

CHAPTER 17: REGULAR SERVICING - PERFORMING LOANS

7 CFR 3555.251

17.1 INTRODUCTION

Servicers are responsible for servicing SFHGLP loans and protecting security interests and servicing accounts in a reasonable and prudent manner. This Chapter provides additional guidance about the ways in which servicers are expected to service loans that are either current or less than 20 days past due. Servicing non-performing loans is described in Chapter 18 of this Handbook.

Section 1 defines the requirements associated with servicing current accounts, such as collecting payments, escrowing funds, and loan reporting functions. Section 2 defines how the servicer should consider borrower requests for partial releases of security, and transfers and assumptions.

A. Sale of Loans to Approved Lenders [7 CFR 3555.54]

Lenders may sell SFHGLP loans to any USDA approved servicing lender (servicer). While the guarantee is transferred with the loan, the originating lender will be held to the responsibilities in accordance with Section 4.9, Indemnification, of Chapter 4 regarding omissions and/or unresolved review findings stemming from problems at loan origination when a loss claim is requested. Requirements for loan sales are described in Chapter 4 of this Handbook.

B. Contracting for Servicing of SFHGLP Loans

The holding lender is responsible for ensuring the loan is properly serviced by a USDA approved servicing lender. If the USDA approved servicing lender contracts out rights to a third-party provider, the holding lender remains responsible for ensuring the loan is properly serviced.

C. Notifying the Agency of Loan Sales or Servicing Transfers

The Agency must be notified within 15 days of a sale or servicing transfer by submitting Form RD 3555-11 to the Single Family Housing Servicing Branch, Lender Reporting Section. Agency notification should be password protected or encrypted and emailed to rd.so.hsb@usda.gov.

D. Non-Compliance

Failure by the lender to comply with Agency requirements including reporting or other program guidelines, or failure to provide high quality origination, underwriting, or servicing can result in the following Agency actions:

- Withdraw the lender's approval;
- Transfer its portfolio of SFHGLP loans;
- Require the lender to indemnify the Agency if a loss is paid; deny or reduce future loss claims; and/or
- Withdraw the loan guarantee.

The Agency will notify the lender in writing of non-compliance and provide appeal rights, if necessary, in accordance with HB-1-3555, Appendix 3. Failure to comply with the reporting requirements and other lender responsibilities outlined in HB-1-3555, Chapter 4 could indicate non-compliance.

SECTION 1: SERVICING PERFORMING LOANS

17.2 REQUIRED SERVICING ACTIONS [7 CFR 3555.252]

In addition to collecting regularly scheduled payments, servicers are also responsible for a wide variety of servicing activities including, but not limited to, the following actions.

A. Ensuring Payment of Loan

Servicers should have a system of record to record loans, monitor payment activity, and the history of borrower accounts. The USDA approved servicer is responsible for monitoring activities completed by any third-party providers.

B. Handling Late Payments and Fees

Servicers may assess late payment charges to a borrower's account when appropriate; however, these charges will not be covered by the loan guarantee. The late payment charge must not exceed a rate that is reasonable and customary, as governed by state law, the percentage of the payment due as prescribed by HUD, or the percentage of payment as prescribed by Fannie Mae or Freddie Mac.

C. Ensuring Payment of Taxes and Insurance

Servicers must have adequate internal control processes to ensure that real estate taxes, assessments, and flood and hazard insurance premiums are paid as required for all property securing a guaranteed loan. Escrow funds may be used only for the purpose for which they were collected. Escrow accounts for all guaranteed loans must be administered in accordance with all applicable regulations and must be insured by the FDIC or the NCUA insurance fund. Rural Development will not include any taxes or insurance amounts that accrued prior to due date of last paid installment in any potential loss claim.

D. Maintaining Hazard and Flood Insurance

Until the loan is paid in full, servicers must ensure that borrowers continuously maintain hazard and, if applicable, flood insurance in an amount sufficient to protect the property securing the guaranteed loan. Servicers should adopt accepted industry standards for hazard and flood insurance as noted in Chapter 16 of this Handbook.

- Servicers must administer hazard insurance claims involving property damage in an expeditious manner. All payments for insured losses must be applied to the restoration of the security or to the loan balance.
- Insurance claims for structural damage may be paid directly to the homeowner to advance funds to contractors, provided all the following conditions are met:
 - The mortgage is current;
 - The borrower's payment history does not show delinquencies of two payments or more;
 - The property is occupied by the borrower;
 - The released funds may not exceed \$20,000.00; and
 - The borrower must execute an affidavit in which the borrower expressly agrees to apply the released funds promptly to repair or reconstruct the residence.
- For insurance claims that do not meet the criteria required above, servicers must supervise the insurance funds if a loss to the insured property occurs. All repairs and replacements using the insurance proceeds must be planned, performed, and inspected in accordance with Agency construction requirements and procedures.

- Chapter 12 of this Handbook describes policies for obtaining plans, specifications, and completing construction inspections involving repairs. See Chapter 18 of this Handbook for additional information regarding insurance claims involving property damage.
- In the case where the borrower cannot demonstrate adequate hazard insurance, the servicer can place a policy with coverage in accordance with Chapter 16 of this Handbook.

E. Obtaining Final Payments

The servicer must not satisfy a borrower's account and release the security instruments until full payment of all amounts owed including unpaid principal and interest, protective advances, overpayment of interest assistance, shared equity, and mortgage recovery advances have been received and verified. For those borrowers who have received interest assistance and/or a mortgage recovery advance (MRA) (whether secured or unsecured), even if the borrower repays the full outstanding account balance, the account is not considered paid in full until shared equity and the MRA have been paid.

F. Handling Borrowers in Bankruptcy

The servicer is responsible to take appropriate action during bankruptcy proceedings to protect the borrower and the government's interest. Upon receipt of a bankruptcy notice, the servicer must:

- Obtain a copy of the bankruptcy petition;
- Complete and file a proof of claim within the time set by the bankruptcy court;
- Maintain copies of all documents associated with the bankruptcy;
- Review the proposed repayment plan;
- Comply with all applicable laws and regulations;
- Monitor the bankruptcy proceedings;
- Monitor receipt of post- and pre-petition payments; and
- Determine that tax and insurance payments are current or determine if additional funds are necessary to maintain an escrow account. The servicer must refer the account to an attorney when the account becomes 30 days or more delinquent.

Refer to Chapter 18 for more detailed information on delinquent accounts in bankruptcy.

G. Complying with the Servicemembers Civil Relief Act (SCRA)

The Servicemembers Civil Relief Act requires that the interest rate charged a borrower who enters full-time active military duty after a loan is closed not exceed six percent if the borrower's military obligations are affecting their ability to pay. The borrower should supply the servicer with documentation of their active-duty status. Active military duty does not include participation in a military reserve or the National Guard unless the borrower is called to active duty.

1. Change of Active Military Status

The servicer will cancel the six percent interest rate and resume the promissory note interest rate when notified by the borrower that he or she is no longer on active military duty. The servicer may process a new payment assistance agreement if the borrower is eligible according to Appendix 6 of this Handbook.

2. Amount of Assistance

According to Appendix 6 of this Handbook, after reduction of the interest rate to six percent, the amount of payment assistance received during the period of active military duty will be the difference between the amount due at the subsidized rate for principal and interest and the amount due at the six percent interest rate. The six percent interest rate will be effective with the first payment due after the servicer confirms active military status of the borrower.

The Agency will not include interest on a loss claim filed in excess of six percent for the period the veteran was eligible, nor for any period of time the servicer failed to establish the note rate after notification by the borrower of non-active military service.

H. Approving Borrower Actions

During the term of the guaranteed loan, the borrower may ask the servicer for permission to undertake actions that could affect the value of the security property.

Section 2 of this Chapter provides guidance to servicers regarding such actions as a partial release of security or a transfer and assumption of an outstanding guaranteed loan.

17.3 REPORTING REQUIREMENTS [7 CFR 3555.51 (b)(8)]

Servicers are required to report monthly loan status (203) and monthly loan default status (264) reports for all SFHGLP loans in their portfolio via Electronic Status Reporting (ESR) by the sixth government workday of each month. Servicers are also required to review and correct status and default reject errors starting on the 13th business day of the month through the last day of the calendar month. New servicers, as part of the lender approval process as outlined in Chapter 3 of this Handbook, will enter into an agreement to electronically report the status of their SFHGLP portfolio. Servicers' documentation, including detailed guides for reporting can be found at:

<https://www.rd.usda.gov/resources/usda-linc-training-resource-library/loan-servicing>

The servicer must continue to report on each loan until:

- The default is cured (default reporting can stop after the appropriate code to end the default event has been reported via ESR);
- The mortgage is paid-in-full, and the loan has been reported as Paid in Full via ESR; or
- The account is liquidated through foreclosure sale, pre-foreclosure sale, or a deed-in-lieu of foreclosure until the servicer is in receipt of the loss claim payment.

If a lender is unable to sell a loan or retains the loan they must contact the Single Family Housing Servicing Branch, Lender Reporting Section at rd.so.hsb@usda.gov to initiate the process for monthly status reporting and annual fee payment. Failure to submit timely loan status reporting or annual fees is a violation of a lender's participation agreement and could result in reduced or denied loss claim payments (HB-1-3555, Appendix 8).

17.4 PROTECTIVE ADVANCES [7 CFR 3555.302]

Servicers may advance funds to pay for emergency expenses necessary to protect the security property and charge the cost against the borrower's account. If the borrower is unable to repay the advance in a lump sum with the next scheduled payment, the servicer may schedule repayment consistent with the borrower's ability to pay if the borrower can make regular payments and bring the mortgage account current within 18 months or less.

In most cases, the servicer should be able to arrange with the borrower to bring the account current within 120 days.

A. Advances for Property Repairs

Servicers must ensure that borrowers immediately notify them of any loss or damage to insured property and collect the amount of the loss from the insurance company. Because protective advances are covered by the guarantee, servicers should advance funds only to pay for emergency repairs to protect the security value of the property. Protective advances for repairs should be considered only if the borrower informs the servicer that an additional loan or reimbursement from an insurer cannot be obtained in an appropriate timeframe, or if the borrower has abandoned the property.

Protective advances that are not reimbursed through insurance coverage may be covered by the guarantee with proper documentation as to why the advance was not covered by insurance if the advance was other than for taxes and insurance premiums.

Either the borrower or the servicer may identify the need for repairs of the security property. All repairs, replacements, and new construction must be planned, performed, and inspected in accordance with the standards specified in Chapter 12 of this Handbook. If the servicer is unsure whether the repairs would affect the security value of the property, the servicer should request that an inspector examine the property to assess whether repairs are necessary. Based on the value of the property, the servicer must determine whether the repairs are cost effective and document this assessment in the servicer's file. Protective advances exceeding \$2,000 require Agency concurrence.

B. Advances for Taxes and Insurance

The servicer is responsible for maintaining escrow funds in a reasonable and prudent manner assuring real estate taxes, insurance, and assessments are paid timely even if a shortage exists requiring the servicer to advance funds on behalf of the borrower. The servicer will notify the borrower in writing of any escrow shortages and document the decision in the servicer's file. Servicers are encouraged to adopt accepted industry standards for hazard and flood insurance as noted in Chapter 16 of this Handbook. Servicers may also advance for unpaid association dues to protect the status of the lien when necessary.

17.5 INSURANCE PROCEEDS [7 CFR 3555.252]

When insurance funds remain after payments for all repairs, replacements, and other authorized disbursements have been made and the repairs have been inspected in accordance with Agency construction requirements noted in Chapter 12 of this Handbook, the funds must be applied in the following order:

1. Prior liens (including past-due property taxes);
2. Past-due amounts (requires written consent from borrower);
3. Protective advances; and
4. Released to the borrower if the servicer's debt is adequately secured.

SECTION 2: BORROWER ACTIONS REQUIRING SERVICER OR AGENCY APPROVAL

17.6 OVERVIEW [7 CFR 3555.255]

A borrower must obtain approval from the servicer before taking actions that may affect the security value of a property. In certain circumstances, the servicer does not need to obtain Agency approval before consenting to a transaction involving a partial release of the security; however, servicers must obtain approval from the Agency before consenting to a transfer with an assumption of the outstanding debt. Specific guidelines for each type of action are provided below.

17.7 PARTIAL RELEASE OF SECURITY [7 CFR 3555.255 (B)]

If a servicer consents to a transaction affecting a security property, such as selling or exchanging security property, or granting a right-of-way across the security property, the servicer must ensure that certain conditions are met and that the mortgage file is carefully documented.

A. Conditions for Partial Release

1. Adequate Compensation

The borrower must receive adequate compensation.

- The sale of any part of the security property must result in a payment equal to the value of the security being released or rights granted; or
- The exchange of security property must result in another parcel of property acquired that has value equal to or greater than that being released; or
- The granting of an easement or right-of-way must result in benefits that are equal to or greater than the value of the security property being released.

2. *Net Proceeds*

In an effort to maintain the current loan to value ratio for the guaranteed loan, all proceeds must be applied in the following order:

1. Pay customary and reasonable costs related to the transaction owed by the borrower.
2. To a prior lien debt, if any.
3. To be used for improvements to the security property. If the funds are to be used for property improvements, the servicer should release the funds as the improvements are completed. The servicer must ensure that the proceeds are used as planned.
4. To be used to repay any delinquency or missed payments.
5. To the outstanding balance to maintain at minimum the current loan to value.
6. If any net proceeds remain and the borrower's post transaction loan to value is no greater than 80%, funds may be released to the borrower.

3. *Program Standards*

After the transaction is completed, the security property must meet program standards.

4. *Ability to Repay the Loan*

The borrower's ability to repay the guaranteed debt must not be jeopardized.

B. Processing a Partial Release Request - Agency

To get Agency approval, the request must be sent to the SFHGLP National Headquarters Servicing Branch at sfhglpservicing@usda.gov. The servicer must send

evidence of all completed actions to the Agency for review. At minimum the servicer should provide the Agency with the following:

- The borrower's reason for requesting the servicer to make the release, including information regarding the contemplated use of land to be released.
- The monetary consideration, if any, to be received by the borrower.
- Determination of the value of the property if a release is processed, taking into consideration any improvements being completed. An appraisal of the security property must be conducted if the most current appraisal is more than 1 year old or if it does not reflect current market value. The appraisals must reflect the value of the property prior to the release of partial security and the value of the remaining property once the release of partial security occurs.
- Plans and specifications, including cost estimates, of any alterations proposed for the remaining property after release.

The approval official will analyze the servicer's request for partial release and consider the following:

- Estimate of value prior to the proposed release.
- Estimate of value after the proposed release.
- Loss in value attributed to the proposed release.
- What use or purpose the released property will serve once released.
- The estimated cost of proposed improvements to the remaining property.
- The estimated value of the remaining property after any proposed improvements are completed.
- Consideration if the remaining mortgage security is less marketable as a result of the release.
- Borrower's ability to repay, including their current delinquency, if any, and the number of missed payments.

Notification of approval/denial will be communicated to the servicer. Any denial must state the reason(s) for denial in detail.

C. Servicer Delegated Approval

If all the following additional conditions are met, servicers are delegated to review and provide a decision to the borrower's request with no review by USDA required for the voluntary or involuntary release of the security:

- The portion of the property being conveyed does not exceed **10%** of the area of the mortgaged property;
- There is no damage to existing structures or other improvements;
- There is no unrepaired damage to sewer, water, or paving;
- Total compensation received for the taking of the property is applied to reduce the unpaid principal balance of the mortgage; and
- The conveyance occurs after the mortgage loan was guaranteed.

D. Processing a Partial Release - Servicer

To process a partial release under the delegation authority described above, the servicer must complete and/or document the following actions. If the servicer eventually files a loss claim, the claim must be accompanied by the servicer's certification that all requirements have been met:

- The borrower's reason for requesting the servicer to make the release, including information regarding the contemplated use of land to be released;
- The monetary consideration, if any, to be received by the borrower;
- Confirm the mortgage loan is in good standing, the amount of principal balance owed and the due date of last paid installment;
- Determine the value of the property if a release is processed, taking into consideration any improvements being completed. An appraisal of the security property will be conducted if the most current appraisal is more than 1 year old or if it does not reflect current market value. The appraisals must reflect the value of the property prior to the release of partial security and the value of the remaining property once the release of partial security occurs;
- Complete any forms required by state law;
- A list of unpaid special assessments, if any, and the total amount payable;

- Update the legal descriptions of the property, as necessary;
- Report any restrictions to be imposed on the land to be released;
- Provide a survey or sketch of the property showing dimensions of the portion to be released, the location of the existing and proposed improvements, and the relation of the property to surrounding properties;
- Plans and specifications, including cost estimates, of any alterations proposed for the remaining property after release;
- For an exchange of a portion of the security property, obtain title clearance for the new security before the release of the existing security. Security instruments must be obtained for the new property;
- For a sale of a portion of the security property, deliver the release when full payment is received; and
- Notify the Agency of any reduction in the outstanding principal balance through monthly status reporting.

17.8 TRANSFER AND ASSUMPTION [7 CFR 3555.256]

Transfers between family members do not require Agency concurrence since the transferee is not required to assume the debt.

A. Transfer without Assumption

If the borrower transfers the security property and the transferee does not assume the debt, the servicer does not need to seek Agency approval but must simply notify the Servicing Office at rd.so.hsb@usda.gov to withdraw the loan guarantee.

B. Transfer Under Garn-St. Germain

In the following limited cases, which generally involve transfers of title between family members, the Agency will continue to honor the guarantee regardless of whether the transferee assumes the outstanding debt. The due-on-sale clause will not be triggered in the following cases as defined by the Garn-St. Germain Depository Institutions Act of 1982:

- A transfer from the borrower to a spouse or children not resulting from the death of the borrower;

- A transfer to a relative, joint tenant, or tenant by the entirety resulting from the death of the borrower;
- A transfer to a spouse or an ex-spouse resulting from a divorce decree, legal separation agreement, or property settlement agreement;
- A transfer to a person other than a deceased borrower's spouse who wishes to assume the loan for the benefit of persons who were dependent on the deceased borrower at the time of death, if the dwelling will be occupied by one or more persons who were dependent on the borrower at the time of death, and there is a reasonable prospect of repayment; or
- A transfer into an inter vivos trust in which the borrower does not transfer rights of occupancy in the property.

When a transferee obtains a property with a guaranteed loan through a transfer of title as noted above, the following actions will occur:

- The servicer will notify the Rural Development Guaranteed Loans Servicing Office at rd.so.hsb@usda.gov of the transfer.
- Rural Development will continue with the guarantee, whether or not the transferee assumes the guaranteed loan.

1. Requirements for an Assumption Under Garn-St. Germain

The Agency may approve a transfer with an assumption of the outstanding debt if the following conditions are met:

- Transferor must remain liable for the debt; and acknowledge continued liability for the debt in writing.
- The transferee must assume the entire outstanding debt and acquire all the property securing the guaranteed loan balance and be an eligible applicant.
- The property must meet the site, dwelling and environmental requirements described in Chapter 12 of this Handbook or be brought to those standards prior to the transfer. Guaranteed loans secured by properties located in areas that are no longer considered rural may still be transferred and assumed.

- The priority of the existing lien securing the guaranteed loan must be maintained or improved.
- The use of GUS is unavailable for transfer and assumptions and must be manually submitted and underwritten; however, the documents can be submitted through GUS. A job aid for this type of submission is available in the <https://www.rd.usda.gov/page/usda-linc-training-resource-library> in the “Loan Origination” tab.

When a transferee assumes a property with a guaranteed loan through a transfer of title as noted above, the following options are available:

- The transferee may assume the guaranteed loan on the rates and terms contained in the promissory note.
- The transferee may assume the guaranteed loan under new rates and terms if the transferee applies and is eligible. Any new rates and terms must not exceed the current market interest rate and term and the interest rate must not exceed the interest rate on the initial loan as described in HB-1-3555, Chapter 7.
- If the account is past due at the time an assumption agreement is executed, the transferee may be reviewed for loss mitigation and, if eligible, the loan may be modified to bring the account current as described in HB-1-3555, Chapter 18, Attachment A, *The Loss Mitigation Guide*.
- Any subsequent transfer of title, except upon the death of the inheritor or between inheritors to consolidate title, will trigger the due-on-sale clause.

2. Closing a Transfer with an Assumption of the Outstanding Debt

The Agency will review the application as it does any other request for a loan guarantee and will issue a conditional commitment if it approves the transfer. Once the servicer obtains Agency approval, the servicer may proceed with closing the transaction. Along with all other required loan closing documents, the servicer must provide the Agency with a copy of the executed assumption agreement. The servicer must process the assumption on a form approved by Fannie Mae, Freddie Mac, HUD, or VA and signed by all parties.

The existing Form RD 35517, *Loan Note Guarantee*, will remain in effect. The servicer should note the date, amount assumed, and name(s) of the assuming party on the original Form RD 3555-17 and provide with all other required loan

closing documents. The lender will follow the same procedures as provided in Chapter 16 of this Handbook.

C. Unauthorized Sale or Transfer

If a servicer becomes aware that a borrower has transferred title to a property without the servicer's knowledge and the transfer does not fall under the Garn-St. Germain rule, the servicer must take one of the following actions:

- Liquidate the guaranteed loan and submit a claim for any loss; or
- Notify the Agency of the transfer and continue with the loan without the guarantee.

D. Modification to Promissory Note and Security Instruments

If the repayment schedule or interest rate changes as a result of the transfer and assumption, the transferor will remain liable for the debt and, therefore, must approve any changes. The rates and terms must not exceed the rates and terms allowed for new guaranteed loans and must not exceed the current market interest rate. The following will apply:

- The debt must not exceed the remaining amount due on the original loan; and
- The term of the loan must not exceed thirty years from the date of the transfer and assumption.

The servicer must request and obtain prior approval for the transfer and submit an explanation of the reasons for the proposed change in rates and terms. Refer to HB-1-3555, Chapter 18 for additional guidance regarding servicing of non-performing loans.

17.9 MINERAL LEASES [7 CFR 3555.255 (a)]

Servicers must obtain approval from the Agency before consenting to the lease of mineral rights.

A servicer may consent to the lease of mineral rights and subordinate its lien to the lessee's rights and interests in the mineral activity provided the subordination of the guaranteed loan to a mineral lease does not entitle the leaseholder to any proceeds from the sale of the security property and the following are met:

- The security property will remain suitable as a residence;
- The lender's security interest will not be adversely affected; and
- Rural Development's environmental requirements are met.

If the proposed activity is likely to decrease the value of the security property, the servicer may consent to the lease under the following conditions:

- The borrower must assign 100 percent of the income from the lease to the servicer;
- Proceeds will be utilized as a principal reduction to the loan; and
- The total rent to be paid is at least equal to the estimated decrease in the market value of the security property.

If the proposed activity is not likely to decrease the value of the security property, the servicer may consent to the lease if:

- The borrower agrees to use any compensation received from the lessee to repair any damage to the site or dwelling; or
- Assign the proceeds to the servicer to reduce the principal balance.

The servicer remains responsible for documenting their approval and oversight of the above activity and borrower request.

17.10 UNAUTHORIZED ASSISTANCE [7 CFR 3555.257]

Refer to HB-1-3555, Chapter 1 for information regarding unauthorized assistance.