the Loan Guarantee Application Package is Complete

The Agency will determine if the lender has submitted all of the required application documentation and met the conditions in the NOFA.

B. Environmental Review by Agency

The State Office or RHS delegated processing office will complete an environmental review in accordance with NEPA and RD Instruction 1940-G prior to taking any official action on an application for a loan guarantee. The RHS processing office will begin the environmental review process as soon as *Form RD 1940-20* and supporting documentation is received from the lender and borrower. The required information that must be provided by the lender and borrower is listed under Paragraph 4.8 B.

C. Civil Rights Impact Analysis

The Agency will conduct civil rights impact analyses to determine whether proposed actions will negatively and disproportionately affect minorities, women, or persons with disabilities, who are employees, program beneficiaries, or applicants for employment or program benefits in USDA conducted or assisted programs, by virtue of their race, color, sex, national origin, religion, age, disability, or marital or familial status. At the time of the site visit, a trained staff member will complete *Form RD 2006-38, "Environmental Justice (EJ) and Civil Rights Impact Analysis Certification"*. The State Civil Rights Coordinator and, as necessary, the State Environmental Coordinator, will be consulted if problems are noted. RD Instruction 2006-P provides further guidance on these requirements.

D. Review of Other Federal Requirements

The Agency will determine that all Civil Rights Impact Analysis Certifications and all other Federal requirements, including intergovernmental review (RD Instruction 1970-I) and flood insurance requirements (RD Instruction 426.2), have been met prior to taking any official action on an application for a loan guarantee.

E. Review of Affirmative Fair Housing Marketing Plan (AFHMP)

As part of the application, borrowers (except when the borrower is a Federally recognized Indian tribe and the housing units will be located on land over which the tribe has sovereignty/civil jurisdiction) must submit to the lender *Form HUD 935.2A* to describe their marketing plan for the project. The intent of this plan is to ensure that eligible persons and families are made aware of the availability of GRRHP multifamily rental housing units. While the lender must review the submission, the Agency must approve and sign this form. An approved AFHMP must be posted in the rental office so that eligible persons and families will be made aware of the availability of affordable multi-family rental housing in the GRRHP.

Required AFHMP Attachments

EQUAL HOUSING OPPORTUNITY

Copies of the specific page(s) from the census report on which the plan was based

Photograph or drawing of the project sign

Copies of the newspaper advertisement or sample of proposed advertisement

Sample community contact letters

Brochures, leaflets, or handouts used

Written instructions provided to staff concerning Federal, State, and local fair housing laws and regulations as well as concerning the AFHMP

The lender will use Exhibit 4-1 when reviewing the AFHMP. This exhibit describes the plan and provides guidance on what to look for in each part. The Agency may require revisions to the plan if any changes need to be made based on the Agency review.

Exhibit 4-1

Actions to be Taken By the Lender

in Reviewing the Affirmative Fair Housing Marketing Plan (AFHMP)

A. Part 1 of the plan provides general information about the borrower and the project's location.

1. Make sure the Census Tract is identified. Copies of the specific page(s) from the census report on which the plan was based must be attached. The areas considered to be the market area should be identified (highlighted) by the borrower.
2. Information on the rental rates should indicate the lowest to the highest rents. If there is rental assistance, the lowest rent should be shown as zero.

B. Part 2 of the plan indicates whether the market area is a minority, non-minority, or mixed area. Verify that the response corresponds directly to the census data.

C. Part 3 of the plan indicates the groups toward which the marketing efforts are going to be directed. It should also correspond directly with the census data and the community contacts that are identified.

D. Part 4 describes the marketing program.

1. Ensure that the borrower has indicated they will advertise on an annual basis.
2. Check to see if minority newspapers have been considered as part of the advertising plan.
3. Make sure the borrower has attached a sample of the proposed advertisement.
4. Review any copies of brochures, leaflets, or handouts that the borrower intends to use. Review them to ensure the equal housing opportunity statement, logo, or slogan is used.
5. A photo or rendering of the project sign must be provided. The dimensions of the project sign must be indicated and described in terms of feet and/or inches. The logo and the words "Equal Housing Opportunity" must be distinguishable in the photo or rendering. If it does not appear, recommend use of the accessibility logo.
6. The proposed community contacts must reflect efforts directed towards groups identified in Part 3. Ensure each blank in this section is completed (address, phone numbers, etc.). The frequency of contacts must be stated, at a minimum, as "at least once annually" or "(date) and annually thereafter." Sample community contact letters must be attached.

E. Part 5 describes future marketing activities. Make sure the borrower has indicated future marketing activities that include, as a minimum, "newspapers, a site sign, and community contacts."

F. Part 6 describes the borrower's experience and the instructions given to staff regarding fair housing marketing. Make sure that the borrower has attached the instructions given to staff concerning Federal, State, and local fair housing laws and regulations, as well as instructions concerning the AFHMP.

G. Part 7 describes additional considerations that are planned to outreach to groups not previously mentioned in the plan or to groups indentified as least likely to apply for the housing. If this plan is for an elderly project, the borrower must have included community contacts for the disabled, who are also eligible to reside at the project. If for a family project, make sure they have included efforts to make the units with special design features known to mobility impaired persons.

H. Part 8 is the signature block. It must be signed by the legal borrower or by the borrower's agent.

F. Decision on Interest Credit Subsidy Awards, If Applicable

The processing State Office will review any information justifying the request for interest credit and will determine whether interest credit will be reserved for the project.

G. Decision on the Guarantee Amount

The guarantee amount, up to 90 percent of the loan amount, will be negotiated between the lender and the processing State Office. Normally, to obtain a 90 percent guarantee, the property must meet all program requirements and be determined to be at least an average or better risk. Factors affecting this determination include but are not be limited to:

- A construction period that is appropriate based on the type of construction contemplated, the market, and the number of units to be leased.
- A debt service coverage (DSC) ratio and a loan-to-value (LTV) ratio that is appropriate given the size and complexity of the project.
- The strength of the market, as indicated by a market vacancy factor appropriate for the market.
- A financially strong borrower and ownership entity
- A lender that has originated and/or serviced 3 or more prior GRRHP loan guarantees.
- An owner or members with extensive experience in the operation of similar housing.
- Other factors as determined by the National Office.

If the lender has proposed a project, which is not qualified for a 90 percent guarantee, the lender may ask the State Office to consider a lesser guarantee.

H. Determination that the Loan is Acceptable for a Conditional Commitment

The lender must underwrite the loan and determine that it is a sound investment. The Agency will review the lender's underwriting and determine if the proposed guaranteed loan meets all program requirements. Such requirements include but are not limited to:

- The lender has certified that the proposed loan amount (for such part of the property that may be attributable to dwelling use) and the applicable maximum per unit dollar amount limitations under section 207(c) of the National Housing Act have not been exceeded;
- The proposed loan term, including construction, is not more than 40 years but not less than 25 years;
- The proposed sources and uses of funds comply with the use of proceeds and lien;
- The LTV ratio does not exceed program limits;
- The Agency guarantee percentage does not exceed 90 percent;
- The borrower has contributed at least two percent of the loan amount for O&M reserves (or provided the lender with a letter of credit, as provided by Paragraph 3.10 C., in lieu of a cash contribution);
- If the Agency is providing a construction guarantee, a construction contingency reserve will be established and funded prior to or at the closing of the construction guarantee; and

- The proposed interest credit rate, if applicable, is set in accordance with the alternatives presented in Paragraph 4.9 D.

4.12 AGENCY DECISION

The State Office will review, assess, and approve applications. An application, which the State Office determines to be acceptable for a guarantee, with any one of the following criteria must first be sent to the Director of Multi-Family Housing Guarantee Loan Division (Director) at the National Office for review and concurrence after the State Office's initial determination that the application is acceptable for a guarantee, but prior to State Office approval. These criteria include any one of the following: (1) congregate care facilities for any loan amount; (2) a property with a loan-to-cost (LTC) or LTV of 75 percent or higher; (3) an application for a loan amount greater than $5 million; or (4) any application at the discretion of the Director. Applications that are sent to the National Office for review and concurrence must be accompanied by the State Office's written assessment of the application.

If the State Office deems an application unacceptable, the application does not need to be sent to the National Office for review and concurrence.

Decisions on applications will normally be rendered within 90 calendar days of receipt of a complete application. In most cases, the Agency will be able to notify the lender of its decision in about 60 calendar days; however, the timing will vary depending on the intergovernmental review and the environmental assessments. If an application is determined ineligible to receive a conditional commitment, it will be returned to the lender. In this case, the State Office will send to the lender his/her appeal rights along with the rejection letter explaining the reasons for rejection. Approved applications will receive a conditional commitment as discussed in Paragraph 4.13.

SECTION 4: ISSUANCE OF A CONDITIONAL COMMITMENT

4.13 GENERAL REQUIREMENTS

A conditional commitment to guarantee the loan will be made upon an Agency determination that:

- The borrower and the lender are both eligible under the GRRHP;
- All other program requirements have been met;
- The lender has determined that the project is financially feasible and has made a conditional loan commitment;
- The Agency has completed a satisfactory environmental review required under NEPA, in accordance with RD Instruction 1940-G; and
- The application fee has been paid, if required.

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

Form RD 3565-2, "Conditional Commitment", is an agreement between the Agency and the lender in which the Agency agrees to guarantee the loan at a future date, if the conditions in the commitment are met within the term specified in the Conditional Commitment. Prior to the issuance of a Conditional Commitment, the State Office will complete and execute *Form RD 1940-3, "Request for Obligation of Funds Guaranteed Loans"*, and the "*Request for Allocation of FY 20XX Section 538 Loan Funds"* form (this form is updated each fiscal year) for the proposed project. These forms, which together constitute an obligation request, are faxed or emailed to the National Office for allocation and obligation of loan guarantee funds. Once the State Office receives the signed and approved *Request for Allocation of FY 20XX Section 538 Loan Funds* form back from the National Office (confirming the National Office has allocated and obligated funds), it may issue the Conditional Commitment. The Director, Multifamily Housing, Guaranteed Loan Division, is the loan guaranteed funds obligation approval authority.

4.14 TERMS OF CONDITIONAL COMMITMENT

The conditional commitment is valid for the length of time specified in the commitment letter not to exceed 24 months which is the maximum term of the commitment. If a commitment has been issued for fewer than 24 months, it may be extended up to 24 months.

On a case-by-case basis and after a thorough due diligence, the State Director may grant an extension to a loan commitment period for a project deemed to remain viable. If it is in the Government's best interest, the State Director may extend a conditional commitment up to 12 months beyond the initial 24-month period (the total cumulative commitment period may not exceed 36 months). The extension must be requested by the lender prior to the expiration of the conditional commitment. The request must include a written justification for the extension and a certification from the lender that the failure to fulfill the conditions for the issuance of a permanent guarantee within the commitment period was beyond the control of the borrower [and the lender], and that those conditions can be fulfilled within the extension period. The lender must also certify that all application documents have been updated and are current, including but not limited to the initial credit and financial underwriting of the borrower and the project. Any changes or updates to the application documents must be submitted to the State Office for its review and approval prior to the issuance of a commitment extension. The lender will also be charged a flat fee [which will be defined by the Agency in a Notice published periodically in the **Federal Register**] for each extension that is granted.

If an extension beyond a cumulative 36-month period is requested and deemed warranted by the State Director, the extension request must be submitted to the National Office to the Director, Multi-Family Housing Guaranteed Loan Division, for review and concurrence. All supporting documentation must be submitted to the National Office along with the State Director's extension approval recommendation.

Please note that in cases where the Government has committed to issue an Option Two guarantee, the commitment extensions cannot to be used as a conduit to extend the construction guarantee period beyond the regulatory maximum of 24 months. The purpose of these conditional commitment extensions is not to extend the guarantee period for construction advances, but rather to extend the Government's commitment to issue a permanent guarantee once the conditions for a permanent guarantee have been met.

A. Subsidy Layering Review

Because the loan guarantee and interest credit assistance are government resources, the Agency must conduct a subsidy layering review. The SAUCE review completed by the lender as part of the application will be reviewed by the Agency in accordance with Paragraph 4.10 C.1. at the conditional commitment stage, with an updated review at the permanent loan closing. The Agency will also rely upon any subsidy layering reviews conducted by state housing finance agencies.

B. Guarantee Fee, Application Fee and Annual Guarantee Renewal Fee (If Applicable)

If Congress has authorized it and the program requires it, at the issuance of the Loan Note Guarantee, the lender must pay a loan guarantee fee. The guarantee fee is calculated as a percentage of the note principal amount times the percentage of guarantee.

The guarantee fee will be defined by the Agency in a Notice published periodically in the **Federal Register**. Where the lender intends to make an Option Two guaranteed loan, the guarantee fee is calculated as a percentage of the sum of the note principal actually disbursed for all approved draws multiplied by the percentage of guarantee. Although the fee is paid by the lender, it may be passed on to the borrower.

A sample of the calculation of the guarantee fee is discussed in Paragraph 6.1 and 6.2 A. The guarantee fee is to be collected by the State Office at closing of the loan and transmitted to the Finance Office on *Form RD 451-2, "Schedule of Remittances"*. Code "30" should be entered into the "Miscellaneous Collection" box, and it should be coded as a regular payment (R) in column #1 under "Loan Coding." The check and Form RD 451-2 will be sent by Agency staff to the address shown on the internal Rural Development staff website.

If authorized a payment of an application fee and an annual guarantee renewal fee will also be collected from the lender. These fees will also be defined by the Agency in a Notice published periodically in the **Federal Register**.

C. Transactions Backed by Ginnie Mae

Lenders who intend to have the GRRHP loan securitized by Ginnie Mae will inform the State Office of their intentions. State Office staff will include the limit acceptable to Ginnie Mae and the Agency in the Conditional Commitment. Ginnie Mae's limit may be found at http://www.ginniemae.gov/products_programs/Documents/chap31.pdf.

D. Termination of the Conditional Commitment

The conditional commitment will expire if the terms are not met or if the lender decides not to originate the loan.

Withdrawal of an Application. The lender must notify the State Office immediately of its intention to withdraw an application. In this case, the Agency will retain the loan application fee. The State Office will prepare *Form RD 1940-10, "Cancellation Of U.S. Treasury Check and/or Obligation"* and fax it to the National Office to request the de-obligation of funds to the project. National Office staff will de-obligate the funds to the project in the GLS. The de-obligation request will be faxed back to the State Office with the date and initials of the person in the National Office who de-obligated the funds.

Lapse of a Conditional Commitment. If the loan guarantee is not issued within the period specified in the commitment letter, the commitment will automatically expire. On a case-by-case basis, the State Office may allow extensions of the loan commitment period following the procedure outlined in paragraph 4.14 of this handbook TERMS OF CONDITIONAL COMMITMENT.

E. Substitution of Lender

There are some circumstances, such as bank mergers, which require a substitution of lender and a transfer of conditional commitment from one eligible/approved lender to another eligible/approved lender. A transfer of a commitment is permitted if the transfer is approved by the State Office and the substitute lender agrees to the underwriting terms approved in the conditional commitment. The substitute lender must provide the State Office with written approval from the original lender for the substitution and the transfer of the application and supporting documentation. To obtain Agency approval, the borrower and substitute lender must certify that there are no changes in the borrower's ownership or control and that the loan purposes and all other elements of the application supporting the conditional commitment remain the same. See Paragraph 2.14 for a full description of the requirements for a substitution of the lender.

F. Lender's Agreement

The lender must execute *Form RD 3565-3, "Lender's Agreement"*, prior to the issuance of the loan guarantee, unless a current *Form RD 3565-3* is already on file with the Agency. The lender signs the Lender's Agreement with the State Office, which processes and closes the lender's first Loan Note Guarantee. The State Director or his designee will sign the Lender's Agreement on behalf of the Agency. The State Office will forward the original to the National Office and keep a copy of the Lender's Agreement on file. Once a lender has a signed Lender's Agreement with the Agency, a copy of *Form RD 3565-3* must be included in each subsequent submission of NOFA responses for proposed projects.

G. Loan Note Guarantee Agreement

Form RD 3565-4, "Loan Note Guarantee", is the only form used to execute the GRRHP guarantees. For guarantee Option One, the guarantee becomes effective upon execution of the form by the State Director and the lender. For guarantee Options Two and Three, the guarantee for the construction loan becomes effective when funds are first drawn down. Under Option Two, the construction and permanent guarantee, once the requirements for the permanent guarantee are met, the State Office gives written confirmation to the lender of the date the Agency deemed those requirements were met.

Even though the Agency provides a single, continuous guarantee for construction and permanent loans under Option Three, [*7 CFR 3565.52(c)(3*)], the State Office must nonetheless require confirmation

from the lender when construction is complete and its loan has transitioned from the construction financing phase to the [fully amortizing] permanent financing phase. The State Office will provide the Finance Office and National Office with a copy of the written confirmation of the conversion to the permanent guarantee phase of a transaction for their records.

SECTION 5: RESPONSE TO THE CONDITIONAL COMMITMENT AND LOAN CLOSING

4.15 GENERAL CONDITIONS TO THE COMMITMENT

Once a lender receives a conditional commitment from the State Office, the lender must respond to the conditions detailed in that commitment within 60 calendar days of receipt. When all of the conditions are resolved and the other requirements outlined in Section 7 of this chapter and in [*7 CFR 3565.303(d)*] are met, the Agency will issue a permanent guarantee to an approved lender in good standing with the program.

As part of loan closing procedures, the State Office must review the lender's underwriting calculations, proformas, and mortgage documents for consistent use of the same interest rate in all documents. The lender must correct any discrepancy prior to loan closing.

Among the conditions specified in the conditional commitment, the lender must submit the following for State Office approval before loan closing occurs. Regional OGC review of these documents is mandatory for the issuance of the State's first Loan Note Guarantee and is encouraged thereafter.

- Final organizational documents for the borrower entity or Certificate of Good Standing, if applicable;
- An opinion letter from lender's Legal Counsel (see Attachment 4-B); and
- A copy of the proposed closing documents (see Attachment 4-C).

4.16 DEVELOPMENT OF THE REGULATORY AGREEMENT

A regulatory agreement governing the relationship between the borrower and lender must be developed by the lender and executed by both the borrower and the lender. The regulatory agreement must contain the provisions specified in Paragraph 7.14 D.1. While the Agency will not be a party to the agreement, the agreement will state that the Agency may assume the role of the lender if necessary to force borrower compliance with the agreement.

As a part of the closing documents, the lender's attorney must certify that the regulatory agreement submitted for Agency review meets the requirements of this paragraph.

4.17 LOAN CLOSING

Once the closing documents have been approved by the State Office, the lender should prepare a closing statement showing how funds will be disbursed and begin to coordinate and schedule the closing date for the loan. All conditions of the conditional commitment must be fulfilled prior to the issuance of the Loan Note Guarantee. If the loan is an Option Two guarantee, then the requirements of Section 6 of this chapter will apply, and the construction guarantee will only cover advances for construction. If the loan is an Option Three loan guarantee, the

guarantee will be issued in accordance with the requirements of Section 6 of this chapter pursuant to [*7 CFR part 3565.212 and .305*]. If the loan is an Option One guarantee, then the guarantee will be issued in accordance with Section 7 of this chapter. In addition to the regulatory agreement, *Form RD 3565-3* must be executed prior to the issuance of the guarantee. Once the loan is closed, *Form RD 1980-19* will be prepared by the lender, signed by both the lender and the State Office, and submitted to the Finance Office. If the loan will receive interest credit, *Form RD 3560-9* must also be completed and submitted in accordance with Paragraph 4.9. *Forms RD 1980-19* and *3560-9* and the executed Loan Note Guarantee will be faxed or emailed to the Finance Office, ATTN: Guaranteed Loan Branch. Contact the State Office for the current fax number or email address.

SECTION 6: GUARANTEE DURING CONSTRUCTION

4.18 CONTINUOUS GUARANTEE AND CONSTRUCTION GUARANTEE AND RELATED RESERVES

In the case of Options Two and Three guarantees, the construction guarantee will go into effect with the first draw of the construction loan. The construction guarantee is only intended to cover construction advances under the construction contract.

Option Two guarantee. The Agency may provide a guarantee which will cover construction loan advances (advances) during construction. The maximum guarantee of construction advances related to a construction and permanent loan will not at any time exceed the lesser of 90 percent [or the percent established by the Agency and announced through a Notice in the **Federal Register**] of the amount of principal and accrued interest up to default for amounts which exceed the original advance if for eligible uses of loan proceeds or 90 percent of the original principal amount and accrued interest up to default of the loan. The Agency's guarantee will cover losses to the extent aforementioned once all sureties/insurances and/or performance and payment bonds have fully performed their contractual obligations. A construction contingency reserve is required. This guarantee will be enforceable during the construction period but will cease to be enforceable once construction is completed unless and until the requirements for the continuation of the guarantee contained in the Conditional Commitment and this part are completed and approved by the Agency by the date stated in the Conditional Commitment and any Agency approved extension(s). The Agency will provide written confirmation to the lender when all of the requirements for continuation of the guarantee to cover the permanent loan have been satisfied. Any losses sustained while the guarantee is unenforceable (after the end of the construction period and, if applicable, before the continuation of the guarantee) are not covered by the guarantee. For purposes of this guarantee, the construction period will end on the earlier of:

(i) Twenty-four months from the closing of the construction loan, if the certificates of occupancy for all units in the project have not been issued by then, or

(ii) The date of the issuance of the last certificate of occupancy, if the certificates of occupancy for all units in the project are issued on or before 24 months from the closing of the construction loan.

Under an Option Two guarantee, if the lender does not establish and provide a schedule for funding the two percent lease-up reserve prior to closing the construction loan with the borrower and does not fund the lease-up

reserve in accordance with the schedule, the project must attain 90% occupancy for 90 continuous days within the 120-day period immediately preceding the issuance of the permanent guarantee at pre-rent-up assumptions before the Agency issues to the lender written confirmation of the effective date of the guarantee on the permanent loan. In this case, the lender will be without a guarantee from the time that construction is complete (all certificates of occupancy are issued) until the requirements in 7 CFR 3565.303(d) are met.

Option Three guarantee. The Agency may provide a single, continuous guarantee for construction and permanent loans. Only projects that have low loan-to-cost ratios, which will be defined by the Agency in a Notice published periodically in the **Federal Register**, are eligible for this type of guarantee. A construction contingency reserve is required. The Agency may require that a lease-up reserve, in an amount established by the Agency and announced through a Notice in the **Federal Register**, be set-aside prior to closing the construction loan. The lease-up reserve must be funded 30 days before the first Certificate of Occupancy is anticipated. This lease-up reserve is an additional amount, over and above the required initial operating and maintenance contribution. The maximum guarantee of construction advances will not at any time exceed the lesser of 90 percent [or the percent established by the Agency and announced through a Notice in the **Federal Register**] of the amount of principal and interest up to default advanced for eligible uses of loan proceeds or 90 percent of the original principal amount and interest up to default.

Under either Option Two or Option Three, the Agency will guarantee construction advances by the lender, not to exceed 90 percent of the work in place, if the lender provides acceptable credit enhancements. Acceptable credit enhancements include any of the following:

- Surety bonding or a performance and payment bond acceptable to the Agency (the preferred enhancement);
- An irrevocable letter of credit acceptable to the Agency; or
- A pledge by the lender of collateral that is acceptable to the Agency;

For Options Two and Three the lender must require an operating and maintenance reserve and provide the Agency adequate evidence of the funding of all required reserves. For both options the Construction Contingency reserve must be fully funded prior to or at the closing of the construction guarantee. For Option Two the funding schedule for the lease-up reserve and the operating and maintenance reserve must be included in the Agency-approved construction budget and be fully funded before the issuance of the permanent guarantee. For Option Three the operating and maintenance reserve must be fully funded before the issuance of the guarantee.

Chapter 5 provides additional details regarding the requirements for a construction guarantee.

SECTION 7: PERMANENT GUARANTEE

The requirements for issuing the permanent guarantee are identified below.

4.19 OCCUPANCY

The permanent guarantee may not go into effect until the lender has provided the State Office with copies of rent rolls showing occupancy levels at 90 percent for 90 consecutive days (90/90 test). The project must meet the 90/90 test in the 120-day period immediately prior to the issuance of the permanent guarantee. In lieu of meeting the

minimum level of occupancy, borrowers may establish a lease-up reserve and provide a schedule for funding it at a level acceptable to the Agency prior to the closing of the construction loan. The lease-up reserve will be at least two percent of the appraised value of the project or two percent of the total development cost, whichever is greater. This cash contribution is an additional amount, over and above the required initial O&M reserve contribution that is described in Paragraph 3.10 C.

If tax credits are used in conjunction with any of the GRRHP options, the borrower must meet any occupancy requirements in the tax credit partnership agreement before the permanent guarantee is issued.

4.20 DOCUMENTATION REQUIREMENTS

The guarantee of a permanent loan provided under § 3565.52(c)(1) or (c)(2) will be issued once the following items have been submitted to and approved by the Agency:

(1) Certification from the lender stating that the lender or its qualified representative inspected the property and found that the construction meets the Government's requirements for the standards and conditions for housing and facilities in 7 CFR part 1924, subpart A and the standards for site development in 7 CFR part 1924, subpart C, or its successor regulations;

(2) Cash flow certification—the lender certifies, in writing, the project's cash flow assumptions are still valid and depict compliance with the section 538 program's debt service coverage ratio requirement of at least 1.15, based on the lender's analysis of current market conditions and comparable properties in the project's market area;
(3) Documentation that either:

(i) The project has attained a minimum level of acceptable occupancy of 90% for 90 continuous days within the 120-day period immediately preceding the issuance of the permanent guarantee, or

(ii) Additional funds, supplementing the funds required under § 3565.303(d), have been added to the lease-up reserve in an amount the Agency determines is necessary to cover projected shortfalls.

(4) A new appraisal based upon completion of construction. Upon a lender's written request, the Agency may exempt a project from this requirement if requested by the lender and the project meets the following criteria:

(iii) *Original appraisal*—the original appraisal that meets the Agency's appraisal requirements with a valuation date no older than 36 months;

(iv) *Valuation*—the appraisal's lowest valuation, regardless of valuation approach and rent restrictions considered, is greater than the section 538 guaranteed loan amount; and

(v) Guaranteed loan balance—the Agency's guaranteed loan's principal balance does not exceed 50 percent [unless a different percent has been announced in a Notice published in the **Federal Register**] of the project's total development costs.

(5) A certificate of substantial completion;

(6) A certificate of occupancy or similar evidence of local approval;

(7) A final inspection conducted by a qualified Agency representative;

(8) A final cost certification in a form acceptable to the Agency. *The cost certification establishes the actual construction costs incurred by the mortgagor and general contractor. If there is an identity of interest (IOI) between the sponsor and contractor, the cost certification must be performed by an experienced audit firm acceptable to the Agency. Where low income housing tax credits are a source of funding, the cost certification should be performed by the agency that awards the tax credits. All IOI and State agency cost certifications must meet the standards 7 CFR 1924.13. All contracts must also indicate that when any IOI exists or comes into being, the contractor agrees to have construction costs as reported to the Agency on Form RD 1924–13 audited by a Certified Public Accountant or Licensed Public Accountant licensed prior to December 31, 1970, who will provide an opinion as to whether the Form RD 1924–13 presents fairly the costs of construction in conformity with eligible construction costs as prescribed in Rural Development regulations. It is the responsibility of the lender to ensure that the borrower has properly completed a cost certification within 60 days of 100% final completion of the project.*

(9) A submission to the Agency of the complete closing docket;

(10) A certification by the lender that the project has reached an acceptable minimum level occupancy;

(11) An executed regulatory agreement;

(12) The Lender certifies that it has approved the borrower's management plan and assures that the borrower is in compliance with Agency standards regarding property management contained in subparts E and F of this part;

(13) Necessary information to complete an updated necessary assistance review by the Agency under § 3565.204(c); and

(14) Compliance with all conditions contained in the conditional commitment for guarantee.

The State Office will review all submitted documents and verify that the project is free and clear of liens prior to the issuance of the permanent guarantee.

The continuous guarantee will remain in effect once construction is completed. In order to remain in compliance with 7 CFR part 3565, the following items must be submitted to and approved by the Agency. These items will be submitted to the Agency by the date stated in the Conditional Commitment and any Agency approved extension(s).

(1) Certification from the lender stating that the lender or its qualified representative inspected the property and found that the construction meets the Government's requirements for the standards and conditions for housing and facilities in 7 CFR part 1924, subpart A and the standards for site development in 7 CFR part 1924, subpart C, or its successor regulations;

(2) Cash flow certification—the lender certifies in writing the project's cash flow assumptions are still valid and depict compliance with the section 538 program's debt service coverage ratio requirement of at least 1.15, based on the lender's analysis of current market conditions and comparable properties in the project's market area;
(3) Documentation that the funds required under § 3565.303(d), have been added to the lease-up reserve in an amount the Agency determines is necessary to cover projected shortfalls.

(4) An appraisal of the property;

(5) A certificate of substantial completion;

(6) A certificate of occupancy or similar evidence of local approval;

(7) A final inspection conducted by a qualified Agency representative;

(8) A final cost certification in a form acceptable to the Agency;

(9) A submission to the Agency of the complete closing docket;

(10) A certification by the lender that the project has reached an acceptable minimum level occupancy;

(11) An executed regulatory agreement;

(12) The Lender certifies that it has approved the borrower's management plan and assures that the borrower is in compliance with Agency standards regarding property management contained in subparts E and F of this part;

(13) Necessary information to complete an updated necessary assistance review by the Agency under § 3565.204(c); and

(14) Compliance with all conditions contained in the conditional commitment for guarantee.

- Evidence that the annual guarantee fee has been paid, if applicable.
- A copy of the Option Three Loan Note Guarantee executed by the Agency with written confirmation from the State Office of the effective date of guarantee.
- An executed regulatory agreement, if applicable.
- A management plan that has been approved by the lender and is in conformance with Agency standards regarding property management.
- Compliance with all conditions in the conditional commitment for guarantee.

Under Option Three, the lender receives a commitment from the Agency for a continuous guarantee and all conditions of this commitment must be established and/or met at closing of the construction loan.

SECTION 8: TERMINATION OF THE LOAN GUARANTEE

4.21 REASONS FOR TERMINATION

Under any of the three options, if the GRRHP loan is terminated or if the lender fails to comply with the program requirements, the guarantee will be terminated or not issued. The guarantee will terminate under the circumstances identified below.

A. Repayment of the Loan

Once the loan note has been completely paid off, the loan guarantee will automatically terminate.

B. Payment of a Claim

Once a claim has been paid, the loan guarantee automatically terminates.

C. Voluntary Termination of the Guarantee Agreement by the Lender

If a guarantee agreement is voluntarily terminated by the lender, the program restrictions must remain in place unless approved by the National Office pursuant to Paragraph 7.4.

D. Non-compliance with Program Requirements

The loan guarantee may be terminated for non-compliance with the program requirements. The Agency will exercise its rights to cancel the guarantee only if:

- The Agency has given the lender notice of the acts or omissions that it considers to constitute such grounds, specifying the applicable provisions of the statute, regulations, Loan Note Guarantee, or Lender's Agreement,
- The lender has not cured the acts or omissions within 90 calendar days after such notice, and
- The acts or omissions can reasonably be expected to have a material adverse effect on the credit quality of the guaranteed mortgage or the physical condition of the property securing the guaranteed mortgage. If such acts or omissions cannot be cured within a 90 calendar day period, the 90 calendar day cure period automatically shall be extended so long as curative activities commence during the 90 calendar day period. At no time shall the curative period extend more than 270 calendar days beyond the expiration of the original 90 calendar day cure period. The lender will remain bound to all obligations under the Loan Note Guarantee, Lender’s Agreement, and the Agency program regulations. Non-compliance with program requirements includes, but is not limited to:

◊ *Negligent Servicing*

Failure to service the loan is a violation of program requirements (see Chapter 7). Negligent servicing is defined as the failure to perform services which a reasonably prudent lender would perform in servicing its own portfolio of loans. This includes not only the concept of a failure to act, but also not acting in a timely manner or acting in a manner contrary to that of a reasonably prudent lender.

◊ *Failure to Pay the Annual Guarantee Renewal Fee (if applicable)*

The guarantee may be reinstated upon payment of all past due annual loan guarantee fees. The Agency will charge interest penalties on any unpaid guarantee fee.

◊ *Improper Sale*

If the Agency determines that the loan has been sold or otherwise transferred without Agency approval, the guarantee may be terminated.

E. Fraud

If the Agency determines that fraud took place on the part of the lender in the loan application process, the Agency may terminate the loan guarantee.

In the event of termination, the lender is required to reimburse the Agency for any unused interest credit, if applicable. A termination is appealable under the adverse action procedures (see Paragraph 1.11).

ATTACHMENT 4-A

SECTION 538 GRRHP APPLICATION CHECKLIST

This checklist is a consolidation of required information contained in the GRRHP Origination and Servicing Handbook (HB-1-3565) for the completion of a GRRHP application.

The lender is responsible for preparing an application that is complete and accurate. The lender must submit the GRRHP application to the RHS State Office where the project will be located. The GRRHP application is comprised of two components: (1) a list of lender certifications and (2) exhibits and supporting information.

(1) The lender's certification will serve as assurance to the Agency that the borrower, the project, and the proposed financing meet the lender's standards for loan making. The lender must certify the following on the lender's letterhead:

- ❑ The information contained in the application is consistent with the lender's underwriting and loan making standards (HB-1-3565, Paragraph 4.8 A.).

- ❑ The lender has completed the lender's review as required by Paragraph 4.10 of the GRRHP Origination and Servicing Handbook and has identified any significant findings in a narrative attached to this certification (HB-1-3565, Paragraph 4.8 A.).

- ❑ The lender agrees to make a loan to the borrower for the proposed project, subject to the Agency's issuance of an appropriate guarantee option (HB-1-3565, Paragraph 4.8 A.).

- ❑ The lender must provide to the Agency a certification from the borrower that the borrower is not under any State or Federal order suspending or debarring participation in State or Federal loan programs and that the borrower is not delinquent on any non-tax obligation to the United States (HB-1-3565, Paragraphs 4.10 A.1. and A.3.).

- ❑ The lender must certify that the proposed loan amount (for such part of the property attributable to dwelling use) and the applicable maximum per unit dollar amount limitations under section 207 (c) of the National Housing Act have not been exceeded (HB-1-3565, Paragraph 4.11 H.).

- ❑ The lender must certify that the owner and development team have the qualifications and experience sufficient to carry out development, management, and ownership responsibilities (HB-1-3565, Paragraph 4.7 A.).

- ❑ The lender must certify that if it is applying for a continuous guarantee, the project has the appropriate low loan-to-cost ratio as determined by the Agency *[7 CFR 3565.52(c)(3)]*.

- ❑ The lender must certify that the property is located in an eligible rural area (HB-1-3565, Paragraph 4.7 A.).

- ❑ The lender must certify that it has conducted due diligence and the results have been taken into consideration in the appraisal (HB-1-3565, Paragraph 4.7 B.).

- ❑ The lender must certify that it has reviewed and approved the management plan and agreement and confirmed that they are consistent with Agency requirements (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Prior to the issuance of the guarantee, the lender must certify that construction meets basic construction requirements (HB-1-3565, Paragraphs 5.3 through 5.12).

(2) Exhibits and Supporting Information:

Forms to be included in the application package:

- ❑ Form RD 3565-1, Application for Loan and Guarantee (HB-1-3565, Paragraph 4.8 B.1.).

- ❑ Form RD 3565-3, Lender's Agreement.

- ❑ Form RD 1940-20, Request for Environmental Information (HB-1-3565, Paragraph 4.8 B.1.).

- ❑ RD Instruction 1940-Q, Exhibit A-2, Statement for Loan Guarantees (HB-1-3565, Paragraph 4.8.B.1).

- ❑ Attachment 4-D, Housing Allowances for Utilities and Other Public Services (HB-1-3565, Paragraph 4.8 B.1.).

- ❑ Form RD 1944-37, Previous Participation Certification (HB-1-3565, Paragraph 4.8 B.1.).

- ❑ Form RD 3560-30, Certification of No Identity of Interest (IOI), if applicable (HB-1-3565, Paragraph 4.8 B.1.).

- ❑ Form RD 3560-31, Identity of Interest Disclosure/Qualification Certification, if applicable (HB-1-3565, Paragraph 4.8 B.1.).

- ❑ Form RD 1910-11, Applicant Certification, Federal Collection Policies for Consumer or Commercial Debts (HB-1-3565, Paragraph 4.8 B.1.).

- ❑ Form HUD 9832, Management Entity Profile (HB-1-3565, Paragraph 4.8 B.1.).

- ❑ Form HUD 935.2, Affirmative Fair Housing Marketing Plan (HB-1-3565, Paragraph 4.8 B.1).

- ❑ AD 1047, Certification Regarding Debarment, Suspension, and Other Responsibility Matters – Primary Covered Transactions (HB-1-3565, Paragraph 4.8 B.1.).

- ❑ AD 1048, Certification Regarding Debarment, Suspension, Ineligibility and Voluntary Exclusion – Lower Tier Covered Transactions (HB-1-3565, Paragraph 4.8 B.1.) for the borrower, contractor, subcontractors and suppliers (HB-1-3565, Paragraphs 5.5, and 4.10 A.1.).

- ❑ FEMA Form 81-93, Standard Flood Hazard Determination (7 CFR 3565.254, HB-1-3565, Paragraphs 4.8 B.2., 9.3, and 11.7 A.).

- ❑ Form RD 1924-13, Estimate and Certificate of Actual Cost (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Form RD 400-4, Assurance Agreement, (HB-1-3565, Paragraph 7.14 C.3.).

- ❑ Form RD 1924-25, Plan Certification Form, (HB-1-3565, Paragraph 5.7).

- ❑ Form RD 400-1, Equal Opportunity Agreement.

- ❑ Form RD 400-6, Compliance Statement.

- ❑ Form RD 400-3, Notice to Contractors and Applicants (prepared by the Agency).

Other Required Supporting Information:

Borrower information:

- ❑ Financial statements with certification(s) (newly formed entities applying for a construction/ permanent guarantee do not need to provide financial statements at the time of application) (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Credit report for the entity and any guarantor (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Proposed limited partnership agreement and certificate of limited partnership (if applicable). Agency requirements should be contained in one section of the agreement and their location identified by the borrower or their attorney in a cover sheet (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ If a corporate entity, its Articles of Organization and its Operating Agreement (HB-1-3565, Paragraph 4.8 B.2.).

If the borrower is a nonprofit organization:

- ❑ Tax-exempt ruling from the IRS designating them as a 501(c)(3) or 501(c)(4) organization. If the designation is pending, a copy of the designation request must be submitted (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Evidence of organization under State law or copies of pending applications (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ A list of board members (HB-1-3565, Paragraph 4.8 B.2.).

If the borrower is a public body:

- ❑ The enabling statute or the State law of organization (HB-1-3565, Paragraph 4.8 B.2.).

Project Information:

- ❑ An application fee, if applicable (HB-1-3565, Paragraph 4.7 B.).

- ❑ An appraisal or market study (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Project information including project name, location, number and type of units, the development team, property manager, lawyer, and syndicator. The development team includes the developer (including all principals), architect, and contractor (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Capital Needs Assessment (for rehabilitation loans only) (HB-1-3565, Paragraph 4.8 B.2.). Does the Capital Needs Assessment and Capital Improvement Plan call for a replacement reserve escrow that meets or exceeds the $1,000/unit threshold by year three? If not, document underwriting explanation (7 CFR 3565.254 (b)(4), HB-1-3565, Paragraph 7.6 D.4.).

- ❑ State Clearinghouse comments or recommendations (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Site plan, including contour lines (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Plot plan (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Floor plan of each living unit type and other type spaces (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Building exterior elevations (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Typical building exterior wall section (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Description and justification of any related facilities and schedule of separate charges for related facilities, if any (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Design development/working plans/construction specifications (HB-1-3565, Paragraph 4.8 B.2.). Plans, specifications, and estimates must fully describe all of the work to be completed, including all landscaping, construction, repairs, and site development work. The plans must be clear and accurate with adequate dimensions and sufficient scale for estimating purposes.

Technical data, tests, or engineering evaluations needed to support the design of the development must be included (HB-1-3565, Paragraph 5.7).

Property Management Information:

- ❑ Management plan and proposed management agreement (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Details for managing a project with scattered sites (if applicable); completion of Form HUD 935.2; procedures for determining applicant eligibility; demonstrated capacity to manage the unique leasing occupancy restrictions of the guaranteed program; description of rent collection; lease provisions covering termination and eviction; provision of a copy of tenant protection and grievance procedures to tenants; description of security plan (7 CFR 3565.351 (b), HB-1-3565, Paragraph 8.4, and Attachment 8-A).

- ❑ Plans for maintenance, repair, replacement, tenant work requests, management and maintenance staffing plans; detailed compliance with Federal and state environmental laws; description of energy conservation measures including recycling; detailed management and maintenance staffing plans; information on staff training programs (7 CFR 3565.351 (b), HB-1-3565, Paragraph 8.4, and Attachment 8-A).

- ❑ Statement whether plan includes provision for access to project's books and records by USDA staff, USDA-IG, GAO, and the Department of Justice; information on accounting, record keeping, data systems, and software. (7 CFR 3565.351 (a)(7), HB-1-3565, Paragraph 8.4, and Attachment 8-A).

- ❑ Qualifications of the property manager (HB-1-3565, Paragraphs 8.6 and 8.7).

Contractor Information:

- ❑ Demonstrated experience of the general contractor in building multifamily housing of the size design, scope, and complexity of the project. Note any exceptions (HB-1-3565, Chapters 4 and 5).

Financing Information:

- ❑ Lender’s conditional commitment on the lender's letterhead with lender’s signature specifying the GRRHP option under which the project loan is to be guaranteed (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Sources and Uses Comprehensive Evaluation (SAUCE) disc and hard copy (to be completed by the lender) or a comparable document.

- ❑ Lender's narrative (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ A copy of the proforma budget detailing the first year and a typical year's operation (Pro-formas with and without the interest credit award will serve as justification for the interest credit award.) (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Disclosure of any change in financing since NOFA response submission (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Type of utilities and utility allowances (Attachment 4-D), if applicable (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Confirm that Operating and Maintenance (O&M) Reserve is at least two percent of the total loan amount (not just guaranteed portion). Calculation of O&M reserve for congregate care facilities and larger projects should reflect absorption rates in the market study to cover shortfalls between estimated operating budget calculations and rent-up assumptions. Funds contributed as O&M reserves are contributed from the borrower's own resources or an irrevocable letter of credit and are not to be included as part of the total development cost calculation. (7 CFR 3565.402 (a)(2),
  HB-1-3565, Paragraph 7.7 B and Paragraph 3.10 C).

- ❑ Confirm that the construction contingency equal to two percent of the construction contract, inclusive of the contractor's fee and hard and soft costs. This is to be funded at or prior to closing by the contractor (7 CFR 3565.402 (a)(2), HB-1-3565, Paragraph 7.7 B and Paragraph 3.10 C.).

- ❑ Make sure that the loan is properly classified in accordance with the following:
  Existing property_____ (7 CFR 3565.252)
  515 Rehab_____
  New construction_____ (7 CFR 3565.252)
  Eligible rural area _____ (7 CFR 3565.251)
  General site requirements _____ (7 CFR 3565.254)
  General site standards _____ (7 CFR 3565.254)

- ❑ Provide evidence of adequate insurance for the project (7 CFR 3565.351, HB-1-3565, Chapter 9).

- ❑ Interest Credit Request, if applicable (HB-1-3565, Paragraphs 4.8 B.2. and 4.9).

Environmental Information:

- ❑ Phase I Environmental Site Assessment Report, as prescribed by the American Society for Testing and Materials (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Compliance with historic and architectural laws, if applicable (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Comments regarding relevant off-site conditions (HB-1-3565, Paragraph 4.8 B.2.).

- ❑ Land survey (HB-1-3565, Paragraph 4.8 B.2.).

Legal and Regulatory Items:

- ❑ Standard Regulatory Agreement approved by the Agency. (7 CFR 3565.303 (d)(9).

- ❑ Non-Standard Regulatory Agreement(s) containing provisions for transferability between lenders, binding on the borrower and their successors (7 CFR 3565.351(a), HB-1-3565, Paragraph 4.17 and 7.14 D.1.), and requires that the borrower: make all principal and interest payments under the note, maintain the project as affordable housing in good physical condition; maintain complete project books and records; and comply with all Federal Fair Housing requirements under the terms of the note (7 CFR 3565.351(a)).

- ❑ Confirmation in writing that the borrower is in compliance with the Affirmative Fair Housing Marketing Plan (7 CFR 3565.353, HB-1-3565, Paragraph 4.11 E., Exhibit 4-1, and Attachment 8-A).

- ❑ Verify use of security instruments prepared, executed, recorded and/or delivered per program guidelines and in compliance with the terms of the conditional commitment (HB-1-3565, Attachment 4-C).

- ❑ Verify use of the construction contract based on standard AIA Document A-101. If this document is used, it should be modified as described in Form RD 1924-25 or similar form (HB-1-3565, Paragraph 5.9).

- ❑ Verify use of contract specifications, documents and forms. Use Form RD 1924-6 “Construction Contract” or similar document as required by Executive Order 11246, Non-Discrimination in Employment by Construction Contractors (HB-1-3565, Paragraph 7.14, Exhibits 7-4 and 7-5).

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

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

1. The corporate records of Borrower, including its organizational documents.

2. The Loan Agreement between the Lender and Borrower.

3. The Security Agreement executed by Borrower on _____(date)_____.

4. The Guaranty (where applicable) executed on _____(date)_____ by ___(personal guarantors)___.

5. Financing Statements executed by Borrower and the Lender.

6. Real Estate Mortgages dated _____ and executed by Borrower in favor of the Lender.

7. Real Estate Mortgages dated _____ and/or other security documents dated _____ executed by _____(personal guarantors)_____ in favor of the Bank.

8. The appropriate title and/or lien searches relating to Borrower's property.

9. The pledge of stock and instruments related thereto.

10. Such other materials, including relevant provisions of the laws of this state as I/we have deemed pertinent as a basis for rendering the opinion hereafter set forth.

IN SOME CIRCUMSTANCES

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

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

1. Borrower is a duly organized _____ in good standing under the laws of the Commonwealth/State of __(State)__.

2. Borrower has the necessary _____ power to authorize and has taken the necessary corporate action to authorize the Regulatory Agreement and to execute and deliver the Note, Security Agreement, Financing Statement, and Mortgage. Said instruments hereinafter collectively referred to as the "Loan Instruments."

3. The Loan Instruments were all duly authorized, executed, and delivered and constitute the valid and legally binding obligation of the Borrower and collectively create a valid (first) lien upon or valid security interest in favor of the Lender, in the security covered thereby, and are enforceable in accordance with their terms, except to the extent that the enforceability (but not the validity) thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors' rights. The restrictive-use provisions will be contained in the mortgage or deed of trust and the regulatory agreement signed by the borrower.

4. The execution and delivery of the Loan Instruments and compliance with the provisions thereof under the circumstances contemplated thereby did not, do not, and will not in any material respect conflict with, constitute default under, or contravene any contract or agreement or other instrument to which the Borrower is a party or any existing law, regulation, court order, or consent decree or device to which the Borrower is subject.

5. All applicable Federal, State, and local tax returns and reports as required have been duly filed by Borrower and all Federal, State, and local taxes, assessments, and other governmental charges imposed upon Borrower or its respective assets, which are due and payable, have been paid.

6. The Guaranty has been duly executed by the Guarantors and is a legal, valid, and binding joint and several obligations of the Guarantors, enforceable in accordance with its terms, except to the extent that the enforceability (but not the validity) thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors' rights.

7. All necessary consents, approvals, or authorizations of any governmental agency or regulatory authority or of stockholders which are necessary have been obtained. The improvements and the use of the property comply in all respects with all Federal, State, and local laws applicable thereto.

8. (In cases involving subordinate or other than first lien position.) That the mortgage/deed of trust on Borrower's real estate and (fixtures, e.g. machinery and equipment) and the security interest on (type of collateral, e.g., machinery and equipment, accounts receivables and inventory) both given as security to the Lender for the Loan, will be subordinate to __(first mortgage) given as security for a loan in the amount of $_____ and the security interest in Borrower's __(type of collateral, e.g., accounts inventory)__ given to __(secured creditor)__ as security for a loan (state type of loan, i.e., revolving line of credit, if known) in the amount of $_____.

9. That there are no liens, as of the date hereof, on record with respect to the property of Borrower other than those set forth above.

10. There are no actions, suits, or proceedings pending or, to the best of our knowledge, threatened before any court or administrative agency against Borrower which could materially adversely affect the financial condition and operations of Borrower.

11. Borrower has good and marketable title to the real estate security free and clear of all liens and encumbrances other than those set forth above. I/we have no knowledge of any defect in the title of the Borrower to the property described in the Loan Instruments.

12. Borrower is the absolute owner of all property given to secure the repayment of the loan, free and clear of all liens, encumbrances, and security interests.

13. Duly executed and valid functioning statements have been filed in all offices in which it is necessary to file financing statements to fully perfect the security interests granted in the Loan Instruments.

14. Duly executed real estate mortgages/deeds of trust have been recorded in all offices in which it is necessary to record to fully perfect the security interests granted in the Loan Instruments.

15. (IN SOME OTHER CIRCUMSTANCES) The Indemnification Agreement has been duly executed by the Indemnitors and is a legal, valid, and binding joint and several obligation of the Indemnitors, enforceable in accordance with its terms, except to the extent that the enforceability (but not the validity) thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors' rights.

16. That the lease contains a valid and enforceable right of assignment and right of reassignment, enforceable in accordance with its terms, except to the extent the enforceability (but not the validity) thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors' rights.

17. The Lender's lien has been duly noted on all motor vehicle titles, stock certificates, or other instruments where such notations are required for proper perfection of security interests therein.

18. That a valid pledge of the outstanding and unissued stock and/or shares of Borrower has been obtained and the Lender has a validly perfected and enforceable security interest in the shares/stock of Borrower, except to the extent the enforceability thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors rights.

ATTACHMENT 4-C
CLOSING DOCUMENTS TO BE SUBMITTED AS PART OF THE FINAL APPLICATION

After the conditional commitment for guarantee has been issued, the proposed closing documents will be prepared by the lender and forwarded to the Agency with the lender's counsel's opinion in the suggested format of Attachment 4-B. Prior to issuing the loan note guarantee, the State Director will forward the loan docket including all required documents to the Office of the General Counsel (OGC) for review unless otherwise directed by OGC. After an administrative review, the State Director will include with the docket a letter of recommendation indicating any special items, documents, or problems that need to be addressed. The docket will be assembled by the lender for OGC review in accordance with guidance listed below and indexed and tabbed.

DOCUMENTS TO BE SUBMITTED FOR OGC REVIEW

(1) Letter from State Office authorizing loan guarantee and containing conditions (if applicable);
(2) *Form RD 3565-2;*
(3) Promissory Notes;
(4) Security documents - Real Estate Mortgage, Security Agreement, Financing Statements, and Leases (if applicable);
(5) Personal or corporation guarantees with related security documents;
(6) *Form RD 3565-3*;
(7) *Form RD 3565-4*;
(8) Opinion of Lender's Counsel in form prescribed by OGC (Attachment 4-B);
(9) Regulatory Agreement with attached certification from the lender’s attorney (see Paragraph 4.16); and
(10) Deed Restriction or other Agency/OGC approved recordable instrument that declares that housing must remain available for occupancy by low and moderate income households for the original term of the guaranteed loan.

Do not submit for OGC review feasibility studies, title information, or the original application unless specifically requested to do so.

OGC will review the docket and furnish advice to the Agency on whether it may issue the loan note guarantee after the loan is closed. Such advice is for the benefit of the Agency only and does not relieve the lender of its responsibilities under Agency regulations. OGC at his/her option may attend the loan closing.

ATTACHMENT 4-D
HOUSING ALLOWANCES FOR UTILITIES AND OTHER PUBLIC SERVICES

NAME OF BORROWER: _____
EFFECTIVE DATE: _____
LOCATION OF PROJECT: _____

PART I: PROJECT-BASED PAID UTILITIES AND SERVICES

	MONTHLY DOLLAR ALLOWANCES					
UTILITY OR SERVICE	0-bdrm	1-bdrm	2-bdrm	3-bdrm	4-bdrm	5-bdrm
HEATING						
Natural gas						
Bottle gas						
Electric						
Oil						
AIR CONDITIONING						
COOKING						
Natural gas						
Bottle gas						
Electric						
OTHER ELECTRIC (LIGHTING, REFRIGERATION, ETC.)						
WATER HEATING						
Natural gas						
Bottle gas						
Electric						
Oil						
WATER						
SEWER						
TRASH COLLECTION						
OTHER (Specify) _____						
TOTAL ALLOWANCE						

Prepared by: _____
Borrower or Agent Title Signature Date

PART II: ALLOWANCES FOR UTILITIES AND SERVICES BILLED AND PAID DIRECTLY BY TENANT

TO: _____
Address of Tenant

Number of Bedrooms:____

You will be billed directly for utilities and service charges. Below are the allowances credited in your rent for the payment of utilities. You may be billed for more or less than shown below depending on your use of utilities.

UTILITY OR SERVICE	PER MONTH EXPENSE
Heating	$_____
Air Conditioning	$_____
Cooking	$_____
Other Electric	$_____
Water Heating	$_____
Water	$_____
Sewer	$_____
Trash Collection	$_____
Other (Specify)_____	$_____
_____	$_____
_____	$_____
TOTAL	$_____

_____ _____
Signature of Borrower or Agent Date

ATTACHMENT 4-E
PLANNING MEETING AGENDA

The purpose of this meeting is to present and discuss USDA Rural Development (Agency) requirements for developing a Guaranteed Rural Rental Housing project. Topics marked with an asterisk (*) include procedures that apply only when an Agency construction loan guarantee is combined with a permanent loan guarantee. Additional information on the topics may be provided in Agency administrative notices, guides, and other documents. The Agency will document the meeting with a list of attendees and note whether it took place in person or via conference call.

	TOPICS	REFERENCES		COMMENTS
		Regulation	**HB-1-3565 / Other**	
1.	**Sites**			
A.	Location	3565.251(a) and 1924.106(c)	3.12 and 3.13	
B.	Services/facilities	No citation	3.13	
C.	Professional services	1924.105(a)(2)	3.14	
D.	Site standards	1924.107(a)(2) and 1924.108	3.14	
E.	Site density	No citation	3.15	
F.	Non-contiguous sites	3565.251(c)	3.16	
G.	Site control	3565.152	3.17	
2.	**Environmental**			
A.	NEPA process and responsibilities	3565.255 and 1940-G	3.18 and 5.8 and Chapters 4 and 11	
B.	Lender's Phase I ESA included in NEPA review	3565.254(b)(2) and 1940-G	3.18 and 5.8 and 11.5	
C.	FEMA Form 81-93	3565.254(b)(3)	11.5	
D.	Timing issues/scheduling	1940.331	Chapters 4 and 11	
E.	Parties involved from local and state agencies	3565.254(b)	Chapter 11	
F.	Lender documentation	3565.254(b)	Chapter 11	
3.	**Design**			
A.	Property standards	3565.254(a) and 1924.5(d)(1)	3.20 and 5.3	
B.	Drawings and specifications	1924.5(d)(2) and 1924.13(c),(d)	4.4 A.1., 5.6, and 5.7	
C.	Professional services	3565.256 and 1924.13(a)	5.6	
D.	Agency Reviews	1924.5(h)	5.7	

PLANNING MEETING AGENDA

	TOPICS	REFERENCES		COMMENTS
		Regulation	**HB-1-3565 / Other**	
E.	Plan certification	3565.256 and 1924.5(f)(1)	5.7 and 5.12	
4.	**Accessibility**			
A.	Americans with Disabilities Act (ADA) compliance	3565.251(d)	3.20 C. and ADA Accessibility Guidelines (ADAAG)	
B.	Van accessible parking space for on-site office and public spaces	No citation	ADAAG 4.1.2(5)(b)	
C.	Fair Housing Act (FHA) of 1988 compliance	3565.251(d)	3.20 C. and FHA / AG	
D.	All common areas accessible	No citation	FHA / AG Sec. 5, Req. 2; and UFAS 4.1.3	
E.	All ground floor units adaptable	No citation	FHA / AG Sec. 5, Req. 4	
F.	Section 504 of the Rehabilitation Act of 1973	7 CFR 15b and 3565.251(d)	3.20 C. and Uniform Federal Accessibility Standards (UFAS)	
G.	5% fully accessible units	No citation	UFAS 4.1.4(11)(b) and 4.34	
H.	Front loading washers	No citation	UFAS 4.34.7.2	
5.	**Construction**			
A.	Contract documents	1924.6(a) and 1924.13(e)(1)(ii)	5.9 and Attachment 5-A	
B.	Pre-Construction Conference	1924.6(a)(11)	5.2	
C.	Debarment/Suspension	1940-M	5.5	
D.	Procurement	3565.257		
E.	Insurance *		5.14	
F.	Inspections	3565.303(c)(3) and 3565.303(d)(7)	3.20 and 4.20 and 5.10 and 5.20	
G.	Substantial Completion	3565.303(d)(5)		
H.	Warranty	1924.12	5.11and 5.21	
I.	Sureties *	3565.303(c)(2)	5.15 and 5.16	
J.	Payments *	1924-A, and 3565.303 (c)(3)	5.17 and 5.20 and 5.21	
K.	Change orders *	1924.10(c)	5.18	
L.	Cost Certification	3565.303(d)(8)	5.21	
M.	Annual inspections	3565.351(e)	7.13 A.2.	

PLANNING MEETING AGENDA

	TOPICS	REFERENCES		COMMENTS
		Regulation	**HB-1-3565 / Other**	
6.	**Professional Mgmt. & Servicing**			
A.	Affirmative Fair Housing Marketing Plan	No citation	7.14 C.1.	
B.	Assurance Agreement	No citation	7.14 C.3.	
C.	Title VI of Civil Rights Act of 1964	No citation	Exhibit 7-5	
D.	Occupancy Requirements	No citation	8.12 A, B, D, E	
E.	Tenant Grievances	No citation	8.14, 8.15	
F.	Pre-Rent Up Instructions	No citation	8.2 I.	

Date _____ Location _____
(indicate if teleconference)

Attendees:

	Name	Contact Information
1.	_____	_____
2.	_____	_____
3.	_____	_____
4.	_____	_____
5.	_____	_____
6.	_____	_____
7.	_____	_____
8.	_____	_____

CHAPTER 5: CONSTRUCTION REQUIREMENTS

5.1 INTRODUCTION

A primary goal of the GRRHP is to encourage the construction of affordable yet safe and sanitary housing units in rural areas. To achieve this goal, the Agency will review the quality of construction of all housing developed under the program. However, the Agency will take a more active role during the construction phase when it is guaranteeing construction advances. This chapter details the basic construction requirements that must be met whenever the Agency is providing a loan guarantee, as well as the additional requirements that apply when the Agency guarantees construction advances.

Key Topics in this Chapter

- Section 1: Pre-Construction Conference
- Section 2: Basic Construction Requirements
- Section 3: Guarantees of Construction Advances
- Section 4: Application Processing for Guarantees on Construction Advances
- Section 5: Claims Processing for Guarantees on Construction Advances

SECTION 1: PRE-CONSTRUCTION CONFERENCE

5.2 CONFERENCE REQUIREMENTS

After a contract is awarded and all documents are completed and signed and prior to any actual construction work, a pre-construction conference must be held between the borrower, contractor, architect, and lender representatives, including the lender's fee inspector. The Agency must be notified of the conference, and Agency representatives may attend. If a representative from the Agency is not able to attend, pre-conference meeting notes should be forwarded to the Agency to maintain in the Agency's files. The conference is held to reach mutual understandings on all terms and conditions of the contract documents. The adequacy of the plans and specifications, as well as the cost estimates, must be reviewed.

The Agency's environmental review must be examined, and any required mitigation measures discussed at this time. The construction schedule must be reviewed to ensure that the work can be completed in a timely manner. If any changes in the plans and specifications are proposed, they must be approved as described in Paragraph 5.18. The Agency has developed a suggested format to record the minutes of the pre-construction conference (*Form RD 1924-16, "Record of Pre-Construction Conference*)" which is available upon request.

SECTION 2: basic CONSTRUCTION requirements

5.3 OVERVIEW

The lender must ensure that the construction meets all local codes and that the product will comply with the Agency construction and environmental guidelines. Even when the construction loan is not guaranteed, the construction must meet local, state and Agency standards. Project construction plans and specifications will be discussed in full detail with the Agency during the planning meeting. The planning meeting must be scheduled after the lender has received the Notice to Proceed letter.

Prior, during and after project construction, the Agency must be able to assess its quality and suitability for the GRRHP. When the Agency is not guaranteeing the construction, the State Director, in consultation with the State Architect, may waive some of the requirements for architectural services when they determine those services are not necessary to complete the project's construction in accordance to Agency requirements.

The lender must ensure that all of the construction requirements described in this section will be met when the Agency is providing either an Option Two or an Option Three guarantee.

5.4 CONSTRUCTION CONTRACTOR EXPERIENCE AND CAPACITY

The lender must ensure that the contractor has demonstrated overall financial stability and is experienced in building multifamily housing of a size, design, scope, and complexity that is similar to the proposed project.

Construction Requirements

The construction requirements cover the following topics:

- Contractor experience and capacity;
- Debarment and suspension;
- Architectural Services and Capital Needs Assessments;
- Plans, specifications, and cost estimates;
- Environmental requirements;
- Construction;
- Inspections; and
- Warranty

5.5 DEBARMENT AND SUSPENSION

The lender must ensure that the general contractor and all subcontractors and suppliers sign certification statements indicating that they are not currently debarred or suspended from participating in federally funded programs. The certification statement is included on *Form AD-1048* . The signed form must be submitted with each proposal to the borrower, including the proposal from the general contractor and each subcontractor. Failure to provide the signed certificate is sufficient grounds to reject the company's bid or proposal.

Information on debarred or suspended contractors is available on the Internet at http://www.epls.gov or https://www.sam.gov/portal/SAM/#1 .

The Agency will verify that the general contractor does not appear on the debarment/ suspension list. Under any of the three guarantee options, *Form AD-1048* must be reviewed by the lender as part of the application for loan guarantee (see Chapter 4, Section 3).

5.6 ARCHITECTURAL SERVICES AND CAPITAL NEEDS ASSESSMENTS

Capital Needs Assessments (CNAs) are required for every property to be rehabilitated regardless of the scope of work. A CNA provides a repair schedule for the property, indicating the necessary repairs and replacements to a property over the coming 20 years. It is not an estimate of existing rehabilitation needs or an estimate of rehabilitation costs. If a rehabilitation of a multifamily housing development is planned, the rehabilitation repair list or scope of work should be developed outside the CNA. A copy of the rehabilitation repair list should be provided to the CNA Provider. This rehabilitation repair list may be developed by the owner, a project architect, or an outside party (such as the CNA Provider hired by the owner). The CNA Provider should prepare an "as is" CNA, based on existing conditions at the property. Then, if requested by the owner and approved by the Agency, the CNA Provider would prepare a "post rehabilitation" CNA, indicating what repairs are planned for the property in the coming 20 years based on conditions after the rehabilitation is completed. Items to be replaced during rehabilitation, such as appliances, that will need to be replaced again during the 20 years will be included in the "post rehabilitation" CNA. Items, such as a new roof, that will not need replacement during the coming 20 years will not appear in the CNA. Because requirements for CNAs may change from time to time, the Agency may issue specific guidance on CNAs for the 538 program through Unnumbered Letters.

The services of a professional architect or engineer must be obtained to perform architectural services related to the construction of the project. This person or organization must be duly licensed and qualified in accordance with State law.

Architectural services include:

- Schematic designs and preliminary cost estimates;
- Preparation of bid documents;
- Design development exhibits;

- Working drawings and specifications for the construction of the entire project in accordance with applicable regulations and codes and review of the final construction budget;
- Assistance in the selection of the contractor and the preparation of the construction contract;
- Attendance at the pre-construction conference to discuss work and schedules;
- Administration of the construction contract including periodic inspections of all phases of construction;
- Review/approval of pay requests;
- Preparation of change orders/directives;
- Preparation of "punchlist" items needing completion and documentation for, and participation in, the final inspection;
- Advice and consultation regarding the warranty items; and
- Development of final "as built" drawings.

5.7 PLANS, SPECIFICATIONS, AND COST ESTIMATES

The borrower must use the services of a professional architect or engineer duly licensed and qualified in accordance with State law to provide architectural services, including the development of plans, specifications, and cost estimates. The lender must provide a copy of preliminary plans, specifications, and cost estimates as part of the application package for Agency review.

Plans, specifications, and cost estimates must fully describe all of the work to be completed, including all landscaping, construction, repairs, and site development work. The plans must be clear and accurate, with adequate dimensions and sufficient scale for estimating purposes. Technical data, tests, or engineering evaluations needed to support the design of the development must be included.

Occasionally, the owner requests of the architect, a Life Cycle Cost Analysis (LCCA) report generated to establish "best value" for product selection for the project. The Life Cycle Cost Analysis is the sum of all recurring and one-time (non-recurring) costs over the full life span

or a specified period of a good, service, structure, or system. The analysis includes purchase price, installation cost, operating costs, maintenance and upgrade costs, and remaining (residual or salvage) value at the end of ownership or its useful life. If available, the LCCA report should become a part of the Rural Development files to assist with development of a CNA for this property.

The level of housing amenities provided in the plan must be competitive within that market. For example, washers, dryers, and air conditioners may be necessary for the units to be competitive within the local market. Amenities must not, however, include such luxury items such as swimming pools and health clubs unless specifically approved by the Agency.

The State Architect will review the preliminary documents. This review will take into account the amenities being provided, the quality of materials being used, development costs, and other items pertinent to the quality and cost of construction and the operation of the property. The project architect must make appropriate changes to the plans, specifications, and cost estimates to respond to Agency concerns prior to submitting a final set of plans, specifications, and cost estimates to the lender. When these items are submitted to the lender, the project architect must also provide *Form RD 1924-25*, which is available from the Agency.

The lender must provide a copy of the final plans, specifications, and cost estimates, together with the Plan Certification, to the Agency for written concurrence by the State Architect. All of these items will be retained as a part of the Agency file. Agency staff should include a statement “that there is evidence of the extent and quality of the work/product and RD is comfortable that the expected value is there” as part of resolution. Construction documents that must be submitted to the Agency are listed in Attachment 5-A.

5.8 ENVIRONMENTAL REQUIREMENTS

The Agency is required by law to complete an environmental review under the National Environmental Policy Act (NEPA) prior to issuing a conditional commitment of a guarantee to the lender. This environmental review may require redesign or relocation of structures, as well as mitigation measures to be taken during and after construction to protect any important resources.

The lender must comply with all applicable Federal, State, and local laws regarding environmental protection and pollution abatement, in addition to applicable permitting and zoning ordinances. It is the responsibility of the lender to ensure that the borrower/developer, architect, and contractor are fully aware of and comply with the mitigation measures contained in the Agency's environmental review and all other applicable Federal, State, and local laws and regulations.

5.9 CONSTRUCTION

The contractual arrangements for the construction of a rural rental housing project must be contained in a written contract between the borrower and the construction company (general contractor).

The construction contract form published by the American Institute of Architects *(AIA)* in AIA *Document A-101* is acceptable provided that it is modified to meet the Agency's requirements. Agency requirements for construction contracts are described in RD Instruction 1924-A at §1924.13(e)(1)(ii) and RD Instruction 1924-A, Guide 1, Attachment 6. Other AIA documents used and supplemented in RD Instruction 1924-A, Guides 1 and 4, are: Instructions to Bidders; Architect's Agreement; and General Conditions to the Construction Contract. The AIA construction contract form is available from the AIA.

Construction of the housing and related facilities must be in conformance with the approved plans and specifications, applicable laws, ordinances, codes and regulations, and good construction practices. To avoid future maintenance problems, quality materials must be used. As a minimum, the materials must be consistent with those described in the Marshall & Swift Company's basic description of "average quality multifamily residences." Compare materials and systems and determine which are most economical, considering the sum of all costs (initial, operation, and maintenance).

5.10 INSPECTIONS

Actual construction work must be inspected by the lender to verify that the terms and conditions of the construction contract are met. This includes verifying that work is being performed in accordance with the approved plans and specifications without deviation. The contract documents and all referenced codes, standards, and other ordinances are the instruments used to judge the acceptability of the work. Items that do not meet the requirements and specifications of these documents must be removed, corrected, or accepted as change orders by the lender with an appropriate price adjustment.

The lender may use its own staff or the services of a qualified independent fee inspector to periodically inspect the construction work to determine that the construction and land development conform to the drawings and specifications. In any case, the lender must ensure that the inspector has experience inspecting work similar in size, design, scope, and complexity to the project. Fees paid to the inspector must be reasonable and customary in the local area for similar work. The lender's inspections must be made as frequently as necessary. If environmental mitigation measures are required, the inspector must follow-up on the implementation of such measures and document compliance in his or her inspection report. Non-compliance with environmental mitigation measures must be promptly reported to the Agency.

At a minimum, inspections must be made at the three stages of development described below, as well as prior to each payment:

- Stage 1. An initial inspection immediately prior to or during the placement of concrete footings or monolithic footings and floor slabs.

- Stage 2. An inspection when the building is enclosed, structural members are still exposed, rough in for heating, plumbing, and electrical work is in place and visible, and wall insulation and vapor barriers are installed. Customarily, this is prior to installation of brick veneer or any interior finish which could include lath, wallboard, and finish flooring.

- Stage 3. A final inspection when all on-site and off-site development has been completed and the structure is ready for occupancy for its intended use.

Note that inspections at each of these stages must be made of each building. In a project with multiple buildings, inspection of one building will not be deemed sufficient to meet these requirements.

The lender must notify the Agency when each of these three major inspections is scheduled so an Agency inspector can accompany the lender's inspector. An Agency inspector must inspect the building to ensure compliance with Agency construction requirements. (See Attachment 5-A for Agency requirements to attend inspections.) In addition to these three major inspections, inspections must be made by the lender or its inspector prior to each payment to the contractor to confirm the estimated values of work completed and stored materials. Payments must be adjusted if there are any discrepancies in the reported values.

Any work or material deficiencies noted or alleged as a result of any inspections by the lender's inspector must be reported to the borrower or borrower's architect or other party with the authority to demand that the contractor make necessary corrections.

Documentation must be provided for deviations from the approved plans and specifications. For cases where the Agency guarantee is only on the permanent loan, "as built" plans must be provided. For cases where the Agency is guaranteeing the construction advance as well as the permanent loan, contract change orders must be submitted as discussed in Paragraph 5.18.

5.11 WARRANTY

The lender must ensure that the contractor or contractors provide a legally enforceable, one-year warranty to the owner indicating that the work done and materials supplied conform to those specified in the contract documents and applicable regulations. The warranty must provide that the contractor agrees to repair defective workmanship and repair or replace any defective materials at the contractor's expense for the period of the warranty. The lender will do its first annual inspection of the property as defined in Chapter 7, Paragraph 7.14 A.2. before the expiration of the warranty period. The first annual inspection must include 100 percent of the units.

5.12 CONSTRUCTION REQUIREMENTS CERTIFICATION

To ensure that each of the basic construction requirements described in Section 2 of this chapter have been met, the lender must provide a signed certification to the Agency prior to the issuance of the loan guarantee.

SECTION 3: Guarantees of CONSTRUCTION ADVANCEs

5.13 OVERVIEW

Example of a Guarantee of Construction Advances		
Total development cost	=	$1,000,000
Lender underwritten loan	=	$900,000
First loan advance	=	$70,000
Guarantee ($70,000 x 90%)	=	$63,000
First plus second loan advances	=	$150,000
Guarantee ($150,000 x 90%)	=	$135,000

The Agency will guarantee construction advances, secured by an acceptable credit enhancement, as part of an Option Two or an Option Three loan guarantee. Under Option Two, the Agency may provide a guarantee that covers up to 90 percent of the amounts actually advanced by the lender. As more construction work is accomplished and more funds are advanced by the lender, the amount of the advanced funds covered by the guarantee increases. In no case will the guarantee during the construction period exceed 90 percent of the original principal amount of the loan.

Option Three is a single continuous guarantee for construction and permanent loans for which there are no conversion requirements to the permanent loan. Similar to Option Two, the lender underwrites the loan, and the Agency provides a guarantee that covers up to 90 percent of the amounts actually advanced by the lender. The guarantee will go into effect with the first draw of the construction loan. As more construction work is accomplished and more funds are advanced by the lender, the advanced funds covered by the guarantee increases. In no case will the guarantee during the construction period exceed 90 percent of the original principal amount of the loan.

Under both Options Two and Three, the Agency will only guarantee construction advances which have acceptable credit enhancements. Acceptable credit enhancements include any one of the following:

- Surety bonding or performance and payment bonding acceptable to the Agency;
- An irrevocable letter of credit acceptable to the Agency.
- A pledge to the lender of additional collateral that is acceptable to the Agency.

5.14 INSURANCE

The lender must ensure that property and liability insurance are in place during the course of construction to protect the borrower, the lender, and the contractor from a variety of losses. The construction contract must not become valid until proof of insurance is obtained. The contractor is usually responsible for obtaining and carrying the insurance policies. The amount of coverage, the deductible, and the beneficiary of the policy must be in accordance with commonly accepted lending practices or State or local law.

5.15 SURETIES

Payment and performance bonds covering the contractor's work must be executed prior to the start of any work. The bonds must each have a face value of 100 percent of the construction contract. These surety bonds must be obtained from a corporate bonding company listed on the current Department of Treasury *Circular 570* (published annually in the Federal Register) as holding a certificate of authority as an acceptable surety on Federal bonds and legally doing business in the state where the project is located. The bonds must remain in effect until the date of final acceptance of work by the owner and the lender and evidence of lien free completion.

5.16 LETTERS OF CREDIT

In lieu of payment and performance bonds, the lender may accept an unconditional and irrevocable letter of credit issued by another lending institution to secure the completion of construction. The letter of credit must equal not less than 25 percent of the construction contract and must remain in effect until the date of final acceptance of work by the owner and the lender, and all certificates of occupancy from the local jurisdiction are issued. In addition, the letter of credit must stipulate that the lending institution that issued the letter of credit, upon written notification by the owner or lender of the contractor's failure to perform under the terms of the contract, will provide payment for an amount not less than 25 percent of the amount of the contract to satisfy all prior debts incurred by the contractor in performing the contract and all funds necessary to complete the work.

An irrevocable letter of credit issued by a bank or other approved financial institution must meet strict credit quality requirements (see Exhibit 5-1 for credit quality requirements) and be valid and collectable.

Exhibit 5-1 Credit Quality Requirements for Letters of Credit		
Thomson's Bankwatch	N/A	"B" or better
S&P	Long term debt, if rated, or long term bank deposit	"A" or better
Moody's	Long term debt, if rated, or long term bank deposit	"A" or better

Criteria for letters of credit are as follows:

- The issuing institution must not be an affiliate of the lender.
- Federal Home Loan District Bank enhancement of a member bank letter of credit is an acceptable method for meeting Agency credit standards.
- The lender must be named as the sole beneficiary.
- The term must be a minimum of one year and remain in effect until the requirements for release of the letter of credit are met.
- The form of the letter of credit and the sight draft (demand for payment) must be reviewed by the Agency. However, the guaranteed lender is solely responsible for ensuring that the letter of credit is acceptable and enforceable.
- For GRRHP loans that are backing Ginnie Mae guaranteed securities, the lender will follow Ginnie Mae procedures for letters of credit.

5.17 PAYMENT PROCEDURES

Payments to the general contractor should usually be made on a monthly basis. The format of the payment request must be consistent with AIA Document 702, *Application and Certificate for Payment*. The payment requests must provide the same breakdown of construction costs as the final and approved cost estimate before construction began. They must be signed by the contractor and the architect. The Agency staff will not sign the payment request forms.

The amounts of the partial payments are based on the amount of work completed, the amount of materials stored on site, and the amount of retainage. The determination of the amount of work completed and the amount of stored materials must be made by the lender after consultation with the borrower, the borrower's architect, and on-site observations. The amount of retainage will be set by the lender. The retainage amount must be withheld until 100 percent of the construction contract is complete, including punch list items.

Payment requests may include charges for change orders only after the change orders have been signed by the lender and the Agency representative. Partial payments for overhead and profit may be made to contractors provided the percentages paid on each item are no higher than the percentage of total construction completed.

When construction is determined to be substantially complete, an amount determined to be adequate to cover any remaining work items must be withheld from the contractor. This amount is normally included in the retainage. If the amount of remaining work is higher than the budgeted retainage, then the retainage must be adjusted upward accordingly.

5.18 CONTRACT CHANGE ORDERS

Any construction changes that occur after a contract is executed, which affect design, costs, time, or the provision of financial assistance in connection with the change order, must be documented as a contract change order. Changes that do not affect design, cost, or time are deemed minor and must be documented as field orders by the architect. These minor changes do not require the preparation of a change order. All proposed change orders must be in writing and signed by the borrower, borrower's architect, contractor, lender, and Agency representative before the work involved in the change is started or the costs are included in a payment request. Provision of additional financial assistance in connection with a contract change order does not require preparation of an environmental review by the Agency, provided that the action will not alter the purpose, operation, location, or design of the project as originally approved.

Agency approval of contract change orders must be obtained to ensure that changes in design or quality of materials/construction do not adversely impact the appraised value of the completed project, holding other appraisal factors (income approach and comparable sales) constant.

5.19 MODIFICATION OF MAXIMUM AMOUNT GUARANTEED UNDER A CONSTRUCTION/PERMANENT LOAN OR A PERMANENT ONLY LOAN OR FOR A CONTINUOUS GUARANTEE LOAN

There are two situations, which may result in a modification of the maximum loan amount that will be guaranteed during the construction period.

- If following full underwriting by the lender and the issuance by the Agency of a conditional commitment to guarantee part of the loan, but prior to the start of construction, there are changes in the proposed construction or development work that will reduce the loan amount, the lender must notify the Agency. While the amount covered by the guarantee will be reduced, the percentage of the loan amount guaranteed will remain the same.

- If the construction is not in accordance with approved plans and specifications, the Agency may not issue the guarantee. At the Agency's discretion it may issue the guarantee at a reduced the guarantee amount. For example, if the materials used are below the standards described in the approved specifications, the Agency may disapprove or reduce the guarantee percentage.

5.20 REPORTING DURING CONSTRUCTION PERIOD

The lender is responsible for ensuring that the Agency is provided a copy of approved payment estimates and the related inspection reports prepared by the lender's fee inspector and by the project architect. This documentation must be provided in a timely fashion to the Agency following each draw.

Once a new draw is issued, the lender is responsible for ensuring that the Agency has the information needed to adjust the guarantee amount. In addition, the lender must submit *Form RD 1980-41, "Guaranteed Loan Status Report"*, on a monthly basis to the USDA Finance Office.

Exhibit 5-2 shows the notifications to the Agency required during the construction guarantee period.

Exhibit 5-2

Notifications Required During the Construction Guarantee Period

Notification	When to Notify	Reference
Major inspections	As soon as a major inspection is scheduled	Paragraph 5.10
Project changes requiring an environmental review	As soon as the project change is proposed that alters purpose, operation, location, or design	Paragraph 5.18
Project changes reducing the loan amount	After Agency issues guarantee but prior to construction start	Paragraph 5.19

5.21 Final payment

The lender must ensure the following items have been completed before final payment is provided to the contractor.

- Final inspection. The lender should coordinate the final inspection with all parties, including the borrower's architect, the lender's fee inspector, the local government, and the Agency, so that the inspections may be done at the same time. In all cases, the Agency will conduct a final inspection.

- Completion of construction. All construction must have been completed in a manner acceptable to the Agency. The borrower, the borrower's architect, and any local jurisdiction must state their final acceptance, in writing, before the lender issues its acceptance, as defined in Paragraph 5.16.

- Final cost certification. The lender is responsible for certifying to the Agency that the borrower's cost certification accurately represents the actual cost of the work performed in connection with the construction. If an identity of interest between the developer and the contractor exists, the cost certification must also be audited. However, if a cost certification is prepared for any other funding source (e.g., an agency providing Low-Income Housing Tax Credits), then a copy of that cost certification may be accepted. If the cost certification indicates any "to be paid" costs, those amounts must be included in the amount of retainage being withheld.

- Warranties. A builder's warranty of at least one year and other required product/material warranties and information must be provided to the borrower before final payment is made. The warranties should become effective on the date of substantial completion.

- Final payment documents. All final payment documents required by the lender, such as release of liens, must have been executed and must be available at the time of final payment.

5.22 CERTIFICATION THAT ADDITIONAL REQUIREMENTS HAVE BEEN MET

To ensure that the lender has addressed each of the additional construction requirements described in Section 3 of this chapter, the lender must include a signed form certifying that each requirement has been met prior to the Agency issuance of a permanent loan guarantee. The lender must not issue final payment until the requirements in Paragraph 5.21 have been fulfilled.

SECTION 4: APPLICATION PROCESSING FOR GUARANTEES ON CONSTRUCTION ADVANCES

5.23 OVERVIEW OF PROCESS

Once construction begins, the guarantee will be adjusted based on the amount of money advanced. Adjustment of the guarantee will be automatic as long as the lender complies with the reporting requirements of this chapter.

SECTION 5: CLAIMS PROCESSING FOR GUARANTEES ON CONSTRUCTION ADVANCES

5.24 OVERVIEW OF PROCESS

The maximum guarantee of construction advances related to a construction and permanent loan will not at any time exceed the lesser of 90 percent [or the percent established by the Agency and announced through a Notice in the **Federal Register**] of the amount of principal and accrued interest up to default for amounts which exceed the original advance if for eligible uses of loan proceeds or 90 percent of the original principal amount and accrued interest up to default of the loan. The Agency's guarantee will cover losses to the extent aforementioned once all sureties/insurances and/or performance and payment bonds have fully performed their contractual obligations.

For loans on construction advances where a default occurs prior to the issuance of the permanent guarantee, liquidation, disposition, and claims processing should be performed in accordance with Chapter 10.

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Attachment 5-A

CONSTRUCTION DOCUMENTS THAT MUST BE SUBMITTED FOR ANY LOAN GUARANTEE (GUIDANCE FOR RURAL DEVELOPMENT STAFF)

Issue	Option One Guarantee	Options Two and Three Guarantees	Paragraph
Pre-construction Conference	Agency will attend, if available [7]	Agency will attend, if available [7]	5.2
Preliminary plans, specs, and cost estimates	Review, provide comments, and file [1]	Review, provide comments, and file [1]	5.7
Design Development Documents	Review, provide comments, and file [2]	Review, provide comments, and file [2]	5.7
Final (WD) plans, specs, cost estimate, and Form RD 1924-25	Review, concur, and file[3]	Review, concur, and file [3]	5.7
Construction Contract	----------	Review, concur, and file [4]	5.9
Debarment and Suspension	Review website list [5]	Review website list [5]	5.5
Surety Bonds and Letters of Credit	----------	Review, approve, and file [6]	5.15 and 5.16
Inspections: Footing Framing Final	Conduct, if available Conduct, if available Conduct, document, and file [8]	Conduct, document, and file. Conduct, document, and file. Conduct, document, and file.	5.10
Payments to contractor	----------	File only [9]	5.17
Change Orders	Review and file	Review, approve, and file [10]	5.18
Final Cost Certification	Review, accept, and file [11]	Review, accept, and file [11]	5.21
As-built plans and specs	Review	Review	5.10
Certification that additional construction requirements were met	----------	----------	5.22
Form RD 1980-41	----------	Monitor	5.20
Lender –approved payment estimates and related inspection reports	Review inspection reports and file	Review and file	5.17 and 5.20

NOTES

1. These are submitted after the preplanning meeting and with the application. They may include life cycle cost analysis for roofing, paving, exterior wall, and mechanical systems, etc.
2. These are in response to the preliminary design review. These documents may be skipped and go directly to the final (WD) documents.
3. The WD Documents include the plan certification and bidding and contract documents due prior to the start of construction.
4. A written agreement is NOT required to be on an AIA form.
5. State Office reviews the GSA website list for the general contractor. Lender reviews Form AD-1048.
6. Letter of Credit may be substituted for payment and performance bonds.
7. Conference must be held. Agency attendance is highly recommended.
8. Agency must be notified of all inspections. Agency participation is required only in the final inspection.
9. Payments are processed and approved by the lender upon receipt of all documentation and signatures cited in 5.17.
10. Agency uses same criteria employed in reviewing final plans and specs.
11. Cost certification from IOI contractors must be audited.

CHAPTER 6: PROGRAM FEES

6.1 OVERVIEW

This chapter provides information on the type and amount of fees that the Agency may charge to lenders. The chapter will also explain when fees should be collected and who is responsible for submitting payment. Exhibit 6-1 provides an overview of each fee discussed in this chapter. None of the fees are refundable. Any changes to the program fees will be announced in a Notice published in the **Federal Register.** State Offices should be contacted for information on the current fee policy.

When fees are applicable, lenders must submit fees via check to the multifamily housing staff in the State Office in which the project is located. The State Office staff will process the fee, including *Form RD 451-2, "Schedule of Remittances"*, and forward it to the Finance Office via lock box. State Office staff will transmit the fee and *Form RD 451-2* to: Wholesale Lock Box, USDA Rural Development, P.O. Box 790391, St. Louis MO 63179-0391.

For guarantee and annual fees, the lender can pay via Pay.gov using a Pre-Authorized Debit (PAD) provided the Guaranteed Loan System (GLS) or USDA Lender Interactive Network Connection (LINC) has been updated with the Lender's banking information.

Exhibit 6-1

Loan Guarantee Fees

*(unless a different fee has been announced in a Notice published in the **Federal Register**)*

FEE	SUBMISSION	AMOUNT	EXAMPLE	TOTAL
Guarantee Fee	At the time the guarantee is issued	1% of total loan amount times the % of the guarantee	$1,000,000 x .01 x 0.90 =	$9,000
Annual Guarantee Renewal Fee	This fee will be collected, in advance, no later than February 28th of each calendar year	0.5% of the outstanding principal amount of the loan	$1,000,000 x .005 =	$5,000
Application Fee	When application is submitted	Flat Fee		$2,500
Extension Fee	When the request is made	Flat Fee		$500
Reopening Fee	When the request is made	Flat Fee		$500
Transfer of Ownership Fee	When the request is made	Flat Fee		$1,250

6.2 FEES ASSOCIATED WITH THE LOAN GUARANTEE

When fees are applicable, the lender pays all fees associated with the loan guarantee to the Agency. The guarantee fee is paid immediately prior to the issuance of a loan note guarantee. If the fee is paid using Pay.gov, Treasury will pull the fee two business days from the time the loan closing is processed in GLS. A description of the fees and submission requirements are described below.

A. Guarantee Fee

The guarantee fee is the non-refundable financing fee a lender must pay to the Agency for the loan guarantee. The guarantee fee is a one-time fee based on a percent of the guarantee amount. The guarantee fee must be paid to the Agency at the time of issuance of the loan note guarantee.

B. Annual Guarantee Renewal Fee

The annual guarantee renewal fee is a non-refundable fee the lender must pay in advance for each year that the loan guarantee will remain in effect. The fee is calculated as of December 31 and it is due to the Agency no later than February 28. The annual guarantee renewal fee is not charged in the first year that the loan note guarantee goes into effect. The lender pays an annual guarantee renewal fee based on a percent of the outstanding total principal amount of the loan each year.

C. Surcharge for Guarantees on Construction Advances

If a surcharge will be assessed it will be announced in a Notice published in the **Federal Register.**

6.3 ADDITIONAL AGENCY FEES

There are other fees that may be incurred by the lender or borrower during the life of the guarantee. The following is a list of fees and times when these fees are due.

A. Application Fee

When fees are applicable, the Agency will charge the lender a flat application fee. The fee will be used to help defray the administrative costs associated with processing the application. This non-refundable fee is to be paid when the application is submitted. If a fee is applicable, an application will not be processed until the fee is received by the Agency.

B. Extension and Reopening Fees

The Agency may charge the lender a flat fee for a term extension of the Agency commitment. The fee is due at the time the request for the term extension is made. This non-refundable fee will cover administrative costs associated with the process of extending the Agency commitment.

If the Agency commitment expires and the Agency decides to reopen the commitment, the lender must pay a flat fee for each reopening at the time the request is made. This non-refundable fee is used to cover administrative costs associated with reopening the Agency commitment.

C. Transfer of Ownership Fee

The Agency may charge the lender a transfer fee for administrative costs associated with the transfer of the property from one owner to another one. A non-refundable fee will be collected at the time a transfer request is submitted. The Agency fee will be in addition to any fee the lender may charge to cover the lender's administrative costs associated with the transfer process.

CHAPTER 7: SERVICING PERMANENT LOANS

7.1 INTRODUCTION

This chapter is designed to serve as a best practices guidebook for servicing GRRHP loans which have reached the permanent financing phase. While it establishes minimum servicing standards, the Agency expects lenders to service the loans according to the same standards of excellence as other loans in the lender's portfolio.

Key Topics in this Chapter

- Section 1: Servicing Objectives
- Section 2: General Servicing Requirements
- Section 3: Asset Management
- Section 4: Special Servicing

SECTION 1: SERVICING OBJECTIVES

7.2 OBJECTIVES

In establishing servicing standards for GRRHP loans, the Agency has four major objectives:

- Protecting the Value of the Financial Asset;
- Ensuring the Program Compliance;
- Protecting the Tenants' Rights; and
- Protecting the Government's Interest.

7.3 PROTECTING THE VALUE OF THE FINANCIAL ASSET

The financial asset includes both the loan and the property that serves as collateral. Protecting the value of the asset ensures that the property will remain available as affordable housing for the term of the loan and protects the financial interests of the lender and the Agency. The lender and the borrower are responsible for protecting the value of the asset through regular monitoring, inspections of the property, regular maintenance, and management of reserve and escrow accounts.

7.4 ENSURING THE PROGRAM COMPLIANCE

The lender must be knowledgeable of the program requirements and be capable of enforcing the program requirements. As an approved lender in the program, the lender agrees to comply with the statute, regulations and guidance issuances for the program. Furthermore, the lender must monitor the borrower's activities to ensure compliance with the statute, regulations, and guidance issuances for the program. A key component of the program compliance is timely submission of reports due to the Agency.

7.5 PROTECTING THE TENANTS' RIGHTS

The lender must ensure that the borrower complies with the GRRHP occupancy requirements, rent restrictions, and tenant protections throughout the term of the guarantee and mortgage. As long as a tenant is in compliance with the lease, he/she has the right to remain in a rental unit even if his/her income increases above the 115% of median income threshold. To maintain affordability, the lender must monitor the project rents to ensure they do not exceed the GRRHP's limits, and monitor the median income levels for the property area as these median income levels change periodically.

7.6 PROTECTING THE GOVERNMENT'S INTEREST

Approved lenders *[7 CFR part 3565, subpart C]* must operate under the Agency approved plan for originating and servicing GRRHP loans. The Agency expects that the lender will service the loans according to the same standards it services all other multifamily loans it originates, services or holds in its portfolio. The requirements for the origination and servicing plan can be found in Chapter 2.

The GRRHP's servicing standards are designed to preserve the asset and protect the interests of the Government. Servicing requirements include, but are not limited to:

- Minimum requirements for annual reviews of the physical and financial conditions of the property.
- Reporting requirements designed to keep the Agency informed of the loan performance and property condition.
- Minimum standards for special servicing for loans that are delinquent or in default.

SECTION 2: GENERAL SERVICING REQUIREMENTS

7.7 FUNDS MANAGEMENT

A. Collecting and Processing Borrower Payments

The lender will collect and apply borrower payments on the loan in accordance with Generally Accepted Accounting Principles. At a minimum, such standards should meet the requirements established by Fannie Mae, Freddie Mac, or Ginnie Mae for similar properties.

B. Escrow and Reserve Account Management

The lender is responsible for proper maintenance of the borrower's escrow accounts Escrow accounts should be established for both hazard and property insurance and, if applicable, flood insurance. Escrows should also be established to reserve the monthly share of annual property tax and property insurance payments. In addition, each property must have a replacement reserve account established to receive monthly deposits for projected replacement of appliances, furnishings, equipment, and major repairs.

C. Interest Credit, if Applicable

For each guarantee option, options one, two and three, interest credit will be paid annually, if applicable, starting on January 1 of the year after the Agency concurs in writing that the project has met the regulatory requirements for a guarantee of its permanent financing phase.

The interest credit calculation and the request for interest credit, if applicable, will be part of the annual report provided to the State Office. The State Office will review the calculation for accuracy and then forward the document to the Finance Office for processing. In its first year, interest credit, if applicable, will be calculated from the date of the Agency's written concurrence that the project has met the regulatory requirements for a guarantee of its permanent financing phase to the end of the year.

D. Approval of Reserve Releases

1. Agency Recommended Approval Requirements

Lenders must establish their own reserve management protocols in the lender servicing plan. The procedures should include, at a minimum, the following:

- **Lender approval** of releases of funds from required reserve accounts.

- **Documentation of completed work**. Most requests should be processed on a post-approval basis (once the work is completed or expenses paid and the required documentation submitted). While the Agency does not have specific requirements for verification of expenses, the lender should ensure that reserve funds are used for eligible purposes. Documentation should include original receipts and a borrower certification that the work described has been completed.

2. Approval of Structural Repairs

The Agency recommends pre-approval by the lender for repairs involving structural work. A review and approval of the plans and specifications for such work may also be warranted.

3. Obtaining Bids in the Use of the Reserve Account

Lenders should require borrowers to obtain bids on major repairs, construction projects, or purchases. A recommended standard is three written bids for any single purchase or project that exceeds $10,000. Borrowers should be required to justify any bid accepted that is higher than the lowest bid.

4. Minimum Replacement Reserve Levels

For new construction, a replacement reserve balance of $1,000 per unit is the minimum level for the reserve account by the time the project reaches the end of its third year of occupancy. The replacement reserve balance of $1,000/unit must be maintained through whichever occurs first: year seven or the performance of a CNA that supports maintaining, decreasing, or increasing the yearly contributions. The CNA must be performed by year seven and updated every five years thereafter. The replacement reserve balances should be reviewed annually and modifications made if the reserve balances are not sufficient to address long term replacement needs.

For projects that are being rehabilitated, required deposits to the replacement reserve account for the first seven years of occupancy will be determined by the lender through a CNA. The lender must update the CNA every five years and update the per unit annual contribution accordingly.

Any drop below required levels for new construction or rehabilitated projects should be reported to the Agency as part of the annual report on the property.

5. Eligible Uses of Reserve Funds

Reserve funds should be used for the repair and replacement of depreciable physical property. The lender has the discretion to approve or disapprove the use of reserve funds, even if an item is permitted by Agency guidance, if the lender feels it is in the best financial interest of the property. A list of eligible uses is suggested in Exhibit 7-1. Items permitted by Fannie Mae, Freddie Mac, and Ginnie Mae as eligible reserve release items will also be considered eligible by the Agency.

Exhibit 7-1
Examples of Eligible Uses of Replacement Reserve Account Funds

- Replacement of refrigerators, ranges, and other major appliances in the dwelling units.
- Replacement of kitchen and bathroom sinks and counter tops, bathroom tubs, toilets, and doors (exterior and interior).
- Major roof repairs, including replacement of sheathing, gutters, downspouts, and eaves or soffits.
- Major plumbing and sanitary system repairs.
- Replacement or major overhaul of central air conditioning and heating systems, including cooling towers, water chilling units, furnaces, stokers, boilers, and fuel storage tanks.
- Overhaul of elevator systems.
- Repaving/resurfacing/seal coating of sidewalks, parking lots, and driveways.
- Repainting of the entire building exterior or interior common areas.
- Replacement of siding.
- Replacement of fire alarms.
- Playground equipment.
- Replacement of exterior (lawn) sprinkler systems.

Replacement items should be at least comparable in quality to items approved at the time of the original construction of the property and in accordance with the initial plans and specifications. When replacing obsolete or broken appliances, the purchase of new energy efficient models is encouraged.

On an annual basis, the lender must submit to the Agency a summary of the reserve withdrawal requests made and related work inspection reports for the prior year.

While enhancements to the property such as a personal computer or software may be considered for funding, items generally considered routine maintenance items should be ineligible for funding from the replacement reserve account. The Agency may require a lender to justify any release of reserve funds for these purposes.
The use of reserve funds is normally considered a categorical exclusion under the Agency's environmental review process, unless the funds will be used in ways that alter the purpose, operation, location, or design of the project. Particular care should be taken that reserve funds are not used to alter the historic integrity of places listed or eligible for listing on the National Register of Historic Places until an environmental review is completed in accordance with RD Instruction 1940-G. Lenders must check with the Agency regarding the possible need for an environmental review prior to approval of the use of reserve funds.

E. Approval of Surplus Cash Distribution to the Borrower

Surplus cash is defined as year-end cash available after the project has met all operating expense and debt service payments, including the required funding of reserves.

While a surplus cash distribution to the owner is not restricted as to the amount, Agency regulations require that the lender ensure that the property be in "good financial and physical condition (no deferred maintenance) and in compliance with the regulatory agreement" prior to any distribution of surplus cash.

1. Borrower Request for Distribution of Surplus Cash

Once the project is fully operational, at the end of the project's 1st fiscal year after the completion of any construction, the borrower may request the release of surplus cash. As a prior condition for such release, the borrower must submit an annual audited financial statement of the property to the lender (see Paragraph 7.12 A.1. for information on audit requirements). The audit must not have any unresolved findings. Once the lender reviews the statement and certifies that the borrower is in compliance with program requirements, the lender may permit the owner to have access to all or a portion of any surplus cash.

2. Lender Denial of Surplus Cash

If the borrower has any current or previous unresolved audit findings or any violation of program requirements, the lender may deny access to surplus cash. Exhibit 7-2 gives examples of reasons for denial of surplus cash.

Exhibit 7-2

Examples of Reasons for Denial of a Year-End Surplus Cash Distribution

- Fair Housing violations
- Violations of State or local law
- Underfunded reserve accounts
- Failure to submit a budget or other reporting requirements to the lender in a timely manner
- Failure to properly maintain the property
- Failure to comply with the mortgage documents or regulatory agreement

3. Borrower Withdrawal of Surplus Cash Without Lender Approval

Primary responsibility for control of surplus cash distribution remains with the lender. If a borrower withdraws surplus cash without lender approval, the lender must require the borrower to replace the funds into the proper operating account. If appropriate, the lender may permit repayments in installments as part of a corrective action plan. If the borrower fails to comply, the lender must enforce the technical default clause under the regulatory agreement and accelerate the loan.

This action must be reported to the Agency in the same manner as a monetary default on the mortgage.

7.8 ADDRESSING DEFAULTS AND DELINQUENCIES

Lender actions to remedy delinquencies and defaults must be addressed in the lender servicing plan. Since delinquencies and defaults trigger special servicing actions, it is important to identify when they occur and when the lender must initiate special action. Unless otherwise approved in the servicing plan, the following definitions will apply to delinquencies and defaults.

A. Delinquencies

A project will be considered to be delinquent when the borrower has failed to make the full amount of a required payment on the due date plus any grace period or fails to comply with non-monetary requirements. Once the loan becomes delinquent, the lender must submit monthly reports to the Agency in accordance with Paragraph 7.12 B.3.

B. Defaults

1. Monetary Default

A project that is in monetary default is defined as one that is delinquent for more than 60 days. Payments are due in the date specified in the Promissory Note.

2. Nonmonetary Default

Nonmonetary defaults include, but are not limited to, failing to maintain the Agency required debt service coverage ratio, failing to maintain project reserves, failing to adequately maintain the physical condition of the property, failing to comply with environmental mitigation measures, failing to meet fair housing requirements, and failing to properly report to the Agency

C. Declaring a Default

A lender may declare a default if the delinquency remains outstanding after 30 days from the due date of the payment or written notice of a non-monetary delinquency or default.

D. Initiating Special Servicing

Special servicing should be initiated in accordance with Section 4 of this chapter as soon as a default occurs. A workout plan must be submitted to the Agency no later than 60 calendar days after the date the lender notifies the borrower that they are in default. The holder must be notified at this time as well.

Example of Initiating Special Servicing – Failure to Pay Mortgage

1st of the month – The mortgage payment is due.

15th of the month – The mortgage payment has not been received. A delinquency notice is sent to the borrower warning them of a default under the mortgage documents if a full payment is not received by the end of the month.

End of the month – The mortgage payment has not been received. The loan is now in default. The lender informs the borrower of the default and demands payment. The borrower may request a workout plan. If the lender agrees to the workout plan, the borrower submits the plan to the lender.

End of the second month – The lender determines if the plan is acceptable (see Section 4 of this chapter). If so, then the plan is submitted to the Agency. It must be submitted to the State Office by the end of the second month (60 days from the date of notification).

7.9 TRANSFER OF OWNERSHIP

A. Changes in the Ownership Entity

Transfer of ownership is normally considered a categorical exclusion under the Agency's environmental review process, unless the transfer will result in an alteration to the purpose, operation, location, or design of the project as originally approved.

Any changes in ownership, in whole or in part, must be approved by the lender and the Agency before such change takes effect. These include any change in the general partners or in limited partners with a partnership interest greater than 10 percent or a change that requires modification of the title. Prior to approving a change in the ownership entity, the lender must assure that the proposed new partner or entity is not currently on the General Services Administration (GSA) debarment list and that they are able to obtain a *Form RD 1944-37* clearance on the entity. The lender may access the GSA debarment list online at https://www.sam.gov/portal/SAM/#1.

If the proposed transfer meets the conditions aforementioned, then the lender must also determine that the transfer will not adversely affect the value and/or operation of the property before it is approved. If the transfer is not approved, the lender must document the reason for a denial and notify the applicant in writing.

B. Transfers of Title/Transfers of Physical Assets

Written Agency approval is required for transfers that involve the entire ownership entity. The lender must conduct a review of property conditions prior to recommending the transfer for Agency approval. All transfers of the entire ownership entity must include a plan to bring the property into full compliance with program requirements and loan documents, including any physical repairs or deficiencies in reserve amounts. The holder must be notified by the lender as well.

Approval of Ownership Changes

- The **lender and the Agency** must approve all changes in general or limited partners, or a change that requires a modification to the title.
- The **Agency** must approve all transfers of the entire ownership entity.

7.10 TRANSFER OF LOANS OR MORTGAGE SERVICING

The transfer of servicing is prohibited unless the Agency determines that circumstances warrant such an action and the proposed lender to whom the loan will be transferred, is approved by the Agency. The Agency must approve the transfer of servicing before it is initiated. If the holder of the loan note guarantee is a different entity than the lender, the lender must notify the holder of the loan note guarantee of the servicing transfer.

SECTION 3: ASSET MANAGEMENT

7.11 OVERVIEW

Asset management involves regular monitoring of the operation and maintenance of a loan and collateral to ensure that the value of the asset is maintained or enhanced over the life of the loan. Asset management includes financial and physical management of the property and compliance with program and other Federal requirements.

7.12 FINANCIAL MANAGEMENT

A. Borrower Reports to the Lender

The purpose of the borrower reporting requirements is to provide the lender with the information necessary to adequately monitor the guaranteed loan. The lender may require additional reporting for its own purposes. Borrower reporting requirements must be applied consistently to all GRRHP loans. The Agency also expects the lender to obtain additional information regarding the property through management reviews and physical inspections of the property. The lender must outline the complete reporting requirements and planned reviews and inspections in the servicing plan.

1. Annual Audited Financial Reports

Within 90 days of the end of the project's fiscal year, the borrower must submit to the lender an audited annual financial statement conducted in accordance with GAGAS. The program review requirements for the GAGAS audit can be found in Attachment 7-B. In addition to this report, the borrower must also certify that they are in compliance with the rent restrictions established in *[7 CFR 3565.203]*. Nonprofit borrowers reporting under OMB Circular A-133 must submit Audited Financial Reports within nine months of the close of the borrower's fiscal year.

The lender may allow the borrower to submit the initial audit that will cover a period of up to 18 months for projects whose first operating year was less than 6 months. The lender must notify the Agency in writing prior to the end of the project's fiscal year of the intent to allow the borrower to submit an extended initial audit.

2. Failure of the Borrower to Comply with Lender Reporting Requirements

The lender may require additional information from the borrower at any time if necessary to fulfill its reporting requirements to the Agency or to properly fulfill its oversight and monitoring responsibilities.

Failure on the part of the borrower to comply on a timely basis with the reporting requirements outlined in this handbook and any additional reporting requirements established by the lender in writing may result in penalties against the borrower ranging from denial of surplus cash distribution to acceleration of the mortgage. Exhibit 7-3 explains the inclusion in the handbook of a Supplemental Government Auditing Standards Guide.

Exhibit 7-3

Supplemental Government Auditing Standards Guide

In previous versions of the handbook, this exhibit was a guide for the program review requirements for the GAGAS audit. In an effort to provide more-detailed guidance to the industry, auditors, and our staff, the Agency took the initiative to revise the guide to make it easier to understand for those who use it. This new and improved guide is now available as Attachment 7-B.

B. Lender Reports to the Agency

The lender must periodically report to the Agency on each GRRHP loan in its portfolio. When compiled, these reports should provide the Agency with an assessment of the guaranteed loan portfolio's performance. The Agency will collect additional information on the lender's portfolio of guaranteed loans during the annual lender audit process. The Agency must diligently review all reports to ensure that the lender and borrower remain compliant with program requirements. The Agency should contact the lender to acknowledge receipt of the report and discuss any deficiencies and cures noted in the report. For any noted deficiencies, i.e., low debt service coverage ratio, inadequate funding levels in the reserves, failure to submit the report in a timely manner, the Agency should relay to the lender any and all steps that should be taken to cure the deficiencies. All reports submitted by the lender should be maintained in a loan servicing file docket established by the Agency and maintained in accordance with File Retention requirements.

Periodic reports include those listed below.

1. Annual Reports

<u>Within 120 calendar days</u> of the end of each project's fiscal year, the lender must submit a report to the Agency detailing their review of the project annual financial statement. The report must contain any findings related to the following items if deficiencies have been identified during the lender's annual review of the project:

- Any unresolved audit findings;

Exhibit 7-4

Classification System of RHS Projects

Class A

No specific problems with project.

Class B

Approved workout agreement in place and on schedule.

Class C

1. Unauthorized surplus cash distribution.
2. Required monthly/quarterly reports not submitted.
3. Deferred maintenance.
4. Below average rating from last lender inspection.
5. Unapproved workout agreement in place and on schedule.

Class D

1. Delinquent loan account.
2. Annual Financial Statement not submitted.
3. Delinquent reserve account.
4. Taxes not paid.
5. Insurance not paid.
6. High vacancy -- reduced rental revenue of 10 percent or more.
7. Health, safety, or environmental problems.
8. Non-compliance with Equal Opportunity and Fair Housing requirements.
9. Unsatisfactory rating from last lender inspection.
10. Substantial deferred maintenance.
11. Unauthorized owner/manager agent withdrawal from project funds.

- Outstanding physical and financial deficiencies. Such deficiencies should be ranked in accordance with the Agency Classification System (Exhibit 7-4);

- Underfunded reserves and escrows, including:
  - ◊ Tax and insurance escrows, and
  - ◊ Replacement reserve levels below $1,000 per unit;
- Current debt service coverage ratios below 1.15;
- Vacancy levels greater than the original underwriting level;
- Tenant income and family size characteristics; and

- Information on unit rent levels and average project rents for the period.

In submitting the information required above, the lender must also certify that the borrower is in compliance with the rent restrictions established in *[7 CFR 3565.203]*.

In the event that the guarantee is terminated prior to the end of original term of the guaranteed loan, i.e., a voluntary termination by the lender, the borrower will still be required to provide to the agency annual status reports to show evidence that the housing remains available for occupancy by low and moderate income households in accordance with 7 CFR 3565.352 or its successor regulations. Status reports will be sent via mail or electronic submission to the Rural Development State Office in which the project is located. The report will be due 120 days after the end of the project's fiscal year. The report should contain information on the physical condition of the property and tenant information such as income and family size.

2. Quarterly Reports

The lender must submit a quarterly report to the State Office using *Form RD 1980-41, "Guaranteed Loan Status Report",* to detail the current status of the GRRHP loan. . Lenders are strongly encouraged to submit quarterly status reports to the Agency using the Lenders Interactive Network Connection (LINC). The lender must designate a Security Administrator, who can then add other users to the LINC system. Lenders without LINC access must send a completed Form RD 1980-41, to the applicable State/Field Office. The LINC system is accessed at https://usdalinc.sc.egov.usda.gov. Additional guidance on the LINC system can be found on the Section 538 Guaranteed Rural Rental Housing Program SharePoint site at: https://mfh.usda.net/MFH538a/default.aspx. For all loans that are reported via the LINC system, the Rural Development office that services the GRRHP loans in its respective State should monitor the Guaranteed Loan System (GLS) to verify that the reports were received in a timely manner and to determine the status of the loan.

3. Monthly Reports

Construction loans guaranteed by the Agency must submit *Form RD 1980-41* monthly until the loan transitions to a guarantee of the permanent financing phase [and quarterly reports].

The lender must submit monthly reports to the Agency on all loans in its portfolio which are in monetary and/or technical default. *Form RD 1980-44," Guaranteed Loan Borrower Default Status"*, must be submitted to the State Office for this purpose. Monthly reports for loans that are in monetary default may also be submitted electronically via LINC. In section 14 of *Form RD 1980-44*, the lender must also submit the following information:

- The reason for the default;
- The physical condition of the property;
- The occupancy rate of the property;
- The corrective action plan to cure the default;
- Anticipated cure date of default; and
- If applicable, date when the Agency should expect a workout plan (if one has not yet been submitted).

All loans reported in default must be serviced in accordance with Section 4 of this chapter, including the development of a workout plan in accordance with Agency requirements. The lender must continue to report on each loan that is in default until the default is cured. Reports submitted to the Agency should be reviewed by the specialist responsible for servicing GRRHP loans, making note of progress and any changes in the default.

4. Failure of the Lender to Comply with Agency Reporting Requirements

Failure of the lender to comply with Agency reporting requirements in a timely manner may result in revocation of lender approval and the transfer of all GRRHP loans to another approved lender. If the lender fails to comply with the Agency transfer requirements, the guarantee may be cancelled.

7.13 COMPLETING THE CAPITAL NEEDS ASSESSMENT AND RESERVE ANALYSIS

The purpose of the Capital Needs Assessment (CNA) and reserve analysis is to ensure that reserve levels will continue to meet the expected capital repair and replacement needs of the property.

A. The Capital Needs Assessment

A CNA must be completed during the underwriting of all loans involving rehabilitation and reviewed by the lender at least once every five years. The lender should use CNAs to determine adjustments to the reserve level requirements for all loans it underwrites (see Paragraph 7.7 D.).

B. Adjusting the Reserve Deposit Requirement

1. Increasing the Reserve Deposit

On an annual basis, the lender must review the reserve level and adjust the deposit requirements accordingly. If reserves have fallen below $1,000 per unit, the lender should determine whether to require an increase in the monthly deposit amount to bring the reserve levels above this recommended threshold. In making this determination, the lender should weigh the need for the increased reserves against the financial security of the property.

2. Decreasing or Suspending the Reserve Requirement

In certain cases, the lender may choose to decrease or suspend the reserve requirement. This might happen if:

- Reserve levels are adequate, based on the lender's assessment of the CNA for the property; or

- The property is financially troubled and in need of the amount deposited in the reserve account to meet other monthly expenditures. (This situation should be documented in the workout plan.)

The lender will submit to the Agency *Form RD 1980-44* monthly with a current status for every loan where reserve account deposits are suspended.

7.14 PHYSICAL MAINTENANCE AND PROGRAM COMPLIANCE AND OVERSIGHT

The lender is responsible for monitoring the physical condition of the property and the borrower's compliance with the regulatory and programmatic requirements of the GRRHP. The lender must inspect the property annually to assess its physical condition and the borrower's compliance with program requirements outlined below. At a minimum, the lender must assess the following areas in its annual report to the State Office:

- The property's physical condition.
- The adequacy of the current CNA and the borrower's annual contribution level to the replacement reserve account.
- The borrower's compliance with the approved Affirmative Fair Housing Marketing Plan.
- The borrower's annual fair housing report.

A. Physical Standards and Inspections

1. Physical Standards

The lender must develop standards for physical inspections consistent with industry standards. Construction standards listed in RD Instruction 1924- A, §1924.5 (d) may be used as a guide.

2. Physical Inspection Reporting

The lender must inspect each property on an annual basis and report the summary findings to the Agency as a part of the lender's regular annual report. The first annual inspection must be completed prior to the expiration of the warranty (see Paragraph 5.11). The lender must use the Form RD 3560-11, "Multi-Family Housing Physical Inspection Report" to document the findings of the physical inspection and, when required by Paragraph 7.12 B.3., to report them to the Agency. . Photographs of the building (exterior and interior), units, common areas, grounds, etc., should be included in the physical inspection report.

3. Responding to Deficiencies

Lenders may allow borrowers 90 calendar days from receipt of the lender's physical inspection report to resolve the deficiencies and/or submit a corrective action plan. If deficiencies remain outstanding beyond the 90-day period, the lender must submit the complete physical inspection report to the Agency along with the lender's proposed action plan for resolving the deficiencies.

B. Capital Improvement Plans

It is the responsibility of the lender to establish standards for the development of capital improvement plans for each property. This format and process must be outlined in the approved servicing plan. A capital improvement plan (CIP) must be developed by the borrower if the lender determines that the property is physically troubled and the property's capital improvement needs are not captured within the most current version of the project's CNA. If developed, the CIP may be used in place of a CNA..

If the lender determines the property has serious physical deficiencies, the lender must report the findings to the Agency and submit a CIP as part of the regular quarterly reporting process.

C. Compliance With Other Federal Requirements

1. Affirmative Fair Housing Marketing Plan

As a part of the lender's annual monitoring and oversight responsibilities, the lender will monitor compliance with the Affirmative Fair Housing Marketing Plan (*Form HUD 935.2A*). If the lender discovers modifications are needed to the plan, such modifications should be suggested to the

borrower. The AFHMP should be updated regularly to reflect the borrower's marketing efforts. Borrowers who repeatedly fail to comply with the established plan must be reported to the Agency. Chapter 4 provides additional information with regard to this plan.

2. Annual Fair Housing Reporting Requirements

Section 526 of Public Law 100-242 of the Housing and Community Development Act of 1987 requires the Administrator to assess the extent to which RHS housing and community facilities programs comply with the Federal Fair Housing Act requirements. The Agency will require lenders to submit a report from the borrower on fair housing compliance as part of the annual audit. This report should detail, for each unit, gross income, race, national origin, head of household, gender, elderly, and disability status. This information is collected for statistical purposes only.

3. Other Civil Rights Laws

Exhibit 7-5 shows other civil rights laws with which GRRHP loans must comply. Lenders must understand the provisions of these laws, and must have a management plan to monitor compliance by their employees, contractors, borrowers, and management agents, as appropriate.

Interest credit is classified as Federal Financial Assistance. Therefore, borrowers with loans receiving interest credit must also comply with the civil rights laws in Exhibit 7-6.

In addition, all borrowers receiving interest credit must sign an assurance agreement (*Form RD 400-4*) and will be subject to civil rights compliance reviews, regularly scheduled no less than once every three years. Compliance reviews will be conducted in accordance with RD Instruction 1901-E and documented on *Form RD 400-8, "Compliance Review"*. They must comply with the design requirements of the Uniform Federal Accessibility Standards, in addition to the HUD Accessibility Guidelines and the ADA Accessibility Guidelines. Also, borrowers who receive interest

credit must provide reasonable accommodations to tenants and prospective tenants at the expense of the borrower.

Exhibit 7-5

Major Civil Rights Laws Affecting All Multifamily Housing Loan and Grant Programs

- **American with Disabilities Act (ADA)**. Guarantees equal opportunity for individuals with disabilities in employment, public accommodations, transportation, State and local government services, and telecommunications.
- **Equal Credit Opportunity Act (ECOA).** Prohibits discrimination in the extension of credit on the basis of race, color, religion, national origin, sex, marital status, age, income from public assistance, and exercise of rights under the Consumer Credit Protection Act.
- **Title VIII of the Civil Rights Act of 1968** (also known as the Fair Housing Act of 1988, as amended). Prohibits discrimination in the sale, rental, or financing of housing on the basis of race, color, religion, sex, national origin, familial status, or disability.
- **Executive Order 11246**. Nondiscrimination in Employment by Construction Contractors (and subcontractors) receiving Federal construction contracts and Federally assisted construction contracts in excess of $10,000 – provides for equal employment opportunity without regard to race, color, religion, sex, or national origin. For purposes of this Executive Order, Federally assisted construction contracts includes any Federal program involving a grant, loan, insurance, or guarantee.
- **Executive Order 12898 — Environmental Justice**. Requires each Federal agency to make environmental justice a part of its mission by identifying and addressing disproportionately high and adverse human health or environmental effects of its programs, policies, and activities on minority and low-income populations.

Section 504 of the Rehabilitation Act of 1973, Age Discrimination Act of 1975, Title IX of the Education Amendments of 1972, Title II of the Americans with Disabilities Act of 1990, as amended and Title VI of the Civil Rights Act of 1964.

Exhibit 7-6

Civil Rights Laws Affecting
Federally Assisted Multifamily Housing Programs

- **Section 504 of the Rehabilitation Act of 1973.** Prohibits discrimination in a Federally-assisted program on the basis of disability.
- **Age Discrimination Act of 1975.** Prohibits discrimination in a Federally-assisted program on the basis of age.
- **Title VI of the Civil Rights Act of 1964.** Prohibits discrimination in a Federally-assisted program on the basis of race, color, and national origin.
- **Title IX of the Education Amendments of 1972.** Prohibits discrimination on the basis of sex in education programs and activities receiving Federal financial assistance from Rural Development.
- **Executive Order 11063 as Amended by 12259.** Prohibits discrimination in Federally-assisted housing financing on the basis of race, color, religion, sex, or national origin.
- **Executive Order 11246.** Prohibits discrimination in employment by construction contractors (and subcontractors) receiving Federally-assisted construction contracts in excess of $10,000. It provides for equal employment opportunity without regard to race, color, religion, sex, and national origin.
- **Title VIII of the Civil Rights Act of 1968 and Title II of the Americans with Disabilities Act of 1990, as amended.**

D. Compliance With Other Program Requirements

1. Regulatory Agreement Compliance

A regulatory agreement governing the relationship between the borrower and lender must be developed by the lender and executed by both the borrower and the lender. While the Agency will not be a party to the agreement, the agreement will state that the Agency may assume the role of the lender if necessary to force borrower compliance with the agreement.

In the case where the Agency assumes the property in the role of mortgagee-in- possession (MIP), the regulatory agreement will remain in force at the Agency's sole discretion.

The regulatory agreement must be transferable from borrower to borrower in the event that the property is transferred and transferable from lender to lender if the guarantee is transferred to an Agency approved lender.

This agreement must, at a minimum, stipulate the following:

- That it is binding upon the borrower and any of its successors and assigns, as well as upon the lender and any of its successors and assigns, for a period of the original duration of the guaranteed mortgage.

- That the borrower must make all payments due under the note and all payments to required escrows and reserves for future capital needs.

- That the borrower must maintain the project as affordable housing in accordance with the purposes and for the duration defined in the statute. The regulatory agreement must be properly recorded along with the mortgage, deed restriction or other recordable instrument acceptable to the Agency.

- That the borrower must maintain the project in good physical and financial condition at all times.

- That the borrower must maintain complete project books and financial records and provide the Agency and the lender with an annual audited financial statement <u>within 90 calendar days</u> of the end of the project's fiscal year. Nonprofit borrowers reporting under OMB Circular A-133 submit annual financial statements within nine months of the close of their fiscal year.

- That the borrower must make project books and financial records available for review by the USDA Inspector General, Agency Staff, and the General Accounting Office (GAO) or their representatives, upon appropriate notification.

- That the borrower must comply with the Affirmative Fair Housing Marketing Plan and all other Fair Housing requirements.

- That the borrower must comply with Civil Rights laws affecting Federally assisted multifamily housing programs and Title II of the Americans with Disabilities Act of 1990 as amended.

- That the borrower must operate as a single asset ownership entity.

- That the borrower must comply with applicable Federal, State, and local environmental laws.

- That the borrower must provide management satisfactory to the Agency and comply with the lender-approved management plan and agreement for the property.

- That the borrower will work with the lender in a workout situation.

2. Preservation of Affordable Housing

For the period of the original term of the guaranteed loan, the housing must remain available for occupancy in accordance with [*7 CFR 3565.352*]. This applies unless the housing is acquired by foreclosure or as an instrument in lieu of foreclosure or the Agency waives the applicability of this requirement after determining through a market study that the following three circumstances exist.

- There is no longer a need for low- and moderate-income housing in the market area in which the housing is located.

- Housing opportunities for low-income households and minorities will not be reduced as a result of the waiver.

- Additional Federal assistance will not be necessary as a result of the waiver.

All requests for removal of the affordable housing restrictions must first be made to the lender. The lender must assess the housing using the three criteria above and forward the borrower's request to the Agency, along with the lender's assessment of the property's compliance with the above tests. The Agency will make the final determination as to whether the occupancy restrictions may be terminated.

SECTION 4: SPECIAL SERVICING

7.15 OVERVIEW

In accordance with Paragraph 7.8, the lender must begin special servicing actions when a property is in default of the guaranteed loan.

7.16 ROLES AND RESPONSIBILITIES OF THE SERVICING LENDER

A. Development of a Workout Plan

At a minimum, a workout plan must be submitted to the Agency using the workout plan format (see Exhibit 7-7) no later than 60 days after the lender has notified the borrower that they are in monetary and/or default under the regulatory agreement.

Exhibit 7-7

Information to be Included in a Workout Plan

Background information. This section describes the project's location, type, and size.

Description of the problem. This section identifies the project's deficiencies and needs, including specific compliance and financial concerns. It should identify the basic causes of the difficulties.

A plan to correct deficiencies. This plan must include the following information:

- Borrower actions needed to correct the problem(s).
- Resources needed in order to accomplish the correction, including those that will come from the lender and those that will come from the borrower.
- A timetable for taking action and applying the resources.
- A summary of the anticipated outcomes.

Agreement by borrower to provide periodic financial statements. This includes any income and expense reports and bank statements, if appropriate.

The signature of the borrower and the lender on the workout agreement.

A copy of the workout agreement must be sent to the State and National Office within 5 business days of execution.

Once the lender has submitted the workout plan to the State Office for Agency review, the lender and the borrower will be considered in compliance with the terms of the note for the purposes of the claims process outlined in Chapter 10. The time frames for submission of a claim and the disposition plan will not be applicable unless the borrower (or lender) falls out of compliance with the approved workout plan or if the workout plan expires before the borrower cures the default.

If the lender chooses not to pursue a workout plan with the borrower, the Agency will review this action prior to approval of the liquidation plan.

To ensure compliance with Section 2 of Chapter 12, the lender must notify the holder, if any, of the default and workout plan or foreclosure proceedings in a timely fashion.

B. Bankruptcy of Borrower

The lender is responsible for protecting the guaranteed loan and all collateral securing the loan in bankruptcy proceedings. These responsibilities include, but are not limited to, the following:

- The lender must file a proof of claim where necessary and all the necessary papers and pleadings concerning the case.
- The lender must participate in meetings of the creditors and all court proceedings.
- When permitted by the Bankruptcy Code, the lender must request modification of a reorganization plan whenever it appears that additional recoveries are likely.
- The lender must keep the Agency adequately and regularly informed in writing of all aspects of the proceedings.
- The lender must take whatever reasonable action necessary to protect the interest of the government including motions to dismiss, exceptions to discharge, and objections to exemptions.
- If the Agency determines that an independent appraisal of collateral is necessary, the lender, at its expense, must obtain an independent appraisal report using the guidance set forth in Chapter 3.

C. Loss Claims During Bankruptcy

When the loan is involved in bankruptcy proceedings, payment of loss claims may be made as defined in Chapter 10.

7.17 ROLES AND RESPONSIBILITIES OF THE BORROWER

This paragraph details the borrower responsibilities with regards to the workout plan.

A. Submission of Information to the Lender

During special servicing actions and the development of a workout plan, the lender can request information from the borrower. The lender may declare the borrower in default if the borrower fails to comply.

B. Development and Execution of the Workout Plan

The borrower must work with the lender to develop a workout plan for the lender's approval. This plan should be completed and ready for lender approval within 30 days of the date of default, in order to ensure that the lender has adequate time to approve the plan. A copy of the workout agreement must be sent to the State and National Office within 5 business days of execution. In developing a workout plan, the time frame for conclusion of the plan should not exceed two years. Extensions to that time frame may be approved by the Agency on a case-by-case basis.

C. Compliance With the Workout Plan

Once a plan is established, a borrower will be considered to be in compliance with program requirements so long as they remain in compliance with the workout plan. While the lender must report to the Agency monthly on the property, the timeline for submission of a claim and a liquidation plan may be delayed until such time as the workout plan expires or the borrower fails to comply with its terms.

If a borrower fails to comply with the terms of the agreement, the property will be considered in default, and the lender must begin processing a notice of liquidation. These procedures are outlined in Chapter 10.

7.18 SPECIAL SERVICING OPTIONS

A workout or special servicing plan may utilize any of the following tools to bring the loan into compliance. If a plan requires modification to the guarantee or a payment of claim by the Agency, the Agency must approve such action. The holder, if any, must be notified by the lender under all of the options presented below.

A. Loan Modifications

A loan modification requires State Office approval. A loan modification would include any change in the amount or term of the guarantee.

B. Partial Payment of Claim

A partial payment of claim is another tool that may be used to work out troubled loans. Under a partial payment of claim, the Agency pays a claim on a portion of the guaranteed loan, thereby reducing the debt that must be amortized. Partial payments must be approved by the National Office prior to the execution of the workout plan.

If a partial payment of claim is approved, the claim will be processed in accordance with the procedures outlined in Chapter 10.

C. Transfer of Physical Assets (TPA)

A TPA is a sale, gift, or other transfer of the property to another party where the original loan remains in place. In a special servicing situation, the TPA must be approved as outlined in Paragraph 7.9. All other changes in the ownership entity must be approved by the lender and recommended to the Agency for concurrence. Although a transfer and assumption is normally considered loan servicing, it should be processed in the same manner as a new loan.

D. Agency Approval of Reserve Releases

The Agency reserves the right to control reserve releases in a special servicing situation. Requests for the use of reserve funds on a workout plan must first be approved by the lender. On a case-by-case basis, the State Office will review requests for uses of reserve funds outside the scope of the eligible uses (e.g. use of reserve funds to pay taxes). In these situations, the borrower must submit the request to the lender. The lender will forward the request and any supporting documentation to the State Office with its recommendation. These requests will be approved on a case-by-case basis in the State Office.

E. Lender Recommendation of Enforcement Action

In situations where the lender believes that the borrower is in violation of regulatory requirements, the lender may recommend that the Agency take enforcement action against the borrower. Such actions may include suspension, debarment, limited denial of participation, or other administrative or judicial remedies.

7.19 Loan Modification (Interest Rate Reduction)

The borrower and lender may agree to a loan modification (interest rate reduction) that will reduce the interest rate when the action will improve the financial viability of the project and its operations. Lenders must get Agency approval prior to a loan modification (interest rate reduction).

The incumbent lender will certify and submit supporting documentation 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.
- the original term (maturity date and guarantee term) of the guaranteed loan will not be modified.

- the outstanding principal balance will not be modified
- there will not be a negative impact to the tenants.
- there are no asset management issues.
- lender's attorney will attest that the modification meets state law requirements. Any out-of-pocket costs incurred by the lender or the owner related to the modification will not be from project funds or loan proceeds.
- third party lender costs will not be added to the principal of the guaranteed loan.

If the loan modification (interest rate reduction) is approved by the Agency, the lender will be responsible for closing the transaction. Agency will review, verify and approve all amended closing documents, (if applicable such as, Mortgage Note, Deed of Trust, Promissory Note, Loan Note Guarantee, Consent Agreements).

The incumbent lender must 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.
- 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.

The Agency shall do the following in response to the request for a loan modification (interest rate reduction):

- 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 require National Office concurrence.
- If the modification is approved, the Finance Office must be contacted to update GLS with the lower interest rate.

GRRHP Lender Servicing Compliance Checklist

✔	Required Report or Activity	Reporting Interval	When Due	Submitted to	Reg/HB Reference	Remarks
	Form RD 1980-24, "Request Interest Assistance/Interest Rate Buydown/Subsidy Payment to Guaranteed Loan Lender" with amortization schedule for the loan (for properties receiving interest credit payments)	Annually	Feb 28	State Office	HB 4.10 D.	State Office reviews and submits to Finance
	Borrower's annual audited financial statement	Annually	Within 90 days of borrower's fiscal year end	Lender	3565.351(d)(1) HB 7.12 A. 1.	Inspectable item in compliance reviews
	Borrower certification of compliance with the rent restrictions established in 7 CFR 3565.203	Annually	Within 90 days of borrower's fiscal year end	Lender	3565.351(d)(1) HB 7.12 A. 1.	Inspectable item in compliance reviews
	Lender's review of the borrower's annual audited financial statements	Annually	Within 120 days of borrower's fiscal year end	State Office	3565.351(d)(2) HB 7.12 B. 1.	
	Summary of the replacement reserve account withdrawal requests and related work completed with reserve funds	Annually	Within 120 days of borrower's fiscal year end	State Office	HB 7.7 D. 5.	
	Form RD 3560-11, "Department of Agriculture Multi-Family Housing Physical Inspection Report"	Annually	Within 120 days of borrower's fiscal year end	State Office	HB 7.14 A. 2.	
	Federal Fair Housing Act compliance report from the borrower as required by Section 526 of Public Law 100-242 of the Housing and Community Development Act of 1987	Annually	Within 120 days of borrower's fiscal year end	State Office	3565.351(a)(8) 3565.354 HB 7.14 B.	
	Review Affirmative Fair Housing Marketing Plan (Form HUD 935.2)	Annually	Within 120 days of borrower's fiscal year end	Lender	3565.353	Inspectable item in compliance reviews
	Form RD 1980-41, "Guaranteed Loan Status Report" (permanent loan phase)	Quarterly	Dec 31, Mar 31, Jun 30, Oct 31	State Office	HB 7.12 B. 2.	Lender copies the State Office
	Property under a Capital Improvement Plan	Quarterly	Dec 31, Mar 31, Jun 30, Oct 31	State Office	HB 7.14 B.	
	Form RD 1980-41, "Guaranteed Loan Status Report" (construction phase)	Monthly	Last day of the month	State Office	HB 5.20	Lender copies the State Office
	Deposits into insurance and tax escrow account (prorated share of annual property tax and property insurance payment)	Monthly	Monthly	Lender	3565.402(2) HB 7.7 B.	Inspectable item in compliance reviews
	Deposits into replacement reserve account for capital improvements	Monthly	Monthly	Lender	3565.402(2) HB 7.7 B.	Inspectable item in compliance reviews
	Form RD 1980-44, "Guaranteed Loan Borrower Default Status" (all loans which are in technical or monetary default or delinquency) until current	Monthly	Last day of the month	State Office	3565.351 (d)(2)(ii) HB 7.12 B. 3	Lender copies the State Office
	Monitor borrower's compliance with the Affirmative Fair Housing Marketing Plan (Form HUD 935.2). Borrowers who repeatedly fail to comply with the established plan must be reported	As needed	When non-compliance is identified	State Office	3565.351 (a)(8) HB 7.14 A.	Plan must be reviewed annually by Lender per 3565.353

ATTACHMENT 7-B

Supplemental Government Auditing Standards Guide

GUARANTEED RURAL RENTAL HOUSING PROGRAM (SECTION 538) SUPPLEMENTAL GOVERNMENT AUDITING STANDARDS GUIDE

This guide is not intended to be a complete manual of procedures, nor is it intended to supplant the auditor's judgment of audit work required. Suggested audit procedures contained herein may not cover all circumstances or conditions encountered in a particular audit. The auditor should use professional judgment to tailor the procedures so that the audit objectives may be achieved. However, all applicable compliance requirements in this guide must be addressed by the auditor. If the auditor desires technical assistance pertaining to the GRRHP, its regulations or operations, the auditor should contact the Rural Development State Office, Local Office, or USDA Service Center, whose information is available at: http://www.rurdev.usda.gov/recd_map.html.

*__NOTE__: The Agency requires the Procedure Notice (PN) citation date to be at the bottom of odd-numbered pages. Due to this fact, all footnote text can be found at the end of the attachment to ensure formatting consistency. This text is identified as "Endnotes."

RURAL HOUSING SERVICE 1400 INDEPENDENCE AVENUE, SW WASHINGTON, DC 20250

GUARANTEED RURAL RENTAL HOUSING PROGRAM (SECTION 538)

SUPPLEMENTAL GOVERNMMENT AUDITING STANDARDS GUIDE

U.S. DEPARTMENT OF AGRICULTURE
RURAL HOUSING SERVICE
1400 INDEPENDENCE AVENUE, S.W.
WASHINGTON, D.C. 20410

Use of this guide is mandatory for audits of individuals, partnerships, limited partnerships, for-profit corporations, limited equity cooperatives, Indian tribes, and trusts participating in the U.S. Department of Agriculture Rural Housing Service Section 538 Guaranteed Rural Rental Housing Program (GRRHP).

Exemptions of use and reference of the guide apply to public agencies and non-profits organizations. These entity audits are to be conducted in accordance with the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156; and its implementing guidance under the Office of Management and Budget (OMB) Circular A-133 *Audits of States, Local Governments, and Non-Profit Organizations.*

This guide also considers a risk-based approach for the applicability of use and reference by individuals, partnerships, limited partnerships, for-profit corporations, limited equity cooperatives, Indian tribes, and trusts. Specifically, use and reference of the guide is based on the unpaid principal loan balance for an individual project in the year in which the audit is to be conducted.

1. Consistent with the non-profit organization audit requirements stated in OMB Circular A-133, GRRHP projects with an aggregate of unpaid principal loan balance less than $500,000 in a year, are not required to use or reference this guide. However, annual unaudited financial statements, certified by the Chief Financial Officer or Executive Officer are required to be submitted to the project's lender or servicer. This will significantly reduce audit costs and burden for smaller projects whose costs associated with obtaining the audit may exceed the benefit that would be derived from the process.

2. GRRHP projects with an aggregate of unpaid principal loan balance is equal to or greater than $500,000 but less than $2,000,000 in a year, may submit audited financial statements that are not conducted in accordance with Government Auditing Standards. However, the auditor must test and report on the projects compliance with specific GRRHP requirements noted in this guide. These projects are classified and referenced throughout the guide as “non-major” projects.

3. The use and reference of the guide is mandatory for GRRHP projects whose aggregate unpaid principal loan balance is equal to or exceeds $2,000,000 in a year. These projects are classified and referenced throughout the guide as “major” projects.

Unpaid principal balance was used as the threshold criteria, as it is a good driver of determining the costs of doing an audit in comparison to USDA’s risk of exposure to defaulted loans or non compliant program activities.

This guide is divided into chapters. The first chapter discusses purpose, objective and applicability for the performance of the audit. Chapter 2 discusses audit planning and other considerations and establishes certain requirements for the performance of audit. Chapter 3 contains the required reporting requirements. Chapter 4 of the guide contains the compliance supplement for Guaranteed Rural Rental Housing Program (Section 538).

Each audit should be conducted in accordance with requirements of Chapters 1 through 3 and the applicable compliance supplement included in Chapter 4, with the exception of the aforementioned.

CHAPTER 1. GUIDE OVERVIEW

1-1 Overview

1-1.1 Purpose: This guide is to assist borrowers and their independent auditors, as well as lenders, servicers, and U.S. Department of Agriculture (USDA) Rural Housing Service (RHS) staff in performing and reviewing audits of projects issued a loan guarantee by the USDA RHS under its Section 538 Guaranteed Rural Rental Housing Program (GRRHP). Unless otherwise prohibited, these audits must be performed in accordance with the standards for financial audits of the U.S. Government Accountability Office's (GAO) Government Auditing Standards (GAS), issued by the Comptroller General of the United States, commonly referred to as generally accepted government auditing standards (GAGAS).

These standards are for use by auditors of government entities and entities that receive government funds and audit organizations performing GAGAS audits. GAGAS contain requirements and guidance dealing with ethics, independence, auditors' professional competence and judgment, quality control, the performance of field work, and reporting. Audit engagements performed under GAGAS provide information used for oversight, accountability, and improvements of government programs and operations. GAGAS contain requirements and guidance to assist auditors in objectively acquiring and evaluating sufficient, appropriate evidence and reporting the results. When auditors perform their work in this manner and comply with GAGAS in reporting the results, their work can lead to improved government management, better decision making and oversight, effective and efficient operations, and accountability for resources and results.

1-1.2 Objectives. The objectives of a USDA GRRHP audit are to assist lenders, servicers, and RHS staff in determining whether the project has: (a) provided financial data and reports that can be relied upon; (b) internal control in place to provide reasonable assurance that it is managing USDA funded programs in compliance with applicable laws and regulations; and (c) complied with the terms and conditions of Federal awards and guarantees, and thus expended Federal funds properly and with supporting documentation.

1-1.3 Applicability. This guide is effective for audits of fiscal years ending March 31, 2011 and thereafter.

GRRHP project audit reports are a primary tool used by lenders, servicers, and RHS staff to meet their stewardship responsibilities in overseeing these programs and assuring the integrity of the funds. Lenders, servicers, and RHS staff must act upon the areas of noncompliance and internal control weaknesses noted in these reports. To be of value, these reports must contain adequate information to give reported matters perspective and to allow the managers to take necessary corrective action.

CHAPTER 2. GENERAL GUIDANCE

2-1 General Guidance

Purpose: This chapter of the guide clarifies and heightens the emphasis of the GAGAS through standardized language that defines several[1] aspects the auditor's level of responsibilities, as well as provides awareness of those responsibility to borrowers, lenders, servicers, and RHS staff. In addition, this chapter of the guide discusses compliance with Fair Housing and Non-Discrimination regulations.

2-1.1 Auditor Qualifications. Independent auditor must meet the auditor qualifications of GAGAS, including the qualifications relating to organizational independence, and competence together with continuing professional education. Additionally, the audit organization is to meet the quality control standards of GAGAS. While GAGAS urge audit organizations to make their external quality control review reports available to appropriate oversight bodies, it is not necessary to submit the report to either the lender, servicer, USDA RHS or the state office unless requested to do so.

The standards on auditor qualifications in the GAGAS require that accountants and accounting firms comply with the applicable provisions of the public accountancy laws and rules of the jurisdictions in which they are licensed and where the audit is being conducted. If the project is located in a State outside the home State of the auditor, and the auditor performs substantial fieldwork in the project's State, the auditor should document his/her compliance with public accountancy laws of that State regarding licensing, in the audit working papers.

This guide does not impose additional licensing requirements beyond those established by the individual state board of accountancies (some states allow temporary practice without a license).

2-1.2 Audit Scope and Approach. The audit should be sufficiently comprehensive in scope to permit an expression of an opinion on the financial statements and supplemental data of the USDA GRRHP activity. The opinion should state whether the basic financial statements present fairly, in all material respects, the financial position of the project as of the date of the financial statements and the results of its operations and its cash flows for the period then ended in conformity with accounting principles generally accepted in the United States of America. In addition, the opinion should state that the supplemental data has been subjected to the audit procedures applied in the audit of the basic financial statements and whether it is fairly stated in all material respects in relation to the financial statements taken as a whole.

The GAGAS require the auditor to consider the project's internal control as part of planning and performing the audit and report on internal control. The auditor should report on internal control in accordance with Chapter 3 of the guide. Also, the auditor is required to test and report on the project's compliance with applicable USDA RHS GRRHP laws and regulations regardless of the amount of the loan guarantee.

The auditor's report on compliance should include an opinion on the project's compliance with specific requirements applicable to major projects. Reporting requirements are discussed further in Chapter 3. Major project means a project with a total unpaid loan principal balance equal to or exceeding $2,000.000 during the applicable year of the period under audit. For projects with total unpaid loan principal equal to or greater than $500,000 but less than $2,000,000 for the period under audit (a non-major project), the auditor must also test and report on the entity's compliance with specific requirements. The auditor's report on compliance is described in Chapter 3. GAGAS require the reporting of all material instances of noncompliance and quantification in terms of dollar value, if appropriate.

2-1.4 Matters Requiring Immediate Action. The auditor should specifically assess the risk of material misstatement of the financial statements due to fraud and should consider that assessment in designing the audit procedures to be performed. In making this assessment, the auditor should consider fraud risk factors contained in AICPA SAS No. 82, Consideration of Fraud in a Financial Statement Audit. Normally, an audit in accordance with generally accepted auditing standards does not include audit procedures specifically designed to detect illegal acts. However, procedures applied for the purpose of forming an opinion on the financial statements may bring possible illegal acts to the auditor's attention.

If the auditor becomes aware of illegal acts or fraud that have occurred or are likely to have occurred, the auditor should promptly prepare a separate written report and include all questioned costs. The auditor should submit this report to the USDA Inspector General for Audit, as the designated oversight official.

2-1.5 Planning the Audit. A letter of engagement between the project and the auditor shall be prepared. The letter should state that the audit is to be performed in accordance with generally accepted auditing standards, the Government Auditing Standards, and this audit guide. It should specify that the scope of the audit and the contents of the financial report meet the requirements of this audit guide. It should also specify that the auditor is required to provide the USDA Inspector General, Agency Staff and the GAO or their representatives, access to working papers or other documents to review the audit. Access to working papers by USDA and GAO representatives includes making necessary photocopies. Generally, the auditor should use professional judgment to determine the extent of testing necessary to support his/her opinion on the project's financial statements and to report on the project's compliance with applicable laws and regulations. Each of the applicable compliance requirements contained in this guide must be tested regardless of the amount of Federal financial assistance. Where the auditor decides not to perform detailed testing of a particular compliance requirement, the reasons therefore must be appropriately explained and documented in the working papers.

All material instances of noncompliance identified by the auditor must be reported as a finding, even in those cases where corrective action was taken by the project after the audit period. For guidance, consult the particular program chapter. The schedule of findings must include the following information for each finding, where applicable, as required by the GAGAS: (a) the number of items and dollar value of the population; (b) the number of items and the dollar value of the selected sample; and (c) the number of items and the dollar value of the instances of noncompliance. The auditor is required to obtain written representation from management that includes matters concerning compliance with program laws and regulations that have a material effect on the financial statements and the USDA GRRHP.

The auditor shall retain working papers and reports for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by a USDA office or the GAO to extend the retention period. When auditors are aware that USDA or the project is contesting an audit finding, the auditor shall contact the parties contesting the audit finding for guidance prior to destruction of the working papers and report.

2-1.6 Consideration of Internal Control and Compliance. Overall guidance for the consideration of internal control, testing and reporting requirements for Federal financial assistance programs is provided in the GAGAS. The GAGAS require the auditor to obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures.

In addition, when auditing GRRHPs projects, the auditor should perform tests of controls to evaluate the effectiveness of the design and operation of internal control in preventing or detecting material noncompliance with the requirements of the GRRHP. The auditor should perform these procedures regardless of whether the auditor assesses the internal control risk below the maximum. The steps performed and conclusions reached should be clearly evidenced in the auditor's working papers. The working papers should clearly demonstrate the auditor's understanding and assessment of control risk related to internal control established for GRRHP activities. Tests may be omitted only in areas when internal control is likely to be ineffective in preventing or detecting noncompliance, in which case a significant deficiency or material weakness should be reported.

2-1.7 Corrective Action Plan. To assist the Department in resolving instances of noncompliance and material weaknesses in internal control identified by the auditor, the project is required to submit a corrective action plan with the auditor's report on USDA GRRHPs. In the corrective action plan, the project must describe the corrective action taken or planned in response to findings identified by the auditor. In addition, the project must comment on the status of corrective action taken on prior findings. The corrective action plan is considered a necessary part of the project audit requirement. Additional guidance concerning the corrective action plan is contained in Chapter 3 of this guide.

2-1.8 Fair Housing and Non-Discrimination. When performing compliance work in the fair housing and non-discrimination area, the following references should be used: Guaranteed Rural Rental Housing Program Origination And Servicing Handbook**;** 7 CFR Part 3565 **(**Guaranteed Rural Rental Housing Program)**;** Consolidated Civil Rights Monitoring Requirements for Section 8; 24 CFR Part 1 (Title VI of the Civil Rights Act, Americans with Disabilities Act, and others) and Part 8 (Section 504 of the Rehabilitation Act); and 24 CFR Part 100, Age Discrimination Act of 1975, prohibits discrimination in a Federally-assisted program on the basis of age and Title IX of the Education amendments of 1975,

prohibits discrimination on the basis of sex to education programs and activities receiving Federal financial assistance from Rural Development. The Fair Housing Act (applicable to all housing in the nation). The Fair Housing Act prohibits discrimination based on race, color, religion, national origin, sex, familial status or disability in all aspects of the sale or rental of a dwelling (familial status refers to family composition, such as number and ages of children). The prohibitions extend to actions, which have disparate impact because of any of the prohibited bases.

CHAPTER 3. REPORTING REQUIREMENTS AND SAMPLE REPORTS

3-1 Reporting Requirements and Sample Reports

Purpose: This chapter clarifies, streamlines, and standardizes the audit reporting requirements, required by GAGAS or the GRRHP.

3-1.1 Reporting Requirements. GAGAS require that the auditor issue the following reports based on the audit of the financial statements: a report on the financial statements, a report on compliance with applicable laws and regulations, and a report on internal control. In addition, there are additional reports required to be issued in an audit conducted in accordance with this audit guide. The audit report should be issued to the project's governing body and/or top official, as appropriate. The report cover should clearly indicate the USDA GRRHP project and period(s) that were audited.

It is expected that the specific compliance requirements identified in this guide will cover those laws and regulations that, if not complied with, could have a direct and material effect on the financial statements. In such cases, the compliance reports (in Section C below) and illustrated in this guide are the only reports necessary for reporting on the project's compliance with laws and regulations. However, if the auditor, as part of the audit of the financial statements, considered laws and regulations in addition to those noted in this guide, for which noncompliance could have a direct and material effect on the financial statements, the auditor should also issue the compliance report in accordance with Government Auditing Standards.

The following reports are required to be submitted by the project:

A. The auditor's report on the basic financial statements together with the auditor's report on accompanying supplemental information required by USDA, stating whether that supplemental information is fairly stated in all material respects in relation to the basic financial statements taken as a whole (Example A).

B. The auditor's combined report on internal control as it relates to both financial reporting and administering the USDA GRRHP. It must identify any significant deficiencies and material weaknesses noted (Example B).

C. A report on compliance with applicable laws and regulations that may have a direct and material effect on the USDA GRRHP including:
   - an opinion on compliance with specific requirements applicable to a major USDA GRRHP project (Example C)
   - a report on compliance with specific requirements applicable to a non-major USDA GRRHP project (Example D)

D. When performing tests of compliance requirements contained in Chapter 4, the auditor should report on fair housing and nondiscrimination. For non-major projects, fair housing reporting should be included in the auditor's report. Where the project meets the criteria for a major project, the auditor's report on specific requirements applicable to fair housing should be separate (Example E) from the auditor's opinion on compliance with specific requirements applicable to major projects.

E. The report on compliance should also identify and include all material instances of noncompliance. The findings should include an identification of all material questioned costs, as a result of noncompliance. In addition, the findings should contain adequate information necessary to facilitate the audit resolution process, i.e. the number of items and dollar value of the population, the number of items and the dollar value of the selected sample, and the number of items and the dollar value of the instances of noncompliance (Example F). Nonmaterial instances of noncompliance should be communicated to the project in accordance with the Government Auditing Standards.

F. In the project's comments on audit resolution matters, the project should determine if significant findings from previous USDA required annual audits, USDA-OIG audits, USDA management reviews, or physical inspections have been corrected and disclose those which remain uncorrected at the time of the review (Example G). The auditor is required to follow up on prior audit findings, perform procedures to assess the reasonableness of the comments on audit resolution matters relating to USDA programs prepared by the project, and report, as a current-year audit finding, when the auditor concludes that the comments materially misrepresent the status of any prior audit finding(s).

G. Any report from the auditors on illegal acts or fraud that have occurred or are likely to have occurred, including all questioned costs found as a result of these acts that the auditors become aware of, should be covered in a separate written report in accordance with the provisions of the Government Auditing Standards. This report should be sent to the USDA Inspector General for Audit. Illegal acts are to be reported on without regard to whether the condition giving rise to the questioned costs has been corrected or whether the project does or does not agree with the finding and questioned costs.

H. A corrective action plan developed by the project, wherein the project officials describe the corrective action taken or planned in response to the findings identified by the auditor. The plan should also include comments on the corrective action taken on prior findings resulting from independent audits or relevant USDA-OIG audits and USDA program reviews (Example H).

I. In addition to these reports, the borrower must also certify that they are in compliance with the rent restrictions established in *[7 CFR 3565.203]*.

3-1.2 Auditor's Reports. The following are illustrations of reports on financial statements, on internal control, on compliance with specific requirements and the project's corrective action plan that may be issued in an audit in accordance with this guide. These reports are not meant to be all-inclusive; auditors should exercise professional judgment in tailoring their reports to the circumstances of individual audits.

Examples:

A. Report on Audited Financial Statements and Supplemental Information.
B. Report on Internal Control.
C. Opinion on Compliance with Specific Requirements Applicable to a Major USDA GRRHP Project.
D. Report on Compliance with Specific Requirements Applicable to a Non-major USDA GRRHP Project.
E. Report on Compliance with Specific Requirements Applicable to Fair Housing and Non-Discrimination.
F. Schedule of Findings and Questioned Costs.
G. Project's Comments on Audit Resolution Matters Relating to USDA GRRHP.
H. Corrective Action Plan

Example A- Applicable to major projects (unpaid principal loan balance equal to or greater than $2,000,000)[2]

REPORT ON AUDITED FINANCIAL STATEMENTS AND SUPPLEMENTAL INFORMATION

Independent Auditor's Report
To [the Entity]
Anytown, U.S.A.:
We have audited the accompanying balance sheet of [the Entity] as of Month Date, Year, and the related statements of income, changes in partners' capital and cash flows for the year then ended. These financial statements are the responsibility of the [the Entity's] management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of [the Entity] as of Month Date, Year, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report(s) dated [date of report] on our consideration of [the Entity's] internal control and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. Those reports are an integral part of the audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The accompanying supplemental information (shown on pages XX-XX) is presented for the purposes of additional analysis and is not a required part of the basic financial statements of [the Entity]. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

Example B- Applicable to major projects (unpaid principal loan balance equal to or greater than $2,000,000)[3]

The reference to major USDA GRRHPs here and throughout this report is used because the auditor's opinion on compliance runs to the major project. However, when required by the Guide the auditor still has the responsibility to test compliance with specific requirements applicable to non-major USDA GRRHP projects and issue the related non-major report, Report on Compliance with Specific Requirements Applicable to Non-major USDA GRRHP.

Independent Auditor's Report on Internal Control
Combined Report Applicable to Internal Control over Financial Reporting Based on an Audit of Financial Statements and Internal Control over Compliance for USDA GRRHP
No Material Weaknesses, No Significant Deficiencies Identified[4]

[Addressee]

We have audited the financial statements of [the entity] as of and for the year ended [date] and have issued our report thereon, dated [date]. We have also audited [the entity's] compliance with requirements applicable to a major U.S. Department of Agriculture (USDA) Guaranteed Rural Rental Housing Program (GRRHP) project for the year ended [date], and have issued our reports thereon, dated [date].

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the GRRHP Supplemental Government Auditing Standard Guide (Guide), issued by the USDA Rural Housing Service.

Those standards and the Guide require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether [the entity] complied with laws and regulations, noncompliance with which would be material to a major USDA GRRHP.

Management of [the entity] is responsible for establishing and maintaining effective internal control over financial reporting and internal control over compliance. In planning and performing our audits of the financial statements and compliance, we considered [the entity's] internal control over financial reporting and its internal control over compliance with requirements that could have a direct and material effect on a major USDA GRRHP project as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements and compliance but not for the purpose of expressing an opinion on the effectiveness of [the entity's] internal control over financial reporting and internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of [the entity's] internal control over financial reporting and internal control over compliance.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct (1) misstatements of the entity's financial statements or (2) noncompliance with applicable requirements of the USDA GRRHP on a timely basis. A material weakness is a deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that (1) a material misstatement of the entity's financial statements or (2) material noncompliance with applicable requirements of the USDA GRRHP will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting and internal control over compliance was for the limited purpose described in the third paragraph of this report and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses as defined above.

This report is intended solely for the information and use of management, [identify the body or individuals charged with governance], others within the entity, and USDA and is not intended to be and should not be used by anyone other than these specified parties.

[Signature]
[Date]

Example B-1 - Applicable to major projects (unpaid principal loan balance equal to or greater than $2,000,000)

The reference to major USDA GRRHPs here and throughout this report is used because the auditor's opinion on compliance runs to the major project. However, when required by the Guide the auditor still has the responsibility to test compliance with specific requirements applicable to non-major USDA GRRHP projects and issue the related non-major report, Report on Compliance with Specific Requirements Applicable to Non-major USDA GRRHP.[5]

Independent Auditor's Report on Internal Control
Combined Report Applicable to Internal Control over Financial Reporting Based on an Audit of Financial Statements and Internal Control over Compliance for USDA GRRHP
Significant Deficiencies Were Identified--No Material Weaknesses Identified[6]

[Addressee]

We have audited the financial statements of [the entity] as of and for the year ended [date], and have issued our report thereon, dated [date]. We have also audited [the entity's] compliance with requirements applicable to a major U.S. Department of Agriculture (USDA) Guaranteed Rural Rental Housing Program (GRRHP) project for the year ended [date], and have issued our reports thereon, dated [date].

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and the GRRHP Supplemental Government Auditing Standards Guide (Guide), issued by the USDA Rural Housing Service.

Those standards and the Guide require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether [the entity] complied with laws and regulations, noncompliance with which would be material to a major USDA GRRHP.

Management of [the entity] is responsible for establishing and maintaining effective internal control over financial reporting and internal control over compliance. In planning and performing our audits of the financial statements and compliance, we considered [the entity's] internal control over financial reporting and its internal control over compliance with requirements that could have a direct and material effect on a major USDA GRRHP project as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements and compliance but not for the purpose of expressing an opinion on the effectiveness of [the entity's] internal control over financial reporting and internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of [the entity's] internal control over financial reporting and internal control over compliance.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct (1) misstatements of the entity's financial statements or (2) noncompliance with applicable requirements of a USDA GRRHP on a timely basis. A material weakness is a deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that (1) a material misstatement of the entity's financial statements or (2) material noncompliance with applicable requirements of the USDA GRRHP will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting and internal control over compliance was for the limited purpose described in the third paragraph of this report and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses as defined above. However, we identified certain deficiencies in internal control that we consider to be significant deficiencies. A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness in internal control over financial reporting or a material weakness in internal control over compliance yet important enough to merit attention by those charged with governance. We consider the deficiencies described below to be significant deficiencies.

[Describe the significant deficiencies that were identified.][7]

[The entity's] responses to the significant deficiencies identified in our audit are described above [are in the accompanying schedule of findings]. We did not audit [the entity's] responses, and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of management, [identify the body or individuals charged with governance], others within the entity, and USDA and is not intended to be and should not be used by anyone other than these specified parties.

[Signature]
[Date]

Example B-2- Applicable to major projects (unpaid principal loan balance equal to or greater than $2,000,000)[8]

The reference to major USDA GRRHPs here and throughout this report is used because the auditor's opinion on compliance runs to the major project. However, when required by the Guide the auditor still has the responsibility to test compliance with specific requirements applicable to non-major USDA GRRHP transactions and issue the related non-major report, Report on Compliance with Specific Requirements Applicable to a Non-major USDA GRRHP project.

Independent Auditors Report on Internal Control
Combined Report Applicable to Internal Control over Financial Reporting Based on an Audit of Financial Statements and Internal Control over Compliance for USDA GRRHP Material Weaknesses and Significant Deficiencies Were Identified[9]

[Addressee]

We have audited the financial statements of [the entity] as of and for the year ended [date], and have issued our report thereon, dated [date]. We have also audited [the entity's] compliance with requirements applicable to a major U.S. Department of Agriculture (USDA) Guaranteed Rural Rental Housing Program (GRRHP) project for the year ended [date], and have issued our reports thereon, dated [date].

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Supplemental Government Auditing Standards Guide (Guide), issued by the USDA Rural Housing Service.

Those standards and the Guide require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether [the entity] complied with laws and regulations, noncompliance with which would be material to a major USDA GRRHP.

Management of [the entity] is responsible for establishing and maintaining effective internal control over financial reporting and internal control over compliance. In planning and performing our audits of the financial statements and compliance, we considered [the entity's] internal control over financial reporting and its internal control over compliance with requirements that could have a direct and material effect on a major USDA GRRHP project as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements and on compliance but not for the purpose of expressing an opinion on the effectiveness of [the entity's] internal control over financial reporting and internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of [the entity's] internal control over financial reporting and internal control over compliance.

Our consideration of internal control over financial reporting and internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.[10]

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct (1) misstatements of the entity's financial statements or (2) noncompliance with applicable requirements of a USDA GRRHP on a timely basis. A material weakness is a deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that (1) a material misstatement of the entity's financial statements or (2) material noncompliance with applicable requirements of the USDA GRRHP will not be prevented or detected and corrected on a timely basis.

We consider the following deficiencies in [the entity's] internal control to be material weaknesses: [Describe the material weaknesses that were identified.][11]

A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness in internal control over financial reporting or a material weakness in internal control over compliance yet important enough to merit attention by those charged with governance. We consider the following deficiencies in [the entity's] internal control to be significant deficiencies.[12]

[Describe the significant deficiencies that were identified.][13]

[The entity's] responses to the material weaknesses [and significant deficiencies] identified in our audit are described above [or in the accompanying schedule of findings]. We did not audit [the entity's] responses, and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of management, [identify the body or individuals charged with governance], others within the entity, and USDA and is not intended to be and should not be used by anyone other than these specified parties.

[Signature]
[Date]

EXAMPLE C- Applicable to major projects (unpaid principal loan balance equal to or greater than $2,000,000)[14]

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS APPLICABLE TO A MAJOR USDA GRRHP PROJECT

To the Partners
[The Entity]
Anytown, U.S.A.:

We have audited the compliance of [the Entity] with the specific program requirements governing [list those requirements tested] that are applicable to each of its major USDA GRRHP, for the year ended [date]. Compliance with those requirements is the responsibility of [the Entity's] management. Our responsibility is to express an opinion on [the Entity's] compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States, and the GRRHP Supplemental Government Auditing Standard Guide(Guide)issued by the USDA Rural Housing Service.

Those standards and the Guide require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the requirements referred to above that could have a direct and material effect on a major USDA GRRP occurred. An audit includes examining, on a test basis, evidence about [the Entity's] compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of [the Entity's] compliance with those requirements.

In our opinion, the [Entity] complied, in all material respects, with the requirements referred to above that are applicable to each of its major USDA GRRP for the year ended [date].

This report is intended solely for the information of the audit committee, management, and the USDA and is not intended to be and should not be used by anyone other than these specified parties.

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

EXAMPLE D- Applicable to non-major projects (unpaid principal loan balance equal to or greater than $500,000 but less than $2,000,000)[15]

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS APPLICABLE TO A NON-MAJOR USDA GRRHP PROJECT

To the Partners
[The Entity]
Anytown, U.S.A.:

We have audited the financial statements of [the Entity] as of and for the year ended [date], and have issued our report thereon dated [date].

In connection with that audit and with our consideration of [the Entity's] internal control used to administer USDA GRRHP, as required by the GRRHP Supplemental Government Auditing Standard Guide (Guide) issued by the USDA Rural Housing Service, we selected certain transactions applicable to certain non-major USDA GRRHP for the year ended [date].

As required by the Guide, we performed auditing procedures to test compliance with the requirements governing [list those requirements tested] that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on [the Entity's] compliance with these requirements. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under the Guide. This report is intended solely for the information of the audit committee, management, and the USDA and is not intended to be and should not be used by anyone other than these specified parties.

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

EXAMPLE E- Applicable to non-major and major projects.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS APPLICABLE TO FAIR HOUSING AND NON-DISCRIMINATION

To the Partners
[The Entity]
Anytown, USA

We have applied procedures to test [the Entity's] compliance with Fair Housing and Non-Discrimination requirements applicable to its USDA GRRHP, for the year ended [date].

Our procedures were limited to the applicable compliance requirement described in the Supplemental Government Auditing Standards Guide (Guide), issued by the USDA Rural Housing Service. Our procedures were substantially less in scope than an audit, the objective of which would be the expression of an opinion on [the Entity's] compliance with the Fair Housing and Non-Discrimination requirements. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under the Guide.

This report is intended solely for the information and use of the audit committee, management, and the USDA and is not intended to be and should not be used by anyone other than these specified parties.

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

EXAMPLE F-- Applicable to non-major and major projects.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

(Should be attached to Auditor's Report on Compliance)

When the auditor identifies a finding, this schedule must include the following information for each finding, where applicable:

(a) The size and corresponding dollar value of the population, (b) the size and dollar value of the sample tested, and (c) the size and dollar value of the instances of noncompliance.

The Government Auditing Standards state that well-developed findings generally consist of the following attributes:[16]

-- **Statement of condition** - the nature of the deficiencies, e.g., a regulation not being followed, a control procedure not followed or one which is inadequate.

-- **Criteria** - what the project should be doing, e.g. the specific regulation, a prudent management practice, or an internal control procedure.

-- **Effect** - what happened as a result of the condition; this should be monetized in all possible instances and described as thoroughly as possible.

-- **Cause** - why the condition exists, e.g. the project was unaware of the regulation or internal control was not a high priority of the project.

-- **Recommendation** - what the project should do to correct the condition, normally addresses the cause e.g. develops procedures to implement regulation or follow established procedures.

The auditor should attempt to identify the condition, criteria, effect, and cause to provide sufficient information to USDA officials to permit timely and proper corrective action. These findings may also serve as a basis for USDA to conduct additional work. In addition, as part of the finding, the auditor is required to make a recommendation for corrective action to the project. As part of this report, the auditor is required to include the project's summary comments on the findings and recommendations in the report. In addition, the project is responsible for developing a separate corrective action plan (see Example H) based on the auditor's findings and recommendations and including the plan when submitting the auditor's report. If corrective action is not necessary, a statement by the auditor describing the reason it is not should accompany the audit report.

EXAMPLE G- Applicable to non-major and major projects.

PROJECT'S COMMENTS ON AUDIT RESOLUTION MATTERS RELATING TO USDA GRRHP*

The Owner has not taken corrective action on findings from prior audit report, number and title:

Finding No. 1 -

Status -

Finding No. 2 –

Status –

* -- This includes all prior audits, project review reports and state agency reports.

* -- The auditor may rely on management's representation as to the completeness of reports submitted during the audit period. The auditor does not have to independently confirm the completeness of audit and other reports received by management.

EXAMPLE H- Applicable to non-major and major projects.

CORRECTIVE ACTION PLAN

Name and Number of Project _____
Auditor/Audit Firm _____
Audit Period _____

The following is a recommended format to be followed by projects for submitting a corrective action plan:

Section I - Internal Control Review

A. Comments on Findings and Recommendations

The project should provide a statement of concurrence or non-concurrence with the findings and recommendations. If the project does not agree with a finding, specific information should be provided by the project to support its position. If the information is voluminous, an appendix may be attached to the submission.

B. Actions Taken or Planned

The project should detail actions taken or planned to correct deficiencies identified in the report. Appropriate documentation should be submitted for actions taken. For planned actions, projects should provide projected dates for completion of major tasks. Officials responsible for completing the proposed actions should also be identified. If the project believes a corrective action is not required, a statement describing the reasons should be included.

C. Status of Corrective Actions on Prior Findings

The project must comment on all prior findings whether or not corrective action has been completed. The project should provide a report on the status of corrective actions taken on prior findings that remain open. An update should be included on dates for completion of major tasks and responsible officials for any actions not completed. In addition, documentation should be submitted for any actions the project considers completed.

Section II - Compliance Review

A. Comments on Findings and Recommendations
(See Section I. A. above.)

B. Actions Taken or Planned
(See Section I. B.)

C. Status of Corrective Actions on Prior Findings
(See Section I. C.)

CHAPTER 4. COMPLIANCE REQUIREMENTS

4-1 COMPLIANCE REQUIREMENTS

Purpose: The intent of this chapter is to function as a GRRHP specific audit guide that enhance and clarify guidance for the consideration of compliance testing and reporting. This chapter is not intended to be a program-specific audit guide for non-profit organizations compliance with the A-133 requirements.

This chapter contains the USDA requirements for conducting the compliance portion of the annual financial audits of profit-motivated and limited-distribution entities participating in the USDA GRRHP, except for projects with an aggregate of unpaid principal loan balance less than $500,000 in a year, of which whom are not required to use or reference this guide.

4-1.1 Reporting Requirements. The regulatory agreement for the project requires the owner to submit audited financial statements, prepared in accordance with the requirements of the Secretary, within 90 days after the end of the fiscal year. Although most regulatory agreements may indicate a required submission date of 60 days after the end of the fiscal year, 24 CFR [*Code of Federal Regulations*] 5.801, Uniform Financial Reporting Standards (UFRS), supersedes this requirement by giving projects 90 days to submit their financial statements. In addition to issuing an opinion, the basic financial statements, and supplemental (supporting) data, the auditor is required to issue, at a minimum, a report on the internal control structure and a report on compliance. The owner must certify to the completeness and accuracy of the financial statements. The management agent, if applicable, must certify to the management of the project. When circumstances prohibit the specified number of partners' or officers' certifying signatures, explanatory information should be provided with the audit report.

The auditor's role is to conduct and report the results of the audit in accordance with auditing standards generally accepted in the United States of America (GAAS) as issued by the American Institute of Certified Public Accountants (AICPA) and the standards applicable to financial audits contained in GAGAS. In that regard, the independent auditor shall

A. Issue an independent auditor's report (refer to chapter 2, example A) on the ownership entity's basic financial statements. This report should cover the following items:
   - Balance sheet.
   - Statement of profit and loss.
   - Statement of changes in partner's capital.[17]
   - Statement of cash flows.

- Footnotes to the basic financial statements, including descriptions of accounting policies.

B. Issue an independent auditor's report (refer to chapter 2, example A) on the supplemental information. A paragraph may be added to the auditor's report on the basic financial statements, or a full report may be issued separately.[18]

C. Issue any additional reports described in chapter 2.

4-2 Compliance Requirements

4-2.1 **Background.** This section of the chapter contains the USDA requirements for conducting the compliance portion of the annual financial audits of profit-motivated and limited-distribution projects in USDAs GRRHP.

4-2.2 **Compliance Requirements and Audit Areas.** The following sections contain suggested audit procedures that USDA believes should be performed. If an auditor determines that the stated procedures to be inappropriate and/or other audit procedures should be performed, the deviation from the stated procedures must be justified and documented in the auditor's working papers.

1. Federal Financial Reports.

a. Compliance Requirement. Projects are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the project and lender or servicer. The individual agreements contain the specific reporting requirements that the project must follow. USDA will usually require monthly reports whenever annual financial reviews, on-site reviews, or other information indicates that the project is experiencing financial or management difficulties or the owner/agent is suspected of noncompliance.

b. Suggested Audit Procedures.

i. Identify all required financial reports by inquiry of the owner/management agent and review of agreements and correspondence with the lender or servicer. Request a copy of project submissions to USDA, the lender, or servicer during the period under audit.

ii. Obtain an understanding of the owner/management agent's procedures for preparing and reviewing the financial reports.

iii. Ascertain whether the GRRHP project is capitalized in the borrower's financial records at the total development cost, including the portion guaranteed by the Agency, and the finance contributed by the borrower, less depreciation.

iv. Select samples of financial reports, other than those included in the annual financial statements, and determine whether the reports selected are prepared in accordance with the lender or servicer instructions.
v. For the sample selected, determine whether significant data reported are accurate. Report all material differences between financial reports and project records.
vi. Determine whether the project complied with reporting requirements.
vii. Ascertain whether the borrower timely prepared and submitted audited financial statements for the previous year if required.
viii. For years in which the project is being constructed, ascertain by reviewing the borrower's financial records whether the borrower contributed the required percentage toward the project's development cost, and whether any cash contribution was expended prior to loan funds.
ix. Ascertain whether any liabilities were improperly charged to, or paid from, project operations for contributions made by the borrower equal to, or in excess of, the required contributions for development costs.

2. Fair Housing and Nondiscrimination.

a. Compliance Requirement. Owners and management agents are prohibited from discriminatory practices in accepting applications, renting units, and designating units or sections of a project for renting to prohibited bases in accordance with the Fair Housing Act and the provisions of the regulatory agreement.

b. Suggested Audit Procedures.

i. Obtain an understanding of the owner/management agent's policies and procedures relating to marketing of the units; processing, approving, and rejecting applications; and providing reasonable accommodation to applicants and tenants with disabilities in accordance with Section 504 of the Rehabilitation Act of 1973, Title II of the Americans with Disabilities Act of 1990, as amended and in accordance with the requirements of applicable federal civil rights laws.
ii. Obtain a copy of the project's approved affirmative fair housing marketing plan, if applicable. Review the marketing plan for compliance with appropriate statutes and the regulatory agreement.
iii. Obtain documentation supporting whether the lender has determined modifications are needed to the plan and whether the project complied with the suggested modification. Provide project justifications for noncompliance.
iv. Obtain documentation supporting gross income, race, national origin, head of household, gender, elderly and disability status for each unit.

1. Validate the information obtained by a comparison to applicant submitted documents.
2. Assess whether the information complies with Section 526 of Public Law 100-242 of the Housing and Community Development Act of 1987.

v. Review a sample of the correspondence chronology files for the period under audit for correspondence evidencing litigation or potential litigation related to discriminatory rental practices.

vi. During the review of cash disbursements look for payments that would evidence actual or potential litigation for any discriminatory rental practices.

vii. During the review of tenant files, look for evidence of discriminatory practices.

viii. Determine that the USDA approved equal housing opportunity logo, slogan, or statement is displayed in marketing materials.

3. Mortgage Status.

a. Compliance Requirement. Owners shall promptly make all payments due under the note and mortgage.

b. Suggested Audit Procedures.

i. Obtain a copy of the mortgage note, mortgage (or deed of trust), and associated loan amortization schedule to determine the terms and conditions of those agreements.

ii. Obtain an understanding of the owner's procedures for assuring prompt payment of the mortgage.

iii. Determine whether all related mortgage and escrow payments were made by either

1. Obtaining or preparing a schedule of the client's mortgage and escrow payments and withdrawals for the period under audit (the schedule should include the amount, including escrow items, and date each item was paid or disbursed. Determine whether monthly payments were made on time and the loan was current at the end of the fiscal year) or
2. Confirming the outstanding loan balance and annual escrow account activity with the lender as of the project's fiscal year end (determine whether monthly payments were made on time and the loan was current at the end of the fiscal year).

iv. If the project is operating under a mortgage modification agreement, workout agreement, forbearance agreement, use agreement, or other agreement, determine whether the owner is complying with the terms and conditions of the agreement.

v. Ascertain whether the borrower is: (1) maintaining the required fidelity bond coverage; (2) maintaining adequate property, worker's compensation, liability, and flood (where applicable) insurance; and (3) timely paying real estate and other applicable personal property taxes.

4. Replacement Reserve.

a. Compliance Requirement. Borrowers, if required, shall establish a reserve for replacement account and make deposits in accordance with USDA requirements, usually the regulatory agreement. The reserve for replacement account is usually required to be under the control of the lender or servicer. Disbursements from the reserve for replacement fund may be made only after written consent is received from USDA. Reserve for replacement funds are to be invested in interest-bearing accounts for certain projects. Interest earned on these projects is required to be maintained in the reserve for replacement account.

b. Suggested Audit Procedures.

i. Obtain an understanding of the project owner's deposit and maintenance requirements included in the regulatory agreement, business agreement and any amendments or other written agreements with USDA and determine whether there were any changes to the funding requirement by:

1. Reviewing reserve funds for replacement authorizations, or
2. Questioning the owner/management agent if any changes were made when rents were increased.

ii. Obtain an understanding of the project owner's procedures for depositing, maintaining, requesting, and disbursing reserve for replacement funds.

iii. Determine whether the reserve fund has been established in a federally insured depository under the control of the mortgagee, if required. For funds in excess of federally insured limits, determine whether the owner/management agent reviewed the depository quarterly to verify that it met USDA requirements.

iv. Using confirmation or the schedule prepared for the mortgage status compliance requirement; determine whether all required deposits to the reserve for replacement were made in compliance with USDA requirements and agreements. Ascertain whether the reserve account is current by comparing the actual amount in reserve to the amount that should have accumulated since the date the project began operation (see loan agreement), less any authorized withdrawals approved by the Agency.

v. Obtain a confirmation of the reserve account balance from the applicable

financial institution, also checking for any encumbrances against the reserves.

vi. Determine whether all disbursements from the reserve for replacement account, identified in the mortgage confirmation or the schedule prepared, were properly authorized by the lender or servicer.

vii. Select a sample of repairs covered by funds from the reserve for replacement account. Trace the reimbursed amount to cancelled invoices and determine whether funds were used for the purpose authorized by USDA.

5. Distributions to Owners.

a. Compliance Requirement. Owners may not make, receive, and/or retain any distribution of assets or any income of any kind of the project except surplus cash and then only under certain conditions. Surplus cash distributions can only be made as of and after the end of an annual fiscal period. Surplus cash distributions cannot be made when the owner is in default under any of the terms of the regulatory agreement, the note, or mortgage. Surplus cash distributions cannot be made out of borrowed funds or if the owner has not complied with all outstanding notices, from the lender, servicer, or USDA for proper maintenance of the project. While a surplus cash distribution to the owner is not restricted as to the amount, Agency regulations require that the lender ensure that the property be in "good financial and physical condition and in compliance with the regulatory agreement" prior to any distribution of surplus cash.

b. Suggested Audit Procedures

i. Determine if the borrower withdrew surplus cash. For each withdrawal obtain the borrower request for the release of surplus cash and the corresponding Lender certification.

ii. Obtain an understanding of the owner/management agent's procedures for determining surplus cash

1. Scan minutes of board or partnership meetings for discussions authorizing distributions. Question the owner or management agent about the existence of any notices of default or other items of noncompliance under any of the terms of the regulatory or business agreement. If any surplus cash existed after payment of general operating expenses, debt service requirements, and escrow and other reserve account installments, ascertain whether the borrower obtained written approval from the lender or servicer before withdrawing the funds.

2. Scan the bank statements for any deposit, from the project owners and/or related parties, which would evidence that incorrect surplus cash distributions or payments were made and that those funds were re-deposited into the project's accounts before the audit.

iii. Review inspection reports and owner responses to verify compliance with all outstanding notices for proper maintenance of the project. Delays in making repairs could erroneously result in surplus cash being reported to be on hand at the end of the reporting period, making funds available for distribution to the owners.

6. Cash Receipts

a. Compliance Requirement. All cash receipts, including those collected by a management agent, must be deposited into an account in the name of the project at an institution in which deposits are federally insured. Most projects will have at least three bank accounts including a regular operating account, a reserve for replacement account, and a tenant security deposit account. The regular operating account is a general operating account in the name of the project, which is used for depositing receipts of the project other than those specifically designated for the security deposits account.

b. Suggested Audit Procedures

i. Obtain an understanding of the owner/management agent's procedures for handling cash receipts.

ii. Determine whether the project owner's written and actual procedures for receiving and depositing funds in the regular operating account/centralized account are in compliance with the regulatory agreement and USDA guidelines.

iii. Determine whether the account is exclusively in the name of the project except as allowed for centralized accounts.

iv. Select a sample of deposits from the cash receipts ledger and perform the following steps:

1. Determine whether the deposits were made in a timely manner after receipt of funds and are in the name of the project. Usually tenant cash receipts are deposited daily during the heavy rent collection days during the first part of the month and when certain amounts of funds are accumulated during the rest of the month.
2. Test the supporting documentation for each deposit in the sample and determine whether all funds that were received were properly accounted for and included in the deposit.

3. Determine that all deposits in the books of account are in agreement with the related bank statements as to amounts and dates.

4. Determine whether the deposits were posted to the appropriate general ledger accounts.
5. Trace all amounts other than tenant/member rental receipts to any contracts, agreements, or other documentation and determine whether the amount that was received was properly deposited and posted to the appropriate account.
6. Select samples of tenant/member rental receipts and trace the amount from the source documents to the individual tenant/member accounts receivable record and their executed leases.
7. If any amounts are added to the account by way of an institution's memorandum or other type of document, determine the reason for that transaction and whether it was proper.

v. Owners may be motivated to both understate and overstate revenue. The following audit steps are designed to disclose such occurrences:
   1. Consider the fraud risk factors and the potential for material misstatement of the financial statements related to revenue recognition including vacancy loss and bad debt expense. Perform testing to address any material fraud risk factors identified. The auditor should tailor audit steps/procedures based on the individual risk factors identified and the results of other audit evidence gathered.

vi. Determine whether vacancy loss is greater than 15 percent of total rental revenue or if the change in vacancy loss between the current year and prior year is greater than 5 percent. If so, the following steps should be performed:
   1. Determine whether rent potential and vacancy loss were properly calculated.
   2. For all revenue accounts, scan the detailed general ledger. Review the supporting documentation for all material manual entries and unusual entries.
   3. Determine the reason for the increase or cause of the high vacancy rate via discussion with management. The auditor may also want to select a sample of vacant units and perform tests to substantiate the high vacancy rate.

vii. Possible tests on the sample include but are not limited to the following:

1. Reviewing the move-out notice from the tenant.
2. Reviewing the documentation from the move-out inspection.
3. Determining whether the security deposit was refunded to the tenant.
4. Reviewing the itemized list of damages and charges provided to the tenant, which was used to reduce the amount of security deposit due back to the tenant.
5. Inspecting the vacant unit if the unit is still unoccupied.
6. Questioning site personal, including the resident manager and the building manager, to determine the period when the unit was vacant.
7. Reviewing work orders to determine the period when the unit was vacant.

viii. Determine whether bad debt expense is greater than 10 percent of total rental revenue or whether the change in bad debt expense is greater than 5 percent between the current year and the prior year. If so, the following steps should be performed:

1. Obtain an understanding of the owner/management agent's procedures for collecting delinquent debt and policy for writing off debt.
2. Determine whether delinquent accounts are sufficiently pursued according to procedures.
3. Select a sample of accounts written off to bad debts expense and review supporting documentation to determine whether debt was written off in accordance with policy and generally accepted accounting principles.
4. Determine the reason for any activity on the tenant record after the debt was written off.

7. Cash Disbursements

a. Compliance Requirement. All disbursements from the regular operating account must be supported by approved invoices, bills, or other supporting documentation. Project funds should only be used to pay for mortgage payments, required deposits to the reserve for replacement fund, reasonable expenses necessary for the operation and maintenance of the project, distributions of surplus cash as permitted, and repayment of owner advances from surplus cash or as authorized by the lender or servicer. Disbursements from a centralized account must clearly be traceable to each project. The actual cash position of each project in this account must be easily identifiable at all times without exception.

b. Suggested Audit Procedures.

i. Obtain an understanding of the project owner/management agent's procedures for withdrawing funds from the regular operating account

or centralized account and determine whether they are properly supported and used in accordance with the regulatory agreement.

ii. Select a sample of disbursements from the cash disbursement ledger or similar record and perform the following steps:
    1. For centralized accounts, determine whether the disbursements were recorded in the books of the appropriate project in accordance with USDA guidelines. Review cash account balances of each project to ensure that balances are easily identifiable to each project. Also, determine whether any projects have a negative or zero balance, which could indicate an improper loan between projects.
    2. Determine whether the disbursements are supported by approved invoices, bills, or other supporting documentation; the supporting documents are in the name of the project; and the costs are reasonable and necessary for the operation of the project. If the supporting documentation is not in the name of the project, determine whether only the portion applicable to the project was paid from project funds.
    3. Determine whether the disbursements were made on behalf of other projects or entities since project funds cannot be loaned or used for non- project purposes. Report instances even if amounts have been repaid.

iii. Determine whether the disbursements were properly charged to the correct account.
    1. Scan the cash disbursements journal for payments that would evidence actual or potential litigation for any discriminatory rental practices.
    2. If any amounts are withdrawn from the project account by way of an institution's memorandum or other type of document, determine the reason for that transaction and that it is proper.
    3. For accounts with balances in excess of FDIC-insured limits, determine the risk.

iv. For years in which loan funds were expended, either outright or through interim financing, test expenditures to determine if they were budgeted and were made for only authorized loan purposes within the prescribed loan limits and limitations on the use of loan funds. Note: Testing should be expanded, as appropriate, for expenditures involving parties having an identity of interest with the borrower (related parties).

v. Test whether funds disbursed from the accounts were for actual, reasonable, and necessary expenditures incurred for authorized purposes, and if required monthly debt service payments and transfers to escrow and reserve accounts were made. Disbursements made for purposes not related to the GRRHP project, including loans to other projects or enterprises, and partnership or corporate legal, tax preparation, and accounting fees, are not authorized or allowable. Note: Testing should be expanded, as appropriate, for expenditures involving parties having an identity of interest with the borrower (related parties).

8. Rent Restrictions

a. Compliance Requirement. The Agency has established certain rent restrictions to preserve affordability of GRRHP units over time. The rent restrictions for the program are as follows:

i. The monthly rent for any individual housing unit, including any tenant-paid utilities, must not exceed an amount equal to 1/12th of 30 percent of 115 percent of area median annual income, adjusted for family size; and

ii. On an annual basis, the average monthly rent for a project, taking into account all individual unit rents, including any tenant-paid utilities, must not exceed 1/12th of 30 percent of 100 percent of area median annual income, adjusted for family size.

b. Suggested Audit Procedures

i. Obtain an understanding of how the estimate of tenant-paid utility costs was calculated.

ii. Obtain the established estimate of tenant-paid utility costs. The calculation for tenant paid utilities for each unit size and type of heating fuel must be made at initial occupancy when the rent structure is established. *Form RD 3560-7, "Multiple Family Housing Project Budget/Utility"* , may be used for this purpose.

iii. Determine if the analysis is updated annually or when information is received from utility companies of a utility cost increase.

iv. Ascertain if the rent structure has become distorted over time due to inaccurate utility expense estimates.

9. Tenant Security Deposits

a. Compliance Requirement. Funds collected as a security deposit shall be kept in the name of the project, separate and apart from all other funds of the project in a trust account. The amount of this account shall at all times equal or exceed the aggregate of all outstanding obligations under that account. Funds must not be commingled with

tenants and for payment of expenses incurred by or on behalf of the tenant, not to exceed the amount to which the tenant is entitled. All disbursements must have supporting documentation. In addition, state and local governments may have specific regulations governing the handling of tenant security deposits.

b. Suggested Audit Procedures

i. Obtain an understanding of the project owner's procedures, including state and local laws, and regulatory agreement and USDA requirements for establishment and maintenance of the security deposit account and making approved disbursements from that account.

ii. Determine whether the account has been established in a federally insured depository in the name of the project, which is segregated from project operating funds, and the owner's records support the amount on deposit.

iii. Determine whether, at the end of the reporting period and throughout the period under review, the amount on deposit is at least equal to the outstanding obligations under the security deposit account.

iv. Determine whether interest is earned on the security deposit account and the disposition of that interest. If state and local law requires the owner to pay the tenant for interest earned, determine that the tenant interest discredited to tenants and paid upon termination of tenancy.

v. Select a sample of tenants that moved in and tenants that moved out during the period under review and perform the following steps:

1. Determine whether security deposits were collected at the time of the initial lease and agree with the amount required in the lease agreement and regulations.
2. Determine whether security deposits collected were deposited promptly in the security deposit account.
3. Trace tenant balances reported on the balance sheet at the end of the fiscal year as the outstanding obligation to the tenant list of security deposits for the same period and determine if it agrees.
4. Determine whether refunds and/or an itemized list of claims were provided to tenants within 30 days after move-out or as required by state or local law.
5. Determine whether refunds were disbursed to the former tenant and in the appropriate amount. Determine the disposition of or proposed disposition of the amounts for checks outstanding for more than 60 days.

6. Identify disbursements from the security deposit bank account statement that do not appear to be tenant refunds to ensure that those disbursements were only made for payment of appropriate expenses incurred by the tenant or on behalf of the tenant.
7. Determine whether forfeited security deposits applied to rents and damages were appropriately recorded as rental income.

vi. Ascertain whether a separate bank account is maintained for tenant security deposits, and if sufficient funds are in the account to cover security deposits collected from current tenants. Obtain a confirmation of the tenant security deposit account balance from the applicable financial institution, also checking for any encumbrances against the funds. Test withdrawals to ensure they represent either refunds to tenants or transfers to the general operating accounts for lease violations.

10. Management Functions

a. Compliance Requirement. The owner is responsible for complying with all requirements of the regulatory agreement. The owner may perform all management functions or contract with a management agent to provide project management, but the responsibility cannot be delegated to the management agent. The owner or management agent must be approved by the Lender.

b. Suggested Audit Procedures

i. Obtain a copy of the most recent approved management agent's certification. Perform the following steps:

1. Determine whether the lender or servicer has approved the owner or current management agent.
2. Obtain a copy of the management entity profile, to identify additional identity-of-interest companies that were not included in the management agent certification for inclusion in the notes to the financial statements.
3. Review maintenance contracts and major contracts and vendor invoices to determine whether there are additional identity-of interest relationships with the owner/agent that need to be reported and in the notes to the financial statements.
4. Determine whether the management agent fees paid exceeded the amount listed on the management agent certification. This amount should also agree with the amount in the management agreement.
5. For payments made to identity-of-interest companies, determine whether the amounts paid exceed the amounts ordinarily paid for such

services and supplies. The amounts ordinarily paid can be determined by comparing costs to similar disbursements noted during the cash disbursement analysis or from the auditors' knowledge of amounts generally paid for services and supplies in the same geographic area, gained through their audits of other area clients.

ii. Determine whether the owner or management agent has responded to all management review reports, physical inspection reports, and inquiries regarding annual financial statements or monthly accounting reports within 30 days.

iii. On a sample basis, test work orders and tenant complaints for timely follow up and compliance with management's procedures.

iv. Determine whether the project is maintained in good repair and condition. If the units are subsidized, determine whether management's procedures ensure that units meet applicable housing quality standards.

v. Inquire whether USDA or the lender/servicer has conducted routine unit and general property inspections. If findings were identified, determine whether corrective action was taken.

1. Question management and scan revenue accounts for any fees charged to the project or residents for additional services. Conduct follow-up or corroboration of management's responses as considered necessary to ensure that fees charged agree with the management agent certification or have been approved.

vi. Test whether the management services provided, compensation paid, and other management related expenses incurred were in accordance with the management plan and agreement.

11. Unauthorized Change of Ownership/Acquisition of Liabilities

a. Compliance Requirements. Owners shall not, without the prior written consent, convey, assign, transfer, dispose of, or encumber any of the mortgaged property or permit the conveyance, transfer, or encumbrance of such property.

b. Suggested Audit Procedures

i. Question management about the existence of any agreements to sell, assign, dispose of, or encumber any of the mortgaged property or assets of/or

beneficial interest in the property. Review any agreements. Determine whether it has approved transactions or is in the process of approving transactions and report any instances of noncompliance.

ii. Confirm all material liabilities listed on the client's balance sheet. Review for indications of change of ownership or additional encumbrances that may have been made without approval.

iii. Ascertain whether the borrower has written documentation supporting a request to, and prior approval from, the Agency for any changes in stockholders, general partners, or trustees.

iv. Report any other instances of unauthorized conveyance, assignment, transfer, disposal, or encumbrance of any of the mortgaged property or assets of or beneficial interest in the property identified during the course of the audit.

v. Ascertain whether there were any changes in limited partners, and if so, whether the borrower has written documentation supporting a notification to the Agency.

12. Unauthorized Loans of Project Funds.

a. Compliance Requirements. Owners shall not, without the prior written consent, assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except for reasonable operating expenses and necessary repairs.

b. Suggested Audit Procedures.

i. Question management about the existence of any agreements to assign, transfer, dispose of, or encumber any of the personal property of the project, including rents, and read any agreements.

ii. Review the results of the audit procedures applied to specific accounts or other general procedures to identify the existence of any unauthorized transactions.

iii. Test accounts receivable to determine whether receivables are the result of routine operations and whether project funds have been loaned to the management agent, other projects, employees, or the owner.

The financial documents are to be submitted to the lender or servicer using the following transmittal/checklist. The transmittal/checklist provides the lender or servicer with project information, the related auditor's information, and a preliminary observation of the items contained in the submission.

Required Transmittal/Checklist for Annual Submission of Financial Documents

Address to: Lender/Servicer

To whom it may concern:

The following information is being sent to support compliance with the United States Department of Agriculture Rural Housing Service Guaranteed Rural Rental Housing Program. If you have any questions regarding the items being sent, you may contact Mr./Mrs. _____ of the organization or me at telephone number _____. Our facsimile number is_____.

Complete items 1 through 7

1. Project name: _____
2. Project address: _____
3. Project tax identification no.: _____
4. Auditor's tax identification no.: _____
5. Auditor's contact person _____
and telephone number: _____

Place a checkmark by item(s) submitted

1. ___Annual audited financial statement for period ended / /__
2. ___Report on Internal Control
3. ___Opinion on Compliance with GRRHP Specific Requirements
4. ___Report on Compliance with Specific Requirements Applicable to Fair Housing and Non-Discrimination
5. ___Schedule of Findings and Questioned Costs (if appropriate)
6. ___Project's Comments on Audit Resolution Matters Relating to USDA GRRHP (if appropriate)
7. ___Corrective Action Plan (if appropriate)

Signature:_____Date: _____
Type or print signature name: ___
_____ Title: _____
_____

ENDNOTES

[1] For the comprehensive listing and descriptions of all GAGAS requirements and standards, see GAO-07-731G Government Auditing Standards.

[2] Reference to Government Auditing Standards is not applicable in the Report on Audited Financial Statements and Supplemental Information for non-major projects.

[3] Reference to Government Auditing Standards is not applicable for non-major projects.

[4] See example B-I for an illustration of a report in which significant deficiencies were identified by the auditor but no material weaknesses were identified. See example B-2 for an illustration of a report in which both material weaknesses and significant deficiencies were identified. Example B-2 would also be used by the auditor for situations in which there were material weaknesses but no significant deficiencies were identified. Note that this combined report format is illustrative of one possible presentation. Auditors may choose to issue separate reports on internal control over financial reporting and internal control over compliance.

[5] Reference to Government Auditing Standards is not applicable for non-major projects.

[6] See example B for an illustration of a report in which no material weaknesses or significant deficiencies were identified by the auditor. See example B-I for an illustration of a report in which significant deficiencies were identified but no material weaknesses were identified. Note that this example (B-2) illustrates the reporting when both material weaknesses and significant deficiencies were identified. Example B-2 would also be used by the auditor for situations in which there were material weaknesses but no significant deficiencies were identified. Note that this combined report format is illustrative of one possible presentation. Auditors may choose to issue separate reports on internal control over financial reporting and internal control over compliance.

[7] If the auditor includes the findings in a separate schedule versus in the body of the report, the third sentence of the previous paragraph would be replaced with language similar to the following: *However, we identified certain deficiencies in internal control that we consider to be significant deficiencies as described in the accompanying schedule of findings [list the item reference numbers related findings, for example findings 1, 2, and 3]*.

[8] Reference to Government Auditing Standards is not applicable for non-major projects.

[9] See example B for an illustration of a report in which no material weaknesses or significant deficiencies were identified by the auditor. See example B-I for an illustration of a report in which significant deficiencies were identified but no material weaknesses were identified. Note that this example (B-2) illustrates the reporting when both material weaknesses and significant deficiencies were identified. Example B-2 would also be used by the auditor for situations in which there were material weaknesses but no significant deficiencies were identified. Note that this combined report format is illustrative of one possible presentation. Auditors may choose to issue separate reports on internal control over financial reporting and internal control over compliance.

[10] If no significant deficiencies were identified, this sentence would read as follows: *However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses*.

[11] If the auditor includes the findings in a separate schedule versus in the body of the report the last sentence of the previous paragraph would be replaced with language similar to the following: *However, we identified certain deficiencies in internal control that we consider to be material weaknesses as described in the accompanying schedule of findings as items [list the reference numbers of the related findings, for example, findings 1, 2, and 3]*.

[12] If no significant deficiencies were identified, this paragraph would he deleted along with the paragraph below as there would be no significant deficiencies to identify.

[13] If the auditor includes the findings in a separate schedule versus in the body of the report, the last sentence of the previous paragraph would be replaced with language similar to the following: *We identified certain deficiencies in internal control that we consider to be significant deficiencies as described in the accompanying schedule of findings items [list the reference numbers of the related findings, for example, findings 1, 2, and 3]*.

[14] See Example D for Independent Auditor's Report On Compliance With Specific Requirements Applicable To Non-Major USDA GRRHP Project.

[15] See Example C for the Independent Auditor's Report On Compliance With Specific Requirements Applicable To A Major USDA GRRHP Project.

[16] Although the Government Auditing Standard requirements are not applicable to non-major projects, the projects should adopt the suggested format and content of the Schedule of Findings.

[17] Or similarly titled report based on the type of participating ownership entity. For example, if a limited liability company owns the property, "statement of changes in members' equity" should be discussed.

[18] Refer to *AICPA Professional Standards, Volume 1, U.S. Auditing Standards*, AU §551.06e.

CHAPTER 8: PROPERTY MANAGEMENT

8.1 INTRODUCTION

Key Topics in this Chapter

- Lender Role in Property Management
- Management Plan
- Property Manager
- Management Agreement
- Occupancy Requirements
- Tenant Protection and Grievance Procedures

The quality of property management has a direct bearing on the performance of a GRRHP loan. While providing for acceptable property management is the responsibility of the borrower, the lender is responsible for ensuring that the asset value is preserved. In this role, the lender has an obligation to establish standards and to review the borrower's actions in developing a management plan and selecting a property manager or management agent. Throughout the life of the loan, the lender must monitor property management through, among other means, review of financial reports and periodic site visits to assess property operations and physical conditions.

SECTION 1: LENDER ROLE IN PROPERTY MANAGEMENT

8.2 RESPONSIBILITIES OF THE LENDER

The Agency and the lender have a mutual interest in assuring that GRRHP properties are managed to:

- Protect the economic value of the property, which will support timely repayment of the loan and minimize losses; and

- Ensure that the property is operated in compliance with the program requirements and continues to provide decent, affordable housing in rural areas.

The lender must monitor GRRHP loans to verify that properties are well managed. To accomplish this, the lender must evaluate key management issues. These issues are briefly summarized below. Major issues such as the management plan, project manager qualifications and performance, management agreement, and occupancy requirements are discussed in more detail in the remaining sections.

A. Management Plan

The management plan specifies the borrower and property manager's plan for operating the property. The lender must approve the management plan. Part of the plan will be site-specific and part of the plan will be a generic description of the property manager's procedures and staffing. To determine if the property will be well-managed, the proposed management plan must be appropriate for the property type and market area.

B. Property Manager Qualifications

The lender must examine the property manager's qualifications to operate the property successfully and in compliance with the Agency's requirements. The manager should have experience with similar properties, and the staffing and organizational capacity to meet all of the property management requirements.

C. Management Agreement

The lender must review the management agreement or contract between the borrower and the property manager covering the terms and conditions under which the property manager will provide services. Section 4 of this chapter details the issues the lender must review or require in the management agreement.

D. Site Visits

The lender must inspect the property annually to ensure that it is being maintained in compliance with program requirements, local codes, and the management plan *[7 CFR 3565.351 (e)]*.

E. Occupancy and Rent

The GRRHP contains a number of unique program requirements on tenant eligibility and rent restrictions. These include a limit on the income of tenants at initial occupancy, unit rent restrictions, and average project rent restrictions. The specific provisions are detailed in Section 5 of this chapter. The lender must ensure that the borrower and property manager thoroughly understand and comply with these requirements.

F. Affirmative Fair Housing Marketing Plan

The lender must review and the State Office must approve the borrower's *Form HUD 935.2A*, as a part of the management plan and determine if it is appropriate for the specific property and market area. It must be reviewed and approved annually and modified when necessary if the goals of the plan are not being met. Instructions for review of this plan can be found in Chapter 4.

G. Reporting

The lender must obtain periodic reports from the borrower on the condition of the property. At a minimum these reports must include:

- On an annual basis, an audited annual financial statement conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS) or OMB Circular A-133. This report will include a balance sheet, income and expense statement, and a statement of borrower compliance with program requirements.

- On a quarterly basis, once the loan note guarantee is issued, the lender must submit *Form RD 1980-41* to the USDA Finance Office and State Office.

- On a monthly basis, for properties that are delinquent or in default, the lender must provide the Agency with a delinquency report including information about:

  ◊ The amount of any monetary delinquency;

  ◊ The physical condition of the property;

  ◊ The financial status of the property;

  ◊ The status of any non-monetary compliance problems; and

  ◊ Proposed actions and a timetable to resolve the delinquency, default, or non-compliance issues.

H. Relationship Reporting

The management agent must complete a *Form HUD 9832* that provides information about the management agent and each member of the management team. Any identity of interest (IOI) relationship with the property manager or subsequent property manager must be fully disclosed in *Form HUD 9832*. IOI is defined in Paragraph 1.9.

I. Pre-Rent-up Instructions

After the lender has been invited by the State Office to proceed with GRRHP application processing, the lender will hold a teleconference with the State Office processing staff and the borrower to discuss compliance issues related to rent-up of the property. This meeting should take place before the management company begins leasing the property. During the teleconference, State Office staff will inform the borrower and lender of the following required compliance items: (1) the posting of the AFHMP; (2) the need to maintain documentation that demonstrates fulfillment of the AFHMP; (3) the maintenance of a standardized, non-discriminatory application and waiting list for prospective tenants; (4) the non-discriminatory logo, clause, and statements in pamphlets,

brochures, and newsletters; (5) handicap accessibility to public areas, including, but not limited to, the rental office; (6) the collection of race and national origin data on tenants to be reported by the borrower in the annual Fair Housing report (see Paragraph 7.14 B.); (7) knowledge and correct usage of current median income limits; and (8) the need for site managers that are properly trained on the aforementioned GRRHP requirements. The lender will be responsible for ensuring borrower compliance with these requirements.

SECTION 2: MANAGEMENT PLAN

8.3 OVERVIEW

The management plan is the borrower's and property manager's plan for operating the property. It should address all aspects of property operation, maintenance, and compliance with applicable laws, regulations, and other program requirements. Standards and deadlines for performance must be included in the plan. The lender should assess the management plan for responsiveness to the specific requirements of the program *[7 CFR 3565.351]* as well as for the specific nature of the property.

The Agency requires that certain provisions be included in the management plan. These components are identified below. Attachment 8-A provides additional detail on the content of the required provisions.

8.4 MANAGEMENT PLAN REQUIREMENTS

The management plan is the document that tells the lender how the property will be operated over the life of the loan. The lender must review the plan to determine if it is appropriate for the property and that the property will be operated within program requirements. It is the responsibility of the lender to monitor the management of the property for compliance with the management plan. A copy of the current plan must be kept on file in the lender's office. The Agency may request a copy of the management plan.

A. Management Plan Contents

The lender must decide if the proposed management plan is suitable to meet the property's needs and if it addresses the minimum requirements identified below. Lenders may add additional requirements to address specific circumstances or market conditions. Remember that the management plan is an active document. The management plan can and should be revised as circumstances warrant.

It is anticipated that GRRHP properties may have supplemental financing or housing subsidies, with related occupancy or management requirements. Some of the other financing programs, such as low income housing tax credits, may have more restrictive income or tenant eligibility rules. The borrower has the responsibility to maintain compliance with all of these requirements. The Agency, in most cases, will defer to the

most stringent requirements imposed as a result of alternative financing sources. However, this may not be appropriate in all cases. For example, if a project's occupancy is suffering due to inadequate numbers of qualified tenants under the "most stringent rules" and may result in a default on the GRRHP loan, the Agency may require the lender to adhere to Agency occupancy standards to avoid a default.

Key components to look for in the management plan are summarized here. They are described in more detail in Attachment 8-A.

- **Occupancy**. Has the property manager shown how it will perform standard operations such as rent collection and tenant screening, and how it will maintain compliance with the AFHMP and unique tenant eligibility rules?

- **Maintenance**. Are there effective maintenance programs and good routines to respond to tenant work orders? Are utility costs monitored and energy conservation practices encouraged?

- **Personnel management**. Is the staffing appropriate for the size and services of the property? Are the job descriptions clear regarding on-site versus main office personnel? Is the bundle of services included in the management fee distinguished from the charges to operations for on-site staff?

- **Financial management**. Are there adequate administrative procedures for money management, rent collection, reporting, recordkeeping, and data systems? What are the procedures for monitoring the operating and reserve accounts and insurance policies?

- **Tenant services**. Does the plan address the quality of services for the tenants, including safety and security, maintenance services, and communication with the property manager?

B. Agency Review

Although the Agency does not approve the management plan, the State Office must approve the initial *HUD Form 935.2A*, which is to be prepared for the specific property and market area. Approval standards for this plan are detailed in Chapter 4.

SECTION 3: PROPERTY MANAGER

8.5 OVERVIEW

This section describes issues related to the property manager that must be reviewed by the lender. Under the direction of the borrower and within the parameters of the management plan, the professional property manager has the direct responsibility for the property's daily operations. As a result, property managers play a key role in successfully marketing the property and in maintaining property values over time. The quality of their work also directly affects the quality of services to tenants.

The lender must review and approve the qualifications of the property manager selected by the borrower. *Form HUD 9832*, required of the management agent, will provide important information about the ownership of the property management firm and its prior experience.

The Agency, the lender, and the borrower all have a keen interest in ensuring the highest quality management of the property and compliance with GRRHP regulations. The lender should be aware that the Agency relies on the lender to monitor the operations at the property. The lender should be sure that property managers are familiar with some of the key features of this program, including:

- The risk-sharing nature of the program which provides that the lender and the borrower will lose money if the loan defaults due to failure to comply with all loan and program requirements;
- Statutory income restrictions that must be certified at initial occupancy;
- Rent restrictions that limit unit rents and average project rents, and rents and utility allowances that must be certified annually; and
- The likelihood that secondary or supplemental financing will be involved and may require additional occupancy and rent restrictions.

Additional detail on the program occupancy requirements are provided in Section 5 of this chapter.

8.6 KEY PROPERTY MANAGER ISSUES

Some of the key property manager issues the lender should review include:

- **Relationship to the lender**. Does the lender have hiring and firing authority over the property manager if the borrower fails to act in a timely manner to resolve management deficiencies? Is the management agreement assignable to the lender, and ultimately to the Agency, in case of a default on the loan?

- **Management compensation**. Is the management fee clearly expressed? Are fees customary and typical for the market area for similar housing?

- **Industry knowledge and management training**. Is the property manager current on affordable housing issues and requirements? Is there a training program in place for training staff on GRRHP, other housing program requirements, and property management techniques? Is the property manager using current data management and recordkeeping technology?

- **On-site management**. Are there clear written job descriptions and responsibilities for on-site staff? Are management policies clearly documented? If the property is too small for on-site management, is the property manager's headquarters close enough to the property to effectively manage on a daily basis?

8.7 PROPERTY MANAGER EXPERIENCE

The property manager must be qualified to fulfill the management plan requirements and have experience managing small rural housing developments. The property manager must provide evidence of knowledge of the GRRHP and the laws and standards governing the property's operations such as: fair housing, local property standards, environmental hazards, equal employment, accessibility laws, and related laws on equal opportunity and maintaining a drug-free workplace.

Because GRRHP properties are likely to have additional sources of project financing, the property manager must also have adequate experience managing the income and occupancy requirements of each financing program. These may include: LIHTCs and HOME funds, Community Development Block Grant Funds, and State or local affordable housing assistance. The property manager must have a process to stay current on affordable housing issues and requirements.

Because the GRRHP may guarantee loans financing new construction or rehabilitation, the property manager must have appropriate experience in leasing newly constructed or rehabilitated rural properties.

The property management firm must have at least one person in a supervisory position with a minimum of two years of experience and satisfactory performance directing and overseeing the management of multifamily properties serving a similar resident clientele.

The lender is encouraged to visit the sites currently managed by the proposed property management firm as a reference check.

8.8 PREVIOUS PARTICIPATION AND OTHER FEDERAL REQUIREMENTS

The lender must obtain a *Form RD 1944-37* from the initial and subsequent property managers and retain the original in the files. This certification must state that neither the property management entity nor its principals are debarred or suspended from Federal work. The lender must confirm this and may do so by accessing the GSA debarment list online at http://www.epls.gov or in CAIVRS (Credit Voice Response System). If a borrower wants to use a debarred or suspended property management firm and believes it has a sufficiently good reason, the borrower may appeal to the lender. If the lender agrees, then the appeal must be forwarded to the Agency. The Agency reserves the right to reject a property management firm based on previous participation.

SECTION 4: MANAGEMENT AGREEMENT

8.9 OVERVIEW

The management agreement details the contractual relationship between the borrower and the property manager. It must require the property manager to conduct its operations according to the Agency's requirements and applicable laws. The lender must review and approve the management agreement and confirm that the terms comply with the Agency requirements, applicable laws, and are reasonable and customary. Also, the lender must obtain an assignment of management agreement from the borrower in the event that the mortgage goes into default for monetary or non-compliance reasons and the property management agreement must be assigned to the lender or the Agency, as appropriate. The executed management agreement and an executed assignment of management agreement must be kept on file with the lender.

8.10 TERMS AND CONDITIONS

The management agreement commits the manager to managing the property in accordance with the management plan and other requirements. The agreement provides the legal authorization for the property manager to act as the borrower's agent in carrying out authorized activities. The principal authorized activities include: budget preparation, entering into contracts for work at the property, collection of rents, and eviction of tenants.

Additional provisions of the agreement typically include: an indemnification of the property manager for good faith actions taken to carry out the borrower's policies and an

acknowledgment that the property manager is not financially obligated to fund the project expenses.

In the event that the property manager does not comply with the terms of the loan, management agreement, or the management plan, the lender must have the authority to require the borrower to replace the management agent with a qualified and competent management agent. The lender's loan documents and the management agreement must include this requirement and, upon failure to comply, provide for the lender or the Agency, as appropriate, to take control of the property as mortgagee-in-possession with the ability to terminate the management agreement.

8.11 MANAGEMENT FEE

The management fee, including any incentives or bonuses to be paid from property funds to the property management firm or any other party, must be reasonable and customary for similar properties in the market area. The total management compensation should be specified in the management agreement.

SECTION 5: OCCUPANCY REQUIREMENTS

8.12 OCCUPANCY REQUIREMENTS AND LENDER REVIEW

[7 CFR 3565.202 and 3565.203]

The lender must ensure that the property is managed in conformance with the following occupancy requirements.

A. Income of Residents

Units are to be available only to households whose incomes (as defined in Paragraph 8.12 C.), at the time of initial occupancy, do not exceed 115 percent of the area median income. After initial occupancy, a tenant's income may exceed this limit *[7 CFR 3565.202]*.

B. Tenant Income Certifications

The initial tenant certifications must contain certain basic information required by the Agency such as types of income and sources. Annual recertification of tenant income is

not required under the GRRHP. When certifying or recertifying a tenant's income, any industry accepted certification form may be used if it provides all of the information required by the Agency. For example, if the property is also a tax credit property, the tax credit certification form may be used to calculate income for GRRHP purposes. If the property has no other subsidies attached, "*Form RD 3560-8, Tenant Certification*", must be used.

When completing the income certification form, the property manager should only complete the portions of the form that are applicable to the GRRHP, such as name, address, telephone number, household members, and source and amount of income of all adults. Applicants are not eligible to claim deductions from income as permitted by Section 515 and certain other programs.

When required by the Agency, the lender may be instructed to submit to the Agency any certification form used and completed by the management agent for other financing or housing assistance programs.

C. GRRHP Definition of Income

Income should be calculated per household as follows:

- The sum of all income of each adult member of the household for the prior year, including any interest income from any assets. Income must include all transfer payments such as child support and alimony.

- No adjustments to income will be made, such as exclusions for lump sum, Social Security Income (SSI) payments, student financial aid, adoption assistance payments, local employment training program participation, payments in support of a developmentally disabled family member at home, or similar payments.

D. Reporting of Income

To document statutory compliance and to provide required fair housing reports, the lender must periodically provide information on the characteristics of tenants, such as tenant incomes and household size. Because some tenants will have incomes recertified annually due to other program requirements, this requirement may be fulfilled by submission of these recertifications. However, the lender must also obtain tenant income and household information on all other tenants [*7 CFR 3565.202*].

To assure tenants that they are not subject to annual recertification of income, property managers should make clear, in writing, that a tenant whose income has increased from the time of initial occupancy continues to be eligible for occupancy at the property.

E. Restrictions on Rent

The Agency has established certain rent restrictions to preserve affordability of GRRHP units over time. The rent restrictions for the program are as follows:

- The monthly rent for any individual housing unit, including any tenant-paid utilities, must not exceed an amount equal to 1/12th of 30 percent of 115 percent of AMI, adjusted for family size (based on the income limits in the most recent update of RD Instruction 1980-D, Exhibit C).
- On an annual basis, the average monthly rent for a project, taking into account all individual unit rents, including any tenant-paid utilities, must not exceed 1/12th of 30 percent of 100 percent of annual AMI, adjusted for family size *[7 CFR 3565.203]*.

To comply with these rent restrictions, the borrower must establish an estimate of tenant-paid utility costs. The calculation for tenant-paid utilities for each unit size and type of heating fuel must be made at initial occupancy when the rent structure is established. *Form RD 3560-7, "Multiple Family Housing Project Budget/Utility Allowance"*, may be used for this purpose.

The analysis must be updated annually or when information is received from utility companies of a utility cost increase. This process should reduce the administrative effort to track utilities on a unit and household basis, yet maintain an appropriate allowance for utilities paid by tenants in the rent calculation. If the lender believes that the rent structure has become distorted over time due to inaccurate utility expense estimates, then the property manager may undertake a utility survey. Utility surveys are not required by the Agency if the tenant-paid utility allowance appears to be accurate.

F. Use Restrictions

The goal of the program is to provide and maintain the supply of affordable housing for low- and moderate-income residents of rural areas. GRRHP properties must not be operated as temporary or transient housing or for use as migrant housing. Nor can the property be operated as a health facility or student housing. The initial and subsequent terms of the lease must be 12 months or greater, unless special servicing issues warrant a shorter lease term.

SECTION 6: TENANT PROTECTION AND GRIEVANCE PROCEDURES

8.13 OVERVIEW

The lender must receive confirmation from the borrower or property manager that the tenants have been informed in writing of their rights under the grievance and appeal section of the regulations *[7 CFR 3565.351]*. In addition, the lender must ensure that the borrower or property manager provide rejected applicants with relevant civil rights information. Tenants must receive and sign for receipt of a packet of information at lease signing that includes the grievance and appeals information. Tenants should also receive information about property rules and regulations, how to contact the property manager, and basic community information.

Some areas of the country have concentrations of non-English speaking residents. In such markets, or if the property has a large number of non-English speaking applicants or tenants, the borrower or property manager must make reasonable efforts to provide tenant information in the tenants' native language.

8.14 TENANT PROTECTION

The lender must verify that the property manager maintains a process for addressing tenant concerns about the management and maintenance of the property. An action or possible inaction by the borrower or property manager may adversely affect tenants of the project. Tenants are entitled to the benefits of the Agency grievance process or to pursue grievances under applicable local, State, and Federal law.

8.15 GRIEVANCE PROCEDURES

The lender must ensure that the borrower or property manager notifies the tenants that they have access to an approved grievance process and appeals system. Borrowers are required to post the Fair Housing Poster in accordance with 24 CFR 110 and other Agency information in accordance with 7 CFR 3560.160 that informs tenants of their rights under the grievance procedures. Exhibit 8-2 provides a flowchart of the process. Attachment 8-B provides details on the hearing process.

When there is a grievance, it is important to determine whether the grievance is appropriate for the Agency's grievance process. Often the grievance is more properly addressed in other venues, such as a civil court in the case of personal disputes between tenants or by the Secretary of Housing and Urban Development or the Secretary of Agriculture in the case of alleged civil rights discrimination (as discussed in Paragraph 8.16). Tenant complaints which are appropriately addressed under the Agency grievance process include unauthorized rent changes or lease modifications, inequitable enforcement of terms of the lease, and inadequate

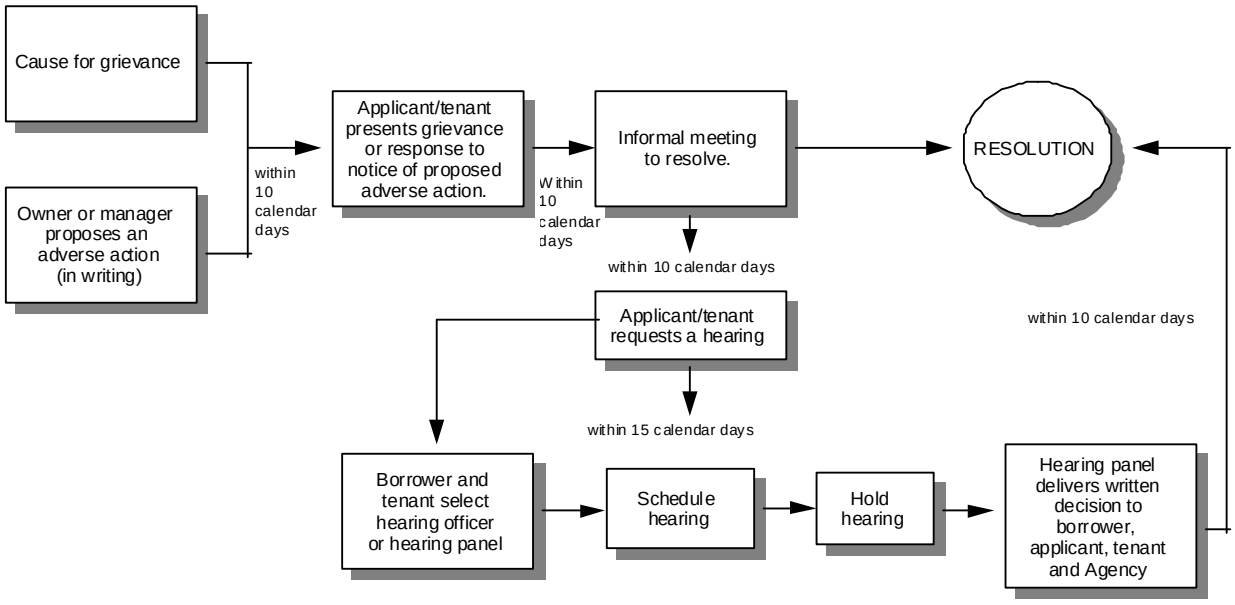
maintenance of the unit or property. Exhibit 8-1 lists the circumstances in which a tenant may or may not be able to file a complaint under the grievance process for this program.

Exhibit 8-1 **Tenant Grievances – Allowable Circumstances**	
A complaint may not be filed if:	***A complaint may be filed if:***
• There is a proposed rent change that is authorized by the Agency. • A tenant or prospective tenant believes that he/she has been discriminated against. This issue cannot be resolved through the appeals process; however, if a person believes that discrimination has occurred, they should file a complaint with the Secretary of HUD or Agriculture. • A project has formed a tenants' association and all parties involved have agreed to use this association as a method of settling grievances. • There are changes in the rules that are required by the Agency and proper notice has been given. • The tenant is in violation of the lease and those violations result in termination of tenancy. • Disputes between tenants that do not involve the borrower. • The grievance is related to displacement or other effects as a result of Agency-approved prepayment of a guaranteed loan.	• The property is not maintained in a manner that is decent, safe, and sanitary. • The borrower violates lease provisions or occupancy rules. • Lease modifications are made. • Occupancy rules changes are made. • Rent charges not authorized by the Agency are implemented. • Tenants are denied approval for occupancy.

The grievance process should only be employed after informal discussions between the aggrieved party and the property manager or borrower have failed and the Agency is asked to intervene. The parties will select a hearing panel or hearing officer to govern the hearing which will be held within 15 calendar days of the request by either party for a hearing. Exhibit 8-2 illustrates the grievance and appeals process.

Exhibit 8-2

Tenant Grievance and Appeals Process Flowchart for the GRRHP



8.16 CIVIL RIGHTS *[7 CFR 3565.8]*

A. Lender Obligations

The lender must require certification from the borrower that the property manager will conduct its activities without regard to race, color, religion, sex, familial status, national origin, age, or disability in accordance with Section 504 of the Rehabilitation Act of 1973, Title II of the Americans with Disabilities Act of 1990, as amended. This includes any actions in the sale, rental, or advertising of the dwellings.

Compliance with the Fair Housing Amendments Act and the Americans with Disabilities Act is required for all participants in the program. These Federal laws direct lenders, borrowers, and their agents, specifically including property managers, to:

Examples of Unit Features That May Be Modified to Accommodate Tenants

- Doorknobs/handles
- Bathroom fixtures
- Light switches
- Appliance handles/knobs
- The size of doorways

- Make accommodations in rules, policies, practices, or services to provide a person with a disability an opportunity to use or continue to use a dwelling unit and all public and common use areas.

- Allow an individual with a disability to modify a unit at his or her expense to make it more suitable or enjoyable. The tenant can be required to escrow funds to restore the unit to its original condition if the modifications are not suitable to the rental market.

Property managers should provide training to their staff on these subjects and establish an internal monitoring program to routinely check compliance with these requirements.

B. Penalties

Lenders, borrowers, or their agents who fail to comply with the requirements of Title VIII of the Civil Rights Act of 1968, as amended by the Fair Housing Amendments Act of 1988 (the Fair Housing Act), are liable to sanctions authorized by law, including, but not limited to, cancellation of the guarantee and investigation by the U.S. Attorney and/or HUD or the Agency..

8.17 HOUSING DISCRIMINATION

To file a complaint of discrimination, write to USDA, Assistant Secretary for Civil Rights, Office of the Assistant Secretary for Civil Rights, 1400 Independence Avenue, S.W., Stop 9410, Washington DC 20250-9410, or call toll-free at (866) 632-9992 (English) or (800) 877-8339 (TDD) or (866) 377-8642 (English Federal-replay) or (800) 845-6136 (Spanish Federal-relay). USDA is an equal opportunity provider and employer.

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ATTACHMENT 8-A

MANAGEMENT PLAN REQUIREMENTS FOR THE GUARANTEED RURAL RENTAL HOUSING PROGRAM

There is no required form to be used for the management plan for the GRRHP; however, this exhibit provides detailed guidance on each of the required management plan components identified in Paragraph 8.4. The lender must ensure that the borrower has provided for acceptable property management services and practices. References to the regulations are noted where applicable.

GRRHP MANAGEMENT PLAN REQUIREMENTS

1. Occupancy Requirements and Monitoring

This part of the plan includes a statement of the occupancy requirements for the property, including the GRRHP requirements and the requirements of any other financing program that is applicable. The plan should describe how the property management firm will implement the requirements and ensure compliance over time.

Because of the important statutory and program requirements, the lender must carefully review this part of the management plan..

- **Non-contiguous or scattered sites with one loan**. Scattered sites are to be managed under one management plan and must be located within an area small enough to allow convenient, efficient management. The plan should detail how this will be accomplished and whether on-site or off-site management is planned.

- **Plans and procedures for marketing units and maintaining compliance with the AFHMP**. The completion of *Form HUD 935.2A* is a statutory requirement. The plan must take into account the unique circumstances of the property and market area and must be able to be implemented by the property manager over the life of the guaranteed loan. The initial plan must be reviewed by the lender and forwarded to RHS for approval. The plan must be reviewed annually by the lender thereafter *[7 CFR 3565.353]*. An approved AFHMP must be posted in the rental office so that eligible persons and families will be made aware of the availability of affordable multi-family rental housing in the GRRHP.

- **Procedures for determining applicant eligibility**. Property managers must demonstrate knowledge of the unique income eligibility rules of the program *[7 CFR 3565.202]*. Due to the likelihood of GRRHP properties being developed with multiple sources of financing, the property manager must be able to interview and document prospective tenants under the requirements of the other programs while meeting all of the GRRHP requirements. Some of the other programs will have more limitations on tenants' incomes than this program so the property manager must know and manage the distinct rules appropriately.

- **Leasing and occupancy policies**. Property managers must demonstrate the capacity to manage the unique leasing occupancy restrictions of the GRRHP program and other applicable programs *[7 CFR 3565.203]*. For projects financed with Options Two or Three, the property managers must demonstrate the ability to lease-up newly constructed or rehabilitated properties in accordance with a schedule that will facilitate the timely conversion from a construction to a permanent loan. Some programs will have requirements, which exceed those of the GRRHP, such as the annual rent recertification requirement of the tax credit program, and managers must be knowledgeable of those requirements.

- **Rent collection**. How and where the tenant pays the monthly rent must be described (whether by mail, to a lock box, or collected on-site). Clear and consistent rules on collection of delinquent rent and assessment of late fees must be in the written plan and in the tenant lease.

- **Termination of leases and eviction**. The plan must identify key lease provisions pertaining to termination of leases and eviction, and how the property manager will monitor compliance and take action to enforce these provisions. The provisions and the enforcement process must be fully consistent with Agency policies as well as with local, State, and Federal law.

- **Tenant Protection and Grievance Procedures**. The borrower or management agent must provide tenants with a copy of the tenant protection and grievance procedures at the time of lease execution and must provide civil rights information to rejected applicants. Tenant grievance procedures must be posted in a conspicuous public location at the property such as the entry or common areas *[7 CFR 3565.351(c)]*.

- **Security**. Adequate security must be provided to the property and the tenants. A written security plan to address issues such as tenant protection measures, vandalism, and drugs is recommended. Any special security concerns for the site should be identified and remedial measures fully described.

2. Tenant Services

The borrower and property manager are encouraged to offer tenant services appropriate to the needs of residents. Such services might include an after-school program for families or social programs for elderly residents. The cost of such services must be included in the operating budget if they are to be paid from project funds. Property managers must also provide a link to other resources in the community for services to the tenants whenever possible. The borrower and property manager must describe which community-based services will be supported at the property. Information packets must be available to new residents which include lists of resources and area employers.

3. Maintenance

- **Plans for carrying out an effective maintenance, repair, and replacement program**. Routine and non-routine maintenance procedures must be explained in the plan, including how tenants access the maintenance system and how work requests from tenants will be handled in a timely manner.

- **Environmental review compliance**. The plan must describe how the property manager will manage compliance with applicable Federal and State environmental laws and any conditions set forth in the Agency's environmental review.

- **Energy conservation measures and practices**. The plan must describe any practices to be used to reduce energy and water consumption in common areas and by tenants. Education programs on conserving energy in their units must be included as part of such practices.

4. Personnel Management

- **Personnel policies and staffing arrangements**. The property manager must detail the management and maintenance staffing plan for both on-site and off-site staff, provide job descriptions and delegations of authority, and list emergency contacts in the management plan. The number, type, and compensation of the staff must be appropriate for the property.

- **Training**. Information about staff training on program requirements and on management procedures and techniques must be included in the plan.

5. Financial Management and Reporting

The plan must describe how the required reports to the lender will be prepared and submitted in a timely manner, including:

- **Access to Books and Records**. The borrower and property manager must agree to provide access to the project books and records for review by the Rural Development staff and the Office of Inspector General, the General Accounting Office, and the Department of Justice (or their representatives) upon appropriate notification *[7 CFR 3565.351(a)(7)]*.

- **Accounting and Record keeping**. The plan must include information on accounting and record keeping, including data systems and software used to address:

  ◊ Rent rolls, lease-up, and vacancy information;

  ◊ Scheduled maintenance;

  ◊ Reserve withdrawals;

  ◊ Accounts payable and receivable;

  ◊ Tenant income reporting;

  ◊ Monthly bank statements and reconciliations; and

  ◊ Procedures to maintain books in accordance with Generally Accepted Government Auditing Standards (GAGAS).

- **Insurance and Fidelity Coverage**. Insurance coverage must be provided in accordance with Agency standards. The type and level of property and fidelity insurance coverage must be specified in the plan. The plan must specifically highlight any unique insurance coverage appropriate for the property area.

ATTACHMENT 8-B

THE HEARING PROCESS FOR TENANT GRIEVANCES AND APPEALS FOR THE GUARANTEED RURAL RENTAL HOUSING PROGRAM

THE HEARING PROCESS

A. Request for a Hearing

If an informal meeting between the tenant or prospective tenant does not resolve a tenant grievance, a grievance hearing may be requested. The tenant or prospective tenant shall present their request within 10 days after the receipt of the summary of the informal meeting. The request must contain the following information:

- The reason for the grievance or contest of the borrower or management agent's proposed action;
- The action or relief sought; and
- Any additional information pertinent to the report.

If the tenant or prospective tenant's request for a hearing is not received within the prescribed time, the right to a hearing will be withdrawn and the borrower or management agent's decision will become final. If the tenant or prospective tenant does not request a hearing within the required time frame, the borrower's or management agent's decision will become final.

B. Selection of the Hearing Panel or Hearing Officer

The two parties shall elect a hearing officer. If a hearing officer cannot be agreed upon, the two parties shall choose members to serve on a hearing panel. The hearing panel will consist of three members. The tenant and the borrower or management agent must each elect one person to the panel. It is then the responsibility of the two chosen members to elect a third member to the panel. If within 30 days of the date a hearing is requested a hearing panel has not been formed, the borrower or management agent must inform the State Office. Within 10 days of reviewing the facts, the State Office will appoint a sole hearing officer who cannot be a person considered by the tenant or borrower/management agent. In lieu of a hearing officer, the borrower or management agent may ask the State Office to approve a hearing panel. Once a hearing officer or panel is selected, the State Office will inform them in writing of their responsibilities for governing the hearing.

Helpful information for selecting a hearing panel or hearing officer includes:

- The hearing officer cannot be a person selected solely by the tenant or management agent.

- The hearing panel members should be impartial.

To minimize time and the level of effort, a borrower or management agent may elect to have a standing panel to hear tenant grievances for each project managed. If a standing panel is chosen, the following process should be substituted for the process discussed above.

- A hearing panel consisting of three members including at least one tenant panelist and one panelist selected by the borrower or management agent.

- Tenants will nominate and vote for both a panel member and an alternate. Residents must be notified of the time, date, and location of the election.

- The borrower or management agent will select two members to serve on the standing panel. One will serve as the alternate.

- The third member of the panel must be selected jointly by the tenants and borrower or management agent.

- The chairperson shall be elected by the other two interested parties. Each party will only have the opportunity to give one vote, even if two people were elected to serve on the panel.

- Each member should be asked to serve on the panel for a specified term. All members of the standing panel shall be willing to render their services without compensation.

C. Hearing Schedule

The hearing shall be scheduled 15 calendar days after the receipt of the tenant's request for a hearing if there is a standing hearing panel. If a hearing officer or panel must be selected, a hearing will be scheduled within 15 calendar days after the selection or appointment of a hearing officer or hearing panel. It is the responsibility of the two parties to agree upon a place and time that is mutually convenient to hold the hearing. If the two parties cannot agree on a place and time, the hearing officer or hearing panel will select a time and place.

D. Examination of Records

At a reasonable time before the hearing, the borrower or management agent must allow the tenant the opportunity to examine all files that are going to be used during the hearing. Documents can be examined and copied at the tenant's expense if:

- The document, record, or policy is one that will be used during the hearing process; and
- The document, record, or policy is not subject to any laws or confidentiality agreements that prohibit reproductions.

Documents That May Not Be Copied

1. Credit reports
2. Project budgets
3. Supervisory findings

E. Escrow Deposits

Tenants may establish escrow accounts whenever a grievance involves a rent increase not authorized by the Agency or a failure to maintain the property in a decent and sanitary manner provided the tenant's rental payments are otherwise current. The tenant must make timely rent payments to the account, but the borrower or management agent will not receive the payment until the grievance has been settled. When an escrow account is employed, tenants must adhere to the following list of rules:

- All rent payments must be made to the escrow account on time and continue until the grievance is resolved. Failure to do so will terminate the entire process, and all sums will be due immediately.
- The escrow account must be established in a Federally-insured institution or with a bonded independent agent.
- All receipts of deposit must be made available for examination by the borrower/agent.

REQUIREMENTS GOVERNING THE HEARING

The hearing is an informal proceeding at which evidence is presented to a hearing officer or hearing panel. The hearing must be designed to ensure that the rights of all parties involved are protected and must permit:

- Both parties to be represented by counsel or another person(s) chosen as their representative;
- The right of the tenant or prospective tenant to request a private hearing;

- The right of the tenant or prospective tenant to present oral and written evidence and arguments in support of their grievance or appeal and to refute the evidence of all witnesses on whose testimony or information the borrower or management agent relies; and

- The right of the borrower or management agent to present oral and written evidence and arguments in support of the decision, to refute evidence relied upon by the tenant or prospective tenant, and to question and cross-examine all witnesses in whose testimony or information the tenant or prospective tenant relies.

During the hearing, each party may present evidence to support their position. Evidence may be presented without regard to whether that evidence could be used in judicial proceedings. All participants of the hearing are to conduct themselves in an orderly manner. Participants that can not conduct themselves in an orderly manner will be excluded from the proceedings and may, as a result, receive an unfavorable decision.

If the tenant or prospective tenant fails to appear at a scheduled hearing, the hearing officer or hearing panel may choose to postpone the hearing for no more than five days or determine that the party has waived his or her right to a hearing. If the determination is made that the absent party has waived their rights, the hearing officer or hearing panel will make a decision on the grievance. All parties involved in the hearing shall be informed in writing of the hearing panel's decision.

THE HEARING DECISION

The hearing officer or hearing panel has the authority to uphold or reverse a borrower or management agent's decision. Hearing decisions must be issued in accordance with the following decisions.

- The hearing officer or hearing panel must prepare a written decision within 10 calendar days after the hearing.

- The written notice must include the reasons for the decision and can only be based upon the facts presented at the hearing.

- The hearing officer or hearing panel must send a copy of the decision to the tenant or prospective tenant, borrower, and the State Office.

- The notice must state that the decision is not effective for 10 calendar days to allow time for the State Office's review.

- The decision of the hearing officer or hearing panel will be binding upon the parties to the hearing unless the parties to the hearing are notified within 10 calendar days by the State Office that the decision is not in compliance with Agency regulations.

- Upon receipt of written notification from the hearing officer or hearing panel, the borrower or management agent and tenant must take the necessary action, or refrain from any actions, specified in the decision.

CHAPTER 9: INSURANCE REQUIREMENTS

9.1 INTRODUCTION

KEY TOPICS IN THIS CHAPTER

- Types of Insurance
- Acceptable Coverage
- Authorized Providers

Insurance protects the GRRHP loan against loss or damage. Lenders must review the borrower's insurance policies to confirm that the coverage is adequate to protect against financial loss due to property damage, employee dishonesty or error, and personal injuries that occur on the property. Lenders intending to sell GRRHP loans in the secondary market must require insurance coverage consistent with the standards of Fannie Mae, Freddie Mac, or Ginnie Mae.

Lenders must continue to monitor the insurance policies over the term of the loan so that each GRRHP property is continuously insured with acceptable property and liability insurance policies. The named insured must be the borrower. Insurance policies must also include the lender in a loss payee/mortgagee clause.

The following section identifies the types of insurance and the specific provisions that must be included in the policy.

SECTION 1: OVERVIEW OF INSURANCE REQUIREMENTS

9.2 OVERVIEW

Described throughout this chapter are the different types of Agency insurance requirements for the GRRHP program. At a minimum, lenders must establish insurance standards for GRRHP loans that meet or exceed the insurance requirements of Fannie Mae, Freddie Mac, or Ginnie Mae. Failure to ensure that proper insurance is maintained on the property may result in denial of the guarantee payment by the Agency.

SECTION 2: TYPES OF INSURANCE

9.3 PROPERTY INSURANCE

Property insurance protects the physical asset against loss due to damage. Property insurance includes:

- **Hazard Insurance** to protect the property against fire and weather-related damage, as well as damage from civil commotion, aircraft, or other vehicles. The policy must be endorsed to include all the extended coverage perils. An "all risks" policy is recommended.

- **Flood Insurance** to protect the property against losses caused by flooding due to natural disasters such as hurricanes. Flood insurance through NFIP is required for all properties located in a Special Flood Hazard Area ("SFHA") as identified by FEMA. For every GRRHP loan, the lender must complete *FEMA Form 81-93, Standard Flood Hazard Determination*, and must determine whether any of the improvements on a property are or will be located in a SFHA. See Chapter 11, Paragraph 11.7 A. for additional requirements.

- **Builder's Risk Insurance** to protect the property against loss or damage during construction or reconstruction after an insured loss. Builder's risk insurance is required during all periods of construction, reconstruction and rehabilitation.

- **Boiler and Machinery Coverage** may be required for any property that operates steam boilers, turbines, engines, or other pressure vessels to cover the cost of boiler replacement and other machinery in the event of an accident.

- **Sinkhole or Earthquake Insurance** is required in areas where there is a risk of damage from this form of natural disaster.

- **Business Income Insurance** is required to cover the loss of income to a property resulting from an event that makes one or more units temporarily uninhabitable.

9.4 FIDELITY INSURANCE

Fidelity insurance protects the property against loss due to employee dishonesty. The policy must provide coverage on all persons with control over or access to project income or other assets. Fidelity coverage may also be known as Blanket Crime Coverage or Fidelity Bonding. Property managers must provide the lender with evidence of fidelity insurance.

9.5 MORTGAGEE'S ERRORS AND OMISSIONS (E&O) INSURANCE

E&O coverage protects the borrower against loss resulting from negligence, errors, or omissions committed by those persons covered under the borrower's fidelity

insurance policy. Obtaining E&O insurance does not diminish or limit the borrower's documentary obligations and responsibilities.

9.6 LIABILITY INSURANCE

This coverage insures against any personal injury that might occur in or on the property's common areas, common elements, commercial space, and public areas.

9.7 WORKER'S COMPENSATION

This insurance coverage, also known as employer's liability coverage, provides for replacement of lost wages to workers that suffer job injuries. This coverage is not required by the Agency but may be required by State or local law.

9.8 EVIDENCE OF INSURANCE, TERMS, AND COVERAGE

The lender must obtain the original policy or the declaration page and evidence that the first full year's premium has been paid for all required insurance coverage. Either originals or certified copies of current insurance policies and receipts for subsequent annual premiums must be kept on file by the lender. The term of the insurance policy may not be less than one year. All policies must be on an occurrence basis. The lender must determine an acceptable level of coverage based on the needs of the property.

SECTION 3: AUTHORIZED INSURANCE PROVIDERS

9.9 OVERVIEW

Borrowers are responsible for selecting an insurance provider that is reputable and financially sound. The lender must review all relevant available information about insurers including financial statements, insurance rating reports from Best's Insurance Reports or another suitable rating firm, and information from State insurance authorities.

The borrower is required to disclose any identity of interest relationships with the insurer company or must certify to the lender that none exists.

9.10 ACCEPTABLE RATINGS FOR INSURANCE PROVIDERS

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

CHAPTER 10: CLAIMS

10.1 PURPOSE AND OVERVIEW

This chapter addresses the property liquidation and claim processes. When all reasonable efforts to resolve deficiencies in loan performance have failed, the lender must liquidate the loan and dispose of the property in order to submit a final loss claim. An overview of the GRRHP liquidation and claim payment process is shown in Exhibit 10-1.

KEY TOPICS IN THIS CHAPTER

- Pre-Liquidation Requirements
- Decision to Liquidate
- Property Liquidation
- Agency Election of Assignment or Conveyance
- Determination of the Claim Amount
- Payment of the Final Claim

EXHIBIT 10-1
THE LIQUIDATION PROCESS FOR GRRHP

The lender submits a liquidation plan and supporting documentation to the Agency within 30 calendar days of the decision to liquidate.

The Agency notifies the lender of its decision to approve or reject the plan within 20 calendar days of receipt of the plan. If the Agency fails to respond to the lender within 20 calendar days, the liquidation plan will be considered approved by default, and the 90-day period for interest accrual will commence.

If the liquidation is expected to exceed 90 calendar days, the lender must submit with the liquidation plan *Form RD 449-30*, *"Loan Note Guarantee Report of Loss"*, for an estimated loss payment.

Payment on the estimated loss claim is normally made within 30 calendar days after the Agency's approval of *Form RD 449-30*.

The lender acquires and disposes of the property in accordance with the liquidation plan.

The lender submits a final report of loss on *Form RD 449-30* to the Agency. The final loss claim is normally paid within 60 calendar days of receipt of the final report of loss.

SECTION 1: PRE-LIQUIDATION REQUIREMENTS

10.2 OVERVIEW

Before a decision to liquidate can be considered, the lender must make all reasonable attempts to resolve the deficiencies with the property. Chapter 7 provides a variety of Agency-recommended special servicing actions to help lenders restore a property's physical and financial health. Implementation of a workout plan can often delay or eliminate the need to liquidate the account. As a part of the notification to the Agency of a decision to liquidate, the lender must certify that they have made all reasonable attempts to resolve the issues using special servicing methods.

SECTION 2: DECISION TO LIQUIDATE

10.3 OVERVIEW

A decision to liquidate must be made by the lender when it determines that the default cannot be cured through special servicing, and it is in the best interest of the Agency and the lender to liquidate.

In the event of a default involving a loan to an Indian tribe or tribal corporation, which is secured by an interest in land within such tribe's reservation (as determined by the Secretary of the Interior), including a community in Alaska incorporated by the Secretary of the Interior pursuant to the Indian Reorganization Act (25 U.S.C. 461 et seq.), the lender shall only pursue liquidation after offering to transfer the account to an eligible tribal member, the tribe, or the Indian housing authority serving the tribe. If the lender subsequently proceeds to liquidate the account, the lender shall not sell, transfer, or otherwise dispose of or alienate the property except to one of the entities described in the preceding sentence.

Liquidation should be considered when any of the following circumstances exist:

- A loan has been delinquent for 90 calendar days, and the lender and borrower have not been able to agree on the terms to cure the delinquency;
- The borrower has failed to comply with the approved workout plan; or
- Delaying liquidation will impair the recovery value of the collateral or jeopardize full recovery on the loan.

If not already paid off under the guarantee, the holder may initiate by written demand to the lender and/or the Agency requesting commencement of foreclosure or repurchase of the unpaid guaranteed portion of the loan when the borrower is not less than 60 days in default or the

lender has failed to remit to the holder its pro rata share of any payment made by the borrower within 30 days of the lender's receipt thereof [*§3565.405(a) and (b)]*. During the liquidation process, the lender must follow the procedures for repurchasing the loan from the holder regardless of when the holder formally requests that it be reimbursed under the guarantee [*§3565.405(a) and (b)*].

Once a decision is made to liquidate a loan, the lender must meet the following deadlines in order to be eligible for payment under the guarantee:

- Notify the borrower and the Agency within 7 calendar days from the date of the decision to liquidate (see Paragraph 10.4);
- Submit a liquidation action plan for Agency approval within 30 calendar days of the notice to the Agency (see Paragraph 10.5); and
- Submit *Form RD 449-30* for an estimated loss payment if the liquidation is expected to exceed 90 calendar days (see Paragraph 10.7).

When the lender decides to liquidate, they must report to the Agency on a monthly basis using *Form RD 1980-41* until the account is satisfied or the guarantee is terminated.

At the same time the lender has decided to pursue liquidation, the lender must notify the holder of the intent to liquidate, unless the holder has already been paid under the guarantee.

10.4 NOTICE OF LIQUIDATION AND POTENTIAL CLAIM

Once the lender has made a decision to liquidate the account, they must notify the Agency and the borrower within 7 calendar days of the decision. This notification will inform the borrower that liquidation proceedings will commence and alert the Agency to expect a submission of the liquidation plan. The holder may request of the lender that it (the holder) be paid off prior to liquidation. If, under the guarantee, the lender does not repurchase the loan from the holder, the Agency will repurchase the loan from the holder in accordance with [*§3565.405 (b)]*.

10.5 SUBMISSION OF A LIQUIDATION PLAN

Within 30 calendar days after notifying the Agency of the decision to liquidate, the lender must submit to the Agency, in writing, the proposed liquidation plan. Upon approval by the Agency, the lender will commence liquidation. If, within 20 calendar days of the Agency's receipt of the liquidation plan, the Agency fails to respond to the lender's proposal, the liquidation plan will be approved by default.

A liquidation plan must include, but is not limited to the following:

- Documentation to establish the lender's and/or holder's ownership of the guaranteed loan, promissory note, and related security instruments and a copy of the payment ledger or equivalent which reflects the current loan balance, accrued interest to date, and the method of computing the interest.
- A full and complete list of all collateral, including any personal and corporate guarantees.
- The recommended liquidation methods for making the maximum collection possible on the indebtedness and the justification for such methods, including recommended actions for:
    - ◊ Acquiring and disposing of all collateral; and
    - ◊ Collecting from guarantors.
- An appraisal of the collateral and the due diligence report. In order to formulate a liquidation plan that maximizes recovery, collateral must be evaluated in accordance with the requirements contained in Chapter 11 for the release of hazardous substances, petroleum products, or other environmental hazards that may adversely impact the market value of the collateral. The appraiser must consider this information in developing an appraised value.
- The proposed date of foreclosure.
- The proposed date of liquidation.
- Steps to be taken to preserve the collateral and protect the tenants.
- Copies of the borrower's latest available financial statements.
- Copies of the personal or corporate guarantor's latest available financial statements.
- An itemized list of estimated liquidation expenses expected to be incurred along with justification for each expense.
- A schedule to periodically report to the Agency on the progress of liquidation.
- An estimate and justification of protective advances.
- Proposed protective bid amounts on collateral to be sold at auction and a breakdown to show how the amounts were determined.
- A determination of whether a deed-in-lieu of foreclosure will be considered.

- If a voluntary conveyance is considered, the proposed amount to be credited to the guaranteed debt.
- Any relevant legal opinions, including, for example, opinions on environmental issues, title searches, and bankruptcy.

10.6 APPROVAL OF LIQUIDATION PLAN

The Agency will accept or reject the lender's liquidation plan within 20 calendar days after receipt of the plan or request that the lender make revisions to the plan. If the Agency fails to meet this deadline, the plan will be approved by default. When the State Office receives the lender's liquidation plan, the State Office immediately must notify the Director of the Multi-Family Housing Guarantee Loan Division.

The State Office will review and assess the lender's liquidation plan. The State Office will recommend acceptance or rejection of a liquidation plan and send it to the National Office for concurrence in a timely manner. The Director of the Multi-Family Housing Guarantee Loan Division will review the State Office recommendation and the liquidation plan. The National Office must concur with the State Office recommendation on all lender submitted liquidation plans.

When a liquidation plan is approved by the Agency, the lender must proceed expeditiously with liquidation, in accordance with the terms of the plan. Agency approval of the lender's liquidation plan is normally classified as a categorical exclusion under the Agency's environmental review process, unless the proposed method of liquidation will result in an alteration of the purpose, operation, location, or design of the project as originally approved. The liquidation plan may be modified when conditions warrant. All modifications must be approved, in writing, by the Agency prior to implementation.

10.7 FILING AN ESTIMATED LOSS CLAIM

Upon approval of the liquidation plan, all interest credit payments, if applicable, from the Agency will cease. If the liquidation plan is expected to exceed 90 calendar days the lender will submit an estimated loss payment with the liquidation plan. Any estimated loss payment must be applied to the outstanding principal and interest of the guaranteed debt. Estimates must be prepared and submitted by the lender on *Form RD 449-30* using the basic loss formula as provided on the report. The estimated loss claim will be promptly processed. Payment of the estimated loss amount will normally be made to the lender within 30 calendar days after the loss estimate has been approved by the Agency.

10.8 WITHDRAWAL OF A CLAIM

At the request of the lender, if the borrower cures the default prior to the earliest payment of the estimated loss claim or foreclosure, the guarantee will continue as if the default had not occurred. The lender must notify the State Office, the Agency Finance Office and the holder that the default has been cured.

SECTION 3: PROPERTY LIQUIDATION

10.9 PROPERTY ACQUISITION

The first step in the liquidation process is to acquire the property. The liquidation plan must inform the Agency of the proposed method of acquisition, including:

- Judicial foreclosure;
- Non-judicial foreclosure; or
- Deed-in-lieu of foreclosure.

The lender must estimate the time frame when the acquisition should occur. In most cases, acquisition should be completed within 120 calendar days from approval of the liquidation plan. If the lender foresees a longer acquisition period, the reasons for the delay must be explained in the liquidation plan. Examples of appropriate reasons for a delay include:

- A State law declaration of bankruptcy by the borrower;
- Time to provide written notice to tenants or similar tenant protection measures;
- Constraints imposed by other liens or financing on the property; and
- Court backlog.

Unless otherwise approved by the Agency, the amount bid by the lender at foreclosure sale must equal the lesser of the sum of the outstanding principal and interest, liquidation expense, and approved protective advances or the appraised value of the property.

Once the collateral has been purchased by a third party through foreclosure, the borrower has conveyed title to the lender, or an estimated loss payment is made by the Agency to the lender, no further transfer of physical assets can be made. Once the lender has title to the property, interested purchasers of the real estate owned (REO) property may negotiate with the lender, at the lender's discretion.

10.10 LENDER LIQUIDATION

If a property is acquired by the lender through foreclosure or other method of conveyance, the lender must dispose of the property in accordance with the liquidation plan. If complications in the liquidation process lead to unforeseen delays, the lender must immediately notify the Agency of the reason for the delay and submit a revised date for expected liquidation. Failure to inform the Agency of the unforeseen circumstance could result in the denial of payments to the lender under the guarantee.

While the Agency expects the lender to dispose of the property in a manner that will yield the highest possible market value, marketing and liquidation actions must ensure that protections afforded to tenants in [*7 CFR part 3560, subpart D]* are provided.

10.11 FAILURE TO COMPLY WITH THE LIQUIDATION PLAN

The purpose of the liquidation plan is to ensure timely liquidation of property at the lowest cost to the Agency. If the lender fails to comply with the liquidation plan that has been approved by the Agency, it may result in the denial of benefits to the lender under the guarantee.

If the lender becomes aware of any situation that would change any part of the liquidation plan, it must immediately inform the Agency of the reasons for such change and submit an amendment to the liquidation plan for approval by the Agency.

SECTION 4: AGENCY ELECTION OF ASSIGNMENT OR CONVEYANCE

10.12 OVERVIEW

While liquidation by the lender will occur in almost every case, the Agency reserves the right to require the lender to assign the loan or convey the property to the government prior to liquidation if it determines that assignment or conveyance of title is in the best interest of the government. In these cases, the lender may submit a claim in accordance with the provisions of Section 5 of this chapter. If a holder remains in possession of a certificate of guarantee of the loan during this process, it must also be notified of such action by the lender.

Examples of reasons the Agency may require loan assignment or conveyance of title include:

- It would be less costly to the government for the Agency to dispose of the property;

- Tenant protection issues are of such a complicated nature that disposal or retention of the property by the Agency is necessary; and

- The lender has been grossly negligent in servicing the loan.

After a review of the proposed liquidation plan, the Agency will inform the lender if it will require an assignment or conveyance of title.

10.13 ASSIGNMENT OF THE LOAN

An assignment of the guaranteed loan to the Agency must be in written and recordable form and must be completed within 90 calendar days of the Agency notice to the lender. The assignment documents will be forwarded to the OGC's Regional Attorney for review. The assignment will be considered complete once the following transactions are completed to the Agency's satisfaction.

- Conveyance to the Agency of all rights and interests arising under the loan.

- Assignment to the Agency of all claims against the borrower or others arising out of the loan transaction, including:

  ◊ All collateral agreements affecting financing, construction, use, or operation of the property; and

  ◊ All claims under policies of title, or other insurance, surety bonds, or other guarantees.

- A due diligence report which evaluates the effect of potential contamination from hazardous wastes and from the release of hazardous substances and petroleum products on the security value of real property and an appraisal which takes the findings of the due diligence report into consideration.

If the Agency requires an assignment, the lender must stop any liquidation actions that are in process.

10.14 CONVEYANCE OF TITLE TO THE AGENCY

When the Agency requires a conveyance of title to the property, the lender must inform the Agency of the method and time frame for obtaining title to the property. The lender must obtain a deed in lieu of foreclosure from the borrower or implement the approved liquidation

plan. Once the foreclosure action is completed and the lender has obtained title to the property, the lender must transfer the title to the Agency. The Agency will accept the conveyance of title upon acceptance of the documents listed below and receipt of a satisfactory warranty deed.

- A release of all claims of the lender or other holder of the guarantee against the property.

- A due diligence report which evaluates the effect of potential contamination from hazardous wastes and from the release of hazardous substances and petroleum products on the security value of real property and an appraisal which takes the findings of the due diligence report into consideration.

- An assignment of the lender's rights to any operating funds and any reserves or escrow account established for such purposes as:

  ◊ The maintenance of the property, including any replacement reserve or capital improvement reserves; or

  ◊ The payment of property taxes and insurance.

Prior to acceptance of conveyance of property, the Agency will conduct an inspection to determine the physical condition, security, and need for rehabilitation and repair. This inspection will encompass site conditions, building exteriors, common elements, and interiors of all units.

SECTION 5: DETERMINATION OF THE CLAIM AMOUNT

10.15 INTRODUCTION

The determination of the claim amount actually begins during the development of the liquidation plan. Factors such as the date of the decision to liquidate, estimated liquidation value of the security property, estimated date of foreclosure and estimated date of liquidation will all affect the amount the Agency will be required to pay to the lender. The Agency will review the liquidation plan to be sure that the costs and time frames of acquisition and liquidation minimize losses to the government. Calculating the amount payable under the guarantee is a multi-step process detailed below.

If there is a loss claim due to contamination from a release of hazardous substances, hazardous wastes, or petroleum products, the Agency shall not finalize loss claims until the guaranteed lender has sold the property or the Agency has accepted assignment or conveyance of title to the property.

10.16 DETERMINATION OF THE DATE OF LOSS

A. Lender Liquidation

The date of loss is the date the loan is terminated due to foreclosure or other means of conveyance. This date will be the earliest of:

- The date on which the property is acquired; or
- The proposed date of acquisition in the liquidation plan or any approved modifications to the liquidation plan.

If the date of acquisition is later than the date approved by the Agency, the date of loss for the purpose of calculation of the claim will be the Agency's approved date.

B. Assignment or Conveyance of Title to the Agency

Where the Agency requires an assignment of the loan or conveyance of title, the date of loss will be the date on which the Agency accepts assignment of the loan or conveyance of title.

In submitting the liquidation plan to the Agency, the lender must specify the estimated date of assignment or conveyance of title. Unless the delay in assignment or conveyance is due to Agency action or inaction, the date of loss may be no later than the date approved in the liquidation plan or any amendment.

10.17 CALCULATION OF LOSS

In order to receive payment under the guarantee, the lender must calculate and submit for Agency approval *Form RD 449-30*. The information contained in the report will be used to estimate the loss to the Agency on an individual loan. The aggregate amounts reported by all lenders will be used to forecast the amount the Agency will need to disburse in claim payments in a fiscal year. When completing the report of loss, the lender should use the following as a guide.

A. Request for Estimated Loss Claim

Form RD 449-30 must be completed following the guidance in Paragraph 10.7. Unpaid principal and interest figures inserted in lines 11 and 12 must be calculated as of the date of submission of the form.

B. Final Report of Loss (when an estimated loss claim payment has not been made)

The unpaid principal and interest figure on *Form RD 449-30* must be calculated based on the date of loss as explained in Paragraph 10.16 A. For interest calculation purposes, the Agency will pay interest that accrues no more than 90 calendar days from the date the liquidation plan is approved by the Agency.

10.18 PROTECTIVE ADVANCES

The calculation of the loss amount may include any amounts approved by the Agency for protective advances not paid from the project's cash flow. In general, protective advances are funds necessary to protect the value of the asset and ensure the security, health, and safety of the tenants. The lender must obtain the Agency's written approval for any protective advance above $5,000. Such amounts may include:

- Property taxes;
- Water and sewer charges and other special assessments that are liens prior to the guaranteed loan; and
- Property insurance.

The lender may include an estimated amount of protective advances as part of the liquidation plan (see Paragraph 10.5). Once the plan is approved by the Agency, this amount must be included by the lender in the calculation for the report of final loss on Form *RD 449-30,* unless a different amount is approved by the Agency.

10.19 LIQUIDATION EXPENSES

The calculation of the loss amount will include any amounts approved by the Agency for liquidation expenses. In general, liquidation expenses are defined as those expenses necessary to market and dispose of the property. Such amounts may include:

- Loan guarantee fees paid after the borrower default;
- Reasonable third-party expenses to maintain and liquidate the property; and
- Independent appraiser's fees, including the cost of the due diligence report.

10.20 LEGAL EXPENSES DURING BANKRUPTCY PROCEEDINGS

The lender is responsible for protecting the guaranteed loan and all collateral securing the loan in bankruptcy proceedings. The State Office will immediately notify the National Office of all bankruptcy and pending bankruptcy proceedings and shall submit status reports to the National Office on a monthly basis.

When a bankruptcy proceeding results in the liquidation of the borrower entity legal expenses will be handled as directed by the court. All reasonable and customary legal expenses to protect the collateral may be shared based on the guaranteed percentage, usually a 90/10 split between the Agency and the lender. Chapter 11 of the Bankruptcy Code pertains to a reorganization of a business, where legal protection is afforded to the business. Expenses incurred by the lender in a Chapter 11 reorganization can never be liquidation expenses unless the proceeding becomes a Chapter 11 liquidation.

10.21 MAXIMUM GUARANTEE PAYMENT

The maximum guarantee payment will not exceed the product of 90 percent, or such lesser guarantee percentage as set forth in the Loan Note Guarantee Agreement, times the allowable loss amount, as determined in *Form RD 449-30*. The maximum guarantee payment must be approved by the Agency in accordance with Section 6 of this chapter.

SECTION 6: PAYMENT OF THE FINAL CLAIM

10.22 OVERVIEW

Within 60 calendar days of liquidation of the property, the lender must submit a report of final loss to the Agency using *Form RD 449-30*.

The lender must certify that all possibilities of collection have been exhausted as a condition for payment of the final claim. Upon payment, in whole or in part, the note or judgement evidencing the debt shall be assigned to the United States, and the lender shall have no further claim against the borrower or the United States.

10.23 SUBMISSION OF A REPORT OF FINAL LOSS

If the final loss is less than the estimated loss payment, the lender will reimburse the Agency for the overpayment, using *Form RD 1980-43, "Lender's Guaranteed Loan Payment to USDA"*.

In those instances where the lender has made authorized protective advances not included in the estimated loss payment, it may claim recovery for the guaranteed portion of approved amounts advanced, and interest resulting from such advances, not to exceed 90 calendar days from the Agency's approval of the liquidation plan. Such payment will be made by the Agency when the final report of loss is approved.

10.24 THE APPROVED CLAIM AMOUNT

If the State Office reviewing the lender's claim is satisfied with the lender's calculation of the final claim amount, then the State Office will forward the claim payment request to the USDA Finance Office for processing. The Finance Office will process the claim normally within 60 calendar days of receipt of the claim request from the State Office.

CHAPTER 11: ENVIRONMENTAL REQUIREMENTS

11.1 PURPOSE AND OVERVIEW

The purpose of this chapter is to describe the environmental requirements that must be met by the Agency and by the lender as a part of multifamily housing lending and loan servicing activities.

Key Topics in this Chapter

- Agency Reviews During Loan Origination
- Environmental Reviews During the Servicing Period
- Other Environmental Requirements

11.2 GENERAL ENVIRONMENTAL REQUIREMENTS

The Agency will complete an environmental review in accordance with National Environmental Policy Act (NEPA) of 1969 and RD Instruction 1940-G prior to taking any official action on an application for a loan guarantee.

NEPA requires that Agency actions be classified into three basic categories of action:

- Those that qualify as categorical exclusions;
- Those that require an Environmental Assessment (EA); and
- Those that require an Environmental Impact Statement (EIS).

Due to the wide range of activities funded by the Agency, RD Instruction 1940-G established two categories of actions for EAs:

- Class I Actions – actions which require an EA with limited detail and analysis; and
- Class II Actions – actions requiring a fully detailed EA.

The classification of actions provides the Agency with a starting point for beginning its environmental review. Most multifamily housing activities will be classified as Class I Actions, but some will be classified as Class II Actions. For a complete list of housing actions and their classifications, refer to RD Instruction 1940-G.

The Agency environmental review must examine the potential impacts of the proposed project on the environment and on a wide range of protected resources. Exhibit 11-1 provides a list of major resources that must be considered.

Exhibit 11-1

Major Protected Resources

Wetlands	Natural Landmarks
Floodplains	Important Farmland
Wilderness Areas	Prime Forestland
Wild and Scenic Rivers	Prime Rangeland
Historical and Archeological Sites	Coastal Zone Management Areas
Critical Habitat or Endangered or Threatened Species	Sole Source Aquifer Recharge Area
Coastal Barriers	
State Water Quality Standards	

The Agency environmental review will provide the necessary documentation to:

- Demonstrate compliance with the requirements for the protection of the human environment, including the development of practicable alternatives (which must always include the “no action” alternative) to either avoid or lessen adverse environmental impacts.

- Demonstrate why the potential impact on the human environment is not considered to be significant, and therefore, an EIS is not required. Environmental files must include appropriate, detailed, and accurate supporting documentation, maps, results of consultation, and evidence that required public notices were published and sent to the parties listed in §1940.331 of RD Instruction 1940-G.

- Demonstrate that all mitigation measures listed in the environmental review will be included in legally binding documents, such as the Letter of Conditions and Conditional Commitment for Guarantee.

- Show that mitigation measures were implemented during project completion. This evidence will be obtained and included in the environmental file.

11.3 ENVIRONMENTAL RISK MANAGEMENT

The Agency and the guaranteed lender will incorporate into their lending

practices an environmental risk management program. The purpose of this risk management program is two-fold:

- To minimize adverse impacts to the security interests of the Agency and the lender in real property caused by potential contamination from hazardous substances, hazardous wastes, and petroleum products; and

- To establish a process by which the Agency and the lender can minimize their liability under the laws regulating management of hazardous substances, hazardous wastes, and petroleum products.

A major component of this risk management program will be the performance of due diligence. Due diligence is the process of inquiring into the environmental condition of the real estate, in the context of a real estate transaction, to determine the presence of contamination from hazardous wastes and petroleum products and to determine what impact such contamination may have on the market value of the property.

Lenders are required to perform due diligence in conjunction with appropriate loan processing and servicing actions. The minimum standard the Agency will accept as evidence of due diligence is the most current version of the *ASTM Standard E 1527, Phase I Environmental Site Assessment Process*, published by the American Society for Testing and Materials (ASTM), completed by a qualified environmental professional. Guaranteed lenders may incorporate the ASTM standards into their processing and servicing procedures or use an equivalent process of due diligence approved by the State Environmental Coordinator in consultation with the Regional OGC. Lenders must provide the Agency with a copy of the due diligence report and maintain a copy in the loan file. Non-compliance with this section may jeopardize the Agency's payment of loss claims due to environmental contamination.

Due diligence will be performed for:

- All applications for existing multifamily housing units when:

  ◊ An appraiser reports to the Agency or to the guaranteed lender that potential contamination from hazardous substances, hazardous wastes, or petroleum products has been observed on the property or encountered through research or interviews with individuals knowledgeable about the property; or

  ◊ The Agency or the guaranteed lender becomes aware of possible contamination through some means other than the appraiser's report.

- All applications for new construction of multifamily housing units.

Additionally, if underground storage tanks are present at existing structures, the lender will ensure that the tanks comply with appropriate regulatory requirements or they will be removed.

11.4 RESPONSIBILITY FOR ENVIRONMENTAL REVIEWS

The Agency is responsible for completing the appropriate level of environmental review in accordance with RD Instruction 1940-G. This includes the assembly and analysis of relevant material, the development and analysis of practicable alternatives and mitigation measures, and the development of recommendations and decisions.

The Agency will require information from the lender and the lender's applicant to complete this environmental review. Lenders have a responsibility to become familiar with Federal environmental requirements so that they can advise applicants and reduce the probability of unacceptable applications being submitted to the Agency. Lenders are also expected to cooperate in the collection of any environmental data which the Agency determines is necessary and in the resolution of potential environmental problems.

The Agency approval official will use the environmental review documents and the recommendations of the State Environmental Coordinator to make the Agency's final decision regarding an environmental impact determination and compliance with environmental requirements, as well as flood insurance requirements. This decision will be documented on *Form RD 1940-22, "Environmental Checklist for Categorical Exclusions"*, for a categorical exclusion, a Finding of No Significant Impact (FONSI) for an EA, or a Record of Decision (ROD) for an EIS.

The State Environmental Coordinator is available to provide technical assistance and guidance to Agency staff, lenders, and borrowers. They are also available to assist in problem resolution on environmental issues. Environmental issues or problems should be referred promptly to the State Environmental Coordinator.

11.5 ENVIRONMENTAL REVIEWS DURING LOAN ORIGINATION

The Agency's environmental review of the property, as required under NEPA, will be initiated as early as possible, but no later than the selection of the proposal for further processing. This means the environmental review will normally be prepared simultaneously with the development of the application package. This review must be complete and a Categorical Exclusion or FONSI issued *prior* to the Agency's issuance of a conditional commitment.

A. The NOFA Submission Stage

One of the NOFA submission requirements is a description of any "known environmental issues that may affect the project." During this stage, the Agency will take note of environmental issues that are disclosed by the lender in assessing the preliminary feasibility of the property. It is important that all known information is disclosed at this stage. Information not disclosed, that was known to the lender or borrower, could be grounds for disqualification of funding at a later stage.

B. The Application Submission Stage

1. Submission Requirement

The lender must submit the following information (unless such information was previously submitted) as part of the loan application package (see Paragraph 4.8 B.):

- *Form RD 1940-20, "Request for Environmental Information"*. This form and accompanying written description must include information about the environmental conditions of the proposed site and the project's potential impact on the environment. This completed form should be submitted to the Agency as quickly as possible since it is used to assist the Agency in completing its environmental review.

- Phase I Environmental Site Assessment report as prescribed by ASTM (ASTM Standard E 1527) or an equivalent process of due diligence approved by the State Environmental Coordinator in consultation with the Regional OGC.

- Lender comments regarding relevant off-site conditions.

- Land survey.

- *FEMA Form 81-93*.

2. Agency Response

As early as possible in the planning and decision making process, the Agency will initiate the collection of environmental information and the appropriate level of environmental review in accordance with RD Instruction 1940-G.

The environmental review will be completed prior to loan approval, obligation of funds, or other commitment of Agency resources, including issuance of a conditional commitment for guarantee whichever occurs first; and prior to the Agency decision on any servicing action which is subject to Agency approval. A commitment of Agency resources may not be made subject to completion of the environmental review.

The environmental review is considered complete when the environmental documents have been properly executed, all applicable public notices have been published, the associated public comment periods have expired, and the Agency has taken any necessary actions to address the comments received.

11.6 ENVIRONMENTAL REVIEWS DURING THE SERVICING PERIOD

All lender servicing actions which require prior approval of the Agency are subject to the Agency's completion of a NEPA environmental review. Agency approval of a liquidation action plan will normally qualify as a categorical exclusion, provided the proposed disposition of the property will not alter the purpose, operation, location, or design of the project as originally approved. However, it is the lender's responsibility to ensure that due diligence is conducted in conjunction with the appraisal for all loan servicing actions which require a determination of security value or which could lead to acquisition of real property by the Agency or the guaranteed lender.

If, through environmental audits, due diligence, or some other means, a release or threatened release of hazardous substances, hazardous wastes, or petroleum products is discovered on a borrower's property, the Agency official, in consultation with the State Environmental Coordinator and the guaranteed lender, will promptly notify the borrower in writing that immediate corrective action must be taken, consistent with appropriate regulatory authority requirements. Simultaneously, the State Environmental Coordinator will notify the appropriate regulatory authority for any necessary enforcement action.

In the case of a defaulted loan where the Agency may consider taking title from the lender, the Agency will review the due diligence report and the appraisal, prior to accepting title. If contamination is present and the cost of mitigation exceeds the market value or the amount of the debt, the Agency may decide not to accept title from the lender. If there is a loss claim due to contamination, the Agency will not finalize the loss claim until the lender has sold the property. The Agency will also review the due diligence report and appraisal prior to its consent to the release of security property by the guaranteed lender and when there are bankruptcy proceedings.

11.7 OTHER ENVIRONMENTAL REQUIREMENTS

A. Flood Hazard Determination

Properties located in Special Flood Hazard Areas (SFHAs) designated by FEMA are not eligible for Federal financial assistance, including loan guarantees, unless flood insurance through NFIP is available. The lender must ensure that NFIP flood insurance is purchased prior to loan closing and issuance of the guarantee, in accordance with the National Flood Insurance Act, as amended, and RD Instruction 426.2.

The lender is responsible for ensuring the completion of *FEMA Form 81-93* and for submitting a copy to the Agency with the request for guarantee. The form provides specific information with regard to the proposal's location in a floodplain, the community's NFIP eligibility, its proximity to floodplains, and the availability of flood insurance. This information is necessary for a determination of site eligibility by the Agency. The environmental review conducted by the Agency will examine whether or not there is a reasonable alternative to a proposed purchase/construction in the floodplain.

Flood insurance must cover the lesser of the outstanding principle balance of the loan or the maximum amount of coverage allowed under FEMA's NFIP. Prior to loan closing, the lender is responsible for sending the applicant a copy of *Form RD 3550-6, "Notice of Special Flood Hazards, Flood Insurance Purchase Requirements, and Availability of Federal Disaster Relief Assistance"*. The applicant must sign and return the form at or before loan closing.

B. Clean Air Act and Water Pollution Control Act

Federal contracts that exceed $100,000 must meet all applicable standards, orders, or requirements issued under section 306 of the Clean Air Act, section 508 of the Clean Air Act, Executive Order 11738, and EPA regulations at 40 CFR part 15. The lender must ensure compliance with this requirement during construction of the property and throughout the servicing period.

CHAPTER 12: SECONDARY MARKET

KEY TOPICS IN THIS CHAPTER

- Transfer to the Secondary Market
- Holder Demand for Repurchase
- Lender Initiated Repurchase
- Repurchase of the Loan or Note by Agency

12.1 PURPOSE AND OVERVIEW

This chapter will describe how GRRHP loans are sold in the secondary market and how the guarantee comes into play in the event of a borrower default. The secondary market is a mechanism that allows lenders to sell GRRHP guaranteed loans and obtain liquidity to make additional loans. Through the secondary market, the lender receives the following benefits which may then be passed on to the borrower in the form of lower interest rates and longer fixed rate terms:

- Reduced interest rate risk by transferring the risk of interest rate increases to the secondary market.
- Increased liquidity by using funds received from a loan sale for additional lending or investing activity.
- Increased return on investment by selling the loan to the secondary market and keeping a servicing fee. A lender may increase their return on their invested capital by lowering their at risk capital.

SECTION 1: TRANSFER TO THE SECONDARY MARKET

12.2 HOLDER VERSUS PARTICIPANT

The Agency makes a clear distinction between a holder of the loan and a participant in the loan. In a non-Government Sponsored Enterprises (GSE) securitization, a holder is a person or organization other than the lender who holds all or part of the loan with no servicing responsibilities. The holder "holds" the note, and the guaranteed portion of the note is backed by the "Full Faith and Credit" of the U.S. Government in case of default. The Agency considers a GSE or the Ginnie Mae issuer as the “holder” of the note in a securitized transaction. A GSE or Ginnie Mae issuer may have servicing responsibilities. Unless otherwise noted, all holders must have a *Form RD 3565-5*, *“Assignment Guarantee Agreement”*, that has been executed by the Agency or a duly executed Agency approved assignment guarantee agreement.

A participant is a person or organization that buys an interest in the loan. A participant owns a share of the note while another entity keeps the note, the collateral securing the note, and all responsibility for loan servicing. A participant does not hold any part of the note but has a participation arrangement with the lender. A participant has no claim to the guarantee in case of default.

12.3 TRANSFER TO THE SECONDARY MARKET

A. Loan Requirements For Sale On The Secondary Market

The lender may sell, assign, or participate all or part of a performing loan to one or more lenders or investors at or after loan closing. Lenders are regularly contacted by and normally maintain a list of brokers or dealers interested in the purchase of GRRHP loans, or they may work directly with Fannie Mae or Freddie Mac or be a Ginnie Mae issuer.

Below is an example of an average transaction involving the steps a lender and a broker would take in the sale of a guaranteed loan on the secondary market:

- Contact several brokers. The brokers will need to know:
  - ◊ Under which of the three loan guarantee programs the loan is made: Option One, permanent guarantee; Option Two, construction advances and permanent financing guarantee; or Option Three, continuous guarantee.
  - ◊ The loan amount and the size of the guaranteed portion.
  - ◊ The interest rate.
  - ◊ The maturity date.
  - ◊ The payment schedule.
  - ◊ If it is a new loan, when it will be funded.
- Determine loan-servicing fee.
- Select a bid.
  - ◊ Hold negotiations concerning premiums and fees. The Agency may participate in such negotiations only as a provider of information.
- Review Documents. The broker or intermediary should send the lender a purchase commitment letter. The lender must notify the Agency that the loan is being sold and obtain the documents that the Agency will need to execute. In order to complete the sale, the lender should sign and return one copy of the commitment letter to the broker along with the following:
  - ◊ A copy of the note.
  - ◊ Executed *Form RD 3565-4.*

◊ Executed *Form RD 3565-5* (see Paragraph 12.3 B.) or an Agency approved assignment guarantee agreement.

- Close the transaction.
  - ◊ Upon receipt of the forms, the holder or broker prepares *Form RD 3565-5* or an Agency approved assignment guarantee agreement and sends it to the lender in triplicate. The lender signs all three forms and forwards them to the Agency for execution. The Agency signs the forms and forwards them to the lender or investment broker, and the settlement date is established.
  - ◊ The broker returns the original copy to the lender and another copy to the Agency.
  - ◊ On the settlement date, the broker wires the funds to the lender.

Once documents are received by the Agency, it will endeavor to return executed forms to the lender within 7 calendar days.

B. Agency Execution of *Form RD 3565-5*

The lender must provide the Agency with copies of all appropriate forms used in the sale or assignment. Once the lender accepts a specific buyer's offer, the lender must notify the Agency that the loan is being sold and submit *Form RD 3565-5* to the Agency for execution. The authorized Agency official shall execute *Form RD 3565-5* after reviewing it according to this paragraph. The form does not have to be signed by the holder before Agency approval of the assignment. After execution by the lender and the Agency, the holder will execute it and return a copy to the Agency for retention in the borrower's case file and to update the pertinent areas in its loan tracking system with the new holder/assignee information.

Before executing *Form RD 3565-5*, the authorized Agency official will review the documents to determine the following items.

- To whom is the loan being sold? A loan may not be sold to the borrower or someone who has a relationship to the borrower or is an owner or subsidiary of the lender itself.
- Is the loan delinquent? Delinquent loans may not be sold into the secondary market.

Upon the lender's sale or assignment of the loan, the lender will remain bound to all obligations indicated in the Loan Note Guarantee, the Lender's Agreement, the Agency program regulations, and future program regulations.

The lender will send the holder the borrower's executed note attached to the Guarantee, and the holder will succeed to all rights of the Loan Note Guarantee pertaining to the portion of the loan purchased.

C. Loans Involving Ginnie Mae, Freddie Mac, and Fannie Mae

For GRRHP loans that are securing Ginnie Mae guaranteed securities, the lender should follow Ginnie Mae procedures to close secondary market transactions. Lenders that do business with Freddie Mac and Fannie Mae will follow their respective procedures to close secondary market transactions involving GRRHP loans. The lenders must provide the Agency with proper documentation to evidence the secondary market transaction in the borrower's case file. The Agency will then update its loan tracking system accordingly.

Once GRRHP loans are formed into Ginnie Mae guaranteed securities, the lender does not need to execute a *Form RD 3565-5* for subsequent assignments. Loans and/or mortgage servicing backing Ginnie Mae guaranteed securities may only be assigned to a Ginnie Mae issuer, with prior Ginnie Mae approval.

For GRRHP loans that are backing Ginnie Mae guaranteed securities where there is a conflict between this chapter and Ginnie Mae requirements, the Ginnie Mae requirements shall prevail.

SECTION 2: REPURCHASE FROM A SECONDARY MARKET HOLDER

12.4 Holder Demand for Repurchase

The holder may make written demand on the lender to repurchase the unpaid portion of the loan when either:

- The borrower has not made a payment of principal and/or interest due on the loan for at least 60 days, or
- The lender has failed to give the holder its pro-rata share of any payment made by the borrower within 30 calendar days of receipt of a payment.

The holder must concurrently send a copy of the demand letter to the Agency.

When a lender is requested to repurchase a loan from the holder, the lender must consider the request according to the servicing actions that are necessary on the loan. In order to facilitate servicing and simplified accounting of loan transactions, lenders are encouraged to repurchase the loan upon the holder's request.

The lender will notify the holder and the Agency of its decision to repurchase within 10 business days from the date of the written demand letter by the holder. The lender may agree to repurchase the unpaid portion of the entire loan from the holder, even though the guarantee will not cover the unguaranteed portion of the loan. If the lender decides to repurchase, the lender has 30 calendar days from the date of the holder's written demand letter to do so. The guarantee will not cover the unguaranteed portion of the loan or the note interest to the holder on the guaranteed loan portion accruing after 90 calendar days from the date of the demand letter to the lender requesting the repurchase. The lender may deduct the lender's servicing fee from the repurchase amount.

The lender will accept an assignment without recourse from the holder upon repurchase. The lender is encouraged to repurchase the loan to facilitate the accounting of funds, resolve the problem, and prevent default, where and when reasonable. Upon repurchase, the lender shall notify the Agency by returning the original Assignment Agreement. The Agency will then update its loan tracking system accordingly.

12.5 Lender Initiated Repurchase

If due to loan default or imminent loan restructuring, the lender determines that its repurchase is necessary to adequately service the loan, the lender may repurchase the loan from the holder. Lender repurchase is not required if the holder will agree to the restructured terms of the note. If interest is capitalized, a new note is taken, the original note is amended, or the principal amount is modified, the lender must ensure that the assignment is amended to reflect the actual guaranteed portion held by the holder.

The lender will not repurchase from the holder for arbitrage purposes. The lender must document all attempts to repurchase the loan from the holder in the loan file.

12.6 Demand for Repurchase of Loans Contained in a Ginnie Mae Pool

Ginnie Mae or its approved issuer/lender may make a written demand to the Agency to repurchase the unpaid portion of the loan when the borrower has not made a payment of principal and/or interest due on the loan for at least 90 days.

12.7 Purchase of the Loan or Note by the Agency

A. Agency Purchase from the Holder

If the lender does not repurchase the loan as provided in Paragraph 12.4, the Agency will purchase from the holder the unpaid principal balance of the **guaranteed**

portion together with accrued interest to date of repurchase, less the lender's servicing fee, within 30 calendar days after written demand to the Agency from the holder. This demand notice is in addition to the copy of the written demand on the lender. The guarantee will not cover the note interest to the holder on the guaranteed loan accruing after 90 calendar days from the date of the original demand letter of the holder to the lender requesting the repurchase.

With its demand on the Agency, the holder will include:

- A copy of the written demand made upon the lender;
- Originals of the Loan Note Guarantee and note properly endorsed to the Agency or the original of an Agency approved assignment guarantee agreement;
- A copy of any written response to the demand provided by the lender to the holder; and
- An account number to which the Agency can forward the purchase amount via electronic funds transfer.

The Agency will notify the lender of its receipt of the holder's demand for payment. The lender must provide the Agency with the information necessary for the Agency to determine the appropriate amount due the holder within 10 business days from the date of the written demand letter to the lender from the holder requesting repurchase of the guaranteed portion. The lender will furnish a current statement certified by an appropriate authorized officer of the lender stating the unpaid principal and interest then owed by the borrower on the loan and the amount then owed to any holder. Any discrepancy between the amount claimed by the holder and the information submitted by the lender must be resolved between the lender and the holder before payment will be approved. The Agency will coordinate the resolution of the discrepancy. Such conflict will suspend the running of the 30 calendar day payment requirement.

The authorized Agency official shall review the borrower's loan file and:

- Verify the amounts owed to the lender and the holder, and
- Complete *Form RD 1980-37*, "*Purchase of a Guaranteed Loan Portion*", and return it to the Finance Office for processing.

At the time of purchase by the Agency, the holder will assign the original Agency approved assignment guarantee agreement to the Agency without recourse, including all rights, title, and interest in the loan. *Purchase by the Agency does not change, alter, or modify any of the lender's obligations to the Agency specified in the Lender's*

Agreement or the Loan Note Guarantee nor does the purchase waive any of the Agency's rights against the lender. The Agency succeeds to all rights of the holder under the Loan Note Guarantee including the right to set-off from any payments the Agency owes the lender any funds payable by the lender to the Agency.

B. Agency Purchase of Loans Contained in Ginnie Mae Pools

The Agency will purchase from Ginnie Mae or its approved issuer/lender the unpaid principal balance of the guaranteed portion together with accrued interest to date of repurchase, less the issuer/lender's servicing fee, within 30 calendar days after written demand to the Agency from Ginnie Mae or its approved issuer/lender. In addition to the unpaid guaranteed portion of the loan, the guarantee will only cover interest accrued up to 90 calendar days from the date that the Agency received the demand notice from Ginnie Mae or its approved issuer/lender.

With its demand on the Agency, Ginnie Mae or its approved issuer/lender will include:

- Originals of the Loan Note Guarantee and note properly endorsed to the Agency;
- An account number to which the Agency can forward the purchase amount via electronic funds transfer; and
- A current statement certified by an appropriate authorized officer of the lender stating the unpaid principal and interest then owed on the loan.

The Agency will notify Ginnie Mae or its approved issuer/lender of its receipt of the demand notice.

The authorized Agency official shall review the borrower's loan file and

- Verify the amounts owed to the lender, and
- Complete *Form RD 1980-37* and return it to the Finance Office for processing.

At the time of purchase by the Agency, Ginnie Mae or its approved issuer/lender will assign any and all interest in the loan to the Agency. *Purchase by the Agency does not change, alter, or modify any of the issuer/lender's obligations to the Agency specified in the Lender's Agreement or the Loan Note Guarantee nor does the purchase waive any of the Agency's right against the issuer/lender.* The Agency succeeds to all rights of the issuer/lender under the Loan Note Guarantee including the right to set-off any payments the Agency owes the issuer/lender.

12.8 Servicing Fees

The Agency Loan Note Guarantee will not cover servicing fees on the unguaranteed portion of the loan.

GLOSSARY

Administrator. The Administrator of the Rural Housing Service, or his or her designee.

Agency. The Rural Housing Service.

Allowable claim amount. The total losses incurred by the holder of guarantee, as calculated pursuant to Subpart J of Part 3565.

Applicable Federal Rate (AFR). The interest rate set by the federal government for federal financing programs pursuant to Section 42 of the Internal Revenue Code.

Approved lender. An eligible lender who has been authorized by the Agency to originate guaranteed multifamily loans under the program.

Assignment. The delivery by a lender to the Agency of the note and any other security instrument securing the guaranteed loan; and any and all liens, interest, or claims the lender may have against the borrower that is party to the note.

Assistance. Financial assistance in the form of a loan guarantee or interest credit received from the Agency.

Borrower. The entity created for purposes of owning and operating a project.

Claim. The presentation to the Agency of a demand for payment for losses incurred on a loan guaranteed under the program.

Combination construction and permanent loan. A guaranteed loan that becomes effective at the time construction of an eligible multifamily property begins.

Conditional commitment. The written commitment by the Agency to guarantee a loan subject to the stated terms and conditions.

Correspondent relationship. A contractual relationship between an approved lender and a non-approved lender or mortgage broker in which the correspondent performs certain origination, underwriting or servicing functions for the approved lender.

Default. Failure by a borrower to meet any obligation or term of a loan, grant, or regulatory agreement.
Delinquency. Failure to make a timely payment under the terms of the promissory note or regulatory agreement.

Eligible borrower. A borrower who has met the requirements of Subpart D of Part 3565.

Eligible lender. A lender who has met the requirements of Subpart C of Part 3565.

Eligible loan. A loan that meets the requirements of Subpart E of Part 3565.

Fannie Mae. A government sponsored enterprise created by Congress to purchase, sell or otherwise facilitate the purchase or sale of mortgage in the secondary mortgage market. These activities support the availability and affordability of mortgage credit.

Federal Home Loan Bank System. A system of savings and loans, banks and other lenders whose primary business is the making of housing loans.

Final claim payment. The amount due to the lender (or the Agency) after disposition of the security collateral is complete and the proceeds from such sale as well as the initial claim payment, if any, are applied against the allowable claim amount.

Foreclosure. The process by which the ownership interest of a borrower in a mortgaged property is extinguished. This process may involve a sale of the property at public auction, with the proceeds of the sale being applied to the mortgage debt.

Freddie Mac. A government sponsored enterprise created by Congress to purchase, sell or otherwise facilitate the purchase or sale of mortgage in the secondary mortgage market. These activities support the availability and affordability of mortgage credit.

Ginnie Mae. Ginnie Mae is a reference to the Government National Mortgage Association.

Government National Mortgage Association. The Government National Mortgage Association (Ginnie Mae) is a government corporation within the Department of Housing and Urban Development. Ginnie Mae guarantees privately issued securities backed by mortgages or loans which are insured or guaranteed by the Federal Housing Administration (FHA), the Department of Veteran Affairs (VA), or the Rural Housing Service (RHS) and certain other loans or mortgages guaranteed or insured by the government.

Guarantee agreement. The written agreement between the Agency and the lender setting forth the terms and conditions of the guarantee with respect to an individual loan.

Guarantee fees. The fees paid by the lender to the Agency for the loan guarantee. An initial guarantee fee is due at the time the guarantee is issued. An annual guarantee fee is due at the beginning of each year that the guarantee remains in effect.

Guaranteed loan. Any loan for which the Agency provides a loan guarantee.

Holder. A person or entity, other than the lender, who owns all or part of the guaranteed portion of the loan with no servicing responsibilities. When the single note option is used and the lender assigns a part or all of the guaranteed note to an assignee, the assignee becomes a holder only when the Agency receives notice and the transaction is completed through use of an assignment guarantee agreement form approved by the Agency.

Housing finance agency. A state or local government instrumentality duly authorized to issue housing bonds or otherwise provide financing for housing.

Identity of interest. With respect to a project, a financial interest of any type, or appearance of same, that exists or will exist between the borrower, management agent, suppliers of materials or services, or vendors, in any combination of relationships.

Income eligibility. A determination that the income of a tenant at initial occupancy does not exceed 115 percent of the area median income as such area median income is defined by the Department of Housing and Urban Development (HUD) or its successor.

Indian tribe. Any Indian tribe, band, nation, or other organized group or community of Indians, including any Alaska Native village or regional or village corporation, as defined by or established pursuant to the Alaska Native Claims Settlement Act (43 U.S.C. 1601 et seq.), that is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians pursuant to the Indian Self-Determination and Education Assistance Act of 1975 (25 U.S.C. 450 et seq.); or any entity established by the governing body of an Indian tribe, as described in this definition, for the purpose of financing economic development.

Interest credit. A subsidy available to eligible borrowers that reduces the effective interest rate of the loan to the Long Term Monthly AFR.

Land lease. A written agreement between a landowner and a borrower stipulating the terms for possession and use of land for a specified period of time.

Lease. A contract setting forth the rights and obligations of a tenant or cooperative member and a borrower, including the amount of the monthly occupancy charge and other terms under which the tenant will occupy the housing.

Lender. A bank or other financial institution that originates and/or services the guaranteed loan.

Lender Agreement. The written agreement between the Agency and the lender setting forth the requirements the lender must meet on a continuing basis to participate in the program.

Loan. A mechanism by which a lender funds the acquisition and development of a multifamily project. A loan in this context is secured by a mortgage executed by the lender and borrower.

Loan guarantee. An Agency pledge to pay part of the loss incurred by a lender or holder in the event of default by the borrower.

Loan participation. A loan made by more than one lender wherein each lender funds a portion of the loan.

Loan-to-value ratio. The amount of the loan divided by the appraised value of the development.

Maximum guarantee payment. The maximum payment by the Agency under the guarantee agreement computed by applying the guarantee percentage times the allowable claim amount. (See Chapter 10 for further detail.)

Mortgage. A written instrument evidencing or creating a lien against real property for the purpose of providing collateral to secure the repayment of a loan. For program purposes, this may include a deed of trust or any similar document.

Multifamily project. A project designed with five or more living units.

Negligent Servicing or Origination. Negligent servicing or origination is a failure to perform those services, which a reasonably prudent lender would perform in servicing or originating its own portfolio, and includes not only the failure to act, but also the failure to act in a timely manner.

NOFA. A “Notice of Funding Availability” published in the Federal Register to inform interested parties of the availability of assistance and other non-regulatory matters pertinent to the program.

Non-monetary default. A default that does not involve the payment of money.

Note. Any note, bond, assumption agreement, or other evidence of indebtedness pertaining to a guaranteed loan.

Office of the General Counsel (OGC). The Office of the General Counsel of the USDA.

Office of the Inspector General (OIG). The Office of Inspector General of the USDA.

Payment effective date. For the month payment is due, the day of the month on which payment will be effectively applied to the account by the lender, regardless of the date payment is received.

Permanent loan. A permanent loan is defined as a mortgage loan usually covering development costs, interim loans, construction loans, financing expenses, marketing, administrative, legal, and other Agency approved costs. This loan differs from the construction loan in that financing goes into place after the project is completely constructed and open for occupancy. It is a long-term obligation, generally for a period of no less than 25 years and no more than 40 years.

Prepayment. The payment of the outstanding balance on a loan prior to the note's original maturity date.

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

Project. The total number of rental housing units and related facilities subject to a guaranteed loan that are operated under one management plan with Regulatory agreement.

Recourse. The lender's right to seek satisfaction from the borrower's personal financial resources for any monetary default.

Regulatory agreement. The agreement that establishes the relationship between the Agency, the lender, and the borrower; and sets forth the borrower's responsibilities with respect to all aspects of the management and operation of the project.

Rural area. A geographic area as defined in title 5 of section 538 of the Housing Act of 1949.

Rural Development. A mission area within USDA which includes RHS, Rural Utilities Service (RUS), and Rural Business-Cooperative Service (RBS).

Rural Housing Service. The Rural Housing Service within the Rural Development mission area of the U.S. Department of Agriculture or its successor agency, which administers Section 538 loans.

Servicing. The broad scope of activities undertaken to manage the performance of a loan throughout its term and to assure compliance with the program requirements.

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

Single asset ownership. A limitation on the real estate assets that may be owned by a borrower.

Surplus cash. The borrower's remaining funds at the property's fiscal year end, after making all required payments.

Tenant. The individual or individuals that hold the right to occupy a unit in accordance with the terms of a lease executed with the project owner.

U.S. citizen. An individual who resides as a citizen in any of the 50 States, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin islands, Guam, American Samoa, the Commonwealth of the Northern Marianas, the Federated States of Micronesia, the Republic of Palau, or the Republic of the Marshall Islands.

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

TABLE OF CONTENTS

Sec.

Subpart A--General Provisions

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

Subpart B--Guarantee Requirements

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

7 CFR Part 3565
Table of Contents

Sec.

Subpart C--Lender Requirements

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

Subpart D--Borrower Eligibility Requirements

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

Subpart E--Loan Requirements

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

Sec.

Subpart E--Loan Requirements

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

Subpart F--Property Requirements

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

Subpart G--Processing Requirements

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

7 CFR Part 3565
Table of Contents

Sec.

Subpart H--Project Management

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

Subpart I--Servicing Requirements

3565.401 Servicing objectives.
3565.402 Servicing responsibilities.
3565.403 Special servicing.
3565.404 Transfer of loans or mortgage servicing.
3565.405 Repurchase of guaranteed loans.
3565-406-3565-449 [Reserved]
3565.450 OMB control number.

Subpart J--Assignment, Conveyance, and Claims

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

Subpart K—Agency Guaranteed Loans that Back Ginnie Mae Guaranteed Securities

3565.501 Applicability.
3565.502 Incontestability.
3565.503 Repurchase.
3565.504 Transfers.
3565.505 Liability.
3565.506-3565.549 [Reserved]
3565.550 OMB control number.

7 CFR PART 3565--Guaranteed Rural Rental Housing Program

Subpart A--General Provisions

Sec. 3565.1 Purpose.

The purpose of the Guaranteed Rural Rental Housing Program (GRRHP) is to increase the supply of affordable rural rental housing, through the use of loan guarantees that encourage partnerships between the Rural Housing Service, private lenders and public agencies.

Sec. 3565.2 Applicability and authority.

The regulation prescribes the policies, authorizations, and procedures for the guarantee of multifamily loans under section 538 of the Housing Act of 1949.

Sec. 3565.3 Definitions.

Administrator. The Administrator of the Rural Housing Service, or his or her designee.

Agency. The Rural Housing Service, or a successor agency.

Allowable claim amount. The total losses incurred by the lender, as calculated pursuant to subpart J of this part.

Applicable Federal Rate (AFR). The interest rate set by the federal government for federal financing programs pursuant to section 42 of the Internal Revenue Code.

Approved lender. An eligible lender who has been authorized by the Agency to originate and service guaranteed multifamily loans under the program.

Assignment. The delivery by a lender to the Agency of the note and any other security instruments securing the guaranteed loan; and any and all liens, interest, or claims the lender may have against the borrower.

Assistance. Financial assistance in the form of a loan guarantee or interest credit received from the Agency.

Borrower. The individuals or entities responsible for repaying the loans.

Claim. The presentation to the Agency of a demand for payment for losses incurred on a loan guaranteed under the program.

Conditional commitment. The written commitment by the Agency to guarantee a loan subject to the stated terms and conditions.

Construction and permanent loan. A loan which provides advances during the construction period and remains in place as a permanent loan at the completion of construction.

Construction contingency reserve. A cash reserve of at least two percent of the construction contract, inclusive of the contractor’s fee and all hard and soft costs that must be set up and fully funded by the closing of the construction loan. This reserve will be held by the lender, and funds will only be disbursed for change order requests approved by the Agency and the lender. Unused funds from the construction contingency reserve will be held in the operating and maintenance reserve and cannot be released to the borrower until the project reaches an

occupancy of 90% for 90 consecutive days. In addition the reserve accounts established in the conditional commitment must be fully funded prior to the release of the construction contingency reserve. These requirements remain in effect regardless of whether the lender has established a lease-up reserve in lieu of the occupancy requirement.

Correspondent relationship. A contractual relationship between an approved lender and a non-approved lender or mortgage broker in which the correspondent performs certain origination, underwriting or servicing functions for the approved lender.

Default. Failure by a borrower to meet any obligation or term of a loan, grant, or regulatory agreement, or any program requirement.

Delinquency. Failure to make a timely payment under the terms of the promissory note or regulatory agreement.

Department of Housing and Urban Development (HUD). A federal agency which may be a partner in some of the Agency guarantees.

Due diligence. The process of evaluating real estate in the context of a real estate transaction for the presence of contamination from release of hazardous substances, petroleum products, or other environmental hazards and determining what effect, if any, the contamination has on the regulatory status or security value of the property.

Eligible borrower. A borrower who meets the requirements of subpart D of this part.

Eligible lender. A lender who meets the requirements of subpart C of this part or any successor regulation.

Eligible loan. A loan that meets the requirements of subpart E of this part or any successor regulation.

Eligible rural area. An eligible rural area is an area which meets the requirements of part 3550 of this chapter or any successor regulation.

Fannie Mae. A Federally chartered--publicly owned enterprise created by Congress to purchase, sell or otherwise facilitate the purchase or sale of mortgages in the secondary mortgage market.

Federal Home Loan Bank System. A system of member savings and loans, banks and other lenders whose primary business is the making of housing loans.

Final claim payment. The amount due to the lender (or the Agency) after disposition of the collateral is complete and the proceeds from liquidation, as well as any other claim payments, are applied against the allowable claim amount.

Foreclosure. The process by which the ownership interest of a borrower in a mortgaged property is extinguished and the security is liquidated with the proceeds applied to the loan.

Freddie Mac. A Federally chartered, publicly owned enterprise created to purchase, sell or otherwise facilitate the purchase or sale of mortgages in the secondary mortgage market.

Ginnie Mae. Ginnie Mae is a reference to the Government National Mortgage Association.

Government National Mortgage Association. The Government National Mortgage Association (Ginnie Mae) is a government corporation within the Department of Housing and Urban Development. Ginnie Mae guarantees privately issued securities backed by mortgages or loans which are insured or guaranteed by the Federal Housing Administration (FHA), the Department of Veteran Affairs (VA), or the Rural Housing Service (RHS) and certain other loans or mortgages guaranteed or insured by the Government.

GRRHP. Guaranteed Rural Rental Housing Program.

Guarantee fees. The fees paid by the lender to the Agency for the loan guarantee.

(1) An initial guarantee fee is due at the time the guarantee is issued.

(2) An annual guarantee fee is due at the beginning of each year that the guarantee remains in effect.

Guaranteed loan. Any loan for which the Agency provides a loan guarantee.

Holder. A person or entity, other than a lender, who owns all or part of the guaranteed portion of the loan with no servicing responsibilities. When a single note option is used and the lender assigns a part of the guaranteed note to an assignee, the assignee becomes a holder only when the Agency receives notice and the transaction is completed through use of an assignment guarantee agreement form approved by the Agency.

Housing Finance Agency (HFA). A state or local government instrumentality authorized to issue housing bonds or otherwise provide financing for housing.

Identity of interest. With respect to a project, an actual or apparent financial interest of any type, that exists or will exist among the borrower, contractor, lender, syndicator, management agent, suppliers of materials or services, including professional services, or vendors (including servicing and property disposal), in any combination of relationships which may result in an actual or perceived conflict of interest

Income eligibility. A determination that the income of a tenant at initial occupancy does not exceed 115 percent of the area median income as such area median income is defined by HUD or a successor agency.

Indian tribe. Any Indian tribe, band, nation, or other organized group or community of Indians, including any Alaska Native village or regional or village corporation, as defined by or established pursuant to the Alaska Native Claims Settlement Act (43 U.S.C. 1601 et seq.), that is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians pursuant to the Indian Self-Determination and Education Assistance Act of 1975 (25 U.S.C. 450 et seq.); or any entity established by the governing body of an Indian tribe, as described in this definition, for the purpose of financing economic development.

Interest credit. A subsidy available to eligible borrowers that reduces the effective interest rate of the loan to the AFR.

Land lease. A written agreement between a landowner and a borrower for the possession and use of real property for a specified period of time.

Lease. A contract containing the rights and obligations of a tenant or cooperative member and a borrower, including the amount of the monthly occupancy charge and other terms under which the tenant will occupy the housing.

Lease-up period. The period of time that begins when the first unit in the project receives a certificate of occupancy until the time that occupancy of 90% of the units for a minimum of 90 consecutive days is achieved.

Lease-up reserve. A cash deposit which is available to a property to help pay operating costs and debt service at the initiation of operations while units are being leased to their initial occupants.

Lender. A bank or other financial institution, including a housing finance agency, that originates or services the guaranteed loan.

Lender Agreement. The written agreement between the Agency and the lender containing the requirements the lender must meet on a continuing basis to participate in the program.

Loan. A mechanism by which a lender funds the acquisition and development of a multifamily project. A loan in this context is secured by a mortgage executed by the lender and borrower.

Loan guarantee. A pledge to pay part of the loss incurred by a lender in the event of default by the borrower.

Loan guarantee agreement. The written agreement between the Agency and the lender containing the terms and conditions of the guarantee with respect to an individual loan.

Loan participation. A loan made by more than one lender wherein each lender funds an individual portion of the loan.

Loan-to-cost ratio. The amount of the loan divided by the total cost to develop the project.

Loan-to-value ratio. The amount of the loan divided by the appraised market value of the project.

Maximum guarantee payment. The maximum payment by the Agency under the guarantee agreement computed by applying the guarantee percentage times the allowable claim amount, but not to exceed original principal amount.

Mortgage. A written instrument evidencing or creating a lien against real property for the purpose of providing collateral to secure the repayment of a loan. For program purposes, this may include a deed of trust or any similar document.

Multifamily project. A project designed with five or more living units.

Negligent servicing or origination. Negligent servicing or origination is a failure to perform those services which a reasonably prudent lender would perform in servicing or originating its own portfolio and includes not only the failure to act but also the failure to act in a timely manner.

NOFA. A “Notice of Funding Availability” published in the Federal Register to inform interested parties of the availability of assistance and other non-regulatory matters pertinent to the program.

Non-monetary default. A default that does not involve the payment of money.

Note. Any note, bond, assumption agreement, or other evidence of indebtedness pertaining to a guaranteed loan.

Office of Inspector General (OIG). The agency of USDA established under the Inspector General Act.

Operating and maintenance reserve. A cash reserve required of all projects of at least two percent of the loan amount held by the lender that is used for the up-keep of the project.

Payment effective date. For the month payment is due, the day of the month on which payment will be effectively applied to the account by the lender, regardless of the date payment is received.

Permanent loan. A permanent loan is defined as a mortgage loan usually covering development costs, interim loans, construction loans, financing expenses, marketing, administrative, legal, and other Agency approved costs. This loan differs from the construction loan in that financing goes into place after the project is completely constructed and open for occupancy. It is a long-term obligation, generally for a period of no less than 25 years and no more than 40 years.

Prepayment. The payment of the outstanding balance on a loan prior to the note's maturity date.

Project. The total number of rental housing units and related facilities subject to a guaranteed loan that are operated under one management plan and one Regulatory Agreement.

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

Promissory Note. See ``Note".

Qualified alien. For the purposes of this part, qualified alien refers to any person lawfully admitted into the country who meets the criteria of 42 U.S.C. 1436a.

Real Estate Owned. Denotes real estate that has been acquired by the lender or the Agency (often known as ``inventory property").

Sec. 3565.3 (Con.)

Recourse. The lender's right to seek satisfaction from the borrower's personal financial resources or other resources for monetary default.

Regulatory Agreement. The agreement that establishes the relationship among the Agency, the lender, and the borrower; and contains the borrower's responsibilities with respect to all aspects of the management and operation of the project.

RHS. The Rural Housing Service within the Rural Development mission area, or a successor agency, which administers section 538 guarantees.

Rural area. A geographic area as defined in section 520 of the Housing Act of 1949.

Rural Development. A mission area within USDA which includes RHS, Rural Utilities Service, and Rural Business-Cooperative Service.

Servicing. The broad scope of activities undertaken to manage the performance of a loan throughout its term and to assure compliance with the program requirements.

Single asset ownership. A borrower who owns only one project.

Surplus cash. The borrower's remaining funds at the project's fiscal year end, after making all required payments, excluding required reserves and escrows.

Tenant. The individual that holds the right to occupy a unit in accordance with the terms of a lease executed with the project owner.

U.S. citizen. An individual who resides as a citizen in any of the 50 States, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Marinas, the Federated States of Micronesia, the Republic of Palau, or the Republic of the Marshall Islands.

USDA. The United States Department of Agriculture.

Sec. 3565.4 Availability of assistance.

The Agency's authority to enter into commitments, guarantee loans, or provide interest credits is limited to the extent that appropriations are available to cover the cost of the assistance. The Agency will publish a NOFA in the Federal Register to notify interested parties of the availability of assistance.

Sec. 3565.5 Ranking and selection criteria.

(a) Threshold criteria. Applications for loan guarantee submitted by lenders must include a loan request for a project that meets all of the following threshold criteria:

(1) The project must involve an owner and a development team with qualifications and experience sufficient to carry out development, management, and ownership responsibilities, and the owner and development team must not be under investigation or suspension from any government programs;

(2) The project must involve the financing of a property located in an eligible rural area;

(3) Demonstrate a readiness, for the project to proceed, including submission of a complete application for a loan guarantee and evidence of financing;

(4) Demonstrate market and financial feasibility; and

(5) Include evidence that the credit risk is reasonable, taking into account conventional lending practices, and factors related to concentration of risk in a given market and with a given borrower.

(b) Priority projects. Priority will be given to projects: in smaller rural communities, in the most needy communities having the highest percentage of leveraging, having the lowest interest rate, having the highest ratio of 3-5 bedroom units to total units, or located in Empowerment Zones/Enterprise Communities or on tribal lands. In addition, the Agency may, at its sole discretion, set aside assistance for or rank projects that meet important program goals. Assistance will include both loan guarantees and interest credits. Priority projects must compete for set-aside funds. The Agency will announce any assistance set aside and selection criteria in the NOFA.

Sec. 3565.6 Inclusion of tax-exempt debt.

Tax-exempt financing can be used a source of capital for the guaranteed loan.

Sec. 3565.7 Agency environmental requirements.

The Agency will take into account potential environmental impacts of proposed projects by working with applicants, other federal agencies, Indian tribes, State and local governments, and interested citizens and organizations in order to formulate actions that advance the program goals in a manner that will protect, enhance, and restore environmental quality. Actions taken by the Agency under this subpart are subject to an environmental review conducted in accordance with the requirements of 7 CFR part 1940, subpart G or any successor regulations.

Sec. 3565.8 Civil rights compliance.

(a) All actions taken by the Agency, or on behalf of the Agency, by a lender will be conducted without regard to race, color, religion, national origin, sex, marital status, age, income from public assistance or having exercised their right under the Consumer Credit Protection Act, and in accordance with the Equal Credit Opportunity Act (ECOA).

(b) Any action related to the sale, rental or advertising of dwellings; in the provision of brokerage services; or in making available residential real estate transactions involving Agency assistance, must be in accordance with the Fair Housing Act, which prohibits discrimination on the basis of race, color, religion, sex, national origin, familial status or handicap. It is unlawful for a lender or borrower participating in the program to:

(1) Refuse to make accommodations in rules, policies, practices, or services if such accommodations are necessary to provide a person with a disability an opportunity to use or continue to use a dwelling unit and all public and common use areas; and

(2) Refuse to allow an individual with a disability to make reasonable modifications to a unit at his or her expense, if such modifications may be necessary to afford the individual full enjoyment of the unit.

Sec. 3565.8 (Con.)

(c) Any resident or prospective resident seeking occupancy or use of a unit, property or related facility for which a loan guarantee has been provided, and who believes that he or she is being discriminated against may file a complaint with the lender, the Agency or the Department of Housing and Urban Development. A written complaint should be sent to the Secretary of Agriculture or of the Department of Housing and Urban Development in Washington, DC.

(d) Lenders and borrowers that fail to comply with the requirements of title VIII of the Civil Rights Act of 1968, as amended (the Fair Housing Act), are liable for those sanctions authorized by law.

(e) For guaranteed loans with “interest credit,” the following additional civil rights laws will apply and be enforced by the agency delivering this guarantee program: title VI of the Civil Rights Act of 1964, section 504 ofthe Rehabilitation Act of 1973, the Americans with Disabilities Act, Age Discrimination Act of 1975, and title IX of the Education Amendments of 1972.

(f) In accordance with title VI, borrowers will be subjected to compliance reviews for projects that receive interest credit.

Sec. 3565.9 Compliance with federal requirements.

The Agency and the lender are responsible for ensuring that the application is in compliance with all applicable federal requirements, including the following specific statutory requirements:

(a) Intergovernmental review. 7 CFR part 3015, subpart V, ``Intergovernmental Review of Department of Agriculture Programs and Activities", or successor regulation, including the Agency supplemental administrative instruction, RD Instruction 1970-I (available in any Rural Development Office).

(b) National flood insurance. The National Flood Insurance Act of 1968, as amended by the Flood Disaster Protection Act of 1973; the National Flood Insurance Reform Act of 1994; and 7 CFR part 1806, subpart B, or successor regulation.

(c) Clean Air Act and Water Pollution Control Act Requirements. For any contract, all applicable standards, orders or requirements issued under section 306 of the Clean Air Act; section 508 of the Clean Water Act; Executive Order 11738; and EPA regulations at part 32, of title 40.

(d) Historic preservation requirements. The provisions of 7 CFR part 1901, subpart F or successor regulation.

(e) Lead-based paint requirements. The provisions of 7 CFR part 1924, subpart A, or successor regulation.

Sec. 3565.10 Conflict of interest.

(a) Objective. It is the objective within the Rural Development mission area to maintain the highest standards of honesty, integrity, and impartiality by employees.

(b) Rural Development requirement. To reduce the potential for employee conflict of interest, all Rural Development activities will be conducted in accordance with 7 CFR part 1900, subpart D, or successor regulation by Rural Development employees who:

(1) Are not themselves a beneficiary;

(2) Are not family members or known relatives of any beneficiary; and

(3) Do not have any business or personal relationship with any beneficiary or any employee of a beneficiary.

(c) Rural Development employee responsibility. Rural Development employees must disclose any known relationship or association with a lender or borrower or their agents, regardless of whether the relationship or association is known to others. Rural Development employees or members of their families may not purchase a Real Estate owned property, security property from a borrower, or security property at a foreclosure sale.

(d) Loan closing agent responsibility. Loan closing agents (or members of their families) who have been involved with a particular property are precluded from purchasing such properties.

(e) Lender and borrower responsibility. Lenders, borrowers, and their agents must identify any known relationship or association with a Rural Development employee.

Secs. 3565.11-3565.12 [Reserved]

Sec. 3565.13 Exception authority.

An Agency official may request and the Administrator or designee may make an exception to any requirement or provision, or address any omission of this part, if the Administrator determines that application of the requirement or provision, or failure to take action, would adversely affect the government's interest or the program objectives, and provided that such an exception is not inconsistent with any applicable law or statutory requirement.

Sec. 3565.14 Review and appeals.

Whenever RHS makes a decision that is adverse to a lender or a borrower, RHS will provide written notice of such adverse decision and of the right to a USDA National Appeals Division hearing in accordance with 7 CFR part 11 or successor regulations. The lender or borrower may request an informal review with the decision maker and the use of available alternative dispute resolution or mediation programs as a means of resolution of the adverse decision. Any adverse decision, whether appealable or non-appealable may also be reviewed by the next level RHS supervisor. Adverse decisions affecting project tenants or applicants for tenancy will be handled in accordance with 7 CFR part 1944, subpart L or successor regulations.

Sec. 3565.15 Oversight and monitoring.

The lender, borrower, and all parties involved in any manner with any guarantee under this program must cooperate fully with all oversight and monitoring efforts of the Agency, Office of Inspector General, the U.S. General Accounting Office, and the U.S. Department of Justice or their representatives including making available any records concerning this transaction. This includes the annual eligibility audit and any other oversight or monitoring activities. If the Agency implements a requirement for an electronic transfer of information, the lender and borrower must cooperate fully.

Sec. 3565.16 [Reserved]

Sec. 3565.17 Demonstration programs.

To test ways to expand the availability or enhance the effectiveness of the guarantee program, or for similar purposes, the Agency may, from time to time, propose demonstration programs that use loan guarantees or interest credit. Toward this end, the Agency may enter into special partnerships with lenders, financial intermediaries, or others to carry out one or more elements of a demonstration program. Demonstration programs will be publicized by notices in the Federal Register.

Secs. 3565.18-3565.49 [Reserved]

Sec. 3565.50 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart B--Guarantee Requirements

Sec. 3565.51 Eligible loans and advances.

Upon approval of an application from an eligible or approved lender, the Agency will commit to providing a guarantee for a permanent loan or a construction and permanent loan, subject to the availability of funds.

Sec. 3565.52 Conditions of guarantee.

A loan guarantee under this part will be evidenced by a Loan Note Guarantee issued by the Agency. Each lender will execute a Lender’s Agreement. If a valid Lender’s Agreement already exists, it is not necessary to execute a new Lender’s Agreement with each loan guarantee.

(a) Rights and liabilities. A guarantee under this part is backed by the full faith and credit of the United States and is incontestable except for fraud or misrepresentation of which the lender had knowledge at the time the lender acquired the guarantee or assigned the loan, or which a lender participates in or condones. The guarantee will be unenforceable by the lender to the extent any loss is occasioned by a violation of usury laws, negligent servicing or origination by the lender, including a failure to acquire required security, or as a result of a use of loan funds for purposes other than those authorized by the Agency. These acts in the previous sentence constitute grounds for the refusal to make full payment under the guarantee to the lender and will not be taken until the Agency gives the lender notice of the acts or omissions that it considers to constitute such grounds, specifying the applicable provisions in the Statute, Regulations, Loan Note Guarantee, or Lender's Agreement; the lender has not cured the acts or omissions within 90 calendar days after such notice; and the acts or omissions can reasonably be expected to have a material adverse effect on the credit quality of the guaranteed mortgage or the physical condition of the property securing the guaranteed mortgage. If such acts or omissions cannot be cured within a 90 calendar day period, the 90 calendar day cure period automatically shall be extended so long as curative activities commence during the 90 calendar day period. At no time shall the curative period extend more than 270 calendar days of the expiration of the original 90 calendar day cure period. When a guaranteed portion of a loan is sold to a holder, the holder shall succeed to all rights of the lender under the Loan Note Guarantee to the extent of the portion purchased. The lender will remain bound to all obligations under the Loan Note Guarantee, Lender’s Agreement, and the Agency program regulations.

(b) Liability of the holder. The holder shall not be liable for the actions of the lender including, but not limited to, negligence, fraud, abuse, misrepresentation or misuse of funds, and its rights under the guarantee shall be fully enforceable notwithstanding the actions of the lender, unless the holder has knowledge of fraud, misrepresentation or misuse of funds when it becomes the holder or condones or participates in such actions.

(c) Types of guarantees. The Agency may provide a lesser guarantee based upon its evaluation of the credit quality of the loan. Penalties incurred as a result of default are not covered by the guarantee. The Agency liability under any guarantee will decrease or increase, in proportion to any increase or decrease in the amount of the unpaid portion of the loan, up to the maximum amount specified in the Loan Note Guarantee. The Agency will not guarantee construction loans only. The Agency offers the following types of guarantees:

(1) Option One. The Agency may guarantee permanent loans subject to the conditions specified in § 3565.303(d). The maximum guarantee for a permanent loan will be 90 percent [unless the Agency establishes a different percent and announces this different percent through a Notice in the Federal Register] of the unpaid principal and interest up to default and accrued interest 90 calendar days from the date the liquidation plan is approved by the Agency, as defined in § 3565.452.

(2) Option Two. The Agency may provide a guarantee which will cover construction loan advances (advances) during construction. The maximum guarantee of construction advances related to a construction and permanent loan will not at any time exceed the lesser of 90 percent [or the percent established by the Agency and announced through a Notice in the Federal Register] of the amount of principal and accrued interest up to default for amounts which exceed the original advance if for eligible uses of loan proceeds or 90 percent of the original principal amount and accrued interest up to default of the loan. The Agency’s guarantee will cover losses to the extent aforementioned once all sureties/insurances and/or performance and payment bonds have fully performed their contractual obligations. A construction contingency reserve is

required. This guarantee will be enforceable during the construction period but will cease to be enforceable once construction is completed unless and until the requirements for the continuation of the guarantee contained in the Conditional Commitment and this part are completed and approved by the Agency by the date stated in the Conditional Commitment and any Agency approved extension(s). The Agency will provide written confirmation to the lender when all of the requirements for continuation of the guarantee to cover the permanent loan have been satisfied. Any losses sustained while the guarantee is unenforceable (after the end of the construction period and, if applicable, before the continuation of the guarantee) are not covered by the guarantee. For purposes of this guarantee, the construction period will end on the earlier of:

(i) Twenty-four months from the closing of the construction loan, if the certificates of occupancy for all units in the project have not been issued by then, or

(ii) The date of the issuance of the last certificate of occupancy, if the certificates of occupancy for all units in the project are issued on or before 24 months from the closing of the construction loan.

(3) Option Three. The Agency may provide a single, continuous guarantee for construction and permanent loans. Only projects that have low loan-to-cost ratios, which will be defined by the Agency in a Notice published periodically in the Federal Register, are eligible for this type of guarantee. A construction contingency reserve is required. The Agency may require that a lease-up reserve, in an amount established by the Agency and announced through a Notice in the Federal Register, be set-aside prior to closing the construction loan. This lease-up reserve is an additional amount, over and above the required initial operating and maintenance contribution. The maximum guarantee of construction advances will not at any time exceed the lesser of 90 percent [or the percent established by the Agency and announced through a Notice in the Federal Register] of the amount of principal and interest up to default advanced for eligible uses of loan proceeds or 90 percent of the original principal amount and interest up to default.

(d) Maximum loss payment. The maximum loss payment to a lender or holder is as follows:

(1) To any holder, 100 percent of any loss sustained by the holder on the guaranteed portion of the loan and on interest due on such portion.

(2) To the lender, the lesser of:

(i) Any loss sustained by the lender on the guaranteed portion, including principal and up to 90 days of accrued interest as evidenced by the notes or assumption agreements and secured advances for protection and preservation of collateral made with the Agency's authorization; or

(ii) The guaranteed principal advanced to or assumed by the borrower and any interest and accrued interest up to 90 days due thereon.

(e) Funding of reserves. For each Option under paragraph (c) of this section, the lender must require an operating and maintenance reserve and provide the Agency adequate evidence of the funding of all required reserves.

(1) For Option 1 under paragraph (c) of this section, the funding schedule for the lease-up reserve and the operating and maintenance reserve must be included in the Agency-approved construction budget and be fully funded before the issuance of the permanent guarantee.

(2) For Option 2 under paragraph (c) of this section, the funding schedule for the lease-up reserve and the operating and maintenance reserve must be included in the Agency-approved construction budget and be fully funded before the issuance of the permanent guarantee.

(3) For Option 3 under paragraph (c) of this section, the operating and maintenance reserve must be fully funded before the issuance of the guarantee. The lease-up reserve must be funded 30 days before the first Certificate of Occupancy is anticipated.

Sec. 3565.53 Guarantee fees.

As a condition of receiving a loan guarantee, the Agency will charge the following guarantee fees to the lender.

(a) Initial guarantee fee. The Agency will charge an initial guarantee fee equal to one percent of the guarantee amount. For purposes of calculating this fee, the guarantee amount is the product of the percentage of the guarantee times the initial principal amount of the guaranteed loan.
(b) Annual guarantee fee. An annual guarantee fee of at least 50 basis points (one-half percent) of the outstanding principal amount of the loan will be charged each year or portion of a year that the guarantee is in effect. This fee will be collected on February 28, of each calendar year.
(c) Surcharge for guarantees on construction advances. The Agency may, at its sole discretion, charge an additional fee on the portion of the loan advanced during construction. This fee will be charged in advance at the start of construction and will be announced in NOFA before loan approval.

Sec. 3565.54 Transferability of the guarantee.

A lender must receive the Agency's approval prior to any sale or transfer of the loan guarantee.
Sec. 3565.55 Participation loans.

Loans involving multiple lenders are eligible for a guarantee when one of the lenders is an approved lender and agrees to act as the lead lender with responsibility for the loan under the loan agreement.

Sec. 3565.56 Suspension or termination of loan guarantee agreement.

A guarantee agreement will terminate when one of the following actions occurs: (In accordance with subpart H of this part, use restrictions on the property will remain if the following actions take place prior to the term of the loan and RHS determines the restrictions apply.)
(a) Voluntary termination. A lender and borrower voluntarily request the termination of the loan guarantee.
(b) Agency withdrawal of guarantee. The Agency withdraws the loan guarantee in the event of fraud, misrepresentation, abuse, negligence, or failure to meet the program requirements.
(c) Mortgage pay-off. The loan is paid.
(d) Settlement of claim. Final settlement of the claim.

Sec. 3565.57 Modification, extension, reinstatement of loan guarantee.

To protect its interest or further the objectives of the program, the Agency may, at its sole discretion, modify, extend, or reinstate a loan guarantee. In making this decision the Agency will consider potential losses under the program, impact on the tenants and the public reaction that may be received regarding the action. Further, the Agency may authorize a guarantee on a new loan that is originated as a part of a workout agreement.

Secs. 3565.58-3565.99 [Reserved]

Sec. 3565.100 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart C--Lender Requirements

Sec. 3565.101 Responsibility of lenders.

A participating lender must originate and service a guaranteed loan in accordance with the regulation and program requirements throughout the life of a loan or guarantee, whichever is less. When it is in the best interests of the Agency, the Agency may permit the transfer of servicing from the originating lender to a servicer.

Sec. 3565.102 Lender eligibility.

An eligible lender must be a licensed business entity or HFA in good standing in the state or states where it conducts business; be approved by the Agency; and meet at least one of the criteria contained below. Lenders who are not eligible may participate in the program if they maintain a correspondent relationship with a lender who is eligible. An eligible lender must:

(a) Meet the qualifications of, and be approved by, the Secretary of HUD to make multifamily housing loans that are to be insured under the National Housing Act;

(b) Meet the qualifications and be approved by Fannie Mae, Freddie Mac, or Ginnie Mae to make multifamily housing loans that are to be sold or securitized by such corporations;

(c) Be a state or local HFA, or a member of the Federal Home Loan Bank system, with a demonstrated ability to underwrite, originate, process, close, service, manage, and dispose of multifamily housing loans in a prudent manner;

(d) Be a lender who meets the requirements for Agency approval contained in this subpart and has a demonstrated ability to underwrite, originate, process, close, service, manage, and dispose of multifamily housing loans in a prudent manner; or

(e) Be a lender who meets the following requirements in addition to the other requirements of this subpart and of subpart I of this part:

(1) Have qualified staff to perform multifamily housing servicing and asset management;

(2) Have facilities and systems that support servicing and asset management functions; and

(3) Have documented procedures for carrying out servicing and asset management responsibilities.

Sec. 3565.103 Approval requirements.

The Agency will establish and maintain a “list of approved Lenders”. To be an approved lender, eligible lenders must meet the following requirements and maintain them on a continuing basis at a level consistent with the nature and size of their portfolio of guaranteed loans.

(a) Commitment. A lender must have a commitment for a guaranteed loan or an agreement to purchase a guaranteed loan.

(b) Audited statement. A lender must provide the Agency with an annual audited financial statement conducted in accordance with generally accepted government auditing standards.

(c) Previous participation. A lender may not be delinquent on a federal debt or have an outstanding finding of deficiency in a federal housing program.

(d) Ongoing requirements. A lender must meet the following requirements at initial application and on a continuing basis thereafter:

Sec. 3565.103 (Con.)

(1) Overall financial strength, including capital, liquidity, and loan loss reserves, to have an acceptable level of financial soundness as determined by a lender rating service (such as Sheshunoff, Inc.); or to be an approved Fannie Mae, Freddie Mac, Ginnie Mae or HUD Federal Housing Administration multifamily lender; or, if a state housing finance agency, to have a top tier rating by a rating agency (such as Standard and Poor's Corporation);
(2) Bonding and insurance to cover business related losses, including directors and officers insurance, business income loss insurance, and bonding to secure cash management operations;
(3) A minimum of two years experience in originating and servicing multifamily loans;
(4) A positive record of past performance when participating in RHS or other federal loan programs;
(5) Adequate staffing and training to perform the program obligations; the head underwriter must have 3 years of experience and all staff must receive annual multifamily training;
(6) Demonstrated overall financial stability of the business over the past five years;
(7) Evidence of reasonable and prudent business practices for management of the program; and
(8) No negative information on Dunn & Bradstreet or similar type report.

Sec. 3565.104 Application requirements.

Eligible lenders must submit a lender approval application, in a format prescribed by the Agency. The lender approval application submission must occur at the time the lender submits its first application for a loan guarantee, or its first application to purchase a guaranteed loan. The application must include documentation of lender compliance with Sec. 3565.103. A non-refundable application fee will be charged for each review of a lender's application. The amount of the fee will be announced in NOFA.

Sec. 3565.105 Lender compliance.

A lender will remain an approved lender unless terminated by the Agency. To maintain approval, the lender must comply with the following requirements.
(a) Maintain eligibility in accordance with Sections 3565.102 and 3565.103;
(b) Comply with all applicable statutes, regulations, and procedures;
(c) Inform the Agency of any material change in the lender's staffing, policies and procedures, or corporate structure;
(d) Cooperate fully with all program or Agency monitoring and auditing policies and procedures, including the Agency's annual audit of approved lenders; and
(e) Maintain active participation in the multifamily guaranteed loan program by initiating a new loan guarantee or holding a loan guaranteed under this program.

Sec. 3565.106 Construction lender requirements.

A lender making a construction loan, as part of a construction and permanent loan, must demonstrate an ability to originate and service construction loans, in addition to meeting the other requirements of this subpart.

Sec. 3565.107 [Reserved]

Sec. 3565.108 Responsibility for actions of agents and mortgage brokers.

An approved lender is responsible for the actions of its agents and mortgage brokers.

Sec. 3565.109 Minimum loan prohibition.

A lender must not establish a minimum loan amount for loans under this program.

Sec. 3565.110 Insolvency of lender.

The Agency may require a lender to transfer a guaranteed loan or loans to another approved lender prior to a determination of insolvency by the lender. If the lender fails to transfer a loan when required, the guarantee will be considered null and void.

Sec. 3565.111 Lobbying activities.

An approved lender must comply with RD Instruction 1940-Q (available in any Rural Development Office) regarding lobbying activities.

Secs. 3565.112-3565.149 [Reserved]

Sec. 3565.150 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart D--Borrower Eligibility Requirements

Sec. 3565.151 Eligible borrowers.

Guaranteed loans must be made to an eligible borrower whose intention is to provide and maintain rural rental housing. The ownership entity must be a valid entity in good standing under the laws of the jurisdiction in which it is organized. Eligible borrowers shall include individuals, corporations, state or local public agencies or an instrumentality thereof, partnerships, limited liability companies, trusts, Indian tribes, or any organization deemed eligible by the Agency. Eligible borrowers must be U.S. citizens or permanent legal residents; a U.S. owned corporation, or a limited liability company, or partnership in which the principals are U.S. citizens or permanent legal residents.

Sec. 3565.152 Control of land.

At time of application, the lender must have evidence of site control by the borrower (option to purchase, lease, deed or other evidence acceptable to the Agency). At the time of loan closing, the lender's closing docket must provide documentary evidence that the borrower owns or has a long-term lease on the land on which the housing is or will be located. The form of ownership or the leasehold agreement must meet Agency requirements. Notwithstanding any investment in the site, the site may not be accepted based on the Agency's environmental assessment.

Sec. 3565.153 Experience and capacity of borrower.

At the time of application, the lender must certify that the borrower:
(a) Has the ability and experience to construct or rehabilitate multifamily housing that meets the requirements established by the Agency, the lender and the loan agreement;
(b) Has the legal and financial capacity to meet all of the obligations of the loan; and
(c) Has the ability and experience to meet the property management requirements established by the Agency, the lender, and the loan agreement.

Sec. 3565.154 Previous participation in state and federal programs.

Loans to borrowers who are delinquent on a federal debt may not be guaranteed. Furthermore, borrowers or principals thereof who have defaulted on state or local government loans will not be eligible for a guarantee unless the Agency determines that the default was beyond the borrower's control, and that the identifiable reasons for the default no longer exist. At the time of application, the lender must obtain from the borrower a certification that the borrower is not under any state or federal order suspending or debarring participation in state or federal loan programs and that the borrower is not delinquent on any non-tax obligation to the United States.

Sec. 3565.155 Identity of interest.

At the time of application, the lender must certify that it has disclosed any and all identity of interest relationships and preexisting conditions with respect to its relationships and that of the borrower, or that no identity of interest relationships exists. Identity of interest relationships include any financial or other relationship that exists or will exist between a lender, borrower, management agent, supplier, or any agent of any of these entities, that could influence, give the appearance of influencing or have the potential to influence the actions of the parties in carrying out their responsibilities under the program. Disclosure will be in a form and manner established by the Agency.

Sec. 3565.156 Certification of compliance with federal, state, and
local laws and with Agency requirements.

At the time of application, the lender must obtain from the borrower a certification of compliance with all applicable federal, state, and local laws, and with Agency requirements regarding discrimination and equal opportunity in housing, including title VIII of the Civil Rights Act of 1968, and the Fair Housing Amendments Act of 1988. The borrower must also certify that it is not the subject of any federal, state, or local sanction or punitive action.

Secs. 3565.157-3565.199 [Reserved] Sec. 3565.200 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart E--Loan Requirements

Sec. 3565.201 General.

To be eligible for a guarantee, a loan must comply with the provisions of this subpart and be originated by an approved lender.

Sec. 3565.202 Tenant eligibility.

(a) Limits on income of tenants. The housing units subject to a guaranteed loan must be available for occupancy only by low or moderate-income families or individuals whose incomes at the time of initial occupancy do not exceed 115 percent of the area median income. After initial occupancy, a tenant's income may exceed these limits.

(b) Citizenship status. A tenant must be a United States citizen or a noncitizen who is a qualified alien as defined in Sec. 3565.3.

Sec. 3565.203 Restrictions on rents.

The rent for any individual housing unit, including any tenant-paid utilities, must not exceed an amount equal to 30 percent of 115 percent of area median income, adjusted for family size. In addition, on an annual basis, the average rent for a project, taking into account all individual unit rents, must not exceed 30 percent of 100 percent of area median income, adjusted for family size.

Sec. 3565.204 Maximum loan amount.

(a) Section 207(c) limits and exceptions. For that part of the property that is attributable to dwelling use, the principal obligation of each guaranteed loan must not exceed the applicable maximum per-unit limitations under section 207(c) of the National Housing Act.

(b) Loan-to-value limits. (1) In the case of a borrower that is a nonprofit organization or an agency or body of any State, local or tribal government, each guaranteed loan must involve a principal obligation that does not exceed the lesser of 97 percent of:

(i) The development costs of the housing and related facilities, or

(ii) The lender's determination of value not to exceed the appraised value of the housing and facilities.

(2) In the case of a borrower that is a for-profit entity or other entity not referred to in paragraph (b)(1) of this section, each guaranteed loan must involve a principal obligation that does not exceed the lesser of 90 percent of:

(i) The development costs of the housing and related facilities, or

(ii) The lender's determination of value not to exceed the appraised value of the housing and facilities.

(3) To protect the interest of the Agency or to further the objectives of the program, the Agency may establish lower loan-to-value limits or further restrict the statutory maximum limits based upon its evaluation of the credit quality of the loan.

(c) Necessary assistance review. (1) A lender requesting a loan guarantee must review all loans to determine the appropriate amount of assistance necessary to complete and maintain the project. The lender shall recommend to the Agency an adjustment in the loan amount if appropriate as a result of this review.

(2) Where the project financing combines a guaranteed loan with Low-Income Housing Tax Credits or other Federal assistance, the project must conform to the policies regarding necessary assistance in 7 CFR part 1944, subpart E or successor provision.

Sec. 3565.205 Eligible uses of loan proceeds.

Eligible uses of loan proceeds must conform with standards and conditions for housing and facilities contained in 7 CFR part 1924, subpart A or successor provision, except that the Agency, at its sole discretion, may approve, in advance, a higher level of amenities, construction, and fees for projects proposed for a guaranteed loan provided the costs and features are reasonable and customary for similar housing in the market area.

(a) Use of loan proceeds. The proceeds of a guaranteed loan may be used for the following purposes relating to the project.

(1) New construction costs of the project;

(2) Moderate or substantial rehabilitation of buildings and acquisition costs when related to the rehabilitation of a building as described in paragraph (b) of this section;

(3) Acquisition of existing buildings, when approved by the Agency, for projects that serve a special housing need;

(4) Acquisition and improvement of land on which housing will be located;

(5) Development of on-site and off-site improvements essential to the use of the property;

(6) Development of related facilities such as community space, recreation, storage or maintenance structures, except that any high cost recreational facility, such as swimming pools and exercise clubs or similar facilities, must be specifically approved in advance by the Agency;

(7) Construction of on-site management or maintenance offices and living quarters for operating personnel for the property being financed;

(8) Purchase and installation of appliances and certain approved decorating items, such as window blinds, shades, or wallpaper;

(9) Development of the surrounding grounds, including parking, signs, landscaping and fencing;

(10) Costs associated with commercial space provided that:

(i) The project is designed primarily for residential use;

(ii) The commercial use consists of essential tenant service type facilities, such as laundry rooms, that are not otherwise conveniently available;

(iii) The commercial space does not exceed 10 percent of the gross floor area of the residential units and common areas, unless a higher level is specifically approved in writing by the Agency; and

(iv) The commercial activity is compatible with the use of the project and that the income is not more than 10 percent of the total annual operating income of the project.

(11) Costs for feasibility determination, loan application fees, appraisals, environmental documentation, professional fees or other fees determined by the Agency to be necessary to the development of the project;

(12) Technical assistance to and by non-profit entities to assist in the formation, development, and packaging of a project, or formation or incorporation of a borrower entity;
(13) Education programs for a board of directors, both before and after incorporation of a cooperative that will serve as the borrower;
(14) Construction interest accrued on the construction loan;
(15) Relocation assistance in the case of rehabilitation projects;
(16) Developers' fees; and
(17) Repaying applicant debts in the following cases:
(i) When the Agency authorizes in writing in advance the use of loan funds to pay debts for work, materials, land purchase, or other fees and charges before the loan is closed; or
(ii) When the Agency concurs in writing with a determination by the lender that costs for work, fees and charges incurred prior to loan application are integral to development of the guarantee application and project.
(b) Rehabilitation requirements. Rehabilitation work must be classified as either moderate or substantial as defined in exhibit K of 7 CFR part 1924, subpart A or a successor document. In all cases, the building or project must be structurally sound, and improvements must be necessary to meet the requirements of decent, safe, and sanitary living units. Applications must include a structural analysis, along with plans and specifications describing the type and amount of planned rehabilitation. The project as rehabilitated must meet the applicable development standards contained in 7 CFR part 1924, subpart A or a successor regulation, as well as any applicable historic preservation requirements. All proposed rehabilitation projects are subject to an environmental review completed in accordance with 7 CFR part 1940, subpart G or a successor regulation.

Sec. 3565.206 Ineligible uses of loan proceeds.

Loan proceeds must not be used for the following:
(a) Specialized equipment for training and therapy;
(b) Housing in military impact areas;
(c) Housing that serves primarily temporary and transient residents;
(d) Nursing homes, special care facilities and institutional type homes that require licensing as a medical care facility;
(e) Operating capital for central dining facilities or for any items not affixed to the real estate, such as special portable equipment, furnishings, kitchen ware, dining ware, eating utensils, movable tables and chairs, etc.;
(f) Payment of fees, salaries and commissions or compensation to borrowers (except developers' fees); or
(g) Refinancing of an outstanding debt, except in the case of an existing guaranteed loan where the Agency determines that the refinancing is in the government's interest or furthers the objectives of the program. The term and amount of any loan for refinancing must not exceed the maximum loan amount or term limits.

Sec. 3565.207 Form of lien.

The loan originated by the lender for a guarantee must be secured by a first lien against the property.

Sec. 3565.208 Maximum loan term.

(a) Statutory term limit. The lender may set the term of the loan, but in no instance may the term of a guaranteed loan exceed the lesser of 40 years or the remaining economic life of the project.

(b) Prepayment of loans. A guaranteed loan may be prepaid in whole or in part at the determination of the lender, and upon the lender's written notice to the Agency at least 30 days prior to the expected date of prepayment. The Agency will not pay any lockout or prepayment penalty assessed by the lender. The lender must certify the following in the notice of prepayment:

(1) The lease documents used by the borrower or its agent prohibit the abrogation of tenant leases in the event of prepayment; and

(2) The borrower has notified tenants of the request to prepay the loan, including notice of the prohibition against abrogation of the lease and the policy and procedure for handling complaints regarding compliance with the long-term use restriction as contained in subpart H of this part.

Sec. 3565.209 Loan amortization.

Each guaranteed loan shall be made for a period of not less than 25 nor greater than 40 years from the date the loan was made and may provide for amortization of the loan over a period of not to exceed 40 years with a final payment of the balance due at the end of the loan term.

Sec. 3565.210 Maximum interest rate.

The interest rate for a guaranteed loan must not exceed the maximum allowable rate specified by the Agency in NOFA. Such rate must be fixed over the term of the loan.

Sec. 3565.211 Interest credit.

(a) Limitation. For at least 20 percent of the loans made during each fiscal year, the Agency will provide assistance in the form of interest credit, to the extent necessary to reduce the agreed-upon rate of interest to the AFR as such term is used in section 42(I)(2)(D) of the Internal Revenue Code of 1986, 26 U.S.C. 7805, Sec. 1.42-1T.

(b) Selection criteria. The Agency will select projects to receive interest credits using any of such criteria as the Agency may establish for priority projects as contained in subpart A of this part.

Sec. 3565.212 Multiple guaranteed loans.

The Agency may guarantee more than one loan on any project if all guaranteed loans, in the aggregate, comply with these regulations, including without limitation:

(a) In the aggregate, loans do not exceed the maximum guaranteed loan amount and loan-to-value limits, as contained in Sec. 3565.204;

(b) In the aggregate, loans are all to be secured equally by a first lien as the Agency may, at its sole discretion, determine necessary to ensure repayment of the loans; and

(c) If different lenders originate the loans, each lender has executed an interest creditor agreement in form and substance acceptable to the Agency.

Sec. 3565.213 Geographic distribution.

The Agency may refuse to guarantee a loan in an area where there is undue risk due to a concentration in the market of properties subject to a Agency guaranteed loan. The Agency will consider the credit quality of the loan and overall market conditions in making a determination of undue risk. If any of the Agency guaranteed loans in the market are experiencing vacancy rates in excess of 15% and the vacancy is due to market conditions, the Agency will invoke this provision and not guarantee the loan.

Sec. 3565.214 [Reserved]

Sec. 3565.215 Special conditions.

(a) Use of third party funds. As a condition of receiving a guaranteed loan, the Agency, or the lender if designated by the Agency, must review the terms and conditions of any secondary financing or funding of projects, including loans, capital grants or rental assistance.

(b) Recourse. If required by the lender, loans guaranteed under this program may be made on a recourse or nonrecourse basis, or with any personal or special borrower guarantees on collateralization.

Sec. 3565.216-3565.249 [Reserved]

Sec. 3565.250 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart F--Property Requirements

Sec. 3565.251 Eligible property.

To be eligible for a guaranteed loan, a property must be used primarily for residential dwelling purposes and must meet the following requirements or the requirements of this subpart:

(a) Property location. All the property must be located in a rural area.

(b) Minimum size of development. The property must consist of at least five rental dwelling units.

(c) Non-contiguous sites. For a loan secured by two or more non-contiguous parcels of land, all sites must meet each of the following requirements:

(1) Located in one market area;

(2) Managed under one management plan with one loan agreement or resolution for all of the sites; and

(3) Consist of single asset ownership.

(d) Compliance with Statutes. All properties must comply with the applicable requirements in section 504 of the Rehabilitation Act of 1973, the Fair Housing Act, the Americans with Disabilities Act, and other applicable statutes.

Sec. 3565.252 Housing types.

The property may include new construction or rehabilitation of existing structures. The units may be attached, detached, semi-detached, row houses, modular or manufactured houses, or multifamily structures. Manufactured housing must meet Agency requirements contained in 7 CFR part 1924, subpart A or a successor regulation. The Agency will guarantee proposals for new construction or acquisition with moderate or substantial rehabilitation of at least $6,500 per dwelling unit. The portion of the guaranteed funds available for acquisition with rehabilitation may be limited in the annual Notice of Fund Availability.

Sec. 3565.253 Form of ownership.

The property must be owned in fee simple or be subject to a ground lease or other legal right in land acceptable to the Agency.

Sec. 3565.254 Property standards.

(a) Housing quality and site and neighborhood standards. The property must meet the site and neighborhood requirements established by the state or locality, and those standards contained under 7 CFR part 1924, subparts A and C or any successor regulations.

(b) Third party assessments. As part of the application for a guaranteed loan, the lender must provide documentation of qualified third parties' assessments of the property's physical condition and any environmental conditions or hazards which may have a bearing on the market value of the property. These assessments must include:

Sec. 3565.254 (Con.)

(1) An acceptable property appraisal.
(2) A Phase I Environmental Site Assessment (American Society of Testing and Materials).
(3) A Standard Flood Hazard Determination.
(4) In the case of the purchase of an existing structure, rehabilitation or refinancing, a physical needs assessment.

Sec. 3565.255 Environmental requirements.

Under the National Environmental Policy Act, the Agency is required to assess the potential impact of the proposed actions on protected environmental resources. Measures to avoid or at least mitigate adverse impacts to protected resources may require a change in site or project design. A site will not be approved until the Agency has completed the environmental review in accordance with 7 CFR part 1940, subpart G or successor regulation.

Sec. 3565.256 Architectural services.

Architectural services must be provided for the project in accordance with 7 CFR part 1924, subpart A or successor regulation, including plan certifications.

Sec. 3565.257 Procurement actions.

All construction procurement actions, whether by sealed bid or by negotiation, must be conducted in a manner that provides maximum open and free competition.

Secs. 3565.258-3565.299 [Reserved]

Sec. 3565.300 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart G--Processing Requirements

Sec. 3565.301 Loan standards.

An approved lender must originate and underwrite the loan and appraise the subject property in accordance with prudent lending practices and Agency criteria addressing the following factors:
(a) Borrower qualifications and creditworthiness;
(b) Property, vacancy, market vacancy or collection loss;
(c) Rental concessions and rent levels;

(d) Tenant demand and housing supply;
(e) Property operating and maintenance expense;
(f) Property requirements as contained in subpart F of this part;
(g) Debt coverage ratio;
(h) Operating and long-term capital requirements;
(i) Loan-to-value ratio;
(j) Return on borrower equity; and
(k) Estimated long-term marketability of the project.

Sec. 3565.302 Allowable fees.

(a) Lender fees. The lender is authorized to charge reasonable and necessary fees in connection with a borrower's application for a guaranteed loan.
(b) Agency fees. The Agency will charge one or more types of fees deemed appropriate as reimbursement for reasonable and necessary costs incurred in connection with applications received from lenders for monitoring or annual renewal fees. These fees will be published in NOFA. Agency fees may include, but are not limited to the following:
(1) Site Assessment and Market Analysis or preliminary feasibility fee. A fee for review of an application for a determination of preliminary feasibility.
(2) Application fee. A fee submitted in conjunction with the application for a loan guarantee.
(3) Inspection fee. A fee for inspection of the property in conjunction with a loan guarantee.
(4) Transfer fee. A fee in connection with a request for approval of a transfer of physical assets or a change in the composition of the ownership entity.
(5) Extension or reopening fees. A fee to extend the guarantee commitment or to reopen an application when a commitment has expired.

Sec. 3565.303 Issuance of loan guarantee.

(a) Preliminary feasibility review. During the initial processing of a loan, the lender may request a preliminary feasibility review by the Agency when required loan documentation is submitted.
(b) Conditional commitment to guarantee a loan. The Agency will issue a conditional commitment to guarantee a loan. This commitment will be good for such time frame as the Agency deems appropriate based on project requirements. The commitment to guarantee a loan, will specify any conditions necessary to obtain a determination by the
Agency that all program requirements have been met. A conditional commitment can be issued, subject to the availability of funds, after:
(1) Completion by the Agency of an environmental review in accordance with 7 CFR part 1940, subpart G or successor regulation, and the National Environmental Policy Act; and
(2) Selection of the proposed project for funding by the Agency in accordance with ranking and selection criteria.
(c) Guarantee during construction. When requesting a guarantee on construction loan advances under § 3565.52(c)(2) and (c)(3), Options 2 and 3, the Agency will only issue a guarantee to an approved lender that the Agency determines is eligible under §3565.106 of this part.
(1) This guarantee will be subject to the limits contained in subpart B of this part and in the loan closing documentation.

(2) In all cases, the lender must obtain one of the following protections:
(i) Surety bonding or performance and payment bonding acceptable to the Agency;
(ii) An irrevocable letter of credit acceptable to the Agency; or
(iii) A pledge to the lender of collateral that is acceptable to the Agency.
(3) The lender must verify amounts expended prior to each payment for completed work and certify that an independent inspector has inspected the property and found it to be in conformance with Agency standards. The lender must provide verification that all subcontractors have been paid and no liens have been filed against the property.
(d) Permanent loan guarantee. The guarantee of a permanent loan provided under § 3565.52(c)(1) or (c)(2) will be issued once the following items have been submitted to and approved by the Agency:
(1) Certification from the lender stating that the lender or its qualified representative inspected the property and found that the construction meets the Government's requirements for the standards and conditions for housing and facilities in 7 CFR part 1924, subpart A and the standards for site development in 7 CFR part 1924, subpart C, or its successor regulations;
(2) Cash flow certification – the lender certifies, in writing, the project's cash flow assumptions are still valid and depict compliance with the section 538 program's debt service coverage ratio requirement of at least 1.15, based on the lender's analysis of current market conditions and comparable properties in the project's market area;
(3) Documentation that either:
(i) The project has attained a minimum level of acceptable occupancy of 90% for 90 continuous days within the 120-day period immediately preceding the issuance of the permanent guarantee, or
(ii) Additional funds, supplementing the funds required under § 3565.303(d), have been added to the lease-up reserve in an amount the Agency determines is necessary to cover projected shortfalls.
(4) An appraisal of the project as built. Upon a lender's written request, the Agency may exempt a project from this requirement if requested by the lender and the project meets the following criteria:
(i) Original appraisal - an original appraisal that meets the Agency's appraisal requirements with a valuation date no older than 36 months;
(ii) Valuation - the appraisal's lowest valuation, regardless of valuation approach and rent restrictions considered, is greater than the section 538 guaranteed loan amount; and
(iii) Guaranteed loan balance - the Agency's guaranteed loan's principal balance does not exceed 50 percent [unless a different percent has been announced in a Notice published in the Federal Register] of the project's total development costs.
(5) A certificate of substantial completion;
(6) A certificate of occupancy or similar evidence of local approval;
(7) A final inspection conducted by a qualified Agency representative;
(8) A final cost certification in a form acceptable to the Agency;
(9) A submission to the Agency of the complete closing docket;
(10) A certification by the lender that the project has reached an acceptable minimum level occupancy;
(11) An executed regulatory agreement;

(12) The Lender certifies that it has approved the borrower's management plan and assures that the borrower is in compliance with Agency standards regarding property management contained in subparts E and F of this part;
(13) Necessary information to complete an updated necessary assistance review by the Agency under §3565.204(c); and
(14) Compliance with all conditions contained in the conditional commitment for guarantee.
(f) Continuous Guarantee Compliance: The continuous guarantee will remain in effect once construction is completed. In order to remain in compliance with 7 CFR part 3565, the following items must be submitted to and approved by the Agency. These items will be submitted to the Agency by the date stated in the Conditional Commitment and any Agency approved extension(s).
(1) Certification from the lender stating that the lender or its qualified representative inspected the property and found that the construction meets the Government's requirements for the standards and conditions for housing and facilities in 7 CFR part 1924, subpart A and the standards for site development in 7 CFR part 1924, subpart C, or its successor regulations;
(2) Cash flow certification – the lender certifies in writing the project's cash flow assumptions are still valid and depict compliance with the section 538 program's debt service coverage ratio requirement of at least 1.15, based on the lender's analysis of current market conditions and comparable properties in the project's market area;
(3) Documentation that either:
(i) The project has attained a minimum level of acceptable occupancy of 90% for 90 continuous days within the 120-day period immediately preceding the issuance of the permanent guarantee, or
(ii) Additional funds, supplementing the funds required under §3565.303(d), have been added to the lease-up reserve in an amount the Agency determines is necessary to cover projected shortfalls.
(4) An appraisal of the property;
(5) A certificate of substantial completion;
(6) A certificate of occupancy or similar evidence of local approval;
(7) A final inspection conducted by a qualified Agency representative;
(8) A final cost certification in a form acceptable to the Agency;
(9) A submission to the Agency of the complete closing docket;
(10) A certification by the lender that the project has reached an acceptable minimum level occupancy;
(11) An executed regulatory agreement;
(12) The Lender certifies that it has approved the borrower's management plan and assures that the borrower is in compliance with Agency standards regarding property management contained in subparts E and F of this part;
(13) Necessary information to complete an updated necessary assistance review by the Agency under §3565.204(c); and
(14) Compliance with all conditions contained in the conditional commitment for guarantee.

Sec. 3565.304 Lender loan processing responsibilities.

(a) Application. The lender will be responsible for submitting an application for a loan guarantee in a format prescribed by the Agency. Lenders may submit an application at the feasibility stage or when they request a conditional commitment.
(b) Project servicing, management and disposition. Unless otherwise permitted by the Agency, the originating lender must perform all loan functions during the period of the guarantee. These

functions include servicing, asset management, and, if necessary, property disposition. The lender must maintain and service the loan in accordance with the provisions of subpart I of this part and Agency servicing procedures.

Sec. 3565.305 Mortgage and closing requirements.

It is the lender's responsibility to ensure that the loan closing statement and required loan documents are in a form acceptable to the Agency and included in the closing docket. The lender is responsible for resolving any underwriting and loan closing deficiencies that are found. The Agency's review of the lender's loan closing documentation does not constitute a waiver of fraud, misrepresentation, or failure of judgment by the lender.

Secs. 3565.306-3565.349 [Reserved]

Sec. 3565.350 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart H--Project Management

Sec. 3565.351 Project management.

As a condition of the guarantee, the lender is to obtain borrower certification that the project is in compliance with local, state, federal laws and program requirements.

(a)Regulatory agreement. A regulatory agreement between the borrower and lender which will be executed at the time of loan closing and contain the following covenants:
(1) That it is binding upon the borrower and any of its successors and assigns, as well as upon the lender and any of its successors and assigns, for the duration of the guaranteed loan;
(2) That the borrower makes all payments due under the note and to the required escrow and reserve accounts;
(3) That the borrower maintains the project as affordable housing in accordance with the purposes and for the duration defined in the statute;
(4) That the borrower maintains the project in good physical and financial condition at all times;
(5) That the borrower obtains and maintains property insurance and any other insurance coverage required to protect the security;
(6) That the borrower maintains complete project books and financial records, and provides the Agency and the lender with an annual audited financial statement after the end of each fiscal year;

(7) That the borrower makes project books and records available for review by the Office of Inspector General, Rural Development staff,
General Accounting Office, and the Department of Justice, or their representatives or successors upon appropriate notification;

(8) That the borrower prepares and complies with the Affirmative Fair Housing Marketing Plan and all other Fair Housing requirements

(9) That the borrower operates as a single asset ownership entity, unless otherwise approved by the Agency;

(10) That the borrower complies with applicable federal, state and local laws; and

(11) That the borrower provides management satisfactory to the lender and to the Agency and complies with an approved management plan for the project.

(b) Management plan. The lender must approve the borrower's management plan and assure that the borrower is in compliance with
Agency standards regarding property management, including the requirements contained in subparts E and F of this part.

(c) Tenant protection and grievance procedures. Tenants in properties subject to a guaranteed loan are entitled to the grievance and appeal rights contained in 7 CFR part 1944, subpart L or successor regulation. The borrower must inform tenants in writing of these rights.

(d) Financial management.

(1) Borrower reporting requirements. At a minimum, the lender must obtain, on an annual basis, an audited annual financial statement conducted in accordance with generally accepted government auditing standards.

(2) Lender reporting requirements. The lender must review the financial reports to assure that the property is in sound fiscal condition and the borrower is in compliance with financial requirements. The lender must report findings to the Agency as follows:

(i) Annual reports. The lender must submit to the Agency a copy of the annual financial audit of the project and must report on the nature and status of any findings. To the extent that outstanding findings or issues remain, the lender must submit to the Agency a copy of a plan of action for any unresolved findings.

(ii) Monthly reports. The lender must submit monthly reports to the
Agency on all loans that are either in default, delinquent, or not in compliance with program requirements. This report must provide information on the financial condition of each loan, the physical condition of the property, the amount of delinquency, any other non-compliance with program requirements and the proposed actions and timetable to resolve the delinquency, default or non-compliance.

(3) Reserve releases. The lender is responsible for approving or disapproving all borrower requests for release of funds from the reserve and escrow accounts. Security deposit accounts will not be considered a reserve or escrow account.

(4) Insurance requirements. At loan closing, the borrower will provide the lender with documentary evidence that Agency insurance requirements have been met. The borrower must maintain insurance in accordance with Agency requirements until the loan is repaid and the lender must be named as the insurance policy's beneficiary. The lender must obtain insurance on the secured property if the borrower is unable or unwilling to do so and charge the cost as an advance.

(5) Distribution of surplus cash. Prior to the distribution of surplus cash to the owner, the lender must certify that the property is in good financial and physical condition and in compliance with the regulatory agreement. Such compliance includes payment of outstanding obligations, debt service, and required funding of reserve and escrow accounts.

Sec. 3565.351 (Con.)

(e) Physical maintenance. The lender must annually inspect the property to ensure that it is in compliance with state and local codes and program requirements. The lender must certify to the Agency that a property is in such compliance, or report to the Agency on any non-compliance items and proposed actions and timetable for resolution. Failure to provide responsive corrective action can result in reduction or cancellation of the guarantee by the Agency.

Sec. 3565.352 Preservation of affordable housing.

(a) Original purpose. During the period of the guarantee, owners are prohibited from using the housing or related facilities for any purpose other than an approved program purpose.

(b) Use restriction. For the original term of the guaranteed loan, the housing must remain available for occupancy by low and moderate income households, in accordance with subpart E of this part. This requirement will be included in a deed restriction or other instrument acceptable to the Agency. The restriction will apply unless the housing is acquired by foreclosure or an instrument in lieu of foreclosure, or the Agency waives the applicability of this requirement after determining that each of the following three circumstances exist.

(1) There is no longer a need for low-and moderate-income housing in the market area in which the housing is located;

(2) Housing opportunities for low-income households and minorities will not be reduced as a result of the waiver; and

(3) Additional federal assistance will not be necessary as a result of the waiver.

Sec. 3565.353 Affirmative fair housing marketing.

As a condition of the guarantee, the lender must ensure that the lender and borrower are in compliance with the approved Affirmative Fair Housing Marketing Plan. This plan must be reviewed annually by the lender to ensure that the borrower remains in compliance and to recommend modifications, as necessary.

Sec. 3565.354 Fair housing accommodations.

The lender must ensure that the borrower is in compliance with the applicable fair housing laws in the development of the property, the selection of applicants for housing, and ongoing management. See subpart A of this part.

Sec. 3565.355 Changes in ownership.

Any change in ownership, in whole or in part, must be approved by the lender and the Agency before such change takes effect.

Secs. 3565.356-3565.399 [Reserved]

Sec. 3565.400 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart I--Servicing Requirements

Sec. 3565.401 Servicing objectives.

The participating lender is responsible for servicing the guaranteed loan throughout the term of the loan or guarantee, whichever is less. In all cases, the lender remains responsible for liquidation of the property in accordance with the Loan Note Agreement, unless otherwise determined by the Agency. A lender-servicing plan must be designed and implemented to achieve the following objectives.

(a) To preserve the value of the loan and the real estate;

(b) To avoid a loss to the lender or the Agency and to limit exposure to potential loss;

(c) To protect the interests of the tenants; and

(d) To further program objectives.

Sec. 3565.402 Servicing responsibilities.

The lender must service the loan in accordance with this subpart and perform the services contained in this section in a reasonable and prudent manner. The lender is responsible for the actions of its agents and representatives.

(a) Funds management. The lender must have a funds management system to receive and process borrower payments, including the following.

(1) All principal and interest (P&I) funds and guarantee fees collected and deposited into the appropriate custodial accounts.

(2) Payments to custodial escrow accounts for taxes and insurance premiums, assessments that might impair the security (such as ground rent), and reserve accounts for repair and capital improvement of the property.

(b) Asset management. The lender must ensure that the property securing the guaranteed loan remains in good physical and financial condition, in accordance with project management requirements contained in subpart H of this part.

(c) Management of delinquencies and defaults. Each month the lender must report to the Agency any delinquencies and defaults in accordance with subpart H of this part.

Sec. 3565.403 Special servicing.

Special servicing must be initiated when regular servicing actions are insufficient to resolve borrower default or property deficiencies.

(a) Repurchase from holder. For securitized loans, the holder may require the lender or Government to repurchase the security in accordance with the provisions of §3565.405.

(b) Responsibility of the lender. It is the lender's responsibility during special servicing to make a special effort to ensure that maintenance of the property meets Agency requirements and the tenants' rights are protected, until such time that the property is liquidated by the lender, the loan is paid in full, or the loan is assigned to the Agency. The lender must update the Agency monthly until the default is cured or a claim is filed. The lender must maintain adequate records of any and all efforts to cure the default or to foreclose.

Sec. 3565.403 (Con.)

(c) Initiating special servicing. When special servicing is initiated, the lender must submit for Agency review a special servicing plan that includes proposed actions to cure the deficiencies and a timeframe for completion. The special servicing plan will specify the proposed terms of any workout agreement recommended by the lender. The lender must obtain Agency approval of the terms of any workout agreement with the borrower. The workout agreement may include a loan modification, transfer of physical assets, or partial payment of claim and reamortization of the loan. Failure to comply with terms contained in the executed workout agreement will be considered a default of the guaranteed loan.

(1) Loan modification. The borrower and lender may agree to a loan modification when such action will improve the financial viability of the project and its operations, and when a circumstance exists that is beyond the borrower's control. The Agency must approve in advance any loan modification that extends the life of the loan or requires an increase in the amount of the guarantee. All changes must be within the requirements of section 538 of the Housing Act of 1949.

(2) Change in ownership and transfer of physical assets. A default or delinquency may be resolved by a change of the ownership entity in whole or in part. The Agency must approve all changes in ownership prior to the effective date of the transfer, and may require additional resources from the lender or borrower to resolve project deficiencies.

(3) Partial payment of claims. The lender may request a partial payment of claim as a result of a loss experienced by the lender as a means to work out a troubled loan. The Agency will accept such claim if it determines that it is in the best interest of the government. In applying the partial payment, the lender must assign the obligation covered by the partial payment to the Agency, and, if required by the Agency, reamortize the obligation using the amount of the remaining obligation over an agreed-upon term.

(d) Claims processing. In the event of a loss, the lender must submit claims under the guarantee in accordance with subpart J of this part. Prior to submitting a claim, the lender must exhaust all possibilities of collection on the loan.

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

Sec. 3565.404 Transfer of loans or mortgage servicing.

Transfer of servicing is prohibited unless the Agency determines that circumstances warrant such action, the proposed lender is an eligible lender approved by the Agency, and the transfer of servicing is approved by the Agency in advance.

Secs. 3565.405-3565.449 [Reserved]

Sec. 3565.405 Repurchase of guaranteed loans.

(a) Repurchase by lender. The holder may make written demand on the lender to repurchase the unpaid guaranteed portion of the loan when the borrower is in default not less than 60 calendar days on principal or interest due on the loan; or the lender has failed to remit to the holder its pro rata share of any payment made by the borrower within 30 calendar days of the

lenders receipt thereof. The holder must concurrently send a copy of the demand letter to the Agency. The lender will notify the holder and the Agency of its decision to repurchase within 10 business days from the date of the written demand letter by the holder. The lender may agree to repurchase the unpaid portion of the entire loan from the Holder, even though the guarantee will not cover the unguaranteed portion of the loan. If the lender decides to repurchase, the lender has 30 calendar days from the date of the holder's written demand letter to do so. The guarantee will not cover the unguaranteed portion of the loan or the note interest to the holder on the guaranteed loan accruing after 90 calendar days from the date of the demand letter to the lender requesting the repurchase. The lender may deduct the lender's servicing fee from the repurchase amount. The lender will accept an assignment without recourse from the holder upon repurchase. The lender is encouraged to repurchase the loan to facilitate the accounting of funds, resolve the problem, and prevent default where and when reasonable.

(b) Repurchase by Agency.

(1) If the lender does not repurchase the loan as provided in paragraph (a) of this section, the Agency will purchase from the holder the unpaid principal balance of the guaranteed portion together with accrued interest to date of repurchase, less the lender's servicing fee, within 30 calendar days after written demand to the Agency from the holder. This demand notice is in addition to the copy of the written demand on the lender. The guarantee will not cover the note interest to the holder on the guaranteed loan accruing after 90 calendar days from the date of the original demand letter of the holder to the lender requesting the repurchase.

Holders of Loan Note Guarantees that have been issued prior to the effective date of this final rule may opt to adhere to the terms and conditions of the Loan Note Guarantee then in effect. In case of loan default, the holder of a Loan Note Guarantee issued prior to the effective date of this final rule will stipulate, in a written demand for repurchase, its preference for repurchase in accordance with the Loan Note Guarantee issued prior to the effective date of this final rule. If the demand for repurchase does not stipulate a preference for repurchase in accordance with the Loan Note Guarantee issued prior to the effective date of this final rule, the Agency will process the demand for repurchase as stated in this final rule. The holder must stipulate a preference for repurchase in accordance with the Loan Note Guarantee issued prior to the effective date of this final rule in the first demand for repurchase. The holder of the Loan Note Guarantee issued prior to the effective date of this final rule cannot make a subsequent demand for repurchase changing the preference stipulated in the original demand for repurchase.

(2) The holder's demand to the Agency must include a copy of the written demand made to the lender. The holder must also include evidence of its right to require payment from the Agency. Such evidence will consist of either the original of the Loan Note Guarantee properly endorsed to the Agency or the original of the Assignment Guarantee Agreement, or an Agency approved assignment guarantee agreement, properly assigned to the Agency without recourse including all rights, title, and interest in the loan. The holder must include in its demand the amount due including unpaid principal, unpaid interest to date of demand, and interest subsequently accruing from date of demand to proposed payment date. The Agency will be subrogated to all rights of the holder.

(3) The Agency will notify the lender of its receipt of the holder's demand for payment. The lender must provide the Agency with the information necessary for the Agency to determine the appropriate amount due the holder within 10 business days from the date of the written demand letter to the lender from the holder requesting repurchase of the guaranteed portion. The lender will furnish a current statement certified by an appropriate authorized officer of the lender stating the unpaid principal and interest then owed by the borrower on the loan and the amount then

owed to any holder. Any discrepancy between the amount claimed by the holder and the information submitted by the lender must be resolved between the lender and the holder before payment will be approved. The Agency will coordinate the resolution of the discrepancy. Such conflict will suspend the running of the 30 calendar day payment requirement.

(4) Purchase by the Agency neither changes, alters, nor modifies any of the lender's obligations to the Agency arising from the loan or guarantee nor does it waive any of the Agency's rights against the lender. As holder, the Agency will have the right to set-off against any payments the Agency owes the lender.

Sec. 3565.450 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart J-Assignment, Conveyance, and Claims

Sec. 3565.451 Preclaim requirements.

(a) Lender certifications. After borrower default and before filing a claim or assignment of the loan to the Agency, the lender must make every reasonable and prudent effort to resolve the default. The lender must provide the Agency with an accounting of all proposed and actual actions taken to cure the default. The lender must certify that all reasonable efforts to cure the default have been exhausted. Where the lender fails to comply with the terms of the loan guarantee agreement and the corresponding regulations and guidance with regard to liquidating the property, the Agency, at its option, may take possession of the security collateral and dispose of the property.

(b) Due diligence by lender. For all loan servicing actions where a market, net recovery or liquidation value determination is required, guaranteed lenders shall perform due diligence in conjunction with the appraisal and submit it to the Agency for review.
The Phase I Environmental Site Assessment published by the American Society of Testing and Materials is considered an acceptable format for due diligence.

(c) Environmental review. The Agency is required to complete an environmental review under the National Environmental Policy Act, in accordance with 7 CFR part 1940, subpart G or a successor regulation, prior to disposition of inventory property, if title is held by the Agency, and prior to any authorization to the guaranteed lender to foreclose and dispose of property, and for any other servicing action requiring Agency approval or consent.

Sec. 3565.452 Decision to liquidate.

(a) A decision to liquidate shall be made when it is determined that the default cannot be cured through actions contained in § 3565.403 or it has been determined that it is in the best interest of the Agency and the lender to liquidate. For interest accrual purposes, interest will accrue for 90 calendar days after the date the liquidation plan is approved by the Agency. If within 20 calendar days of the Agency’s receipt of the liquidation plan, the Agency fails to respond to the lender's

Sec. 3565.452 (a) Con.

proposal or advise the lender to make revisions to the plan that was submitted, the liquidation plan will be approved by default, and the 90 calendar day period for interest accrual will commence.

(b) In the event of a default involving a loan to an Indian tribe or tribal corporation made under this section which is secured by an interest in land within such tribe's reservation (as determined by the Secretary of the Interior), including a community in Alaska incorporated by the Secretary of the Interior pursuant to the Indian Reorganization Act (25 U.S.C. 461 et seq.), the lender shall only pursue liquidation after offering to transfer the account to an eligible tribal member, the tribe, or the Indian housing authority serving the tribe. If the lender subsequently proceeds to liquidate the account, the lender shall not sell, transfer, or otherwise dispose of or alienate the property except to one of the entities described in the preceding sentence.

Sec. 3565.453 Disposition of the property.

(a) Submission of the liquidation plan. The lender will, within 30 calendar days after a decision to liquidate, submit to the Agency in writing, its proposed detailed plan of liquidation. The Agency will inform the lender, in writing, whether the Agency concurs in the lender's liquidation plan. Should the Agency and the lender not agree on the liquidation plan, negotiations will take place between the Agency and the lender to resolve the disagreement. When the liquidation plan is approved by the Agency, the lender will proceed expeditiously with liquidation. The liquidation plan submitted to the Agency by the lender shall include:

(1) Satisfactory proof of the lender's ownership of the guaranteed loan promissory note and related security instruments.

(2) A copy of the payment ledger or equivalent which reflects the current loan balance and accrued interest to date and the method of computing the interest.

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

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

(i) Obtaining an appraisal of the collateral;

(ii) Acquiring and disposing of all collateral;

(iii) Collecting from guarantors;

(iv) Setting the proposed date of foreclosure; and

(v) Setting the proposed date of liquidation.

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

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

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

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

(9) A schedule to periodically report to the Agency on the progress of liquidation.

(10) Estimated protective advance amounts with justification.

(11) Proposed protective bid amounts on collateral to be sold at auction and a breakdown to show how the amounts were determined.

(12) If a voluntary conveyance is considered, the proposed amount to be credited to the guaranteed debt.

(13) Any legal opinions supporting the decision to liquidate.

(14) The lender will obtain a complete appraisal report on all collateral securing the loan, which will reflect the fair market value and potential liquidation value, and an examination of the

title on the collateral. In order to formulate a liquidation plan, which maximizes recovery, collateral must be evaluated for hazardous substances, petroleum products, or other environmental hazards, which may adversely impact the market value of the collateral.

(b) A transfer and assumption of the borrower's operation can be accomplished before or after the loan goes into liquidation. However, if the collateral has been purchased through foreclosure or the borrower has conveyed title to the lender, no transfer and assumption is permitted.

(c) A protective bid may be made by the lender, with prior Agency written approval, at a foreclosure sale to protect the lender's and the Agency's interest. The protective bid will not exceed the amount of the loan, including expenses of foreclosure, and should be based on the liquidation value considering estimated expenses for holding and reselling the property. These expenses include, but are not limited to, expenses for resale, interest accrual, length of weatherization, and prior liens.

(d) Filing an estimated loss claim. When the lender is conducting the liquidation and owns any or all of the guaranteed portion of the loan, the lender will file an estimated loss claim with the liquidation plan if the lender expects liquidation to exceed 90 calendar days. The estimated loss payment will be based on the outstanding loan amount minus the liquidation value of the collateral. For the purpose of reporting and loss claim computation, the loss claim will be promptly processed in accordance with applicable Agency regulations, as set forth in this section.

The loss claim calculation will include 90 calendar days of interest accrual on the defaulted loan at the time the estimated loss claim is paid by the Agency. If the lender estimates that there will be no loss after considering the costs of liquidation, the lender submits an estimated loss claim of zero. Interest accrual will cease 90 calendar days after the date the liquidation plan is approved by the Agency.

(e) Property disposition. Once the liquidation plan has Agency approval, the lender must make every effort to liquidate the property in a manner that will yield the highest market value consistent with the protections afforded to tenants in 7 CFR part 1944, subpart L or successor regulation.

(f) Accounting and reports. When the lender conducts liquidation, the lender will account for funds during the period of liquidation and provide the Agency with reports at least quarterly on the progress of liquidation, including disposition of collateral, resulting costs, and additional procedures necessary for successful completion of the liquidation.

(g) Transmitting payments and proceeds to the Agency. When the Agency is the holder of a portion of the guaranteed loan, the lender will transmit to the Agency its pro rata share of any payments received from the borrower, liquidation, or other proceeds.

Sec. 3565.454 [Reserved]

Sec. 3565.455 Alternative disposition methods.

The Agency, in its sole discretion, may choose to obtain an assignment of the loan from the lender or conveyance of title obtained by the lender through foreclosure or a deed-in-lieu of foreclosure.

(a) Assignment. In the case of an assignment of the loan, the assignment of the security instruments or the security must be in written and recordable form. Completion of the assignment will occur once the following transactions are completed to the Agency's satisfaction.

(1) Conveyance to the Agency of all the lender's rights and interests arising under the loan.
(2) Assignment to the Agency of all claims against the borrower or others arising out of the loan transactions, including:
(i) All collateral agreements affecting financing, construction, use or operation of the property; and
(ii) All insurance or surety bonds, or other guarantees, and all claims under them.
(3) Certification that the collateral has been evaluated for the presence of contamination from the release of hazardous substances, petroleum products or other environmental hazards which may adversely impact the market value of the property and the results of that evaluation.
(b) Conveyance of title. In the case of a conveyance of title to the property, the lender must inform the Agency in advance of how it plans to acquire title and a timetable for doing so. The Agency will accept the conveyance upon receipt of an assignment to the Agency of all claims of the lender against the property and assignment of the lender's rights to any operating funds and any reserves or escrows established for the maintenance of the property or the payment of property taxes and insurance.

Sec. 3565.456 Filing a claim.

Once the lender has disposed of the property or the Agency has agreed to accept an assignment of the loan or conveyance of title to the property, the lender may file a claim for the guaranteed portion of allowable losses. All claim amounts must be calculated in accordance with this subpart and be approved by the Agency.

Sec. 3565.457 Determination of claim amount.

In all liquidation cases, final settlement will be made with the lender after the collateral is liquidated, unless otherwise designated as a future recovery or after settlement and compromise of all parties has been completed. The Agency will have the right to recover losses paid under the guarantee from any party, which may be liable.
(a) Report of loss form. An Agency approved form will be used for calculations of all estimated and final loss determinations. Estimated loss payments may only be approved by the Agency after the Agency has approved a liquidation plan.
(b) Estimated loss. An estimated loss claim based on liquidation appraisal value will be prepared and submitted by the lender.
(1) The estimated loss payment shall be applied as of the date of such payment. The total amount of the loss payment remitted by the Agency will be applied by the lender on the loan debt. Such application does not release the borrower from liability.
(2)The Government's written authorization is required for all protective advances in excess of $5,000. Protective advances include, nut are not limited to, advances made for property taxes, annual assessments, ground rent, hazard or flood insurance premiums affecting the collateral, and other expenses necessary to preserve or protect the security. Attorney fees are not a protective advance. A protective advance claim will be paid only at the time of the final report of loss payment except in certain transfer and assumption situations with Agency approval.
(c) Final loss. Within 30 calendar days after liquidation of all collateral, except for certain unsecured personal or corporate guarantees (as provided for in this section) is completed, a final report of loss must be prepared and submitted by the lender to the Agency. Before approval by

the Agency of any final loss report, the lender must account for all funds during the period of liquidation, disposition of the collateral, all costs incurred, and any other information necessary for the successful completion of liquidation. Upon receipt of the final accounting and report of loss, the Agency may audit all applicable documentation to determine the final loss. The lender will make its records available and otherwise assist the Agency in making any investigation. The documentation accompanying the report of loss must support the amounts shown on the report of loss form.

(1) A determination must be made regarding the collectability of unsecured personal and corporate guarantees. If reasonably possible, such guarantees should be promptly collected or otherwise disposed of prior to completion of the final loss report. However, in the event that collection from the guarantors appears unlikely or will require a prolonged period of time, the report of loss will be filed when all other collateral has been liquidated, and unsecured personal or corporate guarantees will be treated as a future recovery with the net proceeds to be shared on a pro rata basis by the lender and the Agency.

(2) The lender must document that all of the collateral has been accounted for and properly liquidated and that liquidation proceeds have been properly accounted for and applied correctly to the loan.

(3) The lender will show a breakdown of any protective advance amount as to the payee, purpose of the expenditure, date paid, and evidence that the amount expended was proper and that payment was actually made.

(4) The lender will show a breakdown of liquidation expenses as to the payee, purpose of the expenditure, date paid, and evidence that the amount expended was proper and that payment was actually made. Liquidation expenses are recoverable only from collateral proceeds.

(5) Accrued interest will be supported by documentation as to how the amount was accrued.

(6) Loss payments will be paid by the Agency within 60 calendar days after the receipt of the final loss report and accounting of the collateral.

(7) Should there be a circumstance where the lender cannot or will not sign a final report of loss, the State Director may complete the final report of loss and submit it to the Finance Office without the lender's signature. Before this action can be taken, all collateral must be disposed of or accounted for; there must be no evidence of fraud, misrepresentation, or negligent servicing by the lender; and all efforts to obtain the cooperation of the lender must have been exhausted and documented.

(d) Maximum guarantee payment. The maximum guarantee payment will not exceed the amount of guarantee percentage as contained in the guarantee agreement (but in no event more than 90%) times the allowable loss amount.

(e) Rent. Any net rental or other income that has been received by the lender from the collateral will be applied on the guaranteed loan debt after paying operating expenses of the property.

(f) Liquidation costs. Liquidation costs will be deducted from the proceeds of the disposition of primary collateral. If changed circumstances after submission of the liquidation plan require a substantial revision of liquidation costs, the lender will procure the Agency's written concurrence prior to proceeding with the proposed changes.

(g) Payment. When the Agency finds the final report of loss to be proper in all respects, it will approve the form and proceed as follows:

(1) If the loss is greater than any estimated loss payment, the Agency will pay the additional amount owed by the Agency to the lender.

(2) If the loss is less than the estimated loss payment, the lender will reimburse the Agency for the overpayment.

(3) If the Agency determines that it is in the Government's best interest to take assignment of the loan and conduct liquidation, as stipulated in 42 U.S.C. 1490 (i)(3), Assignment by Secretary, the Agency will pay the lender in accordance with the Loan Note Guarantee.

(h) Date of loss. The date of loss is the date on which the collateral will be liquidated in the liquidation plan, unless an alternative date is approved by the Agency. Where the Agency chooses to accept an assignment of the loan or conveyance of title, the date of loss will be the date on which the Agency accepts assignment of the loan or conveyance of title.

(i) Allowable claim amount. The allowable claim amount must be calculated by:

(1) Adding to the unpaid principal and interest on the date of loss, an amount approved by the Agency for payments made by the lender for amounts due and owning on the property, including:

(i) Property taxes and other protective advances as approved by the Agency;

(ii) Water and sewer charges and other special assessments that are liens prior to the guaranteed loan;

(iii) Insurance of the property; and

(iv) Reasonable liquidation expenses.

(2) And by deducting the following items:

(i) Any amount received by the lender on the account of the guaranteed loan after the date of default;

(ii) Any net income received by the lender from the secured property after the date of default; and

(iii) Any cash items retained by the lender, except any amount representing a balance of the guaranteed loan not advanced to the borrower. Any loan amount not advanced will be applied by the lender to reduce the outstanding principal on the loan.

(j) Lender certification. The lender must certify that all possibilities of collection have been exhausted and that all of the items specified in paragraph (c) of this section have been identified and reported to the Agency as a condition for payment of claim.

Sec. 3565.458 Withdrawal of claim.

If the lender provides timely written notice to the Agency of withdrawal of the claim, the guarantee will continue as if the default had not occurred if the borrower cures the default prior to foreclosure or prior to acceptance of a deed-in-lieu of foreclosure.

Secs. 3565.459-3565.499 [Reserved]

Sec. 3565.500 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0174.

Subpart K - Agency Guaranteed Loans that Back Ginnie Mae Guaranteed Securities

§ 3565.501 Applicability.

The provisions of this subpart apply when Agency guaranteed loans are used to back Ginnie Mae securities. In instances where this subpart applies, the provisions of this subpart prevail over any other provisions of this part.

§ 3565.502 Incontestability.

In the case of loans that back Ginnie Mae securities or loans that are acquired by Ginnie Mae as a consequence of its guaranty, the Agency guarantee under this part is incontestable except that the guarantee may not be enforced by a lender who commits fraud or misrepresentation or by a lender who had knowledge of the fraud or misrepresentation at the time such a lender acquired the guarantee or was assigned the loan.

§ 3565.503 Repurchase.

Lenders and security holders must comply with Ginnie Mae requirements regarding the repurchase of loans from pools backing Ginnie Mae guaranteed securities.

§ 3565.504 Transfers.

(a) Loans and/or mortgage servicing on loans backing Ginnie Mae guaranteed securities may only be transferred to a Ginnie Mae issuer and may only be transferred with prior Ginnie Mae approval.
(b) Agency approval shall not be required for transfer of the servicing on the guaranteed mortgages to Ginnie Mae.

§ 3565.505 Liability.

(a) Ginnie Mae shall not be liable for the actions of the lender including, but not limited to, negligence, fraud, abuse, misrepresentation or misuse of funds, property condition, or violations of usury laws.
(b) Ginnie Mae's rights under the guarantee shall be fully enforceable notwithstanding the actions of the lender.

§§ 3565.506-3565.549 [Reserved]

§ 3565.550 OMB control number.

According to the Paperwork Reduction Act of 1995, no party is required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information is 0575-0174.

APPENDIX 2
LIST OF FORMS

Below is a list of forms that are mentioned in the text of this handbook. Since these forms may change more frequently than the handbook, users are encouraged to obtain the most updated copy of these forms from the Rural Development Instructions home page (http://rdinit.usda.gov/regs) for their own reference.

AIA Document A-101
AIA Document 702
ASTM Standard E-1527
Form RD 449-30, Loan Note Guarantee Report of Loss
Form RD 451-2, Schedule of Remittances
Form RD 1910-11, Applicant Certification, Federal Collection Policies for Consumer or Commercial Debts
Form RD 1924-13, Estimate and Certificate of Actual Cost
Form RD 1924-16, Record of Pre-Construction Conference
Form RD 1924-25, Plan Certification
Form RD 1940-3, Request for Obligation of Funds, Guaranteed Loans
Form RD 1940-20, Request for Environmental Information
Form RD 1940-21, Environmental Assessment for Class I Action; or Exhibit H, RD Instruction 1940-G, Environmental Assessment for Class II Actions
Form RD 1940-22, Environmental Checklist for Categorical Exclusions
Form RD 1944-37, Previous Participation Certification
Form RD 1980-11, Guaranteed Rural Housing Lender Record Change
Form RD 1980-19, Guaranteed Loan Closing Report
Form RD 1980-24, Request Interest Assistance/Interest Rate Buydown/Subsidy Payment to Guaranteed Loan Lender
Form RD 1980-37, Purchase of a Guaranteed Loan Portion
Form RD 1980-41, Guaranteed Loan Status Report
Form RD 1980-43, Lender's Guaranteed Loan Payment to USDA
Form RD 1980-44, Guaranteed Loan Borrower Default Status
Form RD 2006-38, Civil Rights Impact Analysis Certification
Form RD 3550-6, Notice of Special Flood Hazards, Flood Insurance Purchase Requirements, and Availability of Federal Disaster Relief Assistance
Form RD 3560-8, Tenant Certification
Form RD 3560-9, Multi-Family Housing Interest Credit Agreement
Form RD 3560-11, Multi-Family Housing Physical Inspection
Form RD 3560-30, Certification of NO Identify of Interest (IOI)
Form RD 3560-31, Identity of Interest Disclosure/Qualification Certificate
Form RD 3565-1, Application for Loan and Guarantee
Form RD 3565-2, Conditional Commitment
Form RD 3565-3, Lender's Agreement

Form RD 3565-4, Loan Note Guarantee
Form RD 3565-5, Assignment Guarantee Agreement
Form AD 1047, Certification Regarding Debarment, Suspension, and Other Responsibility Matters – Primary Covered Transactions
Form AD 1048, Certification Regarding Debarment, Suspension, Ineligibility and Voluntary Exclusion – Lower Tier Covered Transactions
FEMA Form 81-93, *Standard Flood Hazard Determination*
Form HUD 935.2, Affirmative Fair Housing Market Plan
Form HUD 9832, Management Entity Profile
Form I-94, Arrival-Departure Record
Form I-551 (or I-151), Alien Registration Card
RD Instruction 1940-Q Exhibit A-2, Statement of Loan Guarantees