January 11, 2016

TO: State Directors
Rural Development

ATTN: Program Directors
Single Family Housing

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

SUBJECT: Protective Advances and Partial Releases
Single Family Housing Direct Loan Programs

PURPOSE:

The purpose of this memorandum is to address Fiscal Year 2015 Management Control Review findings related to protective advances and partial releases.

BACKGROUND:

Protective advances protect the Government's security interest and can be used for essential repairs, to satisfy prior liens, to pay taxes, to pay insurance premiums, or to pay local assessments. Protective advances for essential repairs are generally handled by the Rural Development (RD) field staff. Protective advances for essential repairs must only be used when there is no other alternative. Protective advances are a last resort measure since they pose a higher risk of loss to the Government in comparison to the alternatives, they create tax consequences for the borrower, and they can be more costly to the borrower since they bear interest at the existing loan's promissory note rate. Partial releases are generally handled by the RD field staff. Communication concerning partial release approvals with the borrower and the Customer Service Center (CSC) is essential so as to not interfere with loan account servicing.

EXPIRATION DATE:
December 31, 2016

FILING INSTRUCTIONS:
Housing Programs

IMPLEMENTATION RESPONSIBILITIES:

Per 7 CFR 3550.206, protective advances for essential repairs will only be made if the borrower cannot obtain a subsequent loan. In cases where the borrower is living in the security property and is income eligible, the RD field staff will ask the borrower to complete an application and provide all the relevant supporting materials. The RD field staff will then review the application to determine the borrower's eligibility for a Section 502 loan, a Section 504 loan, a Section 504 loan/grant combination, or a Section 504 grant depending on the borrower's income and repayment ability.

When reviewing the application for a subsequent program loan, the RD field staff should utilize the following processing and eligibility allowances when applicable. The pertinent paragraphs within Handbook-1-3550 are noted in parentheses.

- The Loan Approval Official should consider making an exception for adverse credit. If the borrower has a good payment record on their existing Agency loan, the case for an exception is strong. If the borrower is delinquent on the Agency loan and the case warrants it, a waiver request could be submitted to National Headquarters on the basis that the subsequent loan would benefit the Government (4.14 A.).
- Title clearance and the use of legal services are not necessary for subsequent loans for minimal essential repairs to protect the Government's interest (5.12 B.).
- An appraisal is not required when a subsequent loan is made to protect the Government's interest, regardless of the amount, or if the subsequent loan is less than $7,500 and is for minimal essential repairs. However, the Loan Originator must include a statement of the estimated property value in the case file (5.17).
- If necessary to protect the Government's security interest, a subsequent loan may be made that causes the total indebtedness to exceed the market value of the property and/or the area loan limit. The excess amount cannot exceed the cost of necessary repairs, reasonable closing costs, and allowable excess costs (6.7 C.).
- Subsidy may be granted on a secured subsequent loan with a term of less than 25 years if the initial loan had a term of 25 years or more (6.8 B. and 6.11 C. 1.).
- The interest rate of the subsequent loan is the current rate, not the rate of the initial loan (6.9).
- The initial loan may be reamortized if the borrower cannot be reasonably expected to meet installment payments after consulting with CSC (6.16 B. 2). A waiver to exceed repayment ratios may be considered, based upon compensating factors.
- In cases where the borrower is not income eligible, the Agency will consider subordinating its lien position to another lender so that the essential repairs can be made (13.10).

Given all the allowances and considerations noted above, there should be limited instances where a protective advance for essential repairs is the only option. In those cases, the decision to use a protective advance for essential repairs must be reviewed and approved by the Housing Program Director. The following items must be provided to the Housing Program Director: A written explanation as to why the alternatives to a protective advance were not feasible as well as a description of the essential repairs and a written explanation as to why the repairs are needed to protect the Government's security interest.

When protective advances for repairs are approved, funds may only be disbursed directly to the supplier or contractor making the repairs. If possible, payment will be made by electronic funds transfer (EFT). It should be noted that protective advances will be reported to the IRS as income to the vendor and an IRS Form 1099 will be generated. In no case should the borrower or RD employee be listed as the vendor. Payment will be made directly to the contractor by EFT or paper check when repairs are completed and the final inspection is performed; a supervised bank account will not be used.

At the time of approval of the protective advance, the borrower must be notified and show repayment ability for the advance. Borrowers are required to repay the advance in a lump sum with the next scheduled payment. If the borrower is unable to repay the lump sum amount, the RD State Office may request CSC schedule repayment consistent with the borrower's ability to pay or re-amortize the loan (13.15).

Per 7 CFR 3550.159 (c), a borrower may request a partial release of security to accommodate a need to sell or exchange part of the property or grant a right-of-way across the security property. Form RD 465-1, Application for Partial Release, Subordination, or Consent, is used by the borrower to request a partial release of security.

When reviewing an application for a partial release of security, the RD field staff should note the pertinent paragraphs within Handbook-1-3550 which are noted in parentheses.

- An appraisal or broker's price opinion from another lender is required for the Agency to subordinate its interests or to approve a partial release of security if the amount of consideration exceeds $5,000. The borrower must pay for the appraisal, or the cost for an appraisal may be charged to the borrower's account (13.9 B.).
- Proceeds from the transaction to be applied to the Agency indebtedness will be remitted to the Cash Management Branch in CSC using Form RD 3550-17, Funds Transmittal Report, with Reason Code "00" together with a brief statement as to the source of the proceeds, a copy of Form RD 465-1, and any related documentation. The RD field staff will also notify CSC using Task 178, Legal Description Correction. (13.9 D.).

- In addition to completing Task 178, the RD field staff will complete any required State release forms, or form RD 460-1, Partial Release. For an exchange of all or a portion of the security property, obtain title clearance for the new security before the release of the existing security. New security instruments must be obtained for the new security property. For a sale of all or a portion of the security property, deliver the release when full payment is received (13.12).

The borrower or third parties are responsible for recording the partial release or new security instruments according to State law. The unrecorded partial release or new deed of trust / mortgage form with any corrected legal descriptions will also be uploaded to the imaging repository as “Loan Documents Class” – “Deeds of Trust Mortgages” as part of the borrower’s permanent record to effectively communicate the transaction with CSC.

If you have any questions, please contact the Single Family Housing Direct Division at (202) 720-1474.