CHAPTER 2: OVERVIEW OF SECTION 502

2.1 INTRODUCTION

This chapter provides an overview of key aspects of the Section 502 program. Section 1 identifies the various types of loans available and details the circumstances in which each kind of loan can be made. Section 2 describes the Agency's Dedicated Loan Origination and Servicing (DLOS) System. The chapter concludes with Section 3, a broad-brush overview of the steps involved in processing Section 502 loans.

SECTION 1: TYPES OF LOANS

2.2 OVERVIEW

The rules governing Section 502 loan origination differ slightly, depending upon the type of loan being made. The types of loans available under Section 502 include:

- Initial loans;
- Assumed loans;
- Subsequent loans; and
- Nonprogram loans.

This section describes the four types of loans and how they differ. The interest rate for SFH loans can be found in Exhibit B of RD Instruction 440.1.

2.3 INITIAL LOANS

Initial loans are made when neither the applicant nor the seller has an existing Agency loan. Generally, they are made for the maximum loan term for which the applicant qualifies, and at the Rural Housing (RH) 502 very low or low interest rate. If no prior Agency loans are involved in the transaction and the loan is to be made on program terms, this is the type of loan used. An initial loan can be made to an existing homeowner, who is not an Agency borrower, for essential repairs to their home provided any senior lien secures an affordable non-Agency loan.

2.4 ASSUMED LOANS

Section 502 loans may be assumed. The terms and conditions of the assumption depend upon the eligibility of the new purchaser.

A. New Rates and Terms Assumption

When purchasing a property currently financed by a Section 502 loan, the new borrower will typically receive new loan funds. However, new rates and terms assumptions must be used when funding is limited (e.g. in September as a fiscal year is coming to a close and in October when a new fiscal year begins).

With a new rates and terms assumption, the purchaser assumes the outstanding debt (including principal and recapture amounts), which is reamortized at new rates and terms. If the new purchaser and the property are eligible for the Section 502 program, the loan can be assumed on program terms. In addition, eligible new purchasers may receive subsequent loans to make up the difference between the amount of debt assumed and the purchase price, or may be able to obtain a leveraged loan. If the property does not meet Agency standards or will not be brought to Agency standards with the use of loan funds, or the new purchaser is not eligible, the loan can be assumed on nonprogram terms. Purchasers who assume the loan under nonprogram terms are not eligible for a loan to cover amounts above the amount assumed.

B. Same Rates and Terms Assumption

In certain limited cases -- generally those involving transfers of title between family members -- a same rates and terms assumption, is permitted. Under this type of assumption, the existing note terms, including the interest rate and the remaining repayment period, do not change.

The new owner is not reviewed for income-eligibility, creditworthiness, or repayment ability; and the property is not reviewed or appraised. The new owner may receive payment subsidy if eligible based on their household's adjusted income.

Same rates and terms assumptions are permitted for the following types of transfers:

- 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 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 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.

A party interested in a same rates and terms assumption must provide the Agency with evidence that they meet one of the permitted types of transfers listed above and a copy of the recorded deed conveying ownership to them.

2.5 SUBSEQUENT LOANS

Subsequent loans can be issued as part of the original purchase of a property in combination with an assumption, or during the term of an Agency loan to help an existing borrower pay for repairs or improvements to the property. The key processing differences between subsequent and initial loans are described in Exhibit 2-1 and in later chapters.

Exhibit 2-1

Key Processing Differences for Subsequent Loans

- An appraisal is not required for a subsequent loan: Less than $7,500 and for minimal essential repairs; $7,500 or more where the Agency obtained an appraisal within the last two years; or to protect the Government's interest (see Paragraph 5.17 A.).
- Subsequent loans may be made in areas that changed from rural to non-rural to make necessary repairs, to pay equity in connection with an assumption of a program loan, or to pay equity of a departing co-borrower (see Paragraph 5.3 C.6.).
- The Agency may reamortize the initial loan when the subsequent loan is made if the borrower cannot reasonably be expected to meet the payments without the reamortization (see Paragraph 6.16 B.2.).
- Full title clearance is not needed for subsequent loans to existing borrowers for minimal essential repairs to protect the Government's interest (see Paragraph 5.12 B.).
- Applicants have a legal right to cancel a subsequent loan within 3 business days from whichever of the following activities occurs last: (1) execution of the mortgage or deed of trust; (2) receipt of the Closing Disclosure at least three business days prior to consummation; or (3) receipt of Form RD 1940-43, Notice of Right to Cancel. Loan funds cannot be disbursed until the three business days have passed, unless a hardship exists and the applicant waives their right to cancel the loan in writing, as mentioned in Paragraph 8.6 F.2. Form RD 1940-43 is not used for subsequent loans made in conjunction with an assumption since the applicant does not have title to the property.

2.6 NONPROGRAM LOANS

Nonprogram loans are loans made on nonprogram terms to borrowers who are not program-eligible, and/or for properties that do not meet Agency standards and will not be brought to Agency standards with the use of loan funds. The interest rate offered is somewhat higher than for program-eligible borrowers, but is competitive in the marketplace. Borrowers with nonprogram loans are not eligible for program benefits, such as payment subsidy, or for servicing actions, such as moratoriums. They also are exempt from occupancy restrictions and the requirement to refinance with private credit. Nonprogram loans are discussed in detail in Chapter 11. The circumstances in which the Field Office can originate nonprogram loans are discussed below.

A. Facilitate Sale By an Existing Agency Borrower

When an existing Agency borrower wishes to sell a security property, the Agency will assist the borrower by providing assistance to an eligible purchaser. If the purchaser does not qualify for assistance under the Section 502 program, the loan may be assumed on nonprogram terms. Nonprogram purchasers acquiring a property from an Agency borrower are only permitted to assume existing debt; new credit cannot be extended to them through a subsequent loan.

B. Facilitate Sale of Real Estate Owned (REO) Property

The Agency may offer credit for the purchase of REO property on nonprogram terms to borrowers who are not program-eligible, and/or for properties that are not program-eligible.

SECTION 2: THE DEDICATED LOAN ORIGINATION AND SERVICING SYSTEM (DLOS)

2.7 DLOS

DLOS is designed to expedite loan-making, standardize information collection and record keeping, and facilitate communication between Field Offices and the Servicing and Asset Management Office (Servicing Office). DLOS tracks loans from application through servicing using two interconnected systems: UniFi and LoanServ.

2.8 UNIFI

UniFi is a web-based application used for loan origination. It retains applicant information, makes complex computations, and maintains a central record of all activities associated with an individual application from the time of pre-qualification through loan closing. UniFi's many data screens are linked so that once a piece of information is entered, UniFi will automatically transfer it to all pertinent data screens.

A few of UniFi's most important features include:

- Its ability to create a waiting list to help the Loan Originator select applications for processing in the proper order;
- Screens that automatically calculate maximum loan amount and payment subsidy; and
- The ability to print out many loan approval and closing forms with borrower information inserted.

2.9 LOANSERV

LoanServ is a mainframe-based application that is used to service Agency loans and monitor loan performance. It is linked to UniFi so that information from UniFi can be uploaded into LoanServ each night.

Field Staff can access certain areas of LoanServ to gather information on a borrower's account, such as determining the amortized loan amount on construction loans. The Loan Originator uses LoanServ to obligate funds and order checks.

LoanServ is also a communications device to help the Servicing Office and Field Staff keep abreast of each other's' activities. If the Servicing Office needs on-site assistance for a servicing action, LoanServ can be used to communicate with Field Staff. For example, a Servicer involved in working out an insurance claim with a borrower might use the LoanServ work queue to ask Field Staff to visit the property to assess the repair work that has been done to date. Similarly, if a Loan Originator obtains information about a change in a borrower's employment status that has not been reported, LoanServ can be used to pass on that information to the Servicing Office.

SECTION 3: OVERVIEW OF LOAN ORIGINATION PROCESS

2.10 APPLICATION PROCESSING (Chapter 3)

Processing Steps

This section outlines the steps involved in processing a Section 502 loan. It is intended to provide a conceptual overview of the process. The detail needed to fully understand each step follows in later chapters of this handbook.

When potential applicants express interest in the Section 502 program, the standard pre-qualification method is the potential applicant's self-assessment using the [Single Family Housing Direct Self-Assessment tool](). Agency staff should refer potential applicants to the tool in their marketing materials, while speaking to them, etc.

Pre-qualifications completed by the Agency staff are limited. The potential applicant may submit an application regardless of the outcome of the pre-qualification.

When an applicant submits a complete application, the application should be reviewed for eligibility within 30 days, using guidance outlined in Chapter 4. The Loan Originator must select applications for processing based on each applicant's priority and the date the application was determined complete. If the applicant is not eligible, the Loan Approval Official will deny the application. If the applicant is determined eligible, the Loan Originator will determine if funding is available, using guidance outlined in Chapter 4, prior to issuing a Certificate of Eligibility. If funding is not available, eligible applicants will be placed on the waiting list. As funds become available, applicants on the waiting list must be processed in the appropriate order, based on priority status and application date.

2.11 BORROWER ELIGIBILITY (Chapter 4)

Once the application has been selected for processing, the Loan Originator must determine the applicant's eligibility. This involves verifying the household's income, checking the credit history of all parties to the note, and reviewing all other eligibility requirements. Once the applicant's eligibility has been verified, the Loan Originator uses verified income information to determine the amount of payment subsidy the household is entitled to, and the maximum loan amount the applicant will be able to receive.

Based on this information, the Loan Originator counsels the applicant about the level of mortgage debt the household can afford, and issues a Certificate of Eligibility, which is signed by the Loan Approval Official. The household then attempts to locate a home. In cases where the applicant has already submitted a contract for a property, no Certificate of Eligibility is needed.

2.12 PROPERTY REQUIREMENTS (Chapter 5)

Once the household has located a home or decided on the design of a dwelling to be constructed, they must provide key information to allow the Loan Originator to determine whether the property is modest and meets the Agency's underwriting guidelines. This includes the information needed to conduct an appraisal, to conduct an environmental review, and to verify that the site and dwelling meet, or will be constructed to meet, all applicable requirements.

2.13 UNDERWRITING THE LOAN (Chapter 6)

If the applicant and the property meet the Agency's standards, the Loan Originator must determine the loan amount needed and whether it can be supported by the household's repayment ability. In order to determine repayment ability the Loan Originator must have a good estimate of the impact that escrow payments for taxes, flood insurance, and hazard insurance will have on the household. Repayment ability also is affected by the payment subsidy the household is entitled to, which is based on the household's adjusted income

2.14 TAXES, INSURANCE, AND ESCROW (Chapter 7)

To ensure that funds are available to pay for the cost of real estate taxes, insurance premiums, and other assessments, the Loan Originator must have a good understanding of how to set up a good escrow account. Before closing the loan, the Loan Originator must work closely with the closing agent to get accurate figures to use in establishing escrow payments.

2.15 LOAN APPROVAL AND CLOSING (Chapter 8)

The Loan Approval Official reviews the case file and determines whether the loan can be approved. If the loan is approved, the Loan Originator notifies the applicant and obligates the funds.

The applicant then selects a closing agent. The closing agent is responsible for conducting the preliminary title clearance and for ensuring that the property conforms to the Agency's security requirements. The Loan Originator and closing agent work together to ensure that all required closing documents are prepared for signature at closing and that Agency funds arrive before the date of closing. The Loan Originator activates the loan in LoanServ after loan closing and prepares a loan docket to send to the Servicing Office for servicing.

When a new home is to be built or rehabilitation on an existing dwelling is involved, the Loan Originator also oversees the progress of construction. This involves ensuring that inspections are performed at appropriate points in the process, that mitigation measures established as part of any environmental review are properly implemented, and that funds are disbursed appropriately to pay for the work.