The purpose of this presentation is to give viewers a basic overview of the Section 502 direct loan program’s pre-qualification and application processes. While this recorded webinar is targeted to Rural Development (RD or Agency) staff, others (such as loan application packagers) may find the covered materials useful.
A pre-qualification involves using unverified information from an interested party to evaluate the likelihood of them being able to obtain a Section 502 direct loan.

The pre-qualification process includes describing the program requirements to an interested party; gathering basic eligibility and financial information from them; pulling their infile credit report (if authorized); calculating their estimated qualification amount; and discussing the unofficial results with them.
Pre-Qualification Process

It is important to note that:

- The pre-qualification process is detailed in Handbook-1-3550, Chapter 3.
- RD staff are not required to conduct pre-qualification reviews.
- The interested party should be encouraged to obtain their free annual credit report by calling 1-877-322-8228 or logging into http://www.annualcreditreport.com since the Agency will not furnish them with a copy of the infile credit report it obtains.

While the program’s loan origination system (a.k.a. UniFi) and contract for credit reports supports the completion of pre-qualifications, **RD staff are not required to conduct pre-qualification reviews.**

Pre-qualifications involving infiles must be entered into UniFi.

As previously mentioned, an infile credit report can be pulled if authorized by the interested party. The interested party can authorize the Agency to order a single repository infile credit report at no charge to them by signing an Authorization to Release Information (Form RD 3550-1).

By law, individuals are entitled to receive one free credit file disclosure every 12 months from each of the nationwide consumer credit reporting companies – Equifax, Experian and TransUnion.
Pre-Qualification Process

It is important to note (continued):

• Some pre-qualifications prompted by a visit, call, email, or fax from an interested party may not rise to the level of needing to input the information into UniFi in order to have a useful exchange with the interested party. Let’s consider some possible scenarios.

• As evidenced by the scenarios, asking questions gives the RD staff a clearer picture of the interested party’s situation and how best to counsel them.

Scenario 1: Ms. Smith visits her local RD office to inquire about qualifying for a direct loan. Through his questions, the RD staff member assisting her learns that Ms. Smith, a widow with no children, receives $2,500/month in Social Security income and has $500,000 in her bank account from her deceased husband’s life insurance policy payoff. While Ms. Smith is within the low-income category for the county in which she wishes to live, the RD staff member shares the program’s assets requirement and the requirement to be unable to obtain credit elsewhere with Ms. Smith. The RD staff member encourages Ms. Smith to seek out conventional credit; he also explains to Ms. Smith that while it appears she won’t qualify for the direct program based on their conversation – she is welcome to apply so that an official Agency decision is rendered (with review, mediation, and appeal rights if adverse/appealable).

Scenario 2: Mr. Wagner called his local RD office to inquire about qualifying for a direct loan. Through her questions, the RD staff member learns that Mr. Wagner is married with two children, is the sole income earner in the household, earns $40,000/year, has been with his employer for five years, and has no debt other than a collection for $20,000. The collection, which isn’t being paid down, seemingly resulted from him mishandling his finances. While Mr. Wagner is within the low-income category for the county in which he wishes to live, the RD staff member explains to Mr. Wagner that the collection is an indicator of unacceptable credit handling as is his limited credit history. The RD staff member encourages Mr. Wagner to seek the assistance of a credit counseling agency to improve his credit record; she also explains to Mr. Wagner that while it appears he won’t currently qualify for the direct program based on their conversation – he can still apply so that an official Agency decision is rendered (with review, mediation, and appeal rights if adverse/appealable).
Scenario 3: Miss Templeton emails her local RD office to inquire about qualifying for a direct loan. She indicates that she is single with no children, her credit score is 680, she makes $36,000/year, has approximately $5,000 in her savings account, pays roughly $100/month on an installment debt, and wishes to live in Grant County (which has an adjusted low-income limit of $38,000). The RD staff emails her back letting her know that based on the unverified information, it appears that she may be eligible for the program and provides instructions on how to apply.

Notice that in all of these scenarios, none of the information is verified, so you must be careful to use phrases which do not imply a definitive decision regarding eligibility. Never say, “you are not eligible” or “you would qualify”. Use phrases like “based on what you have told me, it appears you may qualify for the program” or “based on what you reported, it does not appear that you would likely qualify at this time”.
Pre-Qualification Process

It is important to note (continued):

• Loan Originators need to provide consistent counseling following a pre-qualification review. While counseling an interested party who does not appear to be likely to qualify, be sure to stress that the results are unofficial and they are welcome to submit an application at any time.

If the results of the pre-qualification review are negative, the interested party should be counseled on how to improve their ability to qualify for the program. Refer to Handbook-1-3550, Attachment 3-F for examples on how to properly respond to various negative pre-qualification results.

Discussing the results of the pre-qualification is an important step to assist the interested party understand possible issues as well as resources.

• **Over-Income** – If the household income appears to be above the low-income limit, the interested party should be informed about options available for those with moderate-income such as assuming a loan on nonprogram terms, purchasing a REO property on nonprogram terms, a Guaranteed Rural Housing (GRH) loan, or other conventional credit options.

• **Low Estimated Maximum Loan Amounts** - If the loan amount for which the interested party appears to qualify is not sufficient to purchase a modest, decent, safe, and sanitary house in the area – the Loan Originator should counsel the interested party about other resources such as: subsidized funds (such as affordable housing loans/grants), the need for increased household income, the need to reduce household debt, and/or the possibility of adding additional parties or a co-signer to the note. Keep in mind that a Loan Originator should never tell the interested party they must do these things in order to qualify. An interested party has the right to determine who will apply for the loan and have ownership of the property. It is the role of the Loan Originator to counsel the interested party regarding potential options.
• **Candidates for Financing with Private Credit** - If an interested party’s credit history, income (i.e. they appear to be above the very low-income limit), assets, and lack of need for payment assistance indicate that they should be able to qualify for a GRH loan or private financing, the Loan Originator should ask whether an attempt to obtain such financing has been made. If not, an interested party should be informed that they should attempt to obtain other credit.

• **Unacceptable Credit and/or Lack Repayment Ability** - If the credit appears unacceptable based on an infile credit report or from information supplied by the interested party; or it appears the interested party lacks repayment ability for a loan, the Loan Originator should counsel the interested party. If the pre-qualification was not conducted face-to-face or over the telephone, the Loan Originator should use Handbook Letter 19 (3550), Pre-Qualification Review, as a way to prompt the opportunity to counsel the interested party in ways to correct these problems. The Loan Originator may encourage the interested party to seek credit counseling or a homeownership education course but should **NEVER** discourage the interested party from submitting an application.

Regardless of the results of the pre-qualification, if at any point the interested party requests an application, they will be provided with the information they need to apply and their complete application will be processed once received.
Pre-Qualification Process

It is important to note (continued):

• The pre-qualification review does not apply to someone who has submitted an application. Once an application is received, the application needs to be directly processed using verified information and a Tri-Merge Credit Report (TMCR) so that an official eligibility decision can be rendered. Once an application is received, there is absolutely no reason to order an infile credit report so never order an infile credit report for an applicant.
Pre-Qualification Process

It is important to note (continued):
• When a loan application packager is involved, the packager is responsible conducting the pre-qualification review. The Agency should not be asked to review the results of their pre-qualification.
Using the pre-qualification process has pros and cons.

Through the pre-qualification process, which generally takes less than an hour, RD staff can identify an interested party’s possible barriers to program eligibility (e.g. credit issues, lack of repayment ability, etc.) and counsel them on ways to improve their situation. However, because none of the information is verified, an official decision cannot be made. Additionally, because unverified information is being used, decisions may be flawed and the process itself could adversely impact the interested party. For instance:

- While the infile credit report contains a credit score, it is not a reliable score so a determination cannot be made whether the interested party will qualify for streamlined credit processing should they submit an application.
- The infile credit report is a “hard hit” on the interested party’s credit and may adversely affect their credit score.
- The interested party may not report their income correctly (i.e. they may tell you their net income as opposed to gross income; or they might not accurately relay bonus and overtime income).

Foregoing the pre-qualification process and beginning with the application process:

- Mitigates processing redundancies.
- Avoids multiple hard hits against a person’s credit.
• Leads to only providing an official decision. Applicants who are eligible are prompted to look for a property; applicants who are not eligible are given review, mediation, and appeal rights if the decision is appealable.
An interested party can begin the application process by:

- Requesting that the Agency send them an application package or they can obtain one in person at their local RD office. The package should contain Form RD 410-4 (Uniform Residential Loan Application), Attachment 3-D, Attachment 3-J, and the RD forms referenced in Attachment 3-J.
- Applying online via eForms. To apply online, the interested party will need a Level 2 eAuthentication account.
- Engaging the service of a loan application packager.

Using eForms is beneficial to both the interested party and to RD. For the interested party, eForms provides a convenient and secured way to submit a loan application package to RD that contains all the required documents with the exception of the credit report fee (which will need to be mailed or hand delivered to the RD office that will process the application). For the Agency, eForms streamlines the application process and reduces paper consumption. A link to the Level 2 eAuthentication registration can be found in the handout for this webinar.


Ideally, an interested party who engages the service of a loan application packager was approached by that packager and that is how they learned about the program. However, they may have learned about this service through the Agency since the Agency provides a list of intermediaries involved in the certified packaging process under the Forms & Resources for Single Family Housing Direct Home Loans. A link to this site can be found in the handout for this webinar. By selecting a particular state on this site, interested parties should be able to view the intermediary (or intermediaries) operating in that state plus a list of certified packaging bodies working without an intermediary. Additionally, the local RD office may have discussed this service with the interested party during the pre-qualification process and provided them with the contact information on the packagers in their area. Once an application is received directly from a customer, RD staff will not refer the applicant to a packager.

https://www.rd.usda.gov/programs-services/single-family-housing-direct-home-loans
Regardless of which avenue is taken to begin the process, the interested party must provide the uniform residential loan application and all applicable items in Attachment 3-J, Checklist of Items to Accompany the Uniform Residential Loan Application.
Application Process

Upon receipt of an application, it is:
  • Date stamped and
  • Reviewed within 3 business days to determine if it is complete (i.e. fully completed/signed uniform residential loan application and all applicable items from Attachment 3-J).
    • If complete, processing continues and the TMCR is ordered.
    • If incomplete, HB Letter 11 is sent identifying missing items and providing 15 days for their receipt.

For items in the application package that require the applicant’s signature, a copy of their wet signature is acceptable. If the uniform residential loan application was submitted through eForms, the eForms submission constitutes a signature (i.e. a copy of a wet signature is not needed).

If the application was received from a packager/intermediary, it should also contain items outlined in Attachment 3-A such as a loan narrative and the automated income calculator worksheet.

When the application is received from an applicant or a packager/intermediary, it is important to communicate timely and clearly define what information is missing so that the applicant or packager/intermediary may provide it.
Upon receipt of an application, it is (continued):

- Reviewed to determine if the loan estimate disclosure requirement has been triggered,
- A case file is established (preferably an electronic case file via the Electronic Customer File but hardcopy is also acceptable at this time), and
- The information is entered into UniFi.

When the application is received from a packager/intermediary, it is critical to copy the packager/intermediary when corresponding with the applicant so they are aware of the file status and can provide continued assistance.
Eligibility uses verified information from the applicant and third parties (e.g. TMCR) to make an official decision on the applicant’s loan request. The process includes calculating the applicant’s income; assessing their ability and willingness to meet their debt obligations; determining their repayment ability; and determining if they meet the program’s other borrower eligibility requirements.

Discussing eligibility with the applicant is much like the process used in the pre-qualification process. The big difference is that you are now using verified information to make a decision.

Once the complete application is reviewed, one of two eligibility decisions are made:

- The applicant is eligible – in which case one of the following will occur:
  - Form RD 1944-59, Certificate of Eligibility (COE), is issued for a specified loan amount if funds are available.
  - HB Letter 16 is issued if the applicant will be involved in the self-help program.
  - If funds are available and the applicant submitted an option to purchase or sales agreement prior to their eligibility determination (which is strongly discouraged), the property is then reviewed for eligibility.
  - HB Letter 2 (or HB Letter 4 if a property has been identified) is issued if funds are not available.

A favorable determination of eligibility is not a firm commitment or a guarantee of loan funds.

- The applicant is not eligible – in which case an adverse decision letter is sent.
Eligibility

The Certificate of Eligibility (COE) informs the applicant about:

- Their maximum loan amount based on specified criteria (i.e. county where they wish to live, down payment, taxes, insurance, term, interest rate, and other funding sources).
- Whether or not they must complete a homeownership education course.
- When their COE will expire (i.e. generally 45 days from issuance, however, 60 days is allowed when leveraging is involved).

Let’s assume that the applicant did not submit an option to purchase or sales agreement prior to their eligibility determination (which is strongly encouraged) and that they are determined eligible, funds are available, and a COE is issued.

If the applicant:

- Selects a property in another county or parish, their maximum loan amount may be negatively impacted depending on the new county’s area loan limit and income limits. For instance, if the COE was issued for Jones County (with an area loan limit of $150,000) but the applicant finds a property in the neighboring Smith County (with an area loan limit of $140,000), the applicant (assuming they qualified for the area loan limit in Jones County) would now be limited to a purchase price of no more than $140,000.
- Selects a property with homeowner association dues, higher taxes, or higher insurance, their maximum loan amount may be negatively impacted because of these increased housing costs.
- Is actively looking for a property, the COE may be extended for up to two additional 30 day periods.
- Does not submit an option to purchase or sales agreement within the specified timeframe, the application will be withdrawn due to the applicant’s failure to provide the requested information. The applicant may reapply at a later date by submitting a new complete application.

In the event that an option to purchase or sales agreement falls through or the selected property is not eligible for financing (due to repairs, lack of appraised value, not considered
modest, not in a rural area, etc.), a new COE with a new timeframe is issued to the applicant. This allows the applicant time to look for another property.
In this example, you can see the impact that the specific details of the property can have on an applicant’s eligibility. While the COE was issued for $150,000 and the proposed purchase price is also $150,000 – the proposed property has more costs associated with it which adversely affects the applicant’s eligibility.

Another factor to consider in this scenario is whether the applicant is low- or very low-income, as this affects allowable repayment ratios. Notice that for the proposed property, the taxes are $75 more per month than estimated, and because the property is in a flood zone, the estimated flood insurance is an additional $75/month. If this applicant was very low-income, the resulting ratios would be in excess of the standard 29/41. Whereas if the applicant were low-income, they would remain within the parameters of the 33/41 ratios for low-income.

It is important when issuing the COE, to explain these nuances to the applicant so that when they are considering a property, they take the additional costs into consideration. Applicants should be advised that changes in insurance, taxes, the addition of homeowners’ association dues, leasehold interest payments, and other similar charges have an impact on their eligibility and should be considered prior to selecting a property.

The flip side of this is that if the overall taxes and insurance are LESS than what was estimated, the applicant may qualify for a higher loan amount provided that the COE wasn’t capped by the area loan limit.
Now let’s assume that the applicant is determined ineligible.

There are actually two scenarios in which an application may be denied:

One is when the **applicant** does not qualify for the loan; the other is when the **property** does not qualify. For the purpose of this webinar, our focus is on the applicant scenario. However, it is worth pointing out that when the property does not qualify – the property itself is denied, but the applicant remains eligible and is given the opportunity to select another property.
Adverse Decision

While most adverse decisions are appealable, there are decisions that are not appealable such as decisions based on:

- Parties outside the Agency.
- The Agency’s interest rate.
- An official's refusal to request an administrative waiver.
- Lack of funds (i.e. program was not appropriated funds).
- Confirmed income that is above the program’s limits.
- The rural area designation.

Handbook-1-3550, Appendix 4 and 7 CFR Part 11 provide guidance regarding what is and is not appealable. Let’s discuss the non-appealable items that may be applicable to the direct program.

**Decisions based on parties outside the Agency:** This situation might arise if you have an application which involves a leveraged loan or an affordable housing product. If the other entity cancels their financing and RD cannot provided 100% of the needed financing, the applicant cannot appeal the RD decision because it was based on the decision of the other party.

**Decisions based on the Agency's interest rate:** An applicant cannot appeal a decision because of the interest rate offered by the Agency at the time of the decision. In other words, if the RD interest rate is 5%, the applicant cannot appeal for a lower interest rate. However, the applicant can appeal if they are alleging that an incorrect interest rate was applied.

**Decisions based on an official's refusal to request an administrative waiver** under the provisions of Handbook-1-3550, Paragraph 1.12 or a waiver authorized by any applicable regulation. Waivers are exceptions to the rule. An applicant cannot appeal a decision because an approval official did not request or grant a waiver.

**Decisions based on lack of funds:** This would only apply if the program was not appropriated funds by Congress. This would not apply when appropriated funds are exhausted in a given fiscal year; when this occurs applicants are placed on a wait list.
**Decisions based on confirmed income that is above the program’s limits:** A program loan cannot be granted if the applicant’s adjusted income exceeds the low-income limit at the time of eligibility/approval or the moderate-income limit at the time of closing.

**Decisions based on the rural area designations:** In general, the property must be located in a rural area in order to be financed. If the property is not in a rural area and an exception does not apply, the property (not the applicant) would be denied.
Adverse Decision

For appealable decisions, applicants are informed and can take the following three options if they believe the Agency’s decision or the facts used to make the decision are in error:

- Option 1: Informal Administrative Review,
- Option 2: Mediation, and
- Option 3: Appeal.

Let’s briefly discuss these options.
Option 1: Informal Administrative Review highlights:

- The purpose is to have an open dialog with the applicant to further explain the Agency decision, hear from them, and allow them to provide any additional supportive information.
- Applicant requests in writing to the Agency within the allotted timeframe.
Option 2: Mediation highlights:

- The purpose is to have a neutral mediator facilitate an open dialog between the applicant and the Agency to resolve disputes about the Agency’s decision.
- Applicant requests in writing to the Agency within the allotted timeframe.
- The Agency will provide a list of mediators and their cost. The cost is generally shared between the applicant and the Agency.

Since the handling of the mediation process can differ some state-to-state, each state should have a state supplement which outlines their process.

State-Certified, USDA-Funded mediation is available in some locations.

Mediation is an attempt to reach a resolution by mutual agreement, but mediators have no binding authority over the Agency.
Appealable Decision

Option 3: Appeal highlights:

• The purpose is to have the National Appeals Division (NAD), which reports directly to the Secretary of Agriculture and is independent from the Agency, provide a fair and timely hearing and appeal to the applicant.
• Applicant requests in writing or online to NAD within the allotted timeframe.

The applicant’s request must be signed and contain a copy of their adverse decision and a statement as to why they disagree with the Agency’s decision.

The use of NAD eFile to file a request fulfills any signature requirement.
Appealable Decision

Option 3: Appeal highlights (continued):

• The Agency and the applicant provide detailed case information to support their decision/claim.
• The applicant has a right to a face-to-face hearing or may authorize a hearing by phone.
• Both sides present their case and the NAD Administrative Judge makes a decision.

The applicant may bring witnesses or an attorney with them to the hearing, or may choose to attend by themselves.

If the Administrative Judge determines that the Agency made the correct decision, the denial will stand. If the Administrative Judge determines that the Agency erred in making its decision, the Administrative Judge will overturn the Agency’s decision. In both cases, the Administrative Judge issues a decision in writing and provides the applicant and the Agency any additional review rights which may be available to the both parties within a specified timeframe.

In the event that the applicant is denied, they are welcome to reapply at a later date.

It is critical that the denial letter be well written to support the Agency’s decision. In the following slides, we will look at a bad and good example of a denial letter.
A “Bad” Adverse Decision Letter

Your credit report does not demonstrate acceptable credit handling because you have late car payments, a bill in collection, and a credit score of 600.

This example fills in the specific reasons for the Agency’s adverse decision on Handbook Letter 15.

This letter is bad since:

• The information is vague.
• There are no specific references to 7 CFR 3550 or Handbook-1-3550. References (especially CFR references) are vital so that the applicant and potentially a mediator and/or an Administrative Judge fully understand the basis for the Agency’s decision.
• The letter incorrectly implies that the applicant’s credit score was used as an eligibility criteria.

If this case was sent to a mediator or NAD, the poorly written adverse decision letter would weaken the Agency’s case.
In accordance with 7 CFR 3550, 3550.53 (h), an applicant must have a credit history which “indicates a reasonable ability and willingness to meet debt obligations”. The following indicators of unacceptable credit as reported on your credit report were considered in our decision: ABC Auto was paid 30 days or more late on three occasions within the last 12 months (see 7 CFR 3550, 3550.53 (h)(1)(i)); and an unpaid collection to XYZ Finance in the amount of $5,000 with no record of payments (see 7 CFR 3550, 3550.53 (h)(1)(vii)). While your written explanation regarding these accounts was considered, the Agency determined that a credit exception was not warranted and you have a pattern of unacceptable credit handling.

Now let’s look at the good version of this letter.

This letter is good since:

• Detailed information is given.
• The specific and full regulatory and handbook references are provided.

With this version, the program requirement is clearly stated as to why the applicant did not meet the requirement. It is also clear that the Agency concluded that a credit exception was not warranted based on information provided by the applicant.

From a customer service perspective, it is best to discuss the reasons for the denial with the applicant in person or by phone so that you can fully explain the denial and they have the opportunity to ask questions. You may also want to provide counseling or refer them to resources which may assist them to become eligible in the future. For instance, if credit is the issue – you may suggest that they reach out to a credit counseling agency for assistance. In any event, always reassure an applicant that they may reapply at a later date. Just because their application is denied today, does not mean they can never reapply.
Withdrawing an Application

During the application process, the applicant may decide they no longer want to proceed with their loan application (for whatever reason). In this situation, the applicant may choose to withdraw their application by notifying the Agency in person, by phone, by email, by a mailed statement, etc. Once notification is received, the RD staff will document the request to withdraw in the applicant’s case file and withdraw the application in UniFi.

Under no circumstance should RD staff encourage an applicant to withdraw their application vs. denying their application and giving them review, mediation, and appeal rights if appealable.
Withdrawing an Application

The applicant’s request to withdraw their application aside, the application will be withdrawn if the applicant does not respond to the Agency’s request for information within the specified timeframe. For most items, the applicant has 15 days from the date of the request. A longer period of time is given for a limited number of items such as obtaining repair bids from qualified contractors and entering into an option to purchase or sales agreement.

If the applicant does not respond within the specified timeframe, the application is withdrawn because the Agency is unable to make a decision without the information and the only remaining action to take regarding the application is to withdraw it.

While it’s permissible to allow a little extra time to account for such things as the time it takes for the post office to deliver mail, RD staff should not allow applications to be “inactive” for a long period of time. Let’s suppose that HB Letter 11 was sent to an applicant on 7/1 - giving them 15 days to provide copies of their paystubs. While the applicant should technically have the information to the RD office by 7/16, the RD office may decide to wait to withdraw the application if the information isn’t received by 7/20.

Since requests for information contain instructions on when the information must be provided and indicate that the application will be withdrawn for failure to respond, applicants are not notified when their application is withdrawn due to their failure to respond.
In this webinar, we have examined the program’s pre-qualification and application processes from a high level perspective.

In future webinars, the following aspects of the application process will be separately discussed in detail: Income, Credit, Repayment Ability, Assets, and Other Eligibility Requirements.
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Are you interested in learning more about the Section 502 Direct Loan Program? Please contact your applicable RD State Office. https://www.rd.usda.gov/contact-us/state-offices

Contact information can be found at https://www.rd.usda.gov/contact-us/state-offices.

Finally, please note that the contents of this webinar are current as of this presentation’s revision date. Please refer to Handbook-1-3550 for the most recent program guidance.