

DEPARTMENT OF AGRICULTURE**Rural Housing Service****Rural Business-Cooperative Service****Rural Utilities Service****Farm Service Agency**

7 CFR Parts 1806, 1910, 1922, 1944, 1951, 1955, 1956, 1965, and 3550

RIN 0575-AB99

Reengineering and Reinvention of the Direct Section 502 and 504 Single Family Housing (SFH) Programs

AGENCIES: Rural Housing Service, Rural Business-Cooperative Service, Rural Utilities Service, and Farm Service Agency, USDA.

ACTION: Interim final rule.

SUMMARY: The Rural Housing Service (RHS), formerly Rural Housing and Community Development Service (RHCDS), a successor Agency to the Farmers Home Administration (FmHA), is streamlining and reengineering its regulations and will be utilizing private sector processes and techniques in the administration of its direct SFH portfolio. This action is taken to reduce unnecessary federal regulations, improve customer service, and improve the agency's ability to achieve greater efficiency, flexibility and effectiveness in managing its SFH portfolio. The intended effect of this action is to improve service to rural America and comply with the National Performance Review's (NPR's) goal of reducing unnecessary federal regulations.

DATES: The effective date of this interim final rule is December 26, 1996.

Written comments are requested on §§ 3550.53(g), 3550.57(a), 3550.63, and 3550.68. Comments are due on or before December 26, 1996.

ADDRESSES: Submit written comments in duplicate to the Director, Regulations and Paperwork Management Division, Rural Housing Service, U.S. Department of Agriculture, Stop 6348, 1400 Independence Ave., SW, Washington, D.C. 20250-6348. Comments may be submitted via the Internet by addressing them to "comments.rus.usda.gov" and must contain the word "DLOS" in the Subject. All comments made pursuant to this notice will be made available for public inspection during regular work hours at the above address.

FOR FURTHER INFORMATION CONTACT: David J. Villano, Special Assistant to the Administrator for Regulatory and Policy Development, Rural Housing Service, U.S. Department of Agriculture, Stop 0781, 1400 Independence Ave., S.W.,

Washington, D.C. 20250-0781, telephone (202) 720-1628.

SUPPLEMENTARY INFORMATION:**Classification**

This rule has been determined to be significant, but not economically significant, and was reviewed by the Office of Management and Budget (OMB) under Executive Order 12866.

Congressional Review

In accordance with section 251 of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801 et seq.), this rule was determined to be a major rule by OMB and has been submitted to Congress and the Comptroller General. The aforementioned Act stipulates that a major rule may not take effect until the later of: submission of a report to Congress on the rule; or 60 days after publication in the Federal Register unless the Agency finds good cause that such timeframe is impracticable, unnecessary, or contrary to the public interest.

As discussed in this rule, this regulatory action is taken to consolidate, streamline and simplify existing regulations, make them clearer and easier to understand, improve the delivery of service to our customers, and save the Government \$250 million over the next five years. A delay in implementing these regulations would forestall these savings to the public. For these reasons, RHS has determined that delaying implementation of these regulations is impracticable and contrary to the public interest.

It should also be noted that, in accordance with section 534(b) of the Housing Act of 1949, as amended, these regulations cannot take effect until 30 days after publication in the Federal Register. Further, section 534(b) requires that copies of the rule be sent to Chairman and Ranking Member of the Committee on Banking Housing and Urban Affairs of the senate and the Chairman and Ranking Member of the Committee on Banking, Finance and Urban Affairs of the house before being published in the Federal Register. Copies were submitted to these members on August 29, 1996.

Paperwork Reduction Act

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) under the provisions of 44 U.S.C. Chapter 35 and have been assigned OMB control number 0575-0166, in accordance with the Paperwork Reduction Act (PRA) of 1995. No

comments were received with regard to the proposed information collection requirements during the 60-day comment period under PRA and this rule does not impose any new information collection requirements from those previously approved by OMB. The only change RHS has made to the proposed information collection package is to change the acronym before the form number. The proposed rule was developed when the RHS was known as the RHCDS and was part of the Rural Economic and Community Development (RECD) mission area within the USDA. The name of the RECD mission area has been changed to Rural Development. The proposed rule included the use of the acronym "RECD" before the form number. RHS has changed the acronym from "RECD" to "RHS" for forms used strictly in RHS, or "RD" for forms which may be used by other services within the Rural Development mission area or the Farm Service Agency (FSA).

The information collection requirements for the Handbooks which accompany this regulation were published in the Federal Register for a 60-day comment period on July 18, 1996 (61 FR 37440). No comments were received on this information collection package which is currently under review by OMB. RHS is proposing an overall 11 percent reduction in information collection hours and 20 percent reduction in information collection costs.

Paperwork Reduction Act of 1995

Under the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number as assigned to the collection of information in these final regulations is displayed at the end of the affected section of the regulations.

Civil Justice Reform

This rule has been reviewed under Executive Order 12778, Civil Justice Reform. In accordance with this rule: (1) All state and local laws and regulations that are in conflict with this rule will be preempted; (2) no retroactive effect will be given to this rule; and (3) administrative proceedings must be exhausted before bringing suit in court challenging action taken under this rule in accordance with subtitle H of title II of Pub. L. 103-354.

Unfunded Mandate Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), Pub. L. 104-4, establishes requirements for

Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and the private sector. Under section 202 of the UMRA, RHS generally must prepare a written statement, including a cost-benefit analysis, for proposed and final rules with "Federal mandates" that may result in expenditures to State, local, or tribal governments, in the aggregate, or to the private sector, of \$100 million or more in any one year. When such a statement is needed for a rule, section 205 of the UMRA generally requires RHS to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, more cost-effective or least burdensome alternative that achieves the objectives of the rule.

This rule contains no Federal mandates (under the regulatory provisions of Title II of the UMRA) for State, local, and tribal governments or the private sector. Therefore, this rule is not subject to the requirements of sections 202 and 205 of the UMRA.

National Performance Review

This regulatory action is being taken as part of the National Performance Review (NPR) program to reduce or eliminate unnecessary regulations and improve those that remain in force. Currently, the administration of the SFH program is guided by 18 separate regulations totaling 290 pages in the CFR.

RHS has purchased a commercial-off-the-shelf Dedicated Loan Origination and Servicing System (DLOS) which includes escrow capability to improve program performance and efficiency to its customers. RHS intends to adopt processes and techniques currently utilized by the private sector including centralized servicing and automation of many forms and processes. The system is being customized to provide the additional features and servicing benefits available to RHS customers to assist them in becoming successful homeowners.

Rather than modify the current 18 regulations to implement DLOS, RHS committed itself to meet the true spirit and intent of the NPR. RHS has undertaken a massive effort to completely reinvent and reengineer its regulatory process. RHS is combining the guidance provided in all 18 regulations into one consolidated rule. Administrative matters have been eliminated, remaining text has been completely revised to be consistent, simple, and clear. RHS estimates the final rule, after DLOS is fully implemented, will cover approximately 30 pages in the CFR, for a 90%

reduction in regulations. This regulatory initiative follows our final rule of October 27, 1995, in which the cost of the direct section 502 program was reduced by 30%.

Programs Affected

These programs are listed in the Catalog of Federal Domestic Assistance under Number 10.410, Very-Low to Moderate Income Housing Loans (Section 502 Rural Housing Loans) and 10.417 Very-Low Income Housing Repair Loans and Grants (Section 504 Rural Housing Loans and Grants).

Intergovernmental Consultation

For the reasons set forth in the Final Rule related Notice to 7 CFR part 3015, subpart V, these programs are not subject to Executive Order 12372 which requires intergovernmental consultation with State and local officials.

Environmental Impact Statement

This document has been reviewed in accordance with 7 CFR part 1940, subpart G, "Environmental Program." It is the determination of RHS that this action does not constitute a major Federal action significantly affecting the quality of the human environment and in accordance with the National Environmental Policy Act of 1969, Public Law 91-190, an Environmental Impact Statement is not required.

Regulatory Flexibility Act

This rule has been reviewed with regard to the requirements of the Regulatory Flexibility Act (5 U.S.C. 601-612). The undersigned has determined and certified by signature of this document that this rule will not have a significant economic impact on a substantial number of small entities since this rulemaking action does not involve a new or expanded program.

Background Information

An Overview

The RHS is completing the final steps to the reengineering and reinvention of the manner in which direct loans and grants under sections 502 and 504 of the Housing Act of 1949 are made and serviced. This follows our October 27, 1995, final rule in which the cost of our direct single family housing low income loan program under section 502 of the Housing Act of 1949 was reduced by 30%. The regulations which follow are a significant departure from business practices of the former FmHA. As part of the USDA reorganization, RHS made a commitment to make its programs more customer friendly, to streamline processes, reduce costs to the taxpayer, and increase our level of customer

service. These regulations will accomplish these goals within our SFH program and set the standard for future regulatory actions within RHS.

RHS has approximately 700,000 direct Section 502 and 504 loans with approximately 600,000 customers in its portfolio. With our Fiscal Year (FY) 1996 direct section 502 and 504 loan appropriation, the Agency expects to make approximately 35,000 new direct SFH loans during this FY. The accounting system established by FmHA in the 1970's to maintain its vast farm, housing, community and business loan programs is severely outdated and is not capable of expansion to keep pace with an ever increasingly automated society. FmHA was not able to provide the same level of customer service provided by commercial lenders such as the escrow of real estate taxes and insurance for its customers and toll free telephone numbers to contact a servicing representative. These features are critical for RHS to provide prudent supervised credit to its very-low and low income customers and assist these families in becoming successful homeowners.

Additionally, RHS is aggressively meeting the Administration's goal of reducing staff through reorganization and streamlining of processes. National and field staffs are being reduced and many offices will be consolidated. This, coupled with our outdated accounting system, made the accomplishment of our Agency goals more challenging.

In May 1995, the RHS awarded a contract to Fiserv, Inc. and its subsidiary, Data-Link systems for the purchase of a commercial-off-the-shelf Dedicated Loan Origination and Servicing System (DLOS) which includes escrow capability. This system will replace the Agency's current Program Loan Accounting System (PLAS) and the Management Records System (MRS) and will provide agency personnel with the tools to deliver high quality customer service to its customers. RHS has adopted processes and techniques currently utilized by the private sector including centralized servicing and automation of many forms and processes. The system has been customized to provide the additional features and servicing benefits available to RHS customers to assist them in becoming successful homeowners. The Agency implemented this system on October 1, 1996 in two pilot states. Other states will be phased into the DLOS system through FY 1997 with full implementation anticipated by September 30, 1997. Further information on the implementation of the system follows.

The centralized servicing unit is located in St. Louis, Missouri, and will assume primary responsibility for the functions associated with servicing and managing the loan portfolio such as collection of loan payments, day to day loan servicing, escrowing, and accounting in a focused effort to monitor and reduce loan defaults thereby achieving our goal of having successful homeowners that can eventually refinance to commercial credit. The centralized unit is staffed with many existing RHS employees.

The objectives of DLOS are to:

- Establish an escrow system for real estate taxes and insurance
- Facilitate the centralization of RHS SFH loan servicing
- Reduce the foreclosure rate through early and consistent intervention with customers having trouble making payments
- Reduce costs by reducing delinquency rates, loan losses and operating costs
- Account for direct SFH loans on a amortized rather than simple interest rate
- Improve efficiency and service to our customers
- Develop clear, concise and easy to read regulations and handbooks
- Reduce burden on our customers

This initiative has been highlighted in the NPR and will streamline and improve the delivery of program assistance to customers. There are anticipated savings to the Government of \$250 million over a five year period.

The Regulations

RHS has completed a major redevelopment and consolidation of FmHA regulations affecting the direct Section 502 and 504 programs. Prior to this rule becoming effective, direct SFH customers were affected, in part, by the following regulations:

- 7 CFR part 1806, subpart A—Real Property Insurance
- 7 CFR part 1910, subpart A—Receiving and Processing Applications
- 7 CFR part 1922, subpart C—Appraisal of Single Family Residential Property
- 7 CFR part 1944, subpart A—Section 502 Rural Housing Loan Policies, Procedures, and Authorizations
- 7 CFR part 1944, subpart J—Section 504 Rural Housing Loans and Grants
- 7 CFR part 1951, subpart C—Offsets of Federal Payments to FmHA or its successor agency under Public Law 103-354 Borrowers
- 7 CFR part 1951, subpart D—Final Payment on Loans

- 7 CFR part 1951, subpart F—Analyzing Credit Needs and Graduation of Borrowers

- 7 CFR part 1951, subpart G—Borrower Supervision, Servicing and Collection of Single Family Housing Loan Accounts

- 7 CFR part 1951, subpart I—Recapture of Section 502 Rural Housing Subsidy

- 7 CFR part 1951, subpart J—Management and Collection of Nonprogram (NP) Loans

- 7 CFR part 1951, subpart M—Servicing Cases Where Unauthorized Loan or Other Financial Assistance Was Received—Single Family Housing

- 7 CFR part 1955, subpart A—Liquidation of Loans Secured by Real Estate and Acquisition of Real and Chattel Property

- 7 CFR part 1955, subpart B—Management of Property

- 7 CFR part 1955, subpart C—Disposal of Inventory Property

- 7 CFR part 1956, subpart B—Debt Settlement—Farmer Programs and Housing

- 7 CFR part 1965, subpart C—Security Servicing for Single Family Rural Housing Loans

Some of the above mentioned regulations involve only SFH loans, while others are combined with regulatory provisions of other programs of the former FmHA such as farm loans, business and industrial loans, community facilities and multi-family housing. RHS has consolidated all regulatory actions in the above mentioned regulations which affect direct SFH loans into one new regulation—7 CFR part 3550. This consolidated regulation will make it easier for RHS field staff, and most importantly, our customers, to understand how to obtain program benefits.

Additionally, RHS has removed all administrative processes from the regulations, leaving only regulatory actions which impact the public in the CFR. This streamlining makes the regulation more concise and much easier to read and understand. The Agency has developed two Handbooks which cover administrative matters such as what forms must be filed and where to submit loan requests and the agency's internal processing procedures. The first Handbook will be used in Rural Development field offices and deals primarily with loan originations and property management. The second Handbook will be used in the Centralized Servicing Center in St. Louis, MO., and deals primarily with loan servicing, liquidation and debt settlement. These Handbooks will not

be published in the Federal Register but will be available upon request to the public at no cost.

Implementation Proposal

As previously mentioned, the DLOS system is being implemented over a one year period. Two pilot states started the process and other states will be added to DLOS over the next 12 months. In addition, field offices within a state may be phased onto the DLOS system over a several week period. The 12 month phased implementation period is critical to ensure for the orderly transfer of account information on 700,000 loans to the new DLOS system. This implementation period presents administrative challenges to the Agency as states will be operating under different computer systems with significantly different capabilities. As discussed in our Proposed Rule, RHS is removing the following regulations from the CFR:

- 7 CFR part 1922, subpart C—Appraisal of Single Family Housing Residential Property

- 7 CFR part 1944, subpart A—Section 502 Rural Housing Loan Policies, Procedures, and Authorizations.

- 7 CFR part 1944, subpart J—Section 504 Rural Housing Loans and Grants.

- 7 CFR part 1951, subpart G—Borrower Supervision, Servicing and Collection of Single Family Housing Loan Accounts.

- 7 CFR part 1951, subpart I—Recapture of Section 502 Rural Housing Subsidy.

- 7 CFR part 1951, subpart M—Servicing Cases Where Unauthorized Loan or Other Financial Assistance Was Received—Single Family Housing.

- 7 CFR part 1965, subpart C—Security Servicing for Single Family Rural Housing Loans.

- 7 CFR part 1922, subpart C was not mentioned in the Proposed Rule; however, it is included in this Interim Final Rule as it contains administrative guidance on appraising SFH properties. The above mentioned regulations dealt strictly with the direct SFH programs of the RHS. The following regulations will remain in the CFR as they contain provisions relating to other program areas. These regulations are being amended as part of this final rule to clearly indicate that they no longer apply to the direct SFH loans and grants:

- 7 CFR part 1806, subpart A—Real Property Insurance.

- 7 CFR part 1910, subpart A—Receiving and Processing Applications.

- 7 CFR part 1944, subpart D—Farm Labor Housing Loan and Grant Policies, Procedures and Authorizations.

- 7 CFR part 1951, subpart C—Offsets of Federal Payments to FmHA or its successor agency under Public Law 103-354 Borrowers.

- 7 CFR part 1951, subpart D—Final Payment on Loans.

- 7 CFR part 1951, subpart F—Analyzing Credit Needs and Graduation of Borrowers.

- 7 CFR part 1951, subpart J—Management and Collection of Nonprogram (NP) Loans.

- 7 CFR part 1955, subpart A—Liquidation of Loans Secured by Real Estate and Acquisition of Real and Chattel Property.

- 7 CFR part 1955, subpart B—Management of Property.

- 7 CFR part 1955, subpart C—Disposal of Inventory Property.

- 7 CFR part 1956, subpart B—Debt Settlement—Farmer Programs and Housing.

7 CFR part 1944, subpart D was added to the above list since our Proposed Rule. In making amendments to 7 CFR part 1910, subpart A to exclude the direct SFH program, it was noted that the only Rural Development program that would remain in 7 CFR part 1910, subpart A would be the Farm Labor Housing Programs. To make it clearer for USDA field staff and the public, RHS took the administrative guidance contained in 7 CFR part 1910, subpart A which related to Farm Labor Housing loans and added it to the Farm Labor Housing regulations—7 CFR part 1944, subpart D. Through this effort, 7 CFR part 1944, subpart D is more complete, and 7 CFR part 1910, subpart A only impacts the Farm Credit Programs of the FSA. 7 CFR part 1910, subpart A has been amended to reflect this change.

After the effective date of this rule, the direct SFH program will be guided by 7 CFR part 3550 and the accompanying Handbooks. This method will ensure that all customers have access to the same program benefits. However, some changes contained in 7 CFR part 3550, which cannot be implemented under the PLAS computer system, will be applicable to customers only in states under the DLOS computer system. For example, the regulation imposes a late fee on payments which are more than 15 days delinquent. The DLOS computer system can handle such a charge, whereas the current PLAS computer system cannot. Therefore, customers in states under DLOS will be subject to a late fee. Customers in states under the PLAS system will not be subject to a late fee until they are put under the DLOS system. Another

example is the ability to escrow for taxes and insurance. Existing customers in states under DLOS may escrow; however, customers in states not under DLOS cannot escrow because the PLAS system does not have escrow capability. These differences are unavoidable due to the shortcomings of the current PLAS computer system and the massive effort the Agency will be undertaking to convert all 700,000 loans to the new system.

Discussion of Comments

The proposed rule was published in the Federal Register on April 8, 1996 (61 FR 15395), with a 60-day comment period that ended June 7, 1996. Thirty-five comments were received from Rural Development personnel, housing advocacy groups, developers, builders, attorneys, housing authorities, private lenders, housing organizations, a member of congress, and others with an interest in our housing programs.

Many of the comments focused on areas currently published in the Code of Federal Regulations (CFR) which were not a part of the proposed rule. As discussed, part of the intent behind the reengineering and reinvention of these regulations was to remove much of the administrative guidance from the CFR and include this administrative material in handbooks which would not be published in the CFR. The handbooks provide more flexibility for RHS and its customers. For example, RHS did not publish the actual amount of the downpayment required for Nonprogram (NP) purchasers of real estate owned (REO) by the government or RHS financed property. This is an administrative determination and included in the handbooks. In this manner, RHS can adjust the amount of the downpayment to more quickly react to changes in the marketplace.

In our responses to many of the comments, we have indicated that the guidance requested by a commentor is administrative and contained in the applicable handbooks. RHS sincerely appreciates the time and effort of all the commentors. Comments, by section number from the proposed rule are discussed below:

Section 3550.4(b). Non-appealable decisions. One comment was received on this section which expressed concern that language contained in 7 CFR part 1900, subpart B, which provided that program administrative decisions based upon such clear and objective statutory or regulatory requirements were not appealable was omitted. The commentor felt that this language was critical to ensure that all parties understand appealable decisions and to avoid

unnecessary work on the part of appellants, U.S. Department of Agriculture National Appeals Division (NAD), and RHS. NAD determines if an Agency decision is appealable; therefore, we cannot adopt this comment. We have also made other amendments to this section consistent with the statutes governing appeals and reviews.

Section 3550.6. State law or state supplement. Two comments were received which recommended that this title be broadened to include local and Indian tribal laws. RHS agrees and has adopted this comment.

Section 3550.8. Exception authority. Two comments were received on this section. The commentors recommended that RHS customers be provided the authority to initiate requests for exceptions rather than just the State Director. RHS considered these comments; however, RHS believes that the rules and regulations are necessary to ensure fairness and consistency to all customers. Providing anyone with the opportunity to request an exception creates an administrative burden on RHS and undermines the need for regulations. We continue to support our policy that only State Directors may request an exception to the regulations. Exceptions are rare and only used in individual cases. We believe the regulatory process, which provides for public comment, provides ample opportunity for public input and our regulations provide sufficient flexibility to provide assistance to our clients. Customers are also provided review and appeal rights, and are not prohibited from contacting or writing USDA officials with regard to concerns over regulatory issues.

Section 3550.9. Conflict of interest. Two comments were received on this section which recommended that the language be expanded to include Rural Development employees instead of just Rural Housing Service employees. RHS agrees and has added a definition of "RHS employee," to include Rural Development employees involved with the direct SFH programs. RHS also amended the section with regard to "loan closing agents." This section prohibited loan closing agents from purchasing property which was security for an RHS loan. This prohibition was included in the regulations when the Agency "designated" attorneys and required that an applicant select a designated attorney to perform loan closing functions. Since RHS no longer designates attorneys, only loan closing agents who performed legal work on a particular security property should be prohibited to purchase said property

due to the potential for a conflict of interest.

Section 3550.10. Definitions—Cost appraisals. Two commentors recommended a definition of cost appraisals for properties located in remote areas or on tribal lands. RHS agrees that additional guidance on such appraisals is necessary and will include these in the Handbooks.

Deferred mortgage payments. One commentor requested that we clarify that deferred amounts are subject to recapture on sale. RHS agrees and has amended the definition to provide that deferred amounts are due on sale or nonoccupancy.

Deficient housing. One commentor recommended we expand the definition to include housing that is uninhabitable, unsafe, or poses a health or environmental threat to the occupant or others. RHS agrees and has made this change.

Existing dwelling or unit. Several commentors noted that the definition included an inadvertent “not” with regard to dwellings covered by an approved 10-year warranty plan and that the definition of “New dwelling,” was missing the term “not.” RHS appreciates these comments and has rewritten both definitions for clarity.

False information. One commentor recommended that the definition be expanded to include information deliberately omitted for the purpose of receiving or continuing to receive assistance for which they were not eligible to receive. We agree and have clarified and expanded the definition accordingly.

Legal alien. One commentor did not feel the definition provided sufficient information. RHS believes this definition is sufficient; and will provide additional information on how to verify alien status in the handbooks.

Market value. One commentor recommended that the definition be expanded to include a “Broker Price Opinion,” (BPO) where authorized. A BPO is a quick and inexpensive tool which helps determine the value of a house based upon recent sales in the area. RHS agrees that a BPO would be beneficial for certain servicing, but not loan origination purposes. In addition, it is less costly to the government and RHS customers. As such, we have adopted this comment.

Moderate income. Two comments were received indicating the definition of moderate income for direct SFH assistance (for which RHS had proposed no change) is different than the definition of moderate income for the guaranteed SFH program. RHS recognizes that the definitions are

different. The direct SFH programs are aimed at assisting lower income families, that even with a potential loan guarantee, could not obtain financing for housing. The guarantee program is aimed at assisting higher income families who could not obtain housing without a guarantee. The moderate income level is set higher in the guarantee program to assist a wider spectrum of low and moderate income families to obtain housing.

Modest housing. Two commentors felt that our definition of modest housing, which relies upon the section 203 (b) limits established by the National Housing Act, often times resulted in the Agency financing homes which were not actually modest in rural areas, especially in terms of size. RHS shares these concerns.

For this reason, as discussed elsewhere in this rule, we are reopening the comment period regarding this issue.

One commentor felt that RHS should not prohibit the financing of houses with in-ground swimming pools. The commentor stated that RHS has financed homes where an in-ground pool existed but was removed so the property could be financed by RHS. RHS agrees that physically removing an in-ground swimming pool so that RHS will finance a property is impractical; however, RHS is providing subsidized credit to families with limited incomes. In-ground pools are expensive to own and operate and are viewed as an above-modest feature. It does not serve the best interests of the overall program by financing homes with in-ground pools. Further, the cost of maintaining such a feature is generally beyond the financial capability of our clientele.

Modular home. One commentor noted we had included a definition of “manufactured home,” but did not include a definition of modular home. We regret the oversight and have included a definition.

New dwelling. See comments under “Existing dwelling.”

Person with disability. One commentor thought the definition was cumbersome, and noted that Social Security no longer considers drug addiction and alcoholism a disability. RHS agrees that the definition was long and has streamlined it. With regard to the Social Security Administration (SSA) no longer considering drug addiction or alcoholism a disability, this is a determination made by SSA for their program eligibility. RHS does not consider an applicant’s disability, in itself, for determining eligibility for housing assistance. Disability of an

applicant is used in determining adjusted income.

Recapture amount. One commentor recommended an expansion of the definition to cover exceptional cases such as nonoccupancy beyond the customers control or when in the best interests of the government. RHS believes the definition is sufficient, and such exceptional cases handled on a case-by-case basis under the exception authority. It should be noted that section 521(a)(1)(D)(i) of the Housing Act of 1949, as amended, requires the Secretary to provide for recapture upon the disposition or nonoccupancy of the property by the borrower.

Repayment income. Two commentors did not like this term and felt “gross income” was more appropriate. Gross income is the basis for calculating adjusted income and is not the same income from which a customer could “repay” their loan. RHS believes the term “repayment income” is more appropriate in describing the use of this income.

Rural area. One commentor felt that the reference to “rural in character” was misplaced in the definition. This portion of definition came directly from section 520 of the Housing Act of 1949, as amended, and is correct.

Scheduled payment. One commentor recommended that the definition be expanded to include protective advances. We agree and have included this language in the definition.

Total Debt Ratio. One commentor recommended that this definition include a clarification on whether baby-sitting expenses are included in total debts. We disagree. This is a brief definition and does not include guidance on all the aspects of what is included or not included in total debt ratio. Baby-sitting expenses are not considered a debt and this guidance is contained in the handbooks.

Value appreciation. One commentor felt the definition did not give the homeowner credit for home improvements and for principal paid. RHS agrees and has clarified the definition.

Other amendments to “Definitions.” RHS has added definitions of Household, Nonprogram (NP) interest rate, Principal reduction attributed to subsidy (PRAS), Recipient, RHS employee, Subsidy, U.S. citizen, and USDA and provided to make it easier for our customers and staff to understand these terms used throughout 7 CFR part 3550. RHS has also clarified the definitions of Interest credit, Net family assets, and Payment assistance, and provided legal citations for the Housing Act of 1949. The definition of Veterans

preference was also expanded to include the Persian Gulf War.

Section 3550.51. Program objectives. Several comments were received regarding RHS's encouragement of applicants to seek other sources of funding in conjunction with their single family housing loan. Several commentors recommended that due to limited funding and the tremendous need for affordable housing, that RHS should require leveraging, where feasible, to ensure that limited resources serve the maximum number of families. RHS agrees and has adopted this recommendation. One commentor suggested the proposed reference to "if possible" be replaced with "where the income required for eligibility is not greater than that for a loan funded by Section 502 alone." RHS disagrees. The language in this paragraph only requires an applicant to seek other funds, where feasible. Since most lenders do not use income limits, but rather debt ratios to determine an applicant eligibility, the second comment is not applicable. In addition, we do not believe that participation loans result in our program serving higher income families since many of the participation funds come from other loan and grant programs aimed at assisting very-low income families. We believe the language, as modified, is appropriate.

Section 3550.52. Loan purposes. One commentor recommended that conditional commitment fees and credit report fees be included as an eligible cost for loan making purposes. A conditional commitment fee is paid by a builder to RHS as partial reimbursement to RHS for the administrative costs of appraising and inspecting a property. This is a builder's cost of doing business and not an eligible loan purpose for an applicant. In most cases, this is generally included in the commitment price, so as a practical matter, the conditional commitment fee is included in the amount financed. Credit report fees are small and should be paid by the applicant.

Another commentor felt that RHS should allow packaging fees in connection with the sale of Real Estate Owned (REO) by RHS. REO properties are generally sold by real estate brokers under an exclusive or open-listing arrangement with RHS. RHS pays a typical brokers commission and expects that the selling agent, to facilitate the sale of the REO, will package the loan application if the purchaser is applying for a loan from RHS. Authorizing a packaging fee would increase costs to the government.

Section 3550.52(b). Refinancing non-RHS debts. Two commentors felt that RHS inadvertently forgot to include its ability to refinance debts incurred for necessary repair and rehabilitation work. The regulation provides that funds for refinancing can cover costs for "eligible loan purposes." Since necessary repairs and rehabilitation is an eligible loan purpose, this section is correct.

Section 3550.53(a). Income eligibility. One commentor suggested that we include a reference to moderate income families for renewal of payment subsidies. Since this section deals with an applicant's eligibility for a loan, and not a borrower's eligibility for continued subsidy, the comment is not applicable.

Section 3550.53(g). Repayment ability. Seventeen comments were received on this section, most recommending that the debt ratios for principal, interest, taxes and insurance (PITI), and maximum debt limits should be consistent for very-low and low income applicants, and consistent with our guaranteed SFH program. Currently, the PITI ratio is 29% for very-low income applicants and 33% for low income applicants; and the maximum debt limit is 38% for all applicants. Most argued convincingly that the PITI ratios for very-low and low income applicants should be the same. Some felt the ratios were prudent loan underwriting and should remain as is. Some argued that the ratios should remain the same with the State Director having a broader exception authority. Some argued for higher ratios, but still with a difference between very-low and low income applicants. RHS believes that the different ratios for applicant types and programs is confusing to both Rural Development staff and the public. RHS also agrees that the maximum debt limit should be increased. RHS has retained the limits of 29% for PITI for very-low and 33% for PITI for low income applicants, and modified the total debt ratio to 41%. RHS is still fully analyzing all comments regarding this section and has reopened the comment period on this section to solicit further public input.

Section 3550.53(h). Credit qualifications. Thirteen comments were received on this section, most expressing concern that certain conditions which indicated an acceptable or unacceptable credit history were missing from the proposed rule that are currently contained in 7 CFR part 1944, subpart A.

RHS intent in developing this rule was to remove administrative decisions from the CFR and include these in the Handbooks which will accompany the

regulations. The sections which were left out of the proposed rule dealt strictly with administrative waivers or other conditions which the Agency may consider in determining the creditworthiness of applicants. As these are administrative decisions, these areas are included in the Handbooks and in much greater detail.

One commentor felt RHS should waive instances of poor credit if the applicant was unaware of a collection account. RHS disagrees. It would be difficult to document whether an applicant was unaware of the collection. Further, an applicant must demonstrate that they have a credit history which demonstrates a reasonable ability and willingness to meet debt obligations. Being unaware of a debt and a resulting collection account does not demonstrate a reasonable credit history.

One commentor felt RHS was too liberal in its credit policy by allowing 2 late payments in the past 12 months and by not including a requirement that rent payments over the previous 24 months had to be paid on a timely basis. Low income families are impacted to a greater degree than higher income families with unforeseen changes in their financial situation. A car repair or medical bill could cause a low income family to miss a due date for a short timeframe. These instances of late payments do not necessarily reflect an unwillingness or inability to meet future obligations. We believe this recommendation is too rigid for very-low and low income families.

One commentor felt that RHS was confusing credit history with repayment ability. The commentor felt that someone delinquent on rent payments did not demonstrate a favorable credit history. The concern expressed was over the provision that permits such unfavorable credit to be waived if the proposed PITI under the loan is less than the present rent payment. The commentor felt that comparing rent to PITI was a repayment ability consideration. Credit history and repayment ability are linked in that lessening a family's shelter costs would likely enhance their ability to meet the obligation when due. Therefore, we believe the provision for considering extenuating circumstances, such as this example, is appropriate. The commentor also felt that RHS made an error in explaining the difference between evaluating the rental history of applicants. The proposed regulation could be read to imply that an applicant could be two or more payments late on their rent if their other credit history was satisfactory. We have clarified this to provide that if an applicant's other

credit history is satisfactory, only one year of rental history will be evaluated.

Another commentator recommended that where an applicant had a non-RHS write-off, and subsequently paid off the debt at least 12 months ago, we not count this negative credit reference against the applicant. RHS agrees and has modified the regulation accordingly.

RHS has also clarified that a delinquency on a federal debt and foreclosure in the past 36 months are indicators of unacceptable credit.

One commentator felt that a lack of credit history should not automatically be considered acceptable credit. They explained convincingly that the first credit experience for a family should not be their largest financial obligation. A recent study by Chase Manhattan indicated that the highest delinquency rate in the first year of RHS homeownership was attributed to customers who had no credit history prior to obtaining their RHS loan. This was particularly evident in customers who had resided with family and had no credit experience on their own. This policy has been in effect for many years and was established, in part, to recognize the lack of credit in rural areas. However, as the commentator indicated, non-real estate related credit in one form or another is now readily available even in rural areas, and it is not possible for a prudent loan underwriter to document that someone who has never had any financial obligations demonstrates a reasonable ability and willingness to meet debt obligations. RHS agrees and has removed this criteria from the regulation. Additional guidance in evaluating applications where the applicant may lack a credit history is provided in the Handbooks.

Section 3550.54 Calculation of income and assets. Several comments were received regarding this section asking that RHS further simplify and clarify how to calculate the various types of income and assets. RHS agrees that this section was cumbersome. As such, RHS has clarified this entire section to make it easier to understand repayment, annual and adjusted incomes, and net family assets.

Section 3550.54(a) Annual income. Three comments were received. One commentator recommended that the paragraph be revised because annual income and repayment income are sometimes different. Annual income and repayment income are different. As mentioned in this section, annual income is the base from which repayment income is calculated.

One commentator recommended that the regulation provide guidance on

verifying alimony or child support for separated or divorced persons who cannot afford legal costs, or the action has not proceeded far enough for executed papers to confirm payment amounts. Verifying income is an administrative function and guidance on such cases is provided in the handbooks.

One commentator recommended that the Equivalent Interest Rate be based upon the applicant's income only and not the total family income. The commentator felt the extra income that may be included in the total family income may not be readily available in the future and may jeopardize the customer's repayment ability. RHS understands the comment; however, the income of all persons living in the household must be used to determine monthly payments. Should the income of the household change, the customer may qualify for increased payment assistance or other servicing options.

Section 3550.54(b) Adjusted income. One commentator mentioned that the regulation does not include the actual dollar amount for allowable deductions. These deductions are set by law (see section 501 (b)(5) of the Housing Act, as amended) and need not be repeated in the regulation. They are included in the Handbooks.

One commentator recommended all medical expenses of a disabled family member should be deductible. Section 501(b) of the Housing Act of 1949, as amended, requires that the definition of income and adjusted income for RHS programs have the meanings given section 3(b)(5) of the Housing Act of 1937. The current regulation is not the appropriate forum for the suggested change to be made, but the changes will be considered in a revision of the definition of income under section 3(b)(4) which must be jointly made with the Secretary of HUD.

One commentator was unclear as to whether eligible deductions for an elderly family includes all expenses or just those expenses in excess of three percent of income. RHS has clarified the regulation to be clear that it is only expenses in excess of three percent.

One commentator recommended that long-term debts that will be paid in full within 12 months should not be considered in the total debt ratio for self-help applicants because the time between application, construction, and first payment is generally one year. RHS agrees that the time between application and closing for a self-help applicant is generally longer, however, RHS believes that all applicants must be treated consistently. To provide self-help applicants with this flexibility would

not be consistent with our treatment of other applicants. Generally, RHS does not know the length of time between application and closing when it receives an application. This is influenced by many factors including the availability of funding, the applicant's decision to build or purchase an existing home, the time it takes for the applicant to execute the necessary documents to purchase or build a home, and other influences outside the control of RHS or the applicant. While the comment has merit, the inconsistent manner in which applicants would obtain our services outweighs its advantages.

Section 3550.54(d). Income exclusions. Two comments were received stating that RHS may have inadvertently omitted a list of income that is included in repayment income. This paragraph deals with income exclusions. The information mentioned is correctly included in 3550.54(c), *Repayment income*.

Section 3550.54(e). Net family assets. Two comments were received. One commentator recommended that the cash value of life insurance not be considered an asset from which an imputed income is calculated since the applicant cannot obtain access to its value. RHS must be consistent with the manner in which HUD handles net family assets. HUD considers the cash value of life insurance an asset from which imputed income is calculated, and therefore RHS, through this rulemaking document, cannot adopt this comment.

Another commentator recommended that for self-employed applicants, RHS allow depreciation reported to the Internal Revenue Service (IRS) to be added to income for repayment income and then deducted from income for determining loan payments. RHS disagrees. The Agency has always utilized the net income of such applicants, and used such income consistently throughout the underwriting process. We believe this is more reflective of the income from which self-employed applicants can reasonably depend upon to afford the costs of homeownership.

Section 3550.55(b). Agency processing of applications. One commentator felt that returning incomplete applications is burdensome on both the applicant and RHS. It is policy to return incomplete applications to ensure consistent handling; however, the Handbooks contain administrative provisions for handling minor omissions in the package which would not require returning the complete package to the applicant.

Two commentators felt that RHS should include a specific timeframe for an

applicant to respond to RHS's inquiry as to their continued interest in the program. RHS believes this is an administrative function, and as such, is included in the Handbooks.

Section 3550.55(c). Funding priorities. Seven comments were received. One commentor fully supported the priorities as proposed. The other commentors felt that the priorities should be rearranged consistent with the statute which requires that priority to be given to applicants with the greatest need. Unfortunately, what each commentor felt was the greatest need differed depending upon their own perspective and interests. RHS developed the list taking into consideration the intent of the authorizing statute and prior comments from Rural Development field staff and the public. As evidenced by the comments, "need" is subjective. RHS continues its policy that existing RHS customers with the need for a repair loan to correct health and safety hazards will have the greatest priority. These loans are generally of a smaller amount (compared to an initial loan) and RHS can assist many needy families through this priority. Second priority is for the sale of Real Estate Owned (REO) and for the transfer of existing RHS loans. These priorities ensure that RHS' existing portfolio is adequately managed, and these currently held resources assist as many families as possible. RHS agrees with the majority of other commentors that hardship circumstances should be considered a higher priority than participation loans and self-help housing loans, and has made hardships third priority. The aforementioned areas are considered equally as fourth priority, and all other loans are fifth priority.

In addition, RHS retitled this section to "Selection for Processing," to better reflect the intent of the paragraph. Loans are selected for processing in the order outlined in this section. After selection for processing, loans are funded on first come, first served basis.

Section 3550.56(b). Site standards. Four comments were received. Three favored our proposed removal of the one-acre lot restriction provided the lot could not be subdivided into more than one parcel. One commentor stated that there is no zoning in many rural areas and therefore no documentation could be obtained that the lot could not be subdivided. This and another commentor recommended that the value of the lot should not exceed 30% of the total market value of the proposal. RHS agrees and has modified the language accordingly.

One commentor recommended that RHS provide additional guidance on how to review sites. This information is included in the handbooks.

Section 3550.57(a). Modest dwelling. Five comments were received. The majority supported RHS's current policy that the property must not exceed the limits established under 203(b) of the National Housing Act. However, several questioned what is considered "modest" and several thought the 203(b) limits provided above modest housing in many rural communities. RHS agrees that the housing must be modest, and is aware of cases where the 203(b) limits allow for the financing of homes which are excessive in size and cost. The government should not be providing subsidized credit to anyone to purchase above modest housing. RHS will continue with the 203(b) limits being the maximum loan amount and is reopening the comment period on this section to solicit comments on how the Agency can best address the concerns raised in this area.

Section 3550.57(c). Existing dwellings. One commentor felt RHS should provide more administrative guidance, or a checklist in the regulation on how to determine if a house is structurally sound, functionally adequate, in good repair or to be placed in good repair. RHS disagrees that such guidance is necessary in the regulation, and has included this administrative guidance in the Handbooks.

Section 3550.58(b). Secure leasehold interest. Two commentors recommended that the term of an acceptable lease be increased from 15 to 25 years. RHS agrees and has adopted this comment.

Section 3550.59. Security requirements. Five comments were received. Two commentors recommended that RHS accept a junior lien position if the senior lien is an affordable mortgage and the RHS loan is for necessary repairs. RHS agrees and has adopted this recommendation. Two commentors recommended that when RHS accepts a junior lien position, the total secured debt must be less than or equal to market value. The commentors recommended expansion to include the words "equal to." RHS again agrees and has adopted this comment. One commentor recommended that we allow junior liens to RHS to exceed the market value when the purpose of the junior lien is to secure other financing for a downpayment or closing costs. RHS disagrees, especially since RHS does not require a downpayment, and closing costs may be included in the RHS loan.

Section 3550.60. Escrow account. Eight comments were received on this

section, and all supported the escrow of taxes and insurance to assist our customers in becoming successful homeowners. One commentor felt the language requiring "customers to deposit funds sufficient to pay taxes and insurance premiums applicable to the mortgage for the period since the last payments were made" to be too restrictive. The commentor suggested that RHS consider requiring funds for only the initial year of escrow. We intended this language to cover existing customers who may be delinquent in taxes at the time they go on escrow. Since RHS will consider paying the customer's delinquent taxes, charging them to the customer's account, and then reamortizing the loan, the proposed language would not be too restrictive. It is RHS's intent to assist existing customers to every extent possible to establish an escrow account.

One commentor questioned the timing for escrow accounts. All new loans which are originated or closed under DLOS will have an escrow account automatically established. All customers who received loans since October 27, 1995, have been specifically advised that RHS was in the process of implementing an escrow system and they would be required to escrow when the system became operational. RHS may require these customers to convert to escrow shortly after their state comes under the DLOS system. All other customers will be asked to voluntarily convert to escrow when their state comes under DLOS.

One commentor questioned payments to escrow if a customer is on a moratorium. If a borrower cannot pay their escrow payments during a moratorium, a negative balance may occur in their escrow account. In these cases, RHS will pay the customer's taxes as if the escrow payments had been made. The negative balance, or delinquency created in the escrow account, will be handled at the conclusion of the moratorium period either through repayment or reamortization.

One commentor recommended that the cost of the tax service fee should not be paid entirely by the customer, but shared between RHS and its customer since the benefits of the escrow are shared. RHS understands the comment, but does not agree that the fee to obtain tax service should be split. The small one-time fee is the cost for the customer to ensure that taxes and assessments are paid when due. These are services which directly benefit the customer, and should be paid for by the customer. As previously mentioned, this fee can be included in the loan. For existing

customers, the fee may be charged to their account.

Section 3550.61. Insurance. Two comments were received. One commentor recommended that RHS secure the services of a vendor and have the ability to "force-place" insurance. This was always RHS's intent, and is being administratively secured. This guidance is contained in the Handbooks.

Another commentor recommended that RHS require a "loss payable clause," in all insurance policies to ensure enforceability. The Handbooks contain such language, however, we agree that it should be specifically mentioned in the regulation. The commentor further recommended that insurance be based on the unpaid loan balance and not the depreciated replacement value. This is because the depreciated replacement value is costly to determine, and for existing dwellings, generally more expensive for the client. RHS agrees and has modified the insurance sections to require insurance to cover the entire secured debt. RHS also amended this section to allow excess insurance proceeds, following a loss, to be released to the borrower provided the RHS debt is adequately secured. The previous language required that the borrower had to have at least 20 percent equity in the property before excess proceeds would be released.

Section 3550.62. Appraisals. Two commentors recommended that RHS include a provision that when a participating lender, in a leveraging situation, secures an appraisal acceptable to RHS, that no appraisal fee be charged. RHS agrees and has revised this section accordingly.

Two commentors recommended that a new paragraph be added to this section to provide guidance on appraisals on Indian Trust lands. RHS agrees that guidance is needed, however, this is an administrative matter which will be included in the Handbooks.

One commentor recommended the language for additional security be removed because it is not often used and is confusing. RHS agrees that additional security is rarely taken; however, in those cases where it is taken, we believe the guidance is necessary. Since this passage is not used often, we moved the language to the end of the paragraph.

Section 3550.63. Maximum loan amount. Five comments were received. One commentor felt the limits were too low in rural areas of their state, because many low-end existing property sales brought the median sales price below the average new construction house. Some felt the limits were too high. As

mentioned, RHS shares these concerns and is reopening the comment period on this section.

Section 3550.64. Down payment. One commentor recommended that RHS authorize an exception to allow applicants not to liquidate assets which could be difficult or expensive to liquidate. RHS provides subsidized credit to facilitate the purchase of a home by very-low and low income families. If this family has assets by which to reduce the amount of the loan, they should liquidate those assets. The overall interests of the program are not served when the Government provides subsidized credit to persons with assets that can be liquidated to reduce their loan amounts.

Section 3550.65. Loan to value ratio. In reviewing comments to §§ 3550.63 and 3550.65, RHS recognized that the two sections were interrelated. For clarity, RHS has combined this guidance into one consolidated section—§ 3550.63. The comments discussed below correspond to the numbering in the Proposed Rule.

Section 3550.65(b). Loans limited to 90% of Market Value. Five comments were received. The commentors recommended that we expand our list of allowable inspection sources. RHS agrees and has modified the regulations to provide for other approved inspection sources. The Handbooks will contain a list of such sources.

Section 3550.65(c). Loans in excess of market value. One commentor recommended that we allow junior liens to exceed the market value when the purpose of the junior lien is to secure other financing for downpayments or closing costs. RHS disagrees, especially since RHS does not require a downpayment, and closing costs may be included in the loan.

Section 3550.67. Repayment period. RHS amended this section for clarity and included guidance on manufactured homes.

Section 3550.68. Payment subsidies. The comments under this section were essentially identical to those found in §§ 3550.53(g), 3550.57(a), and 3550.63. As discussed elsewhere in this rule, RHS is reopening the comment period on this section. See the aforementioned section numbers for a summary of the comments and the section in this rule called "Reopening of Comment Period For Selected Issues."

Section 3550.68(b). Conversion from interest credit to payment assistance. Two comments were received. One commentor thought that RHS should provide interest credit on any subsequent loan made to a customer that has an existing loan under interest

credit. This section provides for such authority. RHS customers who are currently on interest credit will continue to receive interest credit for as long as they remain eligible for this assistance. A subsequent loan or reamortization of the account has no impact on this policy.

One commentor felt that RHS administering two types of subsidies was confusing and administratively burdensome upon the Agency. RHS agrees that administering the two programs is administratively burdensome; however, feels that existing customers should be allowed to stay on interest credit until they no longer qualify for this assistance. The two programs are different. Existing customers who have had their loans serviced by the Agency for many years understand the interest credit program and how changes in income impact their payments. In brief, they handle their finances accordingly. Converting to payment assistance, in most cases, increases a customer's payments. And in some cases, some newer customers may not have been able to qualify for their loans if interest credit assistance were not available. RHS believes that it would not serve the public interest by jeopardizing the repayment ability of these existing customers.

One commentor felt that we should continue to extend interest credit to a customer who had once received it, later became ineligible for it, and subsequently needed it again. RHS disagrees. Most typically, a customer becomes ineligible for interest credit when their income increases to the above-moderate level. These customers are making payments at the full note rate and have established their finances accordingly. If they suffer a reduction in income, payment assistance can reduce their payments. In addition, the Agency can consider a moratorium or other servicing tool to assist them. We believe that customers on interest credit should continue to receive it as long as they so qualify; however, if they need a new payment subsidy, they should be treated consistently with new customers requesting a payment subsidy.

For clarity, RHS retitled this section to "Determining type of payment subsidy."

Section 3550.69. Deferred mortgage payments. Four comments were received. One commentor recommended removal of this section from the regulation since the program is not funded; although the regulation should continue to include administrative guidance of how to calculate and collect deferred payments. Administrative guidance is contained in the

Handbooks. Another commentor recommended that although the program is not funded, it remain in the regulations in case the program is ever again funded. Additionally, the commentor recommended the debt ratio be increased from 29% to a higher level. RHS will leave the provisions in the regulation since the program may again be funded. The debt ratio will remain as is for consistency throughout the program.

Two commentors recommended that if a customer who received a deferred mortgage no longer qualifies for the deferral, and at a later date, would benefit from this assistance, the Agency should again defer the loan. The deferred mortgage program is a loan underwriting tool. This is evidenced by the fact that appropriations are necessary to make a deferred loan. A deferral of payments is not a servicing option. In cases where a customer may suffer a reduction in income, they may qualify for an increased payment subsidy or a payment moratorium.

Section 3550.70. Conditional commitments. Three comments were received. One commentor felt that the builder should not have to own the site in order for RHS to provide a commitment and recommended a long term option be acceptable. The premise behind a conditional commitment is to allow a builder to construct a house knowing that RHS will inspect the property and will finance it to a qualified applicant. RHS does not feel it would be prudent for a builder to construct a house on land which it does not own and does not want to encourage such a practice.

One comment was received concerning packaged loans on presold houses. The existing regulation and proposed rule provided that RHS will not approve a conditional commitment until the loan has been approved. In these cases, the property is presold. We believe it prudent practice to ensure that the person holding a valid contract to purchase the property have an approvable loan before the commitment is approved.

Another commentor felt that we should refund the conditional commitment price if RHS does not finance the property. RHS disagrees. RHS incurred the expense of appraising and inspecting the property and is entitled to these fees for the services provided.

Section 3550.71. Special requirements for condominiums. Three comments were received. One felt the revised language would allow RHS to finance more condominiums. RHS agrees. Two commentors felt that RHS should relax

its requirements that at least 70 percent of the units had to be sold before it will consider financing units in the complex. We believe this a prudent underwriting practice and protects the best interests of our customers and the government.

RHS recently became aware that this section was preventing us from financing units in several states because our regulations were not consistent with state laws regarding homeowners association dues. For instance, current regulations provide that if RHS acquires title to a condominium, the Agency would not be liable for more than 3 months of the unit's unpaid regularly budgeted dues or charges accrued before acquisition and the liens priority may not include costs of collecting unpaid dues. However, in Massachusetts, for example, state law provides that the lien of a homeowners association will have priority over a first mortgage for the six month period prior to filing action and such lien may include costs. Other lenders have modified their underwriting standards to be consistent with state laws. RHS has included these changes in the final rule.

Section 3550.72. Community land trusts. Two commentors objected to RHS's requirement that land trust restrictions must be able to be terminated should RHS acquire title to the property. RHS believes this is a prudent loan underwriting practice. Further, without this provision, the market value of the property at loan origination may be significantly lower because of the restrictions which may preclude the Agency from financing the property.

Section 3550.73. Manufactured homes. Four comments were received. One commentor pointed out a potential conflict between paragraphs 3550.73(a)(4) which authorizes a loan for repairs and 3550.73(b)(4) which excludes repairs after the initial loan is made. RHS has corrected the conflict to provide that the purchase loan may not include funds for alteration or remodeling. RHS has also amended this section for clarity.

One commentor felt that RHS should not have to approve dealer-contractors of manufactured homes. RHS disagrees. The Agency and its customer need reasonable assurances, which are provided through the approval process, that our best interests are protected.

Two commentors felt that the Agency should not require a Release of Claimants from all persons furnishing labor or materials. RHS disagrees. Again, these documents help ensure the Agency's, and its customers', interests are protected by verifying that all labor

and materials are paid for and there is no potential for mechanics liens.

Section 3550.74. Nonprogram (NP) loans. One commentor mentioned a conflict between the opening sentence which states that NP credit is available for the assumption of existing RHS loans and § 3550.74(a)(1) which states NP credit can be extended on Real Estate Owned (REO). We have clarified the opening sentence.

Two commentors expressed concern that RHS did not include the amount of the required downpayment in the regulation. NP credit is offered for RHS's convenience as a lender and when in the government's best financial interests. Since it is not a customer entitlement, but rather an administrative function, the downpayment amounts are contained in the Handbooks. The required downpayments are currently 2% for owner-occupants and 5% for investors.

Sections 3550.103 thru 3550.114 Section 504 Origination. These sections have to be reorganized and expanded to be consistent with the sections dealing with section 502 origination. This was done to ensure consistency, where appropriate, between the programs. The comments discussed below refer to the section number as provided in the Proposed Rule.

Section 3550.102. Grant and loan purposes. Two comments were received which requested a definition of "modest" housing for section 504 purposes. The definition of modest housing contained in § 3550.10 applies to both section 502 and 504 loans.

Section 3550.105(b). Age (grant applicants). One commentor recommended that we expand the definition of age for 504 grants to include persons with a disability of any age, especially for handicapped accessibility. Previous appropriations language has prevented RHS from making 504 grants available to persons who were not 62 years young. While we agree that some type of grant should be available for this purpose, the demand for section 504 grant funds far outweighs the available resources. Expanding the base for eligibility would only further delay approving these grants which are used to address critical health and safety needs for those 62 years of age or older. Therefore, we are not adopting this recommendation.

Section 3550.105(f). Credit qualifications. Four comments were received. One requested we clarify that the credit standards do not apply to 504 grants. This clarification has been made.

The other three commentors all strongly opposed the proposed change to the credit qualification standards.

RHS had proposed imposing the same standards on 504 recipients as 502 recipients. The commentors argued convincingly that the standards may be too rigid for such applicants who are generally of extremely low incomes with no alternatives to make necessary repairs and improvements to their homes. RHS agrees and has relaxed the standards for 504 participants; however, similar to the section 502 program, RHS has clarified that a delinquency on a federal debt or foreclosure within the past 36 months are indicators of unacceptable credit.

Section 3550.107(b). Secure leasehold interest. Two commentors recommended that a leasehold for mutual help housing financed by HUD, with no minimum lease term, constitute acceptable ownership for section 504 assistance. RHS agrees and has modified this section accordingly.

Section 3550.108. Loan rates and terms. One commentor recommended that when a combination loan and grant is made, that the loan term not be set at 20 years if the applicant can repay the loan sooner. RHS partially agrees, however grant funds are extremely limited and only provided when the applicant cannot afford repayment ability on a loan. If the loan period were shortened, the grant portion of the proposal may increase to ensure affordability. We believe the language is appropriate. Of course, a recipient of a combined loan and grant can prepay the loan prior to the 20 year term or may request an accelerated repayment schedule at any time he or she experiences an increase in repayment ability.

Section 3550.109. Security requirements (loans only). Two comments were received. One recommended the threshold for a loan which is required to be secured be increased from \$2,500 to \$4,000 to recognize the increase in costs since the regulations were developed. This amount is statutory and no change was made.

One commentor pointed out the different thresholds for security purposes. Loans over \$2,500 must have a mortgage, loans over \$7,500 must also have title clearance, and loans over \$15,000 must also have an appraisal. The commentor recommended more consistency. RHS needs to carefully balance the imposition of costs to a customer against protection of the government's best financial interest. While the aforementioned thresholds are different, we believe they are balanced consistent with the program's objectives and available resources.

Section 3550.110. Appraisals. One commentor recommended that we clarify that an appraisal is required if the total secured debt exceeds \$15,000 or just the section 504 debt exceeds \$15,000. An appraisal is required whenever the secured debts exceeds \$15,000. We have revised the regulations accordingly.

Another commentor recommended that RHS include guidance on appraisals on Indian Trust lands. As previously mentioned, this guidance will be provided in the Handbooks.

Section 3550.111. Escrow account. Four comments were received concerning RHS's proposal to escrow for section 504 customers. RHS agrees that not all section 504 loan recipients should be required to escrow, particularly when a senior lienholder may require an escrow. Section 504 customers have very low incomes and do not often have the resources to establish an escrow account. Based upon comments, any 504 loan recipient with an outstanding 504 indebtedness exceeding \$2,500 may voluntarily request to escrow. RHS will require an escrow on 504 loans where the total secured debt exceeds \$15,000 and there is no junior lienholder requiring an escrow, and in cases where the customer defaults on the terms of the promissory note and escrow is necessary to protect the best interests of the government.

Section 3550.112. Insurance (loans only). Again, comments were received opposing the requirement that all section 504 customers escrow for insurance of their property. These customers have extremely low incomes and in some cases, the home may be uninsurable. RHS will not require proof of insurance to obtain a section 504 loan of less than \$15,000. In all cases where the total secured indebtedness on the property exceeds \$15,000, the customer voluntarily elects to escrow, or when necessary to protect the government's financial interest, insurance will be required.

In accordance with the National Flood Insurance Reform Act of 1994 (Public Law 103-325), flood insurance is required on all section 504 loans when the security property is located in a Special Flood Hazard Area (SFHA) and 504 grants in excess of \$5,000 where the property being repaired is located in a SFHA. RHS has included the ability to include the cost of flood insurance in a loan or grant if necessary to provide section 504 assistance to the customer.

Section 3550.113. Repayment agreement (grants only). Two comments were received. One commentor recommended the elimination of the

repayment agreement since it is not enforceable. RHS disagrees. The agreement is enforceable, plus it provides a written verification to the grantee that the grant must be repaid if the property is sold.

Another commentor recommended that the term "grant closing" be removed since there is no real closing of a "grant similar" to a closing on an initial SFH loan. RHS agrees.

Section 3550.152(a). Payment terms. Two commentors strongly opposed RHS's requirement that a cash payment must be accompanied by an amount sufficient to cover the cost of a money order, stating that such a proposal was unfair to very low and low income families. This is not a change in policy; RHS has been collecting a money order fee with cash payment since March 25, 1991. RHS provides supervised credit. We encourage, like all lenders, customers to send payments by check, money order or bank draft. Cash payments in the local office are discouraged. Since RHS must obtain a money order in order to transmit the payment, the customer should pay that fee.

Section 3550.152(b). Application of Payments. Eight comments were received. Two commentors recommended that RHS should have all loan payments due on the first of each month because it would be easier for clients to remember and make loan servicing easier. RHS has long considered this policy, however, RHS believes its policy of staggering due dates is more customer-oriented. The due date is generally established by the loan closing date. In this manner, an applicant can select a closing date which corresponds to the date when they have funds available to make their mortgage payment. For example, a customer on a fixed income who receives a check at the beginning of each month would benefit from closing on their loan in the middle of the month so they have received their monthly check in time to make their mortgage payment. Having a due date consistent with the loan closing date also eliminates the need for the loan recipient from having to pay prepaid interest at the time of loan closing until the last day of the month. With regard to remembering a due date, we believe our clients do remember their due date. In addition, RHS will provide customers a monthly billing statement. From RHS's perspective, the staggered due-dates provide better customer service in that RHS work-flow is spread-out over the month rather than concentrated at the beginning of each month.

Two commentors also recommended that RHS permit electronic transfer of funds and biweekly loan payments. As mentioned in the proposed rule, RHS will now be encouraging its customers to establish automatic payments with their local banking institution. With regard to biweekly loan payments, RHS customers may contact the Centralized Servicing Center to make arrangement to make biweekly payment should they so desire.

Six commentors objected to RHS holding less than a full payment in suspense. RHS believes this section may have been misinterpreted. A customer with an active account will always be given credit for a partial payment. The distinction, however, is that the accounting system will reflect that the scheduled installment is not paid (is in suspense) until the full installment is made. For example, assume a customer's next scheduled payment of \$300 is due on October 5th. On October 5th, RHS receives a check for \$100, and on November 5th RHS receives a check for \$512. RHS records will indicate that this customer paid \$100 on October 5th. The customer will receive a past due notice and be charged a late fee of \$12 on October 20th. The system will credit the customer with the \$100 payment on October 5th, but will reflect that the October 5th installment has not been paid until the full installment has been received. The October 5th installment is "in suspense" until fully paid. When RHS receives the check of \$512 on November 5th, the October installment will no longer be in "suspense" because it has been fully paid.

It should be noted that RHS chose not to follow many mortgage lenders' practice with regard to partial payment. Many lenders return partial payments to the customer. RHS feels its policy is more advantageous to both the customer and Agency.

One commentor questioned the hierarchy of how payments are applied. This commentor, a large mortgage lender and servicer, stated that RHS's proposed method of applying principal and interest payments, prior to escrow, was not consistent with the private sector. RHS researched payment hierarchy with many private industry lenders. Our research indicated that most lenders apply payments in the manner RHS proposed. The accounting system which RHS recently purchased is a standard industry package used by many other lenders. All lenders using this system apply payments first to principal and interest and then to escrow. This payment hierarchy also benefits our customers by ensuring that something actually due is paid on time,

as opposed to an escrow which is accumulating funds to pay something that is due at a later time. We believe our proposal is more equitable to our clients.

Section 3550.152(d). Application of excess payment. Five comments were received on this section, all recommending that RHS allow its customers to make an extra payment that would relieve them of making the next scheduled payment rather than being applied as an extra payment. RHS agrees and has revised this section accordingly.

Section 3550.153. Fees. Five comments were received on this section. Several thought the tax service fee should be the same for existing customers as new customers. These fees, which are administrative and not included in the regulation, are estimated to be \$28 for existing clients and \$95 for new clients. The fees are set differently because the length of the service will be different for a new client who is just receiving a loan, and an existing client who has had the loan for many years.

Several commentors opposed RHS's proposal to charge late fees. RHS gave this proposal much thought before it was included in the proposed rule, and then again upon analyzing the comments. The negative comments centered around the fact that RHS's customers are very-low and low income families. RHS recognizes that fact; however, also recognizes its mission to provide supervised credit. Additionally, our credit is intended to be temporary with our customers required to refinance their RHS loan when they are capable. We believe a late fee will encourage our clients to make payments on a more timely basis. This not only improves their credit history, but furthers our objectives of making our clients successful homeowners. To minimize any negative impact on the repayment ability of our customers, the late fee is a percentage of the loan payments, therefore a lower income client will pay less than a higher income client with the same loan amount. Further, since RHS is converting customers on escrow to an amortized loan schedule rather than a daily simple interest loan in many cases, a late fee will actually be less costly to the customer. Under the daily simple interest method, the customer accrues additional interest for each day they are late with their payment. The late fee included in this rule will generally be less costly, and is more apparent to the borrower, if they become delinquent on payments. We believe this private sector standard, which many of our clients already pay if they are delinquent on car

payments or other private sector debt, will further our objectives in making our clients successful and able to refinance with private credit in the future.

Section 3550.157(a). Borrowers currently receiving payment subsidy. Four comments were received. One commentor supported our proposal to modify a payment subsidy only when there was a \$10 change in payments. Two commentors agreed that there needs to be a threshold, but recommended that the payment must change by 10% before the agreement is modified which will ensure clients are treated consistently whether their payments are \$60 or \$600 per month. RHS agrees that a percentage threshold better ensures consistency in the treatment of customers and has adopted this comment.

Comments were also received regarding the requirement that clients must notify RHS if they change or obtain employment. There was no indication that a customer must notify RHS if non employment income increases. RHS has clarified §§ 3550.68(e) and 3550.157(a)(3) to reflect that if nonemployment income increases by at least 10 percent, the borrower must notify RHS. RHS has also provided guidance on cancellation of payment subsidies.

Section 3550.158. Active military duty. One commentor recommended we expand the language which provides that participation in a military reserve or the National Guard does not entitle a customer to a 6 percent interest rate as provided under the Soldiers and Sailors Relief Act, unless they are called to active military duty. RHS has clarified this language.

One commentor appeared to be confused with this section with regard to payment subsidies and the 6% interest rate. If a customer enters active military duty, they are entitled to the 6% interest rate. If they also qualify for a payment subsidy, the payment subsidy would cover the difference in payment between the 6% and the amount of assistance for which the customer qualifies. This reduces the amount of subsidy and potential recapture this client would repay. For example, if a customer who entered active military duty had a note rate of 10 percent, and they now qualified for a payment subsidy which reduced their interest rate to 2%, they would receive the 6% rate and then an additional 4% subsidy. This is opposed to a non-active military customer with a note rate of 10%, who qualifies for a payment subsidy which reduces their payment to 2% who would be receiving an 8% subsidy. In the first case, the difference

between the 10 and 6 percent interest rates is not a subsidy which is subject to recapture.

Section 3550.159(a). Mineral leases. One commentor suggested that we change references from "value of the security property" to "value as a residence" in determining whether we should allow a customer to lease mineral rights. Since the value of the security property includes the "residence" we believe the proposed terminology is correct.

Section 3550.159(d). Lease of security property. One commentor recommended we remove the requirement that customers must notify RHS if they lease their property, and that the Agency may liquidate the account if the term of the lease is more than 3 years or includes an option to purchase. RHS disagrees. The purpose of the RHS loan program is to provide long term residence for our borrowers. If they no longer need the dwelling for a long term residence they should pay off the loan. RHS will consider the borrower for refinancing with other credit. In addition, the Agency may consider liquidation of the loan.

Section 3550.160(b). Criteria for refinancing with private credit. Two comments were received. One supported our proposed change of terminology from "graduation" to "refinancing with private credit." One commentor questioned the language which requires that the customer must refinance when RHS determines they have such ability. The commentor felt that RHS may be held accountable if the customer refinanced and then defaulted on their new loan. RHS determines, based upon objective criteria, whether a customer can refinance with private credit. If RHS determines the customer has the potential to secure other credit, they must seek refinancing. RHS does not make the underwriting decision for the other lender, nor is a private lender required to refinance the RHS debt. If the customer is unable to refinance for legitimate reasons, RHS will withdraw the refinancing request. If the customer does meet another lenders criteria, they are expected to refinance. However, as noted, that underwriting decision was made by the other lender. We appreciate the comment but feel that this policy does not impose any accountability concerns.

Section 3550.161(c). Written statements. Two commentors felt that the Agency should provide two written payoff statements within a 30 day period without charge. The proposed language already provides that RHS may charge a fee if more than 2 written payoff statements are requested.

Therefore, the recommendation was already included.

Section 3550.162. Recapture. Eight comments were received and all overwhelmingly supported our proposals to streamline and clarify subsidy recapture. One commentor summed it up best by replying, "I applaud recognition of the difficulties of the subsidy recapture program and encourage efforts to make this provision more understandable to applicants and customers and lessen its impact as a penalty to customers upon sale or refinancing of their properties."

One commentor recommended that principal reduction attributed to subsidy (PRAS) be included on annual statements to the customer. RHS agrees that some type of notice should be provided, however, disagrees that it should necessarily be done on an annual basis. RHS will notify all customers when PRAS is frozen and how it will be repaid. This commentor also recommended that PRAS be explained on Form RHS 3550-12, "Subsidy Repayment Agreement." Since there is no PRAS on loans originated after 1990, there is no need for mention of it on a form that only new customers execute.

One commentor felt that repayment of PRAS plus the lesser of subsidy received or 50% of value appreciation was a double hit to customers. As discussed in the proposed rule, PRAS is not subsidy. It was the accelerated principal reduction which a customer received because their loan was subsidized and repaid at a significantly lower interest rate. PRAS, as proposed, must be repaid. In addition, the customer must pay all or part of the subsidy they received back to the government. This is either the full subsidy or 50% of the value appreciation.

One commentor requested clarification on the opening sentence which provides that customers with loans approved on or after October 1, 1979, are subject to recapture. His comment was whether a loan which was approved before October 1, 1979, but assumed after that date is subject to recapture. Consistent with past policy, such a loan is subject to recapture. RHS has clarified this point.

Two commentors did not feel there was sufficient guidance to calculate recapture. We believe the regulation provides adequate policy guidance. The Handbooks contain the detailed administrative guidance on how to calculate recapture.

One commentor felt that we should forgive PRAS if the customer refinances and retains title to the property 10 years

after refinancing. The commentor felt this would be an incentive to a customer to retain ownership after refinancing. At the time of refinancing, a customer is given the opportunity to receive a discount if they repay recapture at that time. In addition, the government does not charge interest on the amount owed. We believe sufficient incentive is provided to the customer to repay recapture without forgiving the debt.

Section 3550.163. Transfer of security and assumption of indebtedness. Two comments were received. One commentor felt this section was confusing and needed more guidance. The Handbooks contain more administrative guidance on transfers. The commentor also objected to RHS's policy that if a customer transfers title to the property without RHS consent, RHS can liquidate the loan if the loan cannot be transferred. This policy is to ensure that program objectives are met and the government's financial interest is not adversely affected.

The other comment dealt with liquidating excess property to reduce the loan amount. As the commentor mentioned, this rarely occurs since RHS should not have initially financed excess land. However, if there is excess land, we believe it prudent policy to liquidate such excess property to reduce the amount of the subsidized credit provided to the new customer.

Section 3550.202. Past due accounts. Six comments were received on this section, and all centered on RHS charging a late fee. Comments were mixed with the commentors either strongly supporting or opposing the imposition of a late fee. As discussed under the comment to § 3550.153, RHS carefully weighed all comments and believes charging a late fee is in the government's and customer's best interests. RHS has also expanded this section to provide guidance on accounts with annual payments.

Section 3550.207. Payment moratorium. Two comments were received. One commentor recommended that the review period more accurately reflect the need of the customer, and not an arbitrary two-year period. In developing the regulation, RHS proposed that reviews would be done "periodically" rather than the current two year cycle. The proposed language accomplishes this objective while still leaving flexibility for periodic reviews.

One commentor had two concerns. One concern centered around one of the three criteria to qualify for a moratorium. Namely, for a moratorium to be based on a reduction of income, there must be at least a 20% reduction in income. RHS proposed no change to

this policy which has been in effect for many years. It is based upon the premise that for the Agency to completely stop requiring all payments from a customer for up to two years, a substantial reduction in income must have occurred. While it is true that our customers have very-low, low and moderate incomes, a homeowner should be able to adjust to small adjustments in income. Additionally, RHS can provide customers with additional payment subsidies, work-out agreements, etc., in an effort to assist them in working through difficult periods. We believe the 20% reduction is reasonable.

The other comment centered around the inability of a customer to qualify for a moratorium if their account has been accelerated. After an account is accelerated, all loan servicing ceases. RHS makes every effort possible to assist a customer before acceleration of the account. The customer is informed several times throughout the loan origination and servicing process of the moratorium program. Prior to acceleration all of the agency's servicing tools will be used to assist a customer, including the use of a moratorium for a customer who is having temporary financial difficulties for reasons beyond his or her control to keep their home. A loan will be accelerated for a customer in financial distress only if all the servicing authorities have been tried and cannot assist the borrower in retaining the house, possibly because the financial difficulties are not temporary or the borrower has been unresponsive or has failed to work with RHS. Once RHS has exhausted its servicing tools (and any appeals in conjunction with these tools) and accelerates the account, there can be no subsequent financial setback to the borrower which is relevant to the basis for the acceleration.

Section 3550.211. Liquidation. One commentor recommended adding guidance on how to service accounts where the customer has filed for bankruptcy. RHS, like all lenders, must follow bankruptcy laws on servicing such accounts and is providing such guidance in the Handbooks.

Section 3550.251. Property management and disposition. Two comments were received recommending that for-profit entities be provided the same incentives to lease or purchase Real Estate Owned (REO) property for transitional housing as nonprofit organizations. The preference for nonprofit organizations and public bodies is statutory. Section 1414 of the Housing and Community Development Act of 1992, Public Law 102-550, which amended the Stewart B. McKinney

Homeless Assistance Act, Public Law 100-77, provides the preference for nonprofit and public bodies. For-profit organizations can lease or purchase REO property, when available, for transitional housing; however, the incentives are not available for such organizations.

Section 3550.251(c)(2). Decent, safe, and sanitary. One comment was received recommending that RHS remove the energy efficiency requirements to the decent, safe and sanitary restrictions that apply to the sale of REO property not meeting RHS standards. DSS standards, including energy efficient standards, are statutory.

Section 3550.252. Debt settlement policies. Two comments were received. Both questioned guidance on charge-offs and cancellations. A customer can request a compromise or adjustment to their debt and as such, guidance is contained in the regulation. Charge-offs and cancellations are administrative actions and not a customer entitlement and are therefore only referenced in the Handbooks. Detailed guidance on all four options is contained in the Handbooks.

Other Comments

One comment was received regarding RHS's proposal to freeze PRAS for all existing customers and then reduce the "frozen" PRAS in years 15-33 by an equal amount. The commentor felt that RHS should not reduce PRAS. As previously mentioned, PRAS is the accelerated principal write-down certain customers received during the first half of their loan term due to subsidy. In approximately the 20th year, the trend towards accelerated principal writedown reverses itself to the point where subsidized customers pay less principal because of the subsidy. The result is that two customers, one with subsidy and one without would owe the same principal balance in their final year of payments. To not begin reducing PRAS in the second half of the loan term would penalize those customers who received subsidy.

Several comments were received recommending that RHS consider offering a one-time interest rate reduction for customers who received loans at high interest rates and are unable to refinance to other credit. In cases where the customer is receiving subsidy, it was felt that the Agency would save funds because they would provide less subsidy to these customers. In other cases, where the customer is not receiving subsidy, but has a high interest rate, the customer may not be able to refinance to other credit because their RHS loan payments are so high

they may be overextended on other debts or not have sufficient cash required by most other lenders for refinancing. RHS agrees that these comments have merit; however, must weigh the cost of refinancing its own loans. RHS will explore the feasibility and cost of refinancing these debts. If it appears feasible, RHS will propose a separate rule to consider public opinion on this subject.

Positive comments were received on our efforts to streamline forms and use industry standard forms wherever possible. As mentioned in the Proposed Rule, RHS was to publish a Notice in the Federal Register in July to propose our information collection docket on the Handbooks to part 3550. RHS published this Notice on July 18, 1996 (61 FR 37440) and proposed an overall 10% reduction in burden hours and 20% reduction in burden costs. This reduction falls on the heels of a 20% reduction in burden hours published in October 1995, despite the broadening of what is considered public burden in the Paperwork Reduction Act of 1995. RHS is still exploring ways to automate and streamline forms even further.

Several comments were received regarding child care expenses and how these costs figure into loan underwriting. There was confusion as to whether these expenses are considered a debt which must be included in the debt ratios to qualify for assistance. This is an administrative function, and not contained in the rule. For the commentor's information, RHS clarified through this subject recently through an Administrative Notice (AN) which clarified that child care expenses are not considered in total debt. This guidance is included in the Handbooks.

Several commentors expressed concern over RHS's decision to centralize loan servicing. They were concerned that in our efforts to save costs, RHS would be depersonalizing service to its customers and increase the risk of defaults and potential liquidations. RHS is mindful of these issues and has made every effort in its design of the Centralized Servicing Center to ensure a greater and more consistent level of customer service. Our current field structure required staff to specialize in all levels of customer service from outreach and loan origination to portfolio management. As the Agency has been required to reduce staffing levels, we have found that only through consolidation and centralization can we provide the same if not enhanced level of customer service. Experience has also shown that specialization provides for greater consistency and efficiency. The

Centralized Servicing Center will be staffed with talented individuals that will concentrate on one aspect of the program—making our customers successful homeowners. Through specialization, we believe there will be more consistency and timely servicing actions. And through this increased service, default rates will decline and more customers will be successful. The transition will not be easy for either our field staff or our customers. However, in the long run, we believe service to rural America will be enhanced. Field staff can concentrate on outreach and loan origination providing the local level presence that is needed to assist with the prudent development of rural America.

Reopening of Comment Period for Selected Issues

RHS is reopening the comment period on sections 3550.53(g), 3550.57(a), 3550.63 and 3550.68. These section numbers remain unchanged from our proposed rule of April 8, 1996 (61 FR 15395) and are adopted on an interim final basis. All other provisions of part 3550 are adopted as a final rule.

As previously discussed in this rule, these sections generated the vast majority of comments during the comment period. Many commentors supplied RHS with lengthy and well documented cases where these areas may not be serving the best interests of the program. Some of the commentors recommended:

- Returning to our former interest credit program, whereby the interest rate was reduced on the loan to as low as one percent, and modest housing was determined by square footage and amenities. RHS reduced the cost of the program by approximately 30% by implementing the changes in the aforementioned sections. This allows the Agency to provide more homeownership opportunities in rural America while demonstrating that program costs can be substantially reduced. As such, RHS is not further considering this option.

- Modifying the floor payments from 22, 24 and 26% to either a flat 25% or a more incremental scale of 22, 23, 24, 25 and 26%. RHS is analyzing these comments further and will consider them provided they have no negative impact on the overall cost of the program.

- Changing the PITI ratios from 29% for very-low income families and 33% for low-income families to 29% for both, 33% for both, or other percentages. RHS is again considering these options.

- Reimplementing a square footage requirement to ensure that the housing

is modest. Prior to FY 96, RHS considered square footage and amenities in determining modest housing, and changed to the HUD 203(b) limits to provide customers with more choices in selecting a home appropriate to their income and needs. RHS does not want to dictate the type and size of housing to customers, and is not further considering this option.

- Increasing the maximum debt ratio to 41% for very-low and low income families. As mentioned in our discussion of comments, RHS has implemented this change since the impact is minimal on the cost of the program and allows more families an opportunity for homeownership.

- Limiting the maximum loan to a percentage of the HUD 203(b) limits. For example, the State Director could set the percentage by county, and have the authority to increase the percentage on an individual case basis provided the proposed housing is typical of other houses that families with similar incomes and family sizes are purchasing. RHS is further considering this option.

- Modifying the equivalent interest rates from one-half percent increments to one-quarter percent increments and decreasing the income ranges from 10 to 5 percent. RHS is considering this option.

- Returning to the old interest credit formula, increasing the borrower contribution from 20 to 30 percent, but include utilities and maintenance in the total family expenses. Again, because of the substantial cost of the interest credit program, RHS is not considering this option.

- Eliminating utilization of both equivalent interest rates and floor payments to simplify the calculations. RHS may consider this option provided it does not increase program costs.

- Utilizing a state non-metropolitan average income or area median income, whichever is greater, to determine eligibility for assistance. Currently, RHS is utilizing an area (county) income to determine eligibility and the maximum loan amount. This has resulted in some customers qualifying for a loan in one county, but not qualifying for a loan in an adjoining county because of differences in county incomes. RHS is further exploring the use of state non-metropolitan incomes to determine its impact on program costs and our customers.

- RHS is seeking further comments on the above mentioned recommendations and any further comments or recommendations on §§ 3550.53(g), 3550.57, 3550.63 and 3550.68. The Agency's goal is to have a

more simplified and consistent approach to addressing these issues; while not negatively impacting the cost of the program.

Discussion of Interim Final Rule

RHS is issuing this regulation as an Interim Final Rule, with an effective date 30 days after publication in the Federal Register, as it is necessary to implement DLOS and improve our level of service to customers. Further delay would not be in the best interest of the direct SFH program or its recipients. As previously mentioned, all provisions of this regulations except sections 3550.53(g), 3550.57(a), 3550.63 and 3550.68 are adopted as final. Sections 3550.53(g), 3550.57(a), 3550.63 and 3550.68 are adopted on an interim final basis, and are subject to a 30-day comment period. RHS intends to publish a final rule on the aforementioned sections by April 1, 1997.

List of Subjects

7 CFR Part 1806

Insurance, Loan programs—Agriculture, Real property insurance, Rural areas.

7 CFR Part 1910

Applications, Credit, Loan programs—Agriculture, Loan programs—Housing and community development, Low and moderate income housing, Marital status discrimination, Sex discrimination.

7 CFR Part 1922

Loan programs—housing and community development, Low and Moderate income housing, Rural areas.

7 CFR Part 1944

Aged, Farm labor housing, Grant programs—Housing and community development, Home improvement, Loan programs—Housing and community development, Low and moderate income housing—Rental, Migrant labor, Mobile homes, Mortgages, Nonprofit organizations, Public housing, Rent subsidies, Rural housing, Subsidies.

7 CFR Part 1951

Accounting, Accounting servicing, Credit, Debt restructuring, Foreclosure, Government acquired property, Interest credit, Loan programs—Agriculture, Loan programs—Housing and community development, Low and moderate income housing loans—Servicing, Mortgages, Recapture of subsidy, Rent subsidies, Rural areas, Sale of government acquired property, Surplus government property.

7 CFR Part 1955

Foreclosure, Government acquired property, Government property management, Sale of government acquired property, Surplus government property.

7 CFR Part 1956

Accounting, Loan programs—Agriculture, Rural areas.

7 CFR Part 1965

Administrative practice and procedure, Loan programs—Housing and community development.

7 CFR Part 3550

Accounting, Administrative practice and procedure, Conflict of interests, Environmental impact statements, Equal credit opportunity, Fair housing, Grant programs—Housing and community development, Housing, Loan programs—Housing and community development, Low and moderate income housing, Manufactured homes, Reporting and recordkeeping requirements, Rural areas, Subsidies.

Therefore, title 7 of the Code of Federal Regulations is amended as follows:

CHAPTER XVIII—[AMENDED]**PART 1806—INSURANCE**

1. The authority citation for part 1806 is revised to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989; 42 U.S.C. 1480.

Subpart A—Real Property Insurance

2. Section 1806.1(a) is revised to read as follows:

§ 1806.1 General.

(a) *Authority.* This subpart sets forth the policies and procedures regarding insurance requirements on real property which serves as security for a debt under the Farm Credit Programs of the Farm Service Agency (FSA) or the Multi-Family Housing Programs of the Rural Housing Service (RHS). Any references herein to the Farmers Home Administration (FmHA) or its employees are intended to mean FSA or RHS, as applicable, and their employees.

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PART 1910—GENERAL

3. The authority citation for part 1910 is revised to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989; 42 U.S.C. 1480.

Subpart A—Receiving and Processing Applications

4. Section 1910.1 introductory text is revised to read as follows:

§ 1910.1. General.

This subpart prescribes the policies and procedures for informing interested parties of the Farm Credit loan programs available through the Farm Service Agency (FSA), and how such requests are processed. Requests for Nonprogram (NP) assistance will be handled in accordance with subpart J of part 1951 of this chapter. References contained herein to the housing programs of the Rural Housing Service (RHS), or its successor agency, are no longer applicable.

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PART 1922—APPRAISAL

5. The authority citation for part 1922 is revised to read as follows:

Authority: 7 U.S.C. 1989.

Subpart C—Appraisal of Single Family Residential Property

6. Subpart C (§§ 1922.101–1922.150 and all exhibits) is removed and reserved.

PART 1944—HOUSING

7. The authority citation for part 1944 continues to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989; 42 U.S.C. 1480.

Subpart A—Section 502 Rural Housing Loan Policies, Procedures, and Authorizations

8. Subpart A (§§ 1944.1–1944.50) is removed and reserved.

Subpart D—Farm Labor Housing Loan and Grant Policies, Procedures, and Authorizations

9. Section 1944.156 is added to read as follows:

§ 1944.156 General loan/grant processing requirements.

(a) *Timeliness.* All applicants will be informed of a decision regarding their request for assistance within a reasonable timeframe established by RHS. If RHS cannot provide an eligibility determination within a reasonable timeframe, the applicant will be notified when the determination will be made. A request for assistance may be withdrawn at any time by the applicant. RHS may return a request for assistance for failure of the applicant to provide the necessary underwriting

information within a reasonable time period established by RHS.

(b) *Unlawful determination.* The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants based on race, color, religion, national origin, sex, marital status, age (provided that the applicant has the capacity to enter into a binding contract), or because all or part of the applicant's income derives from any public assistance program. Department of Agriculture regulations provide that no agency, officer, or employee of the United States Department of Agriculture shall exclude from participation in, deny the benefits of, or subject to discrimination any person based on race, color, religion, sex, age, handicap, or national origin under any program or activity administered by such agency, officer, or employee. The Fair Housing Act prohibits discrimination in real estate-related transactions, or in the terms and conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin. If an applicant or borrower believes he or she has been discriminated against for any of these reasons, that person can write the Secretary of Agriculture, Washington, DC 20250. Applicants also cannot be denied a loan because the applicant has in good faith exercised his or her rights under the Consumer Credit Protection Act. If an applicant believes he or she was denied a loan for this reason, the applicant should contact the Federal Trade Commission, Washington, DC 20580.

(c) *Taxpayer identification.* All applicants must provide their taxpayer identification number. The taxpayer identification number for individuals who are not businesses is their Social Security Number.

Subpart J—Section 504 Rural Housing Loans and Grants

10. Subpart J (§§ 1944.451–1944.500 and all exhibits) is removed and reserved.

PART 1951—SERVICING AND COLLECTIONS

11. The authority citation for part 1951 continues to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989; 42 U.S.C. 1480.

12. The heading of subpart C is revised to read as follows:

Subpart C—Offsets of Federal Payments to USDA Agency Borrowers

13. Section 1951.101 is revised to read as follows:

§ 1951.101 General.

The Federal Claims Collection Act of 1966 as amended by the Debt Collection Act of 1982, the Deficit Reduction Act of 1984, and the Debt Collection Amendments Act of 1996 provides for the use of administrative, salary and Internal Revenue Service (IRS) offsets by government agencies including the Farm Service Agency (FSA), Rural Housing Service (RHS), Rural Utility Service (RUS) for its water and waste programs, and Rural Business-Cooperative Service (RBS), herein referred to as "USDA Agency," to collect delinquent debts. Any money that is or may become payable from the United States to a USDA Agency borrower or other individual or entity indebted to a USDA Agency may be subject to offset for collection of a debt. In addition, money may be collected from the debtor's retirement payments for delinquent amounts owed to the USDA Agency if the debtor is an employee or retiree of a Federal agency, the U.S. Postal Service, the Postal Rate Commission, or a member of the U.S. Armed Forces or the Reserve. Amounts collected will be processed as regular payments and credited to the borrowers account. USDA Agencies will process requests by other Federal agencies for offset in accordance with § 1951.102 of this subpart. This subpart does not apply to direct single family housing customers of the RHS.

Subpart D—Final Payment on Loans

14. Section 1951.151 is revised to read as follows:

§ 1951.151 Purpose.

This subpart prescribes authorizations, policies, and procedures of the Farm Service Agency (FSA), Rural Housing Service (RHS), Rural Utility Service (RUS) for its water and waste programs, and Rural Business-Cooperative Service (RBS), herein referred to as "Agency," for processing final payment on all loans. This subpart does not apply to direct single family housing customers of the RHS.

Subpart F—Analyzing Credit Needs and Graduation of Borrowers

15. Section 1951.251 is amended by adding a sentence at the end to read as follows:

§ 1951.251 Purpose.

* * * This subpart does not apply to RHS direct single family housing (SFH) customers.

Subpart G—Borrower Supervision, Servicing and Collection of Single Family Housing Loan Accounts

16. Subpart G (§§ 1951.301–1951.350) is removed and reserved.

Subpart I—Recapture of Section 502 Rural Housing Subsidy

17. Subpart I (§§ 1951.401–1951.413 and all exhibits) is removed and reserved.

Subpart J—Management and Collection of Nonprogram (NP) Loans

18. Section 1951.451 is amended by revising the introductory text to read as follows:

§ 1951.451 General.

This subpart contains policies and procedures of the Farm Service Agency (FSA) for making, managing, collecting, liquidating, and servicing loans on nonprogram (NP) terms. All references in this subpart to farm real estate, farm property and farm chattels also include nonfarm property that was security for a Farm Credit debt of the FSA.

* * * * *

Subpart M—Servicing Cases Where Unauthorized Loan or Other Financial Assistance Was Received—Single Family Housing

19. Subpart M (§§ 1951.601–1951.650) is removed and reserved.

PART 1955—PROPERTY MANAGEMENT

20. The authority citation for part 1955 continues to read as follows:

Authority: 5 U.S.C. 301, 7 U.S.C. 1989, 42 U.S.C. 1480.

Subpart A—Liquidation of Loans Secured by Real Estate and Acquisition of Real and Chattel Property

21. Section 1955.1 is revised to read as follows:

§ 1955.1 Purpose.

This subpart delegates authority and prescribes procedures for the liquidation of loans to individuals and to organizations as identified in § 1955.3. It pertains to the Farm Credit programs of the Farm Service Agency (FSA), Water and Waste programs of the Rural Utilities Service (RUS), Multi-Family Housing (MFH) and Community

Facility (CF) programs of the Rural Housing Service (RHS), and direct programs of the Rural Business-Cooperative Service (RBS). Guaranteed RBS loans are liquidated upon direction from the Deputy Administrator, Business Program, RBS. This subpart does not apply to RHS single family housing loans, or to CF loans sold without insurance in the private sector. These CF loans will be serviced in the private sector and future revisions to this subpart no longer apply to such loans.

Subpart B—Management of Property

22. Section 1955.51 is revised to read as follows:

§ 1955.51 Purpose.

This subpart delegates authority and prescribes policies and procedures for the Rural Housing Service (RHS), Rural Business-Cooperative Service (RBS), the Water and Waste programs of the Rural Utilities Service (RUS), and Farm Service Agency (FSA), herein referred to as "Agency," and references contained in this subpart to the Farmers Home Administration (FmHA) are synonymous with "Agency." This subpart does not apply to RHS single family housing loans or community program loans sold without insurance to the private sector. These community program loans will be serviced by the private sector and future revisions to this subpart no longer apply to such loans. This subpart covers:

(a) Management of real property which has been taken into custody by the respective Agency after abandonment by the borrower;

(b) Management of real and chattel property which is in Agency inventory; and

(c) Management of real and chattel property which is security for a guaranteed loan liquidated by an Agency (or which the Agency is in the process of liquidating).

Subpart C—Disposal of Inventory Property

23. Section 1955.101 is amended by adding a new sentence to the end to read as follows:

§ 1955.101 Purpose.

* * * This subpart does not apply to Single Family Housing (SFH) inventory property.

PART 1956—DEBT SETTLEMENT

24. The authority citation for part 1956 is revised to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989; 42 U.S.C. 1480.

Subpart B—Debt Settlement—Farmer Programs and Housing

25. Section 1956.51 is revised to read as follows:

§ 1956.51 Purpose.

This subpart delegates authority and prescribes policy and procedures for settlement of debts owed to the United States under the Farm Credit loan programs of the Farm Service Agency (FSA) and the Multi-Family Housing (MFH) program of the Rural Housing Service (RHS). It also applies to Nonprogram (NP) loans secured by MFH property of the RHS. Settlement of claims against recipients of grant funds for reasons such as the use of funds for improper purposes is also covered by this subpart. Settlement of claims against third party converters, and Economic Opportunity (EO) loans is authorized under the Federal Claims Collection Standards, 4 CFR parts 101–105. This subpart does not apply to RHS direct Single Family Housing (SFH) loans or RHS NP loans secured by SFH property.

PART 1965—REAL PROPERTY

26. The authority citation for part 1965 continues to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989, 42 U.S.C. 1480.

Subpart C—Security Servicing for Single Family Rural Housing Loans

27. Subpart C (§§ 1965.101–1965.150) is removed and reserved.

28. A new chapter XXXV consisting of part 3550 is added to read as follows:

CHAPTER XXXV—RURAL HOUSING SERVICE, DEPARTMENT OF AGRICULTURE**PART 3550—DIRECT SINGLE FAMILY HOUSING LOANS AND GRANTS****Subpart A—General**

Sec.

- 3550.1 Applicability.
- 3550.2 Purpose.
- 3550.3 Civil rights.
- 3550.4 Reviews and appeals.
- 3550.5 Environmental requirements.
- 3550.6 State law or state supplement.
- 3550.7 Demonstration programs.
- 3550.8 Exception authority.
- 3550.9 Conflict of interest.
- 3550.10 Definitions.
- 3550.11–3550.49 [Reserved]
- 3550.50 OMB control number.

Subpart B—Section 502 Origination

- 3550.51 Program objectives.
- 3550.52 Loan purposes.
- 3550.53 Eligibility requirements.
- 3550.54 Calculation of income and assets.
- 3550.55 Applications.

- 3550.56 Site requirements.
- 3550.57 Dwelling requirements.
- 3550.58 Ownership requirements.
- 3550.59 Security requirements.
- 3550.60 Escrow account.
- 3550.61 Insurance.
- 3550.62 Appraisals.
- 3550.63 Maximum loan amount.
- 3550.64 Down payment.
- 3550.65 [Reserved]
- 3550.66 Interest rate.
- 3550.67 Repayment period.
- 3550.68 Payment subsidies.
- 3550.69 Deferred mortgage payments.
- 3550.70 Conditional commitments.
- 3550.71 Special requirements for condominiums.
- 3550.72 Community land trusts.
- 3550.73 Manufactured homes.
- 3550.74 Nonprogram loans.
- 3550.75–3550.99 [Reserved]
- 3550.100 OMB control number.

Subpart C—Section 504 Origination

- 3550.101 Program objectives.
- 3550.102 Grant and loan purposes.
- 3550.103 Eligibility requirements.
- 3550.104 Applications.
- 3550.105 Site requirements.
- 3550.106 Dwelling requirements.
- 3550.107 Ownership requirements.
- 3550.108 Security requirements (loans only).
- 3550.109 Escrow account (loans only).
- 3550.110 Insurance (loans only).
- 3550.111 Appraisals (loans only).
- 3550.112 Maximum loan and grant.
- 3550.113 Rates and terms (loans only).
- 3550.114 Repayment agreement (grants only).
- 3550.115–3550.149 [Reserved]
- 3550.150 OMB control number.

Subpart D—Regular Servicing

- 3550.151 Servicing goals.
- 3550.152 Loan payments.
- 3550.153 Fees.
- 3550.154 Inspections.
- 3550.155 Escrow account.
- 3550.156 Borrower obligations.
- 3550.157 Payment subsidy.
- 3550.158 Active military duty.
- 3550.159 Borrower actions requiring RHS approval.
- 3550.160 Refinancing with private credit.
- 3550.161 Final payment.
- 3550.162 Recapture.
- 3550.163 Transfer of security and assumption of indebtedness.
- 3550.164 Unauthorized assistance.
- 3550.165–3550.199 [Reserved]
- 3550.200 OMB control number.

Subpart E—Special Servicing

- 3550.201 Purpose of special servicing actions.
- 3550.202 Past due accounts.
- 3550.203 General servicing actions.
- 3550.204 Payment assistance.
- 3550.205 Delinquency workout agreements.
- 3550.206 Protective advances.
- 3550.207 Payment moratorium.
- 3550.208 Reamortization using promissory note interest rate.
- 3550.209 [Reserved]
- 3550.210 Offsets.
- 3550.211 Liquidation.

- 3550.212–3550.249 [Reserved]
- 3550.250 OMB control number.

Subpart F—Post-Servicing Actions

- 3550.251 Property management and disposition.
 - 3550.252 Debt settlement policies.
 - 3550.253 Settlement of a debt by compromise or adjustment.
 - 3550.254–3550.299 [Reserved]
 - 3550.300 OMB control number.
- Authority: 5 U.S.C. 301; 42 U.S.C. 1480.

Subpart A—General**§ 3550.1 Applicability.**

This part sets forth policies for the direct single family housing loan programs operated by the Rural Housing Service (RHS) of the U.S. Department of Agriculture (USDA). It addresses the requirements of sections 502 and 504 of the Housing Act of 1949, as amended, and includes policies regarding both loan and grant origination and servicing. Procedures for implementing these regulations can be found in program handbooks, available in any Rural Development office. Any provision on the expenditure of funds under this part is contingent upon the availability of funds.

§ 3550.2 Purpose.

The purpose of the direct RHS single family housing loan programs is to provide low- and very low-income people who will live in rural areas with an opportunity to own adequate but modest, decent, safe, and sanitary dwellings and related facilities. The section 502 program offers persons who do not currently own adequate housing, and who cannot obtain other credit, the opportunity to acquire, build, rehabilitate, improve, or relocate dwellings in rural areas. The section 504 program offers loans to very low-income homeowners who cannot obtain other credit to repair or rehabilitate their properties. The section 504 program also offers grants to homeowners age 62 or older who cannot obtain a loan to correct health and safety hazards or to make the unit accessible to household members with disabilities.

§ 3550.3 Civil rights.

RHS will administer its programs fairly, and in accordance with both the letter and the spirit of all equal opportunity and fair housing legislation and applicable executive orders. Loans, grants, services, and benefits provided under this part shall not be denied to any person based on race, color, national origin, sex, religion, marital status, familial status, age, physical or mental disability, receipt of income from public assistance, or because the applicant has, in good faith, exercised

any right under the Consumer Credit Protection Act (15 U.S.C. 1601 et seq.). All activities under this part shall be accomplished in accordance with the Fair Housing Act (42 U.S.C. 3601–3620), Executive Order 11246, and Executive Order 11063, as amended by Executive Order 12259, as applicable. The civil rights compliance requirements for RHS are in 7 CFR part 1901, subpart E.

§ 3550.4 Reviews and appeals.

Whenever RHS makes a decision that is adverse to a participant, RHS will provide the participant with written notice of such adverse decision and the participant's rights to a USDA National Appeals Division hearing in accordance with 7 CFR part 11. Any adverse decision, whether appealable or non-appealable may be reviewed by the next-level RHS supervisor.

§ 3550.5 Environmental requirements.

(a) *Policy.* RHS will consider environmental quality as equal with economic, social, and other relevant factors in program development and decision-making processes. RHS will take into account potential environmental impacts of proposed projects by working with RHS applicants, other federal agencies, Indian tribes, State and local governments, and interested citizens and organizations in order to formulate actions that advance the program's goals in a manner that will protect, enhance, and restore environmental quality.

(b) *Regulatory references.* Processing and servicing actions under this part will be done in accordance with the requirements provided in 7 CFR part 1940, subpart G which addresses environmental requirements and 7 CFR part 1924, subpart A, which addresses lead-based paint.

§ 3550.6 State law or state supplement.

State and local laws and regulations, and the laws of federally recognized Indian tribes, may affect RHS implementation of certain provisions of this regulation, for example, with respect to the treatment of liens, construction, or environmental policies. Supplemental guidance may be issued in the case of any conflict or significant differences.

§ 3550.7 Demonstration programs.

From time to time, RHS may authorize limited demonstration programs. The purpose of these demonstration programs is to test new approaches to offering housing under the statutory authority granted to the Secretary. Therefore, such demonstration programs may not be

consistent with some of the provisions contained in this part. However, any program requirements that are statutory will remain in effect. Demonstration programs will be clearly identified as such.

§ 3550.8 Exception authority.

An RHS official may request, and the Administrator or designee may make, an exception to any requirement or provision of this part or address any omission of this part that is consistent with the applicable statute if the Administrator determines that application of the requirement or provision, or failure to take action in the case of an omission, would adversely affect the Government's interest.

§ 3550.9 Conflict of interest.

Objective. It is the objective of RHS to maintain the highest standards of honesty, integrity, and impartiality by employees. To reduce the potential for employee conflict of interest, all processing, approval, servicing, or review activity will be conducted in accordance with 7 CFR part 1900, subpart D by RHS employees who:

- (1) Are not themselves the applicant or borrower;
- (2) Are not members of the family or close known relatives of the applicant or borrower;
- (3) Do not have an immediate working relationship with the applicant or borrower, the employee related to the applicant or borrower, or the employee who would normally conduct the activity; or
- (4) Do not have a business or close personal association with the applicant or borrower.

(b) *Applicant or borrower responsibility.* The applicant or borrower must disclose any known relationship or association with an RHS employee when such information is requested.

(c) *RHS employee responsibility.* An RHS employee must disclose any known relationship or association with a recipient, regardless of whether the relationship or association is known to others. RHS employees or members of their families may not purchase a Real Estate Owned (REO) property, security property from a borrower, or security property at a foreclosure sale. Loan closing agents who have been involved with a particular property, as well as members of their families, are also precluded from purchasing such properties.

§ 3550.10 Definitions.

Acceleration. Demand for immediate repayment of the entire balance of a

debt if the security instruments are breached.

Adjusted income. Used to determine whether an applicant is income-eligible. Adjusted income provides for deductions to account for varying household circumstances and expenses. See 4 for a complete description of adjusted income.

Adjustment. An agreement to release a debtor from liability generally upon receipt of an initial lump sum representing the maximum amount the debtor can afford to pay and periodic additional payments over a period of up to 5 years.

Amortized payment. Equal monthly payments under a fully amortized mortgage loan that provides for the scheduled payment of interest and principal over the term of the loan.

Applicant. An adult member of the household who will be responsible for repayment of the loan.

Assumption. The procedure whereby the transferee becomes liable for all or part of the debt of the transferor.

Borrower. A recipient who is indebted under the section 502 or 504 programs.

Cancellation. A decision to cease collection activities and release the debtor from personal liability for any remaining amounts owed.

Compromise. An agreement to release a debtor from liability upon receipt of a specified lump sum that is less than the total amount due.

Conditional commitment. A determination that a proposed dwelling will qualify as a program-eligible property. The conditional commitment does not reserve funds, nor does it ensure that a program-eligible applicant will be available to buy the dwelling.

Cosigner. An individual or an entity that joins in the execution of a promissory note to compensate for any deficiency in the applicant's repayment ability. The cosigner becomes jointly liable to comply with the terms of the promissory note in the event of the borrower's default, but is not entitled to any interest in the security or borrower rights.

Cross-collateralized loan. A situation in which a single property secures both RHS and Farm Service Agency loans.

Custodial property. Borrower-owned real property that serves as security for a loan that has been taken into possession by the Agency to protect the Government's interest.

Daily simple interest. A method of establishing borrower payments based on daily interest charged on the outstanding principal balance of the loan. Principal is reduced by the amount of payment in excess of the accrued interest.

Dealer-contractor. A person, firm, partnership, or corporation in the business of selling and servicing manufactured homes and developing sites for manufactured homes. A person, firm, partnership, or corporation not capable of providing the complete service is not eligible to be a dealer-contractor.

Debt instrument. A collective term encompassing obligating documents for a loan, including any applicable promissory note, assumption agreement, or grant agreement.

Deferred mortgage payments. A subsidy available to eligible, very low-income borrowers of up to 25 percent of their principal and interest payments at 1 percent for up to 15 years. The deferred amounts are subject to recapture on sale or nonoccupancy.

Deficient housing. A dwelling that lacks complete plumbing; lacks adequate heating; is dilapidated or structurally unsound; has an overcrowding situation that will be corrected with loan funds; or that is otherwise uninhabitable, unsafe, or poses a health or environmental threat to the occupant or others.

Elderly family. An elderly family consists of one of the following:

(1) A person who is the head, spouse, or sole member of a family and who is 62 years of age or older, or who is disabled, and is an applicant or borrower;

(2) Two or more persons who are living together, at least 1 of whom is age 62 or older, or disabled, and who is an applicant or borrower; or

(3) In the case of a family where the deceased borrower or spouse was at least 62 years old or disabled, the surviving household member shall continue to be classified as an elderly family for the purpose of determining adjusted income, even though the surviving members may not meet the definition of elderly family on their own, *provided:*

(i) They occupied the dwelling with the deceased family member at the time of the death;

(ii) If one of the surviving family members is the spouse of the deceased family member, the family shall be classified as an elderly family only until the remarriage of the surviving spouse; and

(iii) At the time of the death of the deceased family member, the dwelling was financed under title V of the Housing Act of 1949, as amended.

Escrow account. An account to which the borrower contributes monthly payments to cover the anticipated costs of real estate taxes, hazard and flood

insurance premiums, and other related costs.

Existing dwelling or unit. A dwelling that is more than 1 year old, or less than 1 year old and covered by an approved 10-year warranty plan.

False information. Information that the recipient knew was incorrect or should have known was incorrect that was provided or omitted for the purposes of obtaining assistance for which the recipient was not eligible.

Full-time student. A person who carries at least the minimum number of credit hours considered to be full-time by college or vocational school in which the person is enrolled.

Hazard. A condition of the property that jeopardizes the health or safety of the occupants or members of the community, that does not make it unfit for habitation. (See also the definition of major hazard in this section.)

Household. All persons expected to be living in the dwelling, except for live-in aids, foster children, and foster adults.

Housing Act of 1949, as amended. The Act which provides the authority for the direct single family housing programs. It is codified at 42 U.S.C. 1471 *et seq.*

HUD. The U.S. Department of Housing and Urban Development.

Inaccurate information. Incorrect information inadvertently provided, used, or omitted without the intent to obtain benefits for which the recipient was not eligible.

Indian reservation. All land located within the limits of any Indian reservation under the jurisdiction of the United States notwithstanding the issuance of any patent and including rights-of-way running through the reservation; trust or restricted land located within the boundaries of a former reservation of a federally recognized Indian tribe in the State of Oklahoma; or all Indian allotments, the titles to which have not been extinguished, if such allotments are subject to the jurisdiction of a federally recognized Indian tribe.

Interest credit. A payment subsidy available to certain eligible section 502 borrowers that reduces the effective interest rate of a loan (see 3550.68(d)). Borrowers receiving interest credit will continue to receive it on all current and future loans for as long as they remain eligible for and continue to receive a subsidy. Borrowers who cease to be eligible for interest credit can never receive interest credit again, but may receive payment assistance if they again qualify for a payment subsidy.

Junior lien. A security instrument or a judgment against the security property

to which the RHS debt instrument is superior. Legal alien. For the purposes of this part, legal alien refers to any person lawfully admitted to the country who meets the criteria in section 214 of the Housing and Community Development Act of 1980, 42 U.S.C. 1436a.

Leveraged loan. A loan or grant to an Agency borrower from a non-RHS source for the same property, closed simultaneously with an RHS loan.

Live-in aide. A person who lives with an elderly or disabled person and is essential to that person's care and well-being, not obligated for the person's support, and would not be living in the unit except to provide the support services.

Low income. An adjusted income that is greater than the HUD established very low-income limit, but that does not exceed the HUD established low-income limit (generally 80 percent of median income adjusted for household size) for the county or Metropolitan Statistical Area where the property is or will be located.

Major hazard. A condition so severe that it makes the property unfit for habitation. (See also the definition of hazard in this section.)

Manufactured home. A structure that is built to Federally Manufactured Home Construction and Safety Standard and RHS Thermal Performance Standards. It is transportable in 1 or more sections, which in the traveling mode is 10-body feet (3.048 meters) or more in width, and when erected on site is 400 or more square feet (37.16 square meters), and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities. It is designed and constructed for permanent occupancy by a single family and contains permanent eating, cooking, sleeping, and sanitary facilities. The plumbing, heating, and electrical systems are contained in the structure. A permanent foundation is required.

Market value. The value of the property as determined by a current appraisal, RHS may authorize the use of a Broker's Price Opinion or similar instrument to determine market value in limited servicing situations.

Mobile home. A manufactured unit often referred to as a "trailer," designed to be used as a dwelling, but built prior to the enactment of the Housing and Community Development Act of 1980 (Pub. L. 96-399) enacted October 8, 1980.

Moderate income. An adjusted income that is greater than the low-income limit, but that does not exceed

the HUD established low-income limit by more than \$5,500.

Modest housing. A property that is considered modest for the area, with a cost that does not exceed the applicable limit established under section 203(b) of the National Housing Act (12 U.S.C. 1709) (unless an exception is approved by RHS). In addition, the property must not be designed for income-producing activities nor have an in-ground swimming pool.

Modular or panelized home. Housing, constructed of one or more factory-built sections or panels, which, when completed, meets or exceeds the requirements of the recognized development standards (model building codes) for site built housing, and which is designed to be permanently connected to a site-built foundation.

Moratorium. A period of up to 2 years during which scheduled payments are not required, but are subject to repayment at a later date.

Mortgage. A form of security instrument or consensual lien on real property including a real estate mortgage or a deed of trust.

Net family assets. The value of assets available to a household that could be used towards housing costs. Net family assets are considered in the calculation of annual income and are used to determine whether the household must make additional cash contributions to improve or purchase the property.

Net recovery value. The market value of the security property minus anticipated expenses of liquidation, acquisition, and sale as determined by RHS.

New dwelling. A dwelling that is to be constructed, or an already-existing dwelling that is less than 1 year old and is not covered by an approved 10-year warranty plan.

Nonprogram (NP) interest rate. The interest rate offered by RHS for loans made on NP terms.

NP property. Property that does not meet the program eligibility requirements outlined in §§ 3550.56 and 3550.57.

NP terms. Credit terms available from RHS when the applicant or property is not program-eligible.

Offset. Deductions to pay a debt owed to RHS from a borrower's retirement benefits, salary, income tax refund, or payments from other federal agencies to the borrower. Deductions from retirement benefits and salary generally apply only to current and former federal employees.

Participant. For the purpose of reviews and appeals, a participant is any individual or entity who has applied for, or whose right to participate

in or receive a payment, loan, or other benefit is affected by an RHS decision.

Payment assistance. A payment subsidy available to eligible section 502 borrowers that reduces the effective interest rate of a loan (see § 3550.68(c)). Borrowers eligible for a payment subsidy receive payment assistance unless they are currently eligible for and receive interest credit.

Payment subsidy. A general term for subsidies which reduce the borrower's scheduled payment. It refers to either payment assistance or interest credit.

Person with disability. Any person who has a physical or mental impairment that substantially limits one or more major life activities, including functions such as caring for one's self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning and working, has a record of such an impairment, or is regarded as having such an impairment.

PITI ratio. The amount paid by the borrower for principal, interest, taxes, and insurance (PITI), divided by repayment income.

Principal reduction attributed to subsidy (PRAS). Accelerated principal reduction that can occur when a borrower receives a reduced interest rate through a payment subsidy.

Prior lien. A security instrument or a judgment against the security property that is superior to the RHS debt instrument.

Program-eligible applicant. Any applicant meeting the eligibility requirements described in § 3550.53.

Program-eligible property. A property eligible to be financed under this part, as determined by the criteria listed in §§ 3550.56 through 3550.59.

Program terms. Credit terms that are available only to program-eligible applicants for program-eligible properties.

Property. The land, dwelling, and related facilities for which the applicant will use RHS assistance.

Protective advances. Costs incurred by the Agency to protect the security interest of the Government that are charged to the borrower's account.

Real estate taxes. Taxes and the annual portion of assessments estimated to be due and payable on the property, reduced by any available tax exemption.

Recapture amount. An amount of subsidy to be repaid by the borrower upon disposition or nonoccupancy of the property.

Recipient. Any applicant, borrower, or grant recipient who applies for or receives assistance under the section 502 or 504 programs.

REO. The acronym for "Real Estate Owned." It refers to property for which RHS holds title.

Repayment income. Used to determine whether an applicant has the ability to make monthly loan payments. Repayment income includes amounts excluded for the purpose of determining adjusted income. See § 3550.54 for a complete description.

RHS. The Rural Housing Service of the U.S. Department of Agriculture, or its successor agency, formerly the Rural Housing and Community Development Service (RHCDs), a successor agency to the Farmers Home Administration (FmHA).

RHS employee. Any employee of RHS, or any employee of the Rural Development mission area who carries out grant or loan origination or servicing functions for the section 502 or 504 programs.

RHS interest rate. The unsubsidized interest rate offered by RHS for loans made on program terms.

Rural area: A rural area is:

(1) Open country which is not part of or associated with an urban area.

(2) 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: (i) Has a population not in excess of 10,000 if it is rural in character; or

(ii) Has a population in excess of 10,000 but not in excess of 20,000, 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 HUD.

(3) 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 is effective through receipt of census data for the year 2000.

Rural Development. A mission area within USDA which includes RHS, Rural Utilities Service (RUS), and Rural Business-Cooperative Service (RBS).

Scheduled payment. The monthly or annual installment on a promissory note plus escrow (if required), as modified by any payment subsidy agreement, delinquency workout agreement, other documented agreements between RHS and the borrower, or protective advances.

Secured loan. A loan that is collateralized by property so that in the

event of a default on the loan, the property may be sold to satisfy the debt.

Security property. All the property that serves as collateral for an RHS loan.

Subsidy. Interest credit, payment assistance, or deferred mortgage assistance received by a borrower under the section 502 or 504 programs.

Total debt ratio. The amount paid by the borrower for PITI and any recurring monthly debt, divided by repayment income.

Unauthorized assistance. Any loan, payment subsidy, deferred mortgage payment, or grant for which there was no regulatory authorization or for which the recipient was not eligible.

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.

USDA. The United States Department of Agriculture.

Unsecured loan. A loan evidenced only by the borrower's promissory note.

Value appreciation. The current market value of the property minus: the balance due prior lienholders, the unpaid balance of the RHS debt, unreimbursed closing costs (if any), principal reduction, the original equity (if any) of the borrower, and the value added by capital improvements.

Very low-income. An adjusted income that does not exceed the HUD-established very low-income limit (generally 50 percent of median income adjusted for household size) for the county or the Metropolitan Statistical Area where the property is or will be located.

Veterans preference. A preference extended to any person applying for a loan or grant under this part who served on active duty and has been discharged or released from the active forces on conditions other than dishonorable from the United States Army, Navy, Air Force, Marine Corps, or Coast Guard. The preference applies to the serviceperson, or the family of a deceased serviceperson who died in service before the termination of such war or such period or era. The applicable timeframes are:

- (1) During the period of April 6, 1917, through March 31, 1921;
- (2) During the period of December 7, 1941, through December 31, 1946;
- (3) During the period of June 27, 1950, through January 31, 1955;
- (4) For a period of more than 180 days, any part of which occurred after

January 31, 1955, but on or before May 7, 1975; or

(5) During the period beginning August 2, 1990, and ending the date prescribed by Presidential Proclamation or law.

§§ 3550.11–3550.49 [Reserved]

§ 3550.50 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0166. Public reporting burden for this collection of information is estimated to vary from 5 minutes to 3 hours per response, with an average of 1½ hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to the Department of Agriculture, Clearance Officer, STOP 7602, 1400 Independence Ave. SW., Washington, DC 20250–7602. You are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Subpart B—Section 502 Origination

§ 3550.51 Program objectives.

Section 502 of the Housing Act of 1949, as amended authorizes the Rural Housing Service (RHS) to provide financing to help low- and very low-income persons who cannot obtain credit from other sources obtain adequate housing in rural areas. Resources for the section 502 program are limited, and therefore, applicants are required to use section 502 funds in conjunction with funding or financing from other sources, if feasible. Sections 3550.52 through 3550.73 set forth the requirements for originating loans on program terms. Section 3550.74 describes the differences for originating loans on nonprogram (NP) terms.

§ 3550.52 Loan purposes.

Section 502 funds may be used to buy, build, rehabilitate, improve, or relocate an eligible dwelling and provide related facilities for use by the borrower as a permanent residence. In limited circumstances section 502 funds may be used to refinance existing debt.

(a) **Purchases from existing RHS borrowers.** To purchase a property currently financed by an RHS loan, the new borrower must assume the existing

RHS indebtedness. Section 502 funds may be used to provide additional financing or make repairs. Loan funds also may be used to permit a remaining borrower to purchase the equity of a departing co-borrower.

(b) **Refinancing non-RHS loans.** Debt from an existing non-RHS loan may be refinanced if the existing debt is secured by a lien against the property, RHS will have a first lien position on the security property after refinancing, and:

(1) In the case of loans for existing dwellings, if:

(i) Due to circumstances beyond the applicant's control, the applicant is in danger of losing the property; and

(ii) The debt is over \$5,000 and was incurred for eligible program purposes prior to loan application or was a protective advance made by the mortgagee for items covered by the loan to be refinanced, including accrued interest, insurance premiums, real estate tax advances, or preliminary foreclosure costs.

(2) In the case of loans for a building site without a dwelling, if:

(i) The debt to be refinanced was incurred for the sole purpose of purchasing the site;

(ii) The applicant is unable to acquire adequate housing without refinancing; and

(iii) The RHS loan will include funds to construct an appropriate dwelling on the site for the applicant's use.

(3) Debts incurred after the date of RHS loan application but before closing may be refinanced if the costs are incurred for eligible loan purposes and any construction work conforms to the standards specified in this part.

(c) **Refinancing RHS debt.** Under limited circumstances, an existing RHS loan may be refinanced in accordance with § 3550.204 to allow the borrower to receive payment assistance.

(d) **Eligible costs.** Improvements financed with loan funds must be on land which, after closing, is part of the security property. In addition to acquisition, construction, repairs, or the cost of relocating a dwelling, loan funds may be used to pay for:

(1) Reasonable expenses related to obtaining the loan, including legal, architectural and engineering, technical, title clearance, and loan closing fees; and appraisal, surveying, environmental, tax monitoring, and other technical services; and personal liability insurance fees for Mutual Self-Help borrowers.

(2) The cost of providing special design features or equipment when necessary because of a physical disability of the applicant or a member of the household.

(3) Reasonable connection fees, assessments, or the pro rata installment costs for utilities such as water, sewer, electricity, and gas for which the borrower is liable and which are not paid from other funds.

(4) Reasonable and customary lender charges and fees if the RHS loan is being made in combination with a leveraged loan.

(5) Real estate taxes that are due and payable on the property at the time of closing and for the establishment of escrow accounts for real estate taxes, hazard and flood insurance premiums, and related costs.

(6) Fees to public and private nonprofit organizations that are tax exempt under the Internal Revenue Code for the development and packaging of loan applications, except for loans related to the purchase of an RHS Real Estate Owned (REO) property.

(7) Purchasing and installing essential equipment in the dwelling, including ranges, refrigerators, washers or dryers, if these items are normally sold with dwellings in the area and if the purchase of these items is not the primary purpose of the loans.

(8) Purchasing and installing approved energy savings measures and approved furnaces and space heaters that use fuel that is commonly used, economical, and dependably available.

(9) Providing site preparation, including grading, foundation plantings, seeding or sodding, trees, walks, yard fences, and driveways to a building site.

(e) *Loan restrictions.* Loan funds may not be used to:

(1) Purchase an existing manufactured home, or for any other purposes prohibited in § 3550.73(b).

(2) Purchase or improve income-producing land or buildings to be used principally for income-producing purposes.

(3) Pay fees, commissions, or charges to for-profit entities related to loan packaging or referral of prospective applicants to RHS.

§ 3550.53 Eligibility requirements.

(a) *Income eligibility.* At the time of loan approval, the household's adjusted income must not exceed the applicable low-income limit for the area, and at closing, must not exceed the applicable moderate-income limit for the area (see § 3550.544).

(b) *Citizenship status.* The applicant must be a United States citizen or a noncitizen who qualifies as a legal alien as defined in § 3550.10.

(c) *Primary residence.* Applicants must agree to and have the ability to occupy the dwelling on a permanent basis.

(1) Because of the probability of transfer, loans will not be approved for military personnel on active duty unless the applicant will be discharged within a reasonable period of time.

(2) Because of the probability of moves after graduation, loans will not be approved for a full-time student unless the applicant intends to make the home a permanent residence and there are reasonable prospects that employment will be available in the area after graduation.

(3) If the home is being constructed or renovated an adult member of the household must be available to make inspections and authorize progress payments as the dwelling is being constructed.

(d) *Eligibility of current homeowners.* Current homeowners are not eligible for initial loans except as follows:

(1) Current homeowners may receive RHS loan funds to:

(i) refinance an existing loan under the conditions outlined in § 3550.52(b);

(ii) purchase a new dwelling if the current dwelling is deficient housing as defined in § 3550.10; or

(iii) make necessary repairs to the property which is financed with an affordable non-RHS loan.

(2) Current homeowners with an RHS loan may receive a subsequent loan.

(e) *Legal capacity.* Applicants must have the legal capacity to incur the loan obligation, or have a court appointed guardian or conservator who is empowered to obligate the applicant in real estate matters.

(f) *Suspension or debarment.*

Applications from applicants who have been suspended or debarred from participation in federal programs will be handled in accordance with 7 CFR part 3017.

(g) *Repayment ability.* Applicants must demonstrate adequate repayment ability.

(1) A very low-income applicant is considered to have repayment ability when the monthly amount required for payment of principal, interest, taxes, and insurance (PITI) does not exceed 29 percent of the applicant's repayment income, and the monthly amount required to pay PITI plus recurring monthly debts does not exceed 41 percent of the applicant's repayment income.

(2) A low-income applicant is considered to have repayment ability when the monthly amount required for payment of PITI does not exceed 33 percent of the applicant's repayment income, and the monthly amount required to pay PITI plus recurring monthly debts does not exceed 41 percent of repayment income.

(3) Repayment ratios may exceed the percentages specified in paragraphs (g)(1) and (g)(2) of this section if the applicant has demonstrated an ability to meet higher debt obligations, or if RHS determines, based on other compensating factors, that the household has a higher repayment ability.

(4) If an applicant does not meet the repayment ability requirements, the applicant can have another party join the application as a cosigner.

(5) If an applicant does not meet the repayment ability requirements, the applicant can have other household members join the application.

(h) *Credit qualifications.* Applicants must be unable to secure the necessary credit from other sources on terms and conditions that the applicant could reasonably be expected to fulfill. Applicants must have a credit history that indicates reasonable ability and willingness to meet debt obligations. An applicant with an outstanding judgment obtained by the United States in a federal court, other than the United States Tax Court, is not eligible for a loan or grant from RHS.

(1) Indicators of unacceptable credit include:

(i) Incidents of more than 2 debt payments more than 30 days late within the last 12 months.

(ii) A foreclosure which has been completed within the last 36 months.

(iii) An outstanding Internal Revenue Service tax lien or any other outstanding tax liens with no satisfactory arrangement for payment.

(iv) A court-created or court-affirmed obligation or judgment caused by nonpayment that is currently outstanding or has been outstanding within the last 12 months, except for those excluded in paragraphs (h)(2)(i) and (h)(2)(ii) of this section.

(v) Two or more rent payments paid 30 or more days late within the last 2 years. If the applicant has experienced no other credit problems in the past 2 years, only 1 year of rent history will be evaluated. Rent payment history requirements may be waived if the RHS loan will reduce shelter costs significantly and contribute to an improved repayment ability.

(vi) Outstanding collection accounts with a record of irregular payment with no satisfactory arrangements for repayment, or collection accounts that were paid in full within the last 6 months.

(vii) Non-agency debts written off within the last 36 months unless paid in full at least 12 months ago.

(viii) Agency debts that were debt settled, or are being considered for debt settlement.

(ix) Delinquency on a federal debt.

(2) The following will not be considered indicators of unacceptable credit:

(i) A bankruptcy in which debts were discharged more than 36 months prior to the date of application or where an applicant successfully completed a bankruptcy debt restructuring plan and has demonstrated a willingness to meeting obligations when due for the 12 months prior to the date of application.

(ii) A judgment satisfied more than 12 months before the date of application.

(3) When an application is rejected because of unacceptable credit, the applicant will be informed of the reason and source of information.

§ 3550.54 Calculation of income and assets.

(a) *Repayment income.* Repayment income is the annual amount of income from all sources that are expected to be received by those household members who are parties to the promissory note, except for any student financial aid received by these household members for tuition, fees, books, equipment, materials, and transportation. Repayment income is used to determine the household's ability to repay a loan.

(b) *Annual income.* Annual income is the income of all household members from all sources except those listed in (b)(1) through (b)(12) of this section:

(1) earned income of persons under the age of 18 unless they are a borrower or a spouse of a member of the household;

(2) payments received for the care of foster children or foster adults;

(3) amounts granted for or in reimbursement of the cost of medical expenses;

(4) earnings of each full-time student 18 years of age or older, except the head of household or spouse, that are in excess of any amount determined pursuant to section 501(b)(5) of the Housing Act of 1949, as amended;

(5) temporary, nonrecurring, or sporadic income (including gifts);

(6) lump sum additions to family assets such as inheritances; capital gains; insurance payments under health, accident, or worker's compensation policies; settlements for personal or property losses; and deferred periodic payments of supplemental security income and Social Security benefits received in a lump sum;

(7) any earned income tax credit;

(8) adoption assistance in excess of any amount determined pursuant to section 501(b)(5) of the Housing Act of 1949, as amended;

(9) amounts received by the family in the form of refunds or rebates under State or local law for property taxes paid on the dwelling;

(10) amounts paid by a State agency to a family with a developmentally disabled family member living at home to offset the cost of services and equipment needed to keep the developmentally disabled family member at home;

(11) the full amount of any student financial aid; and

(12) any other revenue exempted by a Federal statute; a list of which is available from any Rural Development office.

(c) *Adjusted income.* Adjusted income is used to determine program eligibility for sections 502 and 504 and the amount of payment subsidy for which the household qualifies under section 502. Adjusted income is annual income as defined in paragraph (b) of this section less any of the following deductions for which the household is eligible.

(1) For each family member, except the head of household or spouse, who is under 18 years of age, 18 years of age or older with a disability, or a full-time student, the amount determined pursuant to section 501(b)(5) of the Housing Act of 1949, as amended.

(2) A deduction of reasonable expenses for the care of minor 12 years of age or under that:

(i) enable a family member to work or to further a member's education;

(ii) are not reimbursed or paid by another source; and

(iii) in the case of expenses to enable a family member to work do not exceed the amount of income earned by the family member enabled to work.

(3) Expenses related to the care of household members with disabilities that:

(i) enable a family member to work;

(ii) are not reimbursed from insurance or another source; and

(iii) are in excess of three percent of the household's annual income.

(4) For any elderly family, a deduction in the amount determined pursuant to section 501(b)(5) of the Housing Act of 1949, as amended.

(5) For elderly households only, a deduction for household medical expenses that are not reimbursed from insurance or another source and which in combination with any expenses related to the care of household members with disabilities described in paragraph (c)(3) of this section, are in excess of three percent of the household's annual income.

(d) *Net family assets.* Income from net family assets must be included in the calculation of annual and repayment

income. Net family assets also are considered in determining whether a down payment is required.

(1) Net family assets include the cash value of:

(i) Equity in real property, other than the dwelling or site;

(ii) Cash on hand and funds in savings or checking accounts;

(iii) Amounts in trust accounts that are available to the household;

(iv) Stocks, bonds, and other forms of capital investments including life insurance policies and retirement plans that are accessible to the applicant without retiring or terminating employment;

(v) Lump sum receipts such as lottery winnings, capital gains, inheritances;

(vi) Personal property held as an investment; and

(vii) Any value, in excess of the consideration received, for any business or household assets disposed for less than fair market value during the 2 years preceding the income determination.

The value of assets disposed of for less than fair market value shall not be considered if they were disposed of as a result of foreclosure or bankruptcy or a divorce or separation settlement.

(2) Net family assets do not include:

(i) Interest in American Indian trust land;

(ii) Cash on hand which will be used to reduce the amount of the loan;

(iii) The value of necessary items of personal property;

(iv) Assets that are part of the business, trade, or farming operation of any member of the household who is actively engaged in such operation;

(v) The value of an irrevocable trust fund or any other trust over which no member of the household has control.

§ 3550.55 Applications.

(a) *Application submissions.* All persons applying for RHS loans must file a complete written application in a format specified by RHS. Applications will be accepted even when funds are not available.

(b) *Application processing.*

(1) Incomplete applications will be returned to the applicant specifying in writing the additional information that is needed to make the application complete.

(2) An applicant may voluntarily withdraw an application at any time.

(3) RHS may periodically request in writing that applicants reconfirm their interest in obtaining a loan. RHS may withdraw the application of any applicant who does not respond within the specified timeframe.

(4) Applicants who are eligible will be notified in writing. If additional

information becomes available that indicates that the original eligibility determination may have been incorrect, or that circumstances have changed, RHS may reconsider the application and the applicant may be required to submit additional information.

(5) Applicants who are ineligible will be notified in writing and provided with the specific reasons for the rejection.

(c) *Selection for processing.* When funding is not sufficient to serve all program-eligible applicants, applications will be selected for processing using the funding priorities specified in this paragraph. Within priority categories, applications will be processed in the order that the completed applications are received. In the case of applications with equivalent priority status that are received on the same day, preference will be extended to applicants qualifying for a veterans preference. After selection for processing, loans are funded on a first-come, first-served basis.

(1) First priority will be given to existing customers who request subsequent loans to correct health and safety hazards.

(2) Second priority will be given to loans related to the sale of an REO property or the transfer of an existing RHS financed property.

(3) Third priority will be given to applicants facing housing related hardships including applicants who have been living in deficient housing for more than 6 months, current homeowners in danger of losing a property through foreclosure, and other circumstances determined by RHS on a case-by-case basis to constitute a hardship.

(4) Fourth priority will be given to applicants seeking, loans for the construction of dwellings in an RHS-approved Mutual Self-Help project or loans that will leverage funding or financing from other sources.

(5) Applications from applicants who do not qualify for priority consideration in paragraphs (c)(1), (c)(2), (c)(3), or (c)(4) of this section will be selected for processing after all applications with priority status have been processed.

(d) *Applicant timeframe.* RHS will specify a reasonable timeframe within which eligible applicants selected for processing must provide the information needed to underwrite the loan.

§ 3550.56 Site requirements.

(a) *Rural areas.* Loans may be made only in rural areas designated by RHS. If an area designation is changed to non-rural:

(1) New conditional commitments will be made and existing conditional commitments will be honored only in conjunction with an applicant for a section 502 loan who applied for assistance before the area designation changed.

(2) REO property sales and transfers with assumption may be processed.

(3) Subsequent loans may be made either in conjunction with a transfer with assumption of an RHS loan or to repair properties that have RHS loans.

(b) *Site standards.* Sites must be developed in accordance with 7 CFR part 1924, subpart C and any applicable standards imposed by a State or local government.

(1) The site must not be large enough to subdivide into more than one site under existing local zoning ordinances;

(2) The site must not include farm service buildings, though small outbuildings such as a storage shed may be included; and

(3) The value of the site must not exceed 30 percent of the as improved market value of the property. The State Director may waive the 30 percent requirement in high cost areas where other lenders permit a higher percentage.

§ 3550.57 Dwelling requirements.

(a) *Modest dwelling.* The property must be one that is considered modest for the area, must not be designed for income providing purposes, must not have an in-ground pool or have a cost in excess of the section 203(b) limit of the National Housing Act unless RHS authorizes an exception:

(1) *Area-wide exception.* Area-wide exceptions may be granted when RHS determines that the section 203(b) limit is too low to enable applicants to purchase adequate housing.

(2) *Individual exceptions.* Individual exceptions may be granted to accommodate the specific needs of an applicant, such as to serve exceptionally large households or to provide reasonable accommodation for a household member with a disability. Any additional loan amount approved must not exceed the amount required to address the specific need.

(b) *New dwellings.* Construction must meet the requirements in 7 CFR part 1924, subpart A.

(c) *Existing dwellings.* Existing dwellings must be structurally sound; functionally adequate; in good repair, or to be placed in good repair with loan funds; have adequate electrical, heating, plumbing, water, and wastewater disposal systems; be free of termites and other wood damaging pests and organisms; and meet the thermal

performance requirements for existing dwellings of 7 CFR part 1924, subpart A.

§ 3550.58 Ownership requirements.

After the loan is closed, the borrower must have an acceptable interest in the property as evidenced by one of the following.

(a) *Fee-simple ownership.* Acceptable fee-simple ownership is evidenced by a fully marketable title with a deed vesting a fee-simple interest in the property to the borrower.

(b) *Secure leasehold interest.* A written lease is required. To be acceptable, a leasehold interest must have an unexpired term that is at least 150 percent of the term of the mortgage, unless the loan is guaranteed, in which case the unexpired term of the lease must be at least 2 years longer than the loan term. In no case may the unexpired term be less than 25 years.

(c) *Life estate interest.* To be acceptable a life estate interest must provide the borrower with rights of present possession, control, and beneficial use of the property. Generally, persons with any remainder interests must be signatories to the mortgage. All of the remainder interests need not be included in the mortgage to the extent that one or more of the persons holding remainder interests are not legally competent (and there is no representative who can legally consent to the mortgage), cannot be located, or if the remainder interests are divided among such a large number of people that it is not practical to obtain the signatures of all of the remainder interests. In such cases, the loan may not exceed the value of the property interests owned by the persons executing the mortgage.

(d) *Undivided interest.* All legally competent co-owners will be required to sign the mortgage. When one or more of the co-owners are not legally competent (and there is no representative who can legally consent to the mortgage), cannot be located, or the ownership interests are divided among so large a number of co-owners that it is not practical for all of their interests to be mortgaged, their interests not exceeding 50 percent may be excluded from the security requirements. In such cases, the loan may not exceed the value of the property interests owned by the persons executing the mortgage.

(e) *Possessory rights.* Acceptable forms of ownership include possessory rights on an American Indian reservation or State-owned land and the interest of an American Indian in land held in severalty under trust patents or deeds containing restrictions against alienation, provided that land in trust or

restricted status will remain in trust or restricted status.

§ 3550.59 Security requirements.

Before approving any loan, RHS will impose requirements to secure its interests.

(a) *Adequate security.* A loan will be considered adequately secured only when all of the following requirements are met:

(1) RHS obtains at closing a mortgage on all ownership interests in the security property or the requirements of § 3550.58 are satisfied.

(2) No liens prior to the RHS mortgage exist at the time of closing and no junior liens are likely to be taken immediately subsequent to or at the time of closing, unless the other liens are taken as part of a leveraging strategy or the RHS loan is essential for repairs and the senior lien secures an affordable non-RHS loan. Liens junior to the RHS lien may be allowed at loan closing if the junior lien will not interfere with the purpose or repayment of the RHS loan and the total value of all liens on the property is less than or equal to the property's market value.

(3) The provisions of 7 CFR part 1927, subpart B regarding title clearance and the use of legal services have been followed.

(4) Existing and proposed property improvements are totally on the site and do not encroach on adjoining property.

(b) *Guaranteed payment.* Mortgage insurance guaranteeing payment from a Government agency or Indian tribe is adequate security.

§ 3550.60 Escrow account.

RHS may require that customers deposit into an escrow account amounts necessary to ensure that the account will contain sufficient funds to pay real estate taxes, hazard and flood insurance premiums, and other related costs when they are due in accordance with the Real Estate Settlement and Procedures Act of 1974 (RESPA) (12 U.S.C. 2601, *et seq.*) and section 501(e) of the Housing Act of 1949, as amended.

§ 3550.61 Insurance.

(a) *Customer responsibility.* Until the loan is paid in full the customer must furnish and continually maintain hazard and flood insurance on property securing RHS loans, with companies, in amounts, and on terms and conditions acceptable to RHS. Customers who are required to have insurance may be required to escrow funds to ensure payment. All policies must have a "loss payable clause" payable to RHS to protect the Government's interest.

(b) *Amount.* Essential buildings must be insured in an amount at least equal to the balance of the secured debts.

(c) *Flood insurance.* Flood insurance must be obtained and maintained for the life of the loan for all property located in a Special Flood Hazard Area (SFHA) as determined by the Federal Emergency Management Agency (FEMA). RHS actions will be consistent with 7 CFR part 1806, subpart B which addressed flood insurance requirements. If flood insurance through FEMA's National Flood Insurance Program is not available in an SFHA, the property is not eligible for federal financial assistance.

(d) *Losses.*

(1) Loss deductible clauses may not exceed \$250 or 1 percent of the insurance coverage, whichever is greater. The deductible for any 1 building may not exceed \$750.

(2) Customers must immediately notify RHS of any loss or damage to insured property and collect the amount of the loss from the insurance company.

(3) Depending on the amount of the loss, RHS may require that loss payments be supervised. All repairs and replacements done by or under the direction of the borrower, or by contract, will be planned, performed, inspected, and paid for in accordance with 7 CFR part 1924, subpart A.

(4) When insurance funds remain after all repairs, replacements, and other authorized disbursements have been made, the funds will be applied in the following order:

(i) Prior liens, including delinquent property taxes.

(ii) Past-due amounts.

(iii) Protective advances due.

(iv) Released to the customer if the RHS debt is adequately secured.

(5) If a loss occurs when insurance is not in force, the borrower is responsible for making the needed repairs or replacements and ensuring that the insurance is reinstated on the property.

(6) If the borrower is not financially able to make the repairs, RHS may take one of the following actions:

(i) Make a subsequent loan for repairs.

(ii) Subordinate the RHS lien to permit the borrower to obtain funds for needed repairs from another source.

(iii) Permit the borrower to obtain funds secured by a junior lien from another source.

(iv) Make a protective advance to protect the Government's interest.

(v) Accelerate the account.

§ 3550.62 Appraisals.

(a) *Requirement.* An appraisal is required when the debt to be secured exceeds \$15,000 or whenever RHS

determines that it is necessary to establish the adequacy of the security. Appraisals must be made in accordance with the Uniform Standards of Professional Appraisal Practices. When other real estate is taken as additional security, it will be appraised if it represents a substantial portion of the security for the loan.

(b) *Fees.* RHS will charge a fee for each loan application that requires an appraisal, except the appraisal fee is not required on appraisals done for subsequent loans needed to make minimal, essential repairs or in cases where another party provides an appraisal which is acceptable to RHS. Fees collected in connection with a dwelling constructed under an approved conditional commitment will be paid to the contractor at closing to offset the cost of the real estate appraisal that is included in the conditional commitment fee.

§ 3550.63 Maximum loan amount.

Total secured indebtedness must not exceed the section 203(b) or market value limitations specified in paragraphs (a) and (b) of this section. In addition, the borrower may also finance the amount of the RHS appraisal and tax monitoring fee and the amount required to establish an escrow account for taxes and insurance over and above the limitations specified below. This section does not apply to NP loans.

(a) *Section 203(b) Limitation.* The section 203(b) limitation is the amount established by 203(b) of the National Housing Act, unless RHS authorizes an exception, as described in 7(a) of this subpart.

(b) *Market Value Limitation.*

(1) The market value limitation is 100 percent of market value for existing housing and for new dwellings for which RHS will receive adequate documentation of construction quality and the source of such documentation is acceptable to RHS.

(2) The market value limitation is 90 percent of market value for new dwellings for which adequate documentation of construction quality is not available.

(3) The market value limitation can be increased by:

(i) Up to one percent, if RHS makes a subsequent loan for closing costs only, in conjunction with the sale of an REO property or an assumption.

(ii) The amount necessary to make a subsequent loan for repairs necessary to protect the Government's interest, and reasonable closing costs.

(iii) The amount necessary to refinance an existing borrower's RHS

loans, plus closing costs associated with the new loan.

§ 3550.64 Down payment.

Elderly families must use any net family assets in excess of \$10,000 towards a down payment on the property. Non-elderly families must use net family assets in excess of \$7,500 towards a down payment on the property. Applicants may contribute assets in addition to the required down payment to further reduce the amount to be financed.

§ 3550.65 [Reserved]

§ 3550.66 Interest rate.

Loans will be written using the applicable RHS or NP interest rate in effect at loan approval or loan closing, whichever is lower. Information about current interest rates is available in any Rural Development office.

§ 3550.67 Repayment period.

Loans will be scheduled for repayment over a period that does not exceed the expected useful life of the property as a dwelling. The loan repayment period will not exceed:

(a) Thirty-three years in all cases except as noted in paragraphs (b), (c), and (d) of this section.

(b) Thirty-eight years:

(1) For initial loans, or subsequent loans made in conjunction with an assumption, if the applicant's adjusted income does not exceed 60 percent of the area adjusted median income and the longer term is necessary to show repayment ability.

(2) For subsequent loans not made in conjunction with an assumption if the applicant's initial loan was for a period of 38 years, the applicant's adjusted income at the time the subsequent loan is approved does not exceed 60 percent of area adjusted median income, and the longer terms is necessary to show repayment ability.

(c) Ten years for loans not exceeding \$2,500.

(d) Thirty years for manufactured homes.

§ 3550.68 Payment subsidies.

RHS administers two types of payment subsidies: payment assistance and interest credit. Payment subsidies are subject to recapture when the borrower transfers title or ceases to occupy the property.

(a) *Eligibility for payment subsidy.*

(1) Applicants or borrowers who receive loans on program terms are eligible to receive payment subsidy if they personally occupy the property and have adjusted income at or below the applicable moderate-income limit.

(2) Borrowers with loans approved before August 1, 1968, are not eligible for payment assistance, even if they assumed the loan after that date.

(3) Payment assistance may be granted for initial loans or subsequent loans made in conjunction with an assumption only if the term of the loan is at least 25 years or more.

(4) Payment assistance may be granted for subsequent loan not made in conjunction with an assumption if the initial loan was for a term of 25 years or more.

(b) *Determining type of payment subsidy.* A borrower currently receiving interest credit will continue to receive it for the initial loan and for any subsequent loan for as long as the borrower is eligible for and remains on interest credit. A borrower who has never received interest credit, or who has stopped receiving interest credit and at a later date again qualifies for a payment subsidy, will receive payment assistance.

(c) *Calculation of payment assistance.* The amount of payment assistance granted is the difference between the installment due on the promissory note and the greater of the payment amortized at the equivalent interest rate or the payment calculated based on the required floor payment. In leveraging situations, the equivalent interest rate will be used.

(1) The floor payment is a minimum percentage of adjusted income that the borrower must pay for PITI:

(i) Very low-income borrowers must pay a minimum of 22 percent of adjusted income;

(ii) Low-income borrowers with adjusted income below 65 percent of area adjusted median income must pay a minimum of 24 percent of adjusted income; and

(iii) Low-income borrowers with adjusted incomes between 65 and 80 percent of area adjusted median income must pay a minimum of 26 percent of adjusted income.

(2) The equivalent interest rate is determined by a comparison of the borrower's adjusted income to the adjusted median income for the area in which the security property is located. The following chart is used to determine the equivalent interest rate paid by applicants eligible for payment assistance.

PERCENTAGE OF MEDIAN INCOME AND THE EQUIVALENT INTEREST RATE

When the applicants adjusted income is—		
Equal to or more than	But less than	Then the equivalent interest rate is ¹
00%	50.01% of adjusted median income.	1
50.01%	55% of adjusted median income.	2
55%	60% of adjusted median income.	3
60%	65% of adjusted median income.	4
65%	70% of adjusted median income.	5
70%	75% of adjusted median income.	6
75%	80.01% of adjusted median income.	6.5
80.01%	90% of adjusted median income.	7.5
90%	100% of adjusted median income.	8.5
100%	110% of adjusted median income.	9
110%	or more than median income.	9.5

¹ Or note rate, whichever is less; in no case will the equivalent interest rate be less than one percent.

(d) *Calculation of interest credit.* The amount of interest credit granted is the difference between the sum of the annual installments due at the promissory note interest rate and the greater of:

(1) Twenty percent of the borrower's adjusted income less the cost of real estate taxes and insurance; or

(2) The amount the borrower would pay if the loan were amortized at an interest rate of one percent.

(e) *Annual review.* The borrower's income will be reviewed annually to determine whether the borrower is eligible for continued payment subsidy. The borrower must notify RHS whenever an adult member of the household changes or obtains employment, there is a change in household composition, or if income increases by at least 10 percent so that RHS can determine whether a review of the borrowers circumstances is required.

§ 3550.69 Deferred mortgage payments.

For qualified borrowers, RHS may defer up to 25 percent of the monthly principal and interest payment at 1 percent for up to 15 years. This assistance may be granted only at initial loan closing and is reviewed annually. Deferred mortgage payments are subject to recapture when the borrower transfers title or ceases to occupy the property.

(a) *Eligibility.* In order to qualify for deferred mortgage payments, all of the following must be true:

(1) The applicants adjusted income at the time of initial loan approval does not exceed the applicable very low-income limits.

(2) The loan term is 38 years, or 30 years for a manufactured home.

(3) The applicant's payments for principal and interest, calculated at a one percent interest rate for the maximum allowable term, plus estimated costs for taxes and insurance exceeds:

(i) For applicants receiving payment assistance, 29 percent of the applicants repayment income by more than \$10 per month; or

(ii) For applicants receiving interest credit, 20 percent of adjusted income by more than \$10 per month.

(b) *Amount and terms.*

(1) The amount of the mortgage payment to be deferred will be the difference between the applicants payment for principal and interest, calculated at one percent interest for the maximum allowable term, plus estimated costs for taxes and insurance and:

(i) For applicants receiving payment assistance, 29 percent of the applicants repayment income.

(ii) For applicants receiving interest credit, 20 percent of adjusted income.

(2) Deferred mortgage payment agreements will be effective for a 12-month period.

(3) Deferred mortgage assistance may be continued for up to 15 years after loan closing. Once a borrower becomes ineligible for deferred mortgage assistance, the borrower can never again receive deferred mortgage assistance.

(c) *Annual review.* The borrower's income, taxes, and insurance will be reviewed annually to determine eligibility for continued deferred mortgage assistance. The borrower must notify RHS whenever an adult member of the household changes or obtains employment or if income increases by at least 10 percent so that RHS can determine whether a review of the borrower's circumstances is required.

§ 3550.70 Conditional commitments.

A conditional commitment is a determination by RHS that a dwelling be offered for sale will be acceptable for purchase by a qualified RHS loan applicant if it is built or rehabilitated in accordance with RHS-approved plans, specifications, and regulations and priced within the lessor of the property's appraised value or the applicable HUD section 203(b) limit. The conditional commitment does not

reserve funds, does not guarantee funding, and does not ensure that an eligible loan applicant will be available to buy the dwelling.

(a) *Eligibility.* To be eligible to request a conditional commitment, the builder, dealer-contractor, or seller must:

(1) Have an adequate ownership interest in the property, as defined in § 3550.58, prior to the beginning of any planned construction;

(2) Have the experience and ability to complete any proposed work in a competent and professional manner;

(3) Have the legal capacity to enter into the required agreements;

(4) Be financially responsible and have the ability to finance or obtain financing for any proposed construction or rehabilitation; and

(5) Comply with the requirements of 7 CFR part 1901, subpart E and all applicable laws, regulations, and Executive Orders relating to equal opportunity. Anyone who receives 5 or more conditional commitments during a 12-month period must obtain RHS approval of an affirmative marketing plan.

(b) *Limitations.* Conditional commitments for new or substantially rehabilitated dwellings will not be issued after construction has started. RHS may limit the total number of conditional commitments issued in any locality based on market demand.

(c) *Commitment period.* A conditional commitment will be valid for 12 months from the date of issuance. The commitment may be extended for up to an additional 6 months if there are unexpected delays in construction caused by such factors as bad weather, materials shortages, or marketing difficulties. Conditional commitments may be canceled if construction does not begin within 60 days after the commitment is issued.

(d) *Conditional commitments involving packaging of applications.* A conditional commitment may be made to a seller, builder, or dealer-contractor who packages an RHS loan application for a prospective purchaser. In cases where the dwelling is to be constructed for sale to a specific eligible applicant, all of the following conditions must be met:

(1) The conditional commitment will not be approved until the applicant's loan has been approved;

(2) Construction will not begin until loan funds are obligated for the loan. Exceptions may be made when it appears likely that funding will be forthcoming and as long as the RHS lien priority is not jeopardized. The sales agreement must indicate that the loan has been approved but not funded and

must provide that if the loan is not closed within 90 days of the date of approval, the contractor may terminate the sales agreement and sell the property to another party. If the sales agreement is terminated, the conditional commitment will be honored for another eligible loan applicant for the remaining period of the commitment; and

(3) The RHS loan will be closed only after the dwelling is constructed or the required rehabilitation completed and final inspection has been made.

(e) *Fees.* An application for a conditional commitment must include payment of the conditional commitment fee. The fee will be refunded if for any reason preliminary inspection of the property or investigation of the conditional commitment applicant indicates that a conditional commitment will not be issued. Application fees will not be refunded for any property on which the required appraisal has been made.

(f) *Failure of conditional commitment applicant or dwelling to qualify.* The conditional commitment applicant will be informed if the conditional commitment is denied. Conditional commitments will be canceled if the property does not meet program requirements.

(g) *Changes in plans, specifications, or commitment price.* The holder of the conditional commitment must request approval for changes in plans, specifications, and commitment price. RHS may approve the changes if the following requirements are met:

(1) The property price does not exceed the maximum loan limit and increases in costs are due to factors beyond the control of the commitment holder; and

(2) The requested changes are justifiable and appropriate.

(h) *Builder's warranty.* The builder or seller, as appropriate, must execute either an RHS-approved "Builder's Warranty," or provide a 10-year insured warranty when construction is completed or the loan is closed.

§ 3550.71 Special requirements for condominiums.

RHS loans may be made for condominium units under the following conditions:

(a) The unit is in a project approved or accepted by U.S. Department of Housing and Urban Development (HUD), the Federal National Mortgage Association (Fannie Mae), or the Federal Home Loan Mortgage Corporation (Freddie Mac).

(b) The condominium project complies with the requirements of the

condominium enabling statute and all other applicable laws. Any right of first refusal in the condominium documents will not impair the rights of RHS to:

(1) Foreclose or take title to a condominium unit pursuant to the remedies in the mortgage;

(2) Accept a deed in lieu of foreclosure in the event of default by a mortgagor; and

(3) Sell or lease a unit acquired by RHS.

(c) If RHS obtains title to a condominium unit pursuant to the remedies in its mortgage or through foreclosure, RHS will not be liable for more than 6 months of the unit's unpaid regularly budgeted dues or charges accrued before acquisition of the title to the unit by RHS. The homeowners association's lien priority may include costs of collecting unpaid dues.

(d) In case of condemnation or substantial loss to the units or common elements of the condominium project, unless at least two-thirds of the first mortgagees or unit owners of the individual condominium units have given their consent, the homeowners association may not:

(1) By act or omission seek to abandon or terminate the condominium project;

(2) Change the pro rata interest or obligations of any condominium unit in order to levy assessments or charges, allocate distribution of hazard insurance proceeds or condemnation awards, or determine the pro rata share of ownership of each condominium unit in the common elements;

(3) Partition or subdivide any condominium unit;

(4) Seek to abandon, partition, subdivide, encumber, sell, or transfer the common elements by act or omission (the granting of easements for public utilities or other public purposes consistent with the intended use of the common elements by the condominium project is not a transfer within the meaning of this clause); or

(5) Use hazard insurance proceeds for losses to any condominium property (whether units or common elements) for other than the repair, replacement, or reconstruction of the condominium property.

(e) All taxes, assessments, and charges that may become liens prior to the first mortgage under local law relate only to the individual condominium units and not to the condominium project as a whole.

(f) No provision of the condominium documents gives a condominium unit owner or any other party priority over any rights of RHS as first or second mortgagee of the condominium unit pursuant to its mortgage in the case of

a payment to the unit owner of insurance proceeds or condemnation awards for losses to or taking of condominium units or common elements.

(g) If the condominium project is on a leasehold the underlying lease provides adequate security of tenure as described in § 3550.58(b).

(h) At least 70 percent of the units have been sold. Multiple purchases of condominium units by one owner are counted as one sale when determining if the sales requirement has been met.

(i) No more than 15 percent of the unit owners are more than 1 month delinquent in payment of homeowners association dues or assessments at the time the RHS loan is closed.

§ 3550.72 Community land trusts.

Eligible dwellings located on land owned by a community land trust may be financed if:

(a) The loan meets all the requirements of this subpart; and

(b) Any restrictions, imposed by the community land trust on the property or applicant are:

(1) Reviewed and accepted by RHS before loan closing; and

(2) Automatically and permanently terminated upon foreclosure or acceptance by RHS of a deed in lieu of foreclosure.

§ 3550.73 Manufactured homes.

With the exception of the restrictions and additional requirements contained in this section, section 502 loans on manufactured homes are subject to the same conditions as all other section 502 loans.

(a) *Eligible costs.* In addition to the eligible costs described in § 3550.52(d), RHS may finance the following activities related to manufactured homes when a real estate mortgage covers both the unit and the site:

(1) Purchase of an eligible unit, transportation, and set-up costs, and purchase of an eligible site if not already owned by the applicant;

(2) Site development work in accordance with 7 CFR part 1924, subpart A;

(3) Subsequent loans in conjunction with an assumption or sale of an REO property; or

(4) Subsequent loans for repairs of units financed under section 502.

(b) *Loan restrictions.* In addition to the loan restrictions described in § 3550.52(e), RHS may not use loan funds to finance:

(1) An existing unit and site unless it is already financed with a section 502 loan or is an RHS REO property.

(2) The purchase of a site without also financing the unit.

(3) Alteration or remodeling of the unit when the initial loan is made.

(4) Furniture, including movable articles of personal property such as drapes, beds, bedding, chairs, sofas, divans, lamps, tables, televisions, radios, stereo sets, and other similar items of personal property. Furniture does not include wall-to-wall carpeting, refrigerators, ovens, ranges, washing machines, clothes dryers, heating or cooling equipment, or other similar items.

(c) *Dealer-contractors.* No loans will be made on a manufactured home sold by any entity that is not an approved dealer-contractor that will provide complete sales, service, and site development services.

(d) *Loan term.* The maximum term of a loan on a manufactured home is 30 years.

(e) *Construction and development.* Unit construction, site development and set-up must conform to the Federal Manufactured Home Construction and Safety Standards (FMHCSS) and 7 CFR part 1924, subpart A. Development under the Mutual Self-Help and borrower construction methods is not permitted for manufactured homes.

(f) *Contract requirements.* The dealer-contractor must sign a construction contract, as specified in 7 CFR 1924.6 which will cover both the unit and site development work. The use of multi-contracts is prohibited. A dealer-contractor may use subcontractors if the dealer-contractor is solely responsible for all work under the contract. Payment for all work will be in accordance with 7 CFR part 1924, subpart A, except no payment will be made for materials or property stored on site (e.g., payment for a unit will be made only after it is permanently attached to the foundation).

(g) *Lien release requirements.* All persons furnishing materials or labor in connection with the contract except the manufacturer of the unit must sign a Release by Claimants document, as specified in 7 CFR part 1924, subpart A. The manufacturer of the unit must furnish an executed manufacturer's certificate of origin to verify that the unit is free and clear of all legal encumbrances.

(h) *Warranty requirements.* The dealer-contractor must provide a warranty in accordance with the provisions of 7 CFR 1924.12. The warranty must identify the unit by serial number. The dealer-contractor must certify that the unit substantially complies with the plans and specifications and the manufactured home has sustained no hidden damage during transportation and, if

manufactured in separate sections, that the sections were properly joined and sealed according to the manufacturer's specifications. The dealer-contractor will also furnish the applicant with a copy of all manufacturer's warranties.

§ 3550.74 Nonprogram loans.

NP terms may be extended to applicants who do not qualify for program credit, or for properties that do not qualify as program properties, when it is in the best interest of the Government. NP loans are originated and serviced according to the requirements for program loans except as indicated in this section.

(a) *Purpose.* NP terms may be offered to expedite:

(1) Sale of an REO property.

(2) Assumption of an existing program loan on new rates and terms. If additional funds are required to purchase the property, the applicant must obtain them from another source.

(3) Conversion of a program loan that has received unauthorized assistance.

(4) Continuation of a loan on a portion of a security property when the remainder is being transferred and the RHS debt is not paid in full.

(b) *Terms.*

(1) Rate and term:

(i) For an applicant who intends to occupy the property, the term will not exceed 30 years.

(ii) For other applicants, the term will not exceed 10 years. If more favorable terms are necessary to facilitate the sale, the loan may be amortized over a period of up to 20 years with payment in full due not later than 10 years from the date of closing.

(iii) An applicant with an NP loan under paragraph (b)(1)(i) of this section who wishes to retain the property and purchase a new property with RHS credit must purchase the second property according to the terms of paragraph (b)(1)(ii) of this section, even if the new property will serve as the applicant's principal residence.

(2) NP loans are written at the NP interest rate in effect at the time of loan approval.

(3) NP borrowers are not eligible for payment assistance or a moratorium.

(c) *Additional requirements.*

(1) NP applicants other than public bodies and nonprofit organizations must pay a nonrefundable application fee.

(2) NP applicants must make a down payment based upon the purchase price and whether the applicant intends to personally occupy the property or use it for other purposes.

(3) NP applicants cannot finance loan closing costs or escrow, tax service, or appraisal fees.

(d) *Reduced restrictions.*

(1) NP applicants need not be unable to obtain other credit in order to receive an NP loan and are not required to refinance with private credit when they are able to do so.

(2) NP applicants are not required to occupy the property.

(3) NP applicants are not subject to leasing restrictions.

(e) *Waiver of costs.* When the purpose of the loan is the conversion of a program loan that has received unauthorized assistance or continuation of a loan on a portion of a security property when the remainder is being transferred, the application fee, appraisal fee, and down payment may be waived.

§§ 3550.75–3550.99 [Reserved]

§ 3550.100 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0166. Public reporting burden for this collection of information is estimated to vary from 5 minutes to 3 hours per response, with an average of 1½ hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comment regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to the Department of Agriculture, Clearance Officer, STOP 7602, 1400 Independence Avenue, SW., Washington, DC 20250–0762. You are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Subpart C—Section 504 Origination

§ 3550.101 Program objectives.

This subpart sets forth policies for administering loans and grants under section 504(a) of title V of the Housing Act of 1949, as amended. Section 504 loans and grants are intended to help very low-income owner-occupants in rural areas repair their properties.

§ 3550.102 Grant and loan purposes.

(a) *Grant funds.* Grant funds may be used only to pay costs for repairs and improvements that will remove identified health and safety hazards or to repair or remodel dwellings to make them accessible and useable for household members with disabilities.

Unused grant funds must be returned to the Rural Housing Service (RHS).

(b) *Loan funds.* Loan funds may be used to make general repairs and improvements to properties or to remove health and safety hazards, as long as the dwelling remains modest in size and design.

(c) *Eligibility of mobile and manufactured homes.* Repairs necessary to remove health and safety hazards may be made to mobile or manufactured homes provided:

(1) The applicant owns the home and site and has occupied the home prior to filing an application with RHS; and

(2) The mobile or manufactured home is on a permanent foundation or will be put on a permanent foundation with section 504 funds.

(d) *Eligible costs.* In addition to construction costs to make necessary repairs and improvements, loan and grant funds may be used for:

(1) Reasonable expenses related to obtaining the loan or grant, including legal, architectural and engineering, title clearance, and loan closing fees; and appraisal, surveying, environmental, tax monitoring, and other technical services.

(2) The cost of providing special design features or equipment when necessary because of a physical disability of the applicant or a member of the household.

(3) Reasonable connection fees, assessments, or the pro rata installation costs for utilities such as water, sewer, electricity, and gas for which the borrower is liable and which are not paid from other funds.

(4) Real estate taxes that are due and payable on the property at the time of closing and for the establishment of escrow accounts for real estate taxes, hazard and flood insurance premiums, and related costs.

(5) Fees to public and private nonprofit organizations that are tax exempt under the Internal Revenue Code for the development and packaging of applications.

(e) *Restrictions on uses of loan or grant funds.* Section 504 funds may not be used to:

(1) Assist in the construction of a new dwelling.

(2) Make repairs to a dwelling in such poor condition that when the repairs are completed, the dwelling will continue to have major hazards.

(3) Move a mobile home or manufactured home from one site to another.

(4) Pay for off-site improvements except for the necessary installation and assessment costs for utilities.

(5) Refinance any debt or obligation of the applicant incurred before the date of

application, except for the installation and assessment costs of utilities.

(6) Pay fees, commission, or charges to for-profit entities related to loan packaging or referral of prospective applicants to RHS.

§ 3550.103 Eligibility requirements.

To be eligible, applicants must meet the following requirements:

(a) *Owner-occupant.* Applicants must own, as described in § 3550.107, and occupy the dwelling.

(b) *Age (grant only).* To be eligible for grant assistance, an applicant must be 62 years of age or older at the time of application.

(c) *Income eligibility.* At the time of loan or grant approval, the household's adjusted income must not exceed the applicable very low-income limit. Section 3550.54 provides a detailed discussion of the calculation of adjusted income.

(d) *Citizenship status.* The applicant must be a U.S. citizen or a non-citizen who qualifies as a legal alien, as defined in § 3550.10.

(e) *Need and use of personal resources.* Applicants must be unable to obtain financial assistance at reasonable terms and conditions from non-RHS credit or grant sources and lack the personal resources to meet their needs. In cases where the household is experiencing medical expenses in excess of three percent of the household's income, this requirement may be waived or modified. Elderly families must use any net family assets in excess of \$10,000 to reduce their section 504 request. Non-elderly families must use any net family assets in excess of \$7,500 to reduce their section 504 request. Applicants may contribute assets in excess of the aforementioned amounts to further reduce their request for assistance. The definition of assets for this purpose is net family assets as described in § 3550.54 of subpart B of this part, less the value of the dwelling and a minimum adequate site.

(f) *Legal capacity.* The applicant must have the legal capacity to incur the loan obligation or have a court appointed guardian or conservator who is empowered to obligate the applicant in real estate matters.

(g) *Suspension or debarment.* Applications from applicants who have been suspended or debarred from participation in federal programs will be handled in accordance with FmHA Instruction 1940-M (available in any Rural Development office).

(h) *Repayment ability (loans only).* Applicants must demonstrate adequate

repayment ability as supported by a budget.

(1) If an applicant does not meet the repayment ability requirements, the applicant can have another party join the application as a cosigner.

(2) If an applicant does not meet the repayment ability requirements, the applicant can have other household members join the application.

(i) *Credit qualifications.* Applicants must be unable to secure the necessary credit from other sources under terms and conditions that the applicant could reasonably be expected to fulfill. Loan applicants must have a credit history that indicates reasonable ability and willingness to meet debt obligations. An applicant with an outstanding judgment obtained by the United States in a federal court, other than the United States Tax Court, is not eligible for a loan or grant from RHS.

(1) Indicators of unacceptable credit include:

(i) Repeated incidents of 2 debt payments being more than 30 days late within the last 12 months that indicate an unwillingness to meet financial obligations when due.

(ii) Loss of security due to a foreclosure if the foreclosure has been completed within the last 36 months.

(iii) An outstanding Internal Revenue Service tax lien or any other outstanding tax liens with no satisfactory arrangement for payment.

(iv) A court-created or court-affirmed obligation or judgment caused by nonpayment that is currently outstanding or has been outstanding within the last 12 months, except for those excluded by paragraphs (i)(2)(ii) and (i)(2)(iii) of this section.

(v) Outstanding collection accounts with a record of irregular payment with no satisfactory arrangements for repayment, or collection accounts that were paid in full within the last 6 months.

(vi) Non-agency debts written off within the last 36 months or paid in full at least 12 months ago.

(vii) Agency debts that were debt settled, or are being considered for debt settlement.

(viii) Delinquency on a federal debt.

(2) The following will not be considered indicators of unacceptable credit:

(i) A bankruptcy in which debts were discharged more than 36 months prior to the date of application or where an applicant successfully completed a bankruptcy debt restructuring plan and has demonstrated a willingness to meet obligations when due for the 12 months prior to the date of application.

(ii) A non-foreclosure judgment satisfied more than 12 months before the date of application.

(3) When an application is rejected because of unacceptable credit, the applicant will be informed of the reason and source of information.

§ 3550.104 Applications.

(a) *Application submissions.* All persons applying for section 504 loans or grants must file a complete written application in a format specified by RHS. Applications will be accepted even when funds are not available.

(b) *Application processing.*

(1) Incomplete applications will be returned to the applicant specifying in writing the additional information that is needed to make the application complete.

(2) An applicant may voluntarily withdraw an application at any time.

(3) RHS may periodically request in writing that applicants reconfirm their interest in obtaining a loan or grant. RHS may withdraw the application of any applicant who does not respond within the specified timeframe.

(4) Applicants who are eligible will be notified in writing. If additional information becomes available that indicates that the original eligibility determination may have been in error or that circumstances have changed, RHS may reconsider the application and the applicant may be required to submit additional information.

(5) Applicants who are ineligible will be notified in writing and provided with the specific reasons for the rejection.

(c) *Processing priorities.* When funding is not sufficient to serve all eligible applicants, applications for assistance to remove health and safety hazards will receive priority for funding. In the case of applications with equivalent priority status that are received on the same day, preference will be extended to applicants qualifying for a veterans preference. After selection for processing, requests for assistance are funded on a first-come, first-served basis.

§ 3550.105 Site requirements.

(a) *Rural areas.* Loans may be made only in rural areas designated by RHS. If an area designation is changed to nonrural an existing RHS borrower may receive 504 assistance.

(b) *Not subdividable.* The site must not be large enough to subdivide into more than one site under existing local zoning ordinances.

§ 3550.106 Dwelling requirements.

(a) *Modest dwelling.* The property must be one that is considered modest

for the area, must not be designed for income producing purposes, have an in-ground pool, or have a value in excess of the 203(b) limits of the National Housing Act.

(b) *Post-repair condition.* Dwellings repaired with section 504 funds need not be brought to the agency development standards or thermal performance standards of 7 CFR part 1924, subpart A, nor must all existing hazards be removed. However, the dwelling may not continue to have major health or safety hazards.

(c) *Construction standards.* All work must be completed in accordance with local construction codes and standards. When potentially hazardous equipment or materials are being installed, all materials and installations must be in accordance with the applicable standards in 7 CFR part 1924, subpart A.

§ 3550.107 Ownership requirements.

The applicant must have an acceptable ownership interest in the property as evidenced by one of the following:

(a) *Full fee ownership.* Acceptable full fee ownership is evidenced by a fully marketable title with a deed vesting a fee interest in the property to the applicant.

(b) *Secure leasehold interest.* A written lease is required. For loans, the unexpired portion of the lease must not be less than 2 years beyond the term of the promissory note. For grants, the remaining lease period must be at least 5 years. A leasehold for mutual help housing financed by U.S. Department of Housing and Urban Development (HUD) on Indian lands requires no minimum lease period and constitutes acceptable ownership.

(c) *Life estate interest.* To be acceptable, a life estate interest must provide the applicant with rights of present possession, control, and beneficial use of the property. For secured loans, generally persons with any remainder interests must be signatories to the mortgage. All of the remainder interests need not be included in the mortgage to the extent that one or more of the persons holding remainder interests are not legally competent (and there is no representative who can legally consent to the mortgage), cannot be located, or if the remainder interests are divided among such a large number of people that it is not practical to obtain the signatures of all of the remainder interests. In such cases, the loan may not exceed the value of the property interests owned by the persons executing the mortgage.

(d) *Undivided interest.* An undivided interest is acceptable if there is no reason to believe that the applicant's position as an owner-occupant will be jeopardized as a result of the improvements to be made, and:

(1) In the case of unsecured loans or grants, if any co-owners living or planning to live in the dwelling sign the repayment agreement.

(2) In the case of a secured loan, when one or more of the co-owners are not legally competent (and there is no representative who can legally consent to the mortgage), cannot be located, or the ownership interests are divided among so large a number of co-owners that it is not practical for all of their interests to be mortgaged, their interests not exceeding 50 percent may be excluded from the security requirements. In such cases, the loan may not exceed the value of the property interests owned by the persons executing the mortgage.

(e) *Possessory rights.* Acceptable forms of ownership include possessory right on an American Indian reservation or State-owned land and the interest of an American Indian in land held severalty under trust patents or deeds containing restrictions against alienation, provided that land in trust or restricted status will remain in trust or restricted status.

(f) *Land purchase contract.* A land purchase contract is acceptable if the applicant is current on all payments, and there is a reasonable likelihood that the applicant will be able to continue meeting the financial obligations of the contract.

(g) *Alternative evidence of ownership.* If evidence, as described in paragraphs (a) through (e) of this section, is not available, RHS may accept any of the following as evidence of ownership:

(1) Records of the local taxing authority that show the applicant as owner and that demonstrate that real estate taxes for the property are paid by the applicant.

(2) Affidavits by others in the community stating that the applicant has occupied the property as the apparent owner for a period of not less than 10 years, and is generally believed to be the owner.

(3) Any instrument, whether or not recorded, which is commonly accepted as evidence of ownership.

§ 3550.108 Security requirements (loans only).

When the total section 504 indebtedness is \$2,500 or more, the property will be secured by a mortgage on the property, leasehold interest, or land purchase contract.

(a) RHS does not require a first lien position, but the total of all debts on the secured property may not exceed the value of the security, except by the amount of any required contributions to an escrow account for taxes and insurance and any required appraisal fee.

(b) Title clearance and the use of legal services generally must be conducted in accordance with 7 CFR part 1927, subpart B. These requirements need not be followed for:

(1) Loans where the total RHS indebtedness is \$7,500 or less; or

(2) Subsequent loans made for minimal essential repairs necessary to protect the Government's interest.

§ 3550.109 Escrow account (loans only).

RHS may require that borrowers deposit into an escrow account amounts necessary to ensure that the account will contain sufficient funds to pay real estate taxes, hazard and flood insurance premiums, and other related costs when they are due in accordance with the Real Estate Settlement and Procedures Act of 1974 (RESPA) and section 501(e) of the Housing Act of 1949, as amended.

§ 3550.110 Insurance (loans only).

(a) *Borrower responsibility.* Until the loan is paid in full, any borrower with a secured indebtedness in excess of \$15,000 must furnish and continually maintain hazard insurance on the security property, with companies, in amounts, and on terms and conditions acceptable to RHS and include a "loss payable clause" payable to RHS to protect the Government's interest.

(b) *Amount.* Essential buildings must be insured in an amount at least equal to the balance of the secured debts.

(c) *Flood insurance.* Flood insurance must be obtained and maintained for the life of the loan for all property located in Special Flood Hazard Areas (SFHA) as determined by the Federal Emergency Management Agency (FEMA). RHS actions will be consistent with 7 CFR part 1806, subpart B which addresses flood insurance requirements. If flood insurance through FEMA's National Flood Insurance Program is not available in a SFHA, the property is not eligible for federal financial assistance.

(d) *Losses.*

(1) Loss deductible clauses may not exceed \$250 or 1 percent of the insurance coverage, whichever is greater. The deductible for any 1 building may not exceed \$750.

(2) Borrowers must immediately notify RHS of any loss or damage to insured property and collect the amount of the loss from the insurance company.

(3) RHS may require that loss payments be supervised. All repairs and

replacements done by or under the direction of the borrower, or by contract, will be planned, performed, inspected, and paid for in accordance with 7 CFR part 1924, subpart A.

(4) When insurance funds remain after all repairs, replacements, and other authorized disbursements have been made, the funds will be applied in the following order:

- (i) Prior liens, including delinquent property taxes.
- (ii) Delinquency on the account.
- (iii) Advances due for recoverable cost items.

(iv) Released to the borrower if the RHS debt is adequately secured.

(5) If a loss occurs when insurance is not in force, the borrower is responsible for making the needed repairs or replacements and ensuring that the insurance is reinstated on the property.

(6) If the borrower is not financially able to make the repairs, RHS may take one of the following actions:

- (i) Make a subsequent loan for repairs.
- (ii) Subordinate the RHS lien to permit the borrower to obtain funds for needed repairs from another source.
- (iii) Permit the borrower to obtain funds secured by a junior lien from another source.
- (iv) Make a protective advance to protect the Government's interest.
- (v) Accelerate the account and demand payment in full.

§ 3550.111 Appraisals (loans only).

An appraisal is required when the section 504 debt to be secured exceeds \$15,000 or whenever RHS determines that it is necessary to establish the adequacy of the security. RHS may charge an appraisal fee. Appraisals must be made in accordance with the Uniform Standards of Professional Appraisal Practices. When other real estate is taken as additional security it will be appraised if it represents a substantial portion of the security for the loan.

§ 3550.112 Maximum loan and grant.

(a) *Maximum loan permitted.* The sum of all outstanding section 504 loans to 1 borrower or on 1 dwelling may not exceed \$20,000.

(1) Transferees who have assumed a section 504 loan and wish to obtain a subsequent section 504 loan are limited to the difference between the unpaid principal balance of the debt assumed and \$20,000.

(2) For a secured loan, the total of all debts on the secured property may not exceed the value of the security, except by the amount of any required appraisal and tax monitoring fees, and the contributions to an escrow account for taxes and insurance.

(b) *Maximum loan based upon ability to pay.* The maximum loan is limited to the principal balance that can be supported given the amount the applicant has available, as determined by RHS, to repay a loan at 1 percent interest with a 20-year term.

(c) *Maximum grant.* The lifetime total of the grant assistance to any recipient is \$7,500. No grant can be awarded unless the maximum level of loans, as supported by a budget, have been obtained.

§ 3550.113 Rates and terms (loans only).

(a) *Interest rate.* The interest rate for all section 504 loans will be 1 percent.

(b) *Loan term.* The repayment period for the loan should generally be as short as possible based on the applicant's repayment ability, and may never exceed 20 years; however loans made in combination with grants must have a term of 20 years.

§ 3550.114 Repayment agreement (grants only).

Grant recipients are required to sign a repayment agreement which specifies that the full amount of the grant must be repaid if the property is sold in less than 3 years from the date the grant was approved.

§ 3550.115–3550.149 [Reserved]

§ 3550.150 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0166. Public reporting burden for this collection of information is estimated to vary from 5 minutes to 3 hours per response, with an average of 1½ hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comment regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to the Department of Agriculture, Clearance Officer, STOP 7602, 1400 Independence Avenue, SW, Washington, DC 20250–0762. You are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Subpart D—Regular Servicing

§ 3550.151 Servicing goals.

This subpart sets forth the Rural Housing Service (RHS) policies for

managing the repayment of loans made under sections 502 and 504 of the Housing Act of 1949, as amended.

§ 3550.152 Loan payments.

(a) *Payment terms.* Unless the loan documents specify other loan repayment terms, borrowers are required to make monthly payments. Borrowers with existing loans specifying annual payments may request conversion to monthly payments, and must convert to a monthly payment schedule before any subsequent loan or new payment assistance is approved. Suitable forms of payment are: check, money order, or bank draft. Borrowers who make cash payments will be assessed a fee to cover the cost of conversion to a money order.

(b) *Application of payments.* If a borrower makes less than the scheduled payment, the payment is held in suspense and is not applied to the borrower's account. When subsequent payments are received in an amount sufficient to equal a scheduled payment, the amount will be applied in the following order:

- (1) Protective advances charged to the account.
- (2) Accrued interest due.
- (3) Principal due.
- (4) Escrow for taxes and insurance.

(c) *Multiple loans.* When a borrower with multiple loans for the same property makes less than the scheduled payment on all loans, the payment will be applied to the oldest loan and then in declining order of age. Future remittances will be applied beginning with the oldest unpaid installment.

(d) *Application of excess payments.* Borrowers can elect to make payments in excess of the scheduled amount to be applied to principal, provided there are no outstanding fees.

§ 3550.153 Fees.

RHS may assess reasonable fees including a tax service fee, fees for late payments, and fees for checks returned for insufficient funds.

§ 3550.154 Inspections.

RHS or its agent may make reasonable entries upon and inspections of any property used as security for an RHS loan as necessary to protect the interest of the Government. RHS will give the borrower notice at the time of or prior to an inspection.

§ 3550.155 Escrow account.

Escrow accounts will be administered in accordance with RESPA and section 501(e) of the Housing Act of 1949, as amended.

(a) Upon creation of the escrow account, RHS may require borrowers to

deposit funds sufficient to pay taxes and insurance premiums applicable to the mortgage for the period since the last payments were made and to fund a cushion as permitted by RESPA.

(b) Borrowers may elect to escrow at any time during the terms of the loan if the outstanding RHS loan balance is over \$2,500.

(c) RHS may require borrowers to escrow in conjunction with any special servicing action.

§ 3550.156 Borrower obligations.

(a) After receiving a loan from RHS, borrowers are expected to meet a variety of obligations outlined in the loan documents. In addition to making timely payments, these obligations include:

(1) Maintaining the security property; and

(2) Maintaining an adequately funded escrow account, or paying real estate taxes, hazard and flood insurance, and other related costs when due.

(b) If a borrower fails to fulfill these obligations, RHS may obtain the needed service and charge the cost to the borrowers account.

§ 3550.157 Payment subsidy.

(a) *Borrowers currently receiving payment subsidy.*

(1) RHS will review annually each borrower's eligibility for continued payment subsidy and determine the appropriate level of assistance. To be eligible for payment subsidy renewal, the borrower must also occupy the property.

(2) If the renewal is not completed before the expiration date of the existing agreement, the effective date of the renewal will be either the expiration date of the previous agreement if RHS error caused the delay, or the next due date after the renewal is approved in all other cases.

(3) The borrower must notify RHS whenever an adult member of the household becomes employed or changes employment, there is a change in household composition, or if income increases by at least 10 percent. The household may also report decreases in income. If the change in the household's income will cause the payment for principal and interest to change by at least 10 percent, the household's payment subsidy may be adjusted for a new 12-month period. The new agreement will be effective the due date following the date the borrower's information is verified by RHS.

(b) *Borrowers not currently receiving payment subsidy.* Payment assistance may be granted to borrowers not currently receiving payment subsidy

whose loans were approved on or after August 1, 1968, whose income does not exceed the applicable low-income limit for the area, are personally occupying the RHS financed property, and who meet the requirements of § 3550.53(b), (e), and (f). In general, to receive payment assistance the term of the loan at closing must have been at least 25 years. If an account has been reamortized and the initial term of the loan was at least 25 years, payment assistance may be granted even though the term of the reamortized loan is less than 25 years. Payment assistance may be granted on a subsequent loan for repairs with a term of less than 25 years.

(c) *Cancellation of payment subsidy.* RHS will cancel a payment subsidy if the borrower does not occupy the property, has sold or transferred title to the property, or is no longer eligible for payment subsidy.

§ 3550.158 Active military duty.

The Soldiers and Sailors 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. Active military duty does not include participation in a military reserve or the National Guard unless the borrower is called to active duty.

(a) *Amount of assistance.* If a borrower qualifies for payment subsidy after reduction of the interest rate to six percent, the amount of payment subsidy 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 a six percent interest rate. The six percent interest rate will be effective with the first payment due after RHS confirms the active military status of the borrower.

(b) *Change of active military status.* The borrower must notify RHS when he or she is no longer on active military duty. RHS will cancel the six percent interest rate and resume use of the promissory note interest rate. A new payment subsidy agreement may be processed if the borrower is eligible.

§ 3550.159 Borrower actions requiring RHS approval.

(a) *Mineral leases.* Borrowers who wish to lease mineral rights to a security property must request authorization from RHS. RHS may consent to the lease of mineral rights and subordinate its liens to the lessee's rights and interests in the mineral activity if the security property will remain suitable as a residence and the Government's security interest will not be adversely

affected. Subordination of RHS loans to a mineral lease does not entitle the leaseholder to any proceeds from the sale of the security property.

(1) If the proposed activity is likely to decrease the value of the security property, RHS may consent to the lease only if the borrower assigns 100 percent of the income from the lease to RHS to be applied to reduce principal and the rent to be paid is at least equal to the estimated decrease in the market value of the security.

(2) If the proposed activity is not likely to decrease the value of the security property, RHS may consent to the lease if the borrower agrees to use any damage compensation received from the lessee to repair damage to the site or dwelling, or to assign it to RHS to be applied to reduce principal.

(b) *Subordination.* RHS may subordinate its interests to permit a borrower to defer recapture amounts and refinance the loan, or to obtain a subsequent loan with private credit.

(1) When it is in the best interest of the Government, subordination will be permitted if:

(i) The other lender will verify that the funds will be used for purposes for which an RHS loan could be made;

(ii) The prior lien debt will be on terms and conditions that the borrower can reasonably be expected to meet without jeopardizing repayment of the RHS indebtedness;

(iii) Any proposed development will be planned and performed in accordance with 7 CFR part 1924, subpart A or directed by the other lender in a manner which is consistent with that subpart; and

(iv) An agreement is obtained in writing from the prior lienholder providing that at least 30 days prior written notice will be given to RHS before action to foreclose on the prior lien is initiated.

(2) The total amount of debt permitted when RHS subordinates its interests depends on whether the borrower pays off the RHS loan.

(i) For situations in which the borrower is obtaining a subsequent loan from another source and will not pay off the RHS debt, the prior lien debt plus the unpaid balance of all RHS loans, exclusive of recapture, will not exceed the market value of the security.

(ii) For situations in which RHS is subordinating only a deferred recapture amount, the prior lien debt plus the deferred recapture amount will not exceed the market value of the security.

(c) *Partial release of security.* RHS may consent to transactions affecting the security, such as sale or exchange of security property or granting of a right-

of-way across the security property, and grant a partial release provided:

(1) The compensation is:

(i) For sale of the security property, cash in an amount equal to the value of the security being disposed of or rights granted.

(ii) For exchange of security property, another parcel of property acquired in exchange with value equal to or greater than that being disposed of.

(iii) For granting an easement or right-of-way, benefits derived that are equal to or greater than the value of the security property being disposed of.

(2) An appraisal must be conducted if the latest appraisal is more than 1 year old or if it does not reflect market value and the amount of consideration exceeds \$5,000. The appraisal fee will be charged to the borrower.

(3) The security property, after the transaction is completed, will be an adequate but modest, decent, safe, and sanitary dwelling and related facilities.

(4) Repayment of the RHS debt will not be jeopardized.

(5) If applicable, the environmental requirements of 7 CFR part 1940, subpart G are met.

(6) When exchange of all or part of the security is involved, title clearance is obtained before release of the existing security.

(7) Proceeds from the sale of a portion of the security property, granting an easement or right-of-way, damage compensation, and all similar transactions requiring RHS consent, will be used in the following order:

(i) To pay customary and reasonable costs related to the transaction that must be paid by the borrower.

(ii) To be applied on a prior lien debt, if any.

(iii) To be applied to RHS indebtedness or used for improvements to the security property in keeping with purposes and limitations applicable for use of RHS loan funds. Proposed development will be planned and performed in accordance with 7 CFR part 1924, subpart A and supervised to ensure that the proceeds are used as planned.

(d) *Lease of security property.* A borrower must notify RHS if they lease the property. If the lease is for a term of more than 3 years or contains an option to purchase, RHS may liquidate the loan. During the period of any lease, the borrower is not eligible for a payment subsidy or special servicing benefits.

§ 3550.160 Refinancing with private credit.

(a) *Objective.* RHS direct loan programs are not intended to supplant or compete with private credit sources. Therefore, borrowers are required to

refinance RHS loans with private credit sources when RHS determines that the borrower meets RHS criteria.

(b) *Criteria for refinancing with private credit.* Borrowers must refinance with private credit when RHS determines that the borrower has the ability to obtain other credit at reasonable rates and terms based on their income, assets, and credit history. Reasonable rates and terms are those commercial rates and terms that borrowers are expected to meet when borrowing for similar purposes. Differences in interest rates and terms between RHS and other lenders will not be an acceptable reason for a borrower to fail to refinance with private credit if the available rates and terms are within the borrower's ability to pay.

(c) *Notice of requirement to refinance with private credit.* The financial status of all borrowers may be reviewed periodically to determine their ability to refinance with private credit. A borrower's financial status may be reviewed at any time if information becomes available to RHS that indicates that the borrower's circumstances have changed.

(1) A borrower undergoing review is required to supply, within 30 days of a request from RHS, sufficient financial information to enable RHS to determine the borrower's ability to refinance with private credit. Foreclosure action may be initiated against any borrower who fails to respond.

(2) When RHS determines that a borrower has the ability to refinance with private credit, the borrower will be required to refinance within 90 days.

(3) Within 30 days after being notified of the requirement to refinance with private credit, a borrower may contest the RHS decision and provide additional financial information to document an inability to refinance with private credit.

(d) *Failure to refinance with private credit.*

(1) If the borrower is unable to secure private credit, the borrower must submit written statements and documentation to RHS showing:

(i) The lenders contacted.

(ii) The amount of the loan requested by the borrower and the amount, if any, offered by the lenders.

(iii) The rates and terms offered by the lenders or the specific reasons why other credit is not available.

(iv) The information provided by the borrower to the lenders regarding the purpose of the loan.

(2) If RHS determines that the borrower's submission does not demonstrate the borrower's inability to refinance with private credit, or if the

borrower fails to submit the required information, foreclosure may be initiated.

(e) *Subordination of recapture amount.* RHS may subordinate its interest in any deferred recapture amount to permit a borrower to refinance with private credit. The amount to which the RHS debt will be subordinated may include:

(1) The amount required to repay the RHS debt, exclusive of recapture;

(2) Reasonable closing costs;

(3) Up to one percent of the loan amount for loan servicing costs, if required by the lender; and

(4) The cost of any necessary repairs or improvements to the security property.

(f) *Application for additional credit.* A borrower who has been asked to refinance with private credit will not be considered for additional credit until the refinancing issue is resolved unless such additional credit is necessary to protect the Government's interest.

§ 3550.161 Final payment.

(a) *Payment in full.* Full payment of a borrower's account includes repayment of principal and outstanding interest, unauthorized assistance, recapture amounts, and charges made to the borrower's account. Any supervised funds or funds remaining in a borrower's escrow account will be applied to the borrower's account or returned to the borrower.

(b) *Release of security instruments.* RHS may release security instruments when full payment of all amounts owed has been received and verified. If RHS and the borrower agree to settle the account for less than the full amount owed, the security instruments may be released when all agreed-upon amounts are received and verified. Security instruments will not be released until any deferred recapture amount has been paid in full.

(c) *Payoff statements.* At the borrower's request, RHS will provide a written statement indicating the amount required to pay the account in full. RHS may charge a fee for statements for the same account if more than 2 statements are requested in any 30 day period.

(d) *Suitable forms of payment.* Suitable forms of payment are: check, money order, or bank draft. Borrowers who make cash payments will be assessed a fee to cover conversion to a money order.

(e) *Recording costs.* Recording costs for the release of the mortgage will be the responsibility of the borrower, except where State law requires the mortgagee to record or file the satisfaction.

§ 3550.162 Recapture.

(a) *Recapture policy.* Borrowers with loans approved or assumed on or after October 1, 1979, will be required to repay subsidy amounts received through payment subsidy or deferred mortgage assistance. Amounts to be recaptured are due and payable when the borrower transfers title or ceases to occupy the property.

(b) *Amount to be recaptured.*

(1) The maximum amount to be recaptured is the amount of principal reduction attributed to subsidy and the lesser of:

- (i) The amount of subsidy received; or
- (ii) 50 percent of the value appreciation.

(2) The value appreciation of a property with a cross-collateralized loan is based on the market value of the dwelling; and if located on a farm, the dwelling and a minimum adequate site.

(3) Interest reduced from the promissory note rate to six percent under the Soldiers and Sailors Relief Act is not subject to recapture.

(c) *Option to defer payment of recapture amounts.*

(1) Borrowers may defer payment of recapture amounts if the loan is repaid, the title does not transfer, and the borrower continues to occupy the property.

(2) The RHS mortgage securing the deferred recapture amount may be subordinated to permit refinancing if the RHS mortgage will be adequately secured.

(3) Borrowers eligible to defer recapture may receive a discount on the recapture amount due if the recapture amount is paid along with the final payment, or in the case of a final installment, within 60 days of the date RHS notifies the borrower that recapture may be due.

(d) *Borrower ceases to occupy the property.* When a borrower ceases to occupy a property:

(1) The borrower may pay the recapture amount in full or reamortize the existing loan to include the recapture amount.

(2) If the borrower does not pay the recapture amount or consent to reamortization within 30 days, RHS may proceed with foreclosure.

(e) *Assumed loans.*

(1) When a loan subject to recapture is assumed under new rates and terms, the recapture amount may be paid in full by the seller or included in the principal amount assumed by the buyer.

(2) When a loan is assumed under the terms of the promissory note, recapture amounts will not be due. When the new borrower transfers title or ceases to occupy the property, all subsidy subject

to recapture before and after the assumption is due.

(3) When a borrower has deferred payment of recapture amounts, the deferred recapture amount may be included in the principal amount of the new loan.

§ 3550.163 Transfer of security and assumption of indebtedness.

(a) *General policy.* RHS mortgages contain due-on-sale clauses that generally require RHS consent before title to a security property can be transferred with an assumption of the indebtedness. If it is in the best interest of the Government, RHS will approve the transfer of title and assumption of indebtedness on program or nonprogram (NP) terms, depending on the transferee's eligibility and the property's characteristics.

(b) *RHS approval of assumptions.*

(1) A borrower with a loan on program terms who wishes to transfer a security property restricted by a due-on-sale clause to a purchaser who wishes to assume the debt must receive prior authorization from RHS. If RHS authorizes the transfer and assumption, the account will be serviced in the purchaser's name and the purchaser will be liable for the loan under the terms of the security instrument.

(2) If a borrower sells a security property with a due-on-sale clause without obtaining RHS authorization, RHS will not approve assumption of the indebtedness, and the loan will be liquidated unless RHS determines that it is in the Government's best interest to continue the loan. If RHS decides to continue the loan, the account will be serviced in the original borrower's name and the original borrower will remain liable for the loan under the terms of the security instrument.

(c) *Exceptions to due-on-sale clauses.*

(1) Due-on-sale clauses are not triggered by the following types of transfers:

(i) A transfer from the borrower to a spouse or children not resulting from the death of the borrower.

(ii) A transfer to a relative, joint tenant, or tenant by the entirety resulting from the death of the borrower.

(iii) A transfer to a spouse or ex-spouse resulting from a divorce decree, legal separation agreement, or property settlement agreement.

(iv) 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.

(v) A transfer into an inter vivos trust in which the borrower does not transfer rights of occupancy in the property.

(2) A transferee who obtains property through one of the types of transfer listed in paragraph (c)(1) of this section:

(i) Is not required to assume the loan, and RHS is not permitted to liquidate the loan, if the transferee continues to make scheduled payments and meet all other obligations of the loan. A transferee who does not assume the loan is not eligible for payment assistance or a moratorium.

(ii) May assume the loan on the rates and terms contained in the promissory note, with no down payment. If the account is past due at the time an assumption is executed, the account may be brought current by using any of the servicing methods discussed in subpart E of this part.

(iii) May assume the loan under new rates and terms if the transferee applies and is program-eligible.

(3) Any subsequent transfer of title, except upon death of the inheritor or between inheritors to consolidate title, will be treated as a sale.

(d) *Requirements for an assumption.*

(1) Loans secured by program-eligible properties to be assumed by program-eligible purchasers may be assumed on program terms. Loans secured by nonprogram properties and loans to be assumed by purchasers who are not eligible for program terms may be assumed on NP terms.

(2) The amount the transferee will assume will be either the current market value less any prior liens and any required down payment, or the indebtedness, whichever is less.

(3) For loans assumed on program terms, the interest rate charged by RHS will be the rate in effect at loan approval or loan closing, whichever is lower. For loans assumed on nonprogram terms, the interest rate will be the rate in effect at the time of loan approval.

(4) If additional financing is required to purchase the property or to make repairs, RHS may approve a subsequent loan under subparts B or C of this part.

(5) If an appraisal is required for an assumption on new terms, the purchaser is responsible for the appraisal fee.

(6) If all or a portion of the borrower's account balance is assumed, the borrower and cosigner, if any, will be released from liability on the amount of the indebtedness assumed. If an account balance remains after the assumption, RHS may pursue debt settlement in accordance with subpart F of this part.

(7) Unless it is in the Government's best interest, RHS will not approve an

assumption of a secured loan if the seller fails to repay any unsecured RHS loan.

(8) If a loan is secured by a property with a dwelling situated on more than a minimum adequate site and the excess property cannot be sold separately as a minimum adequate site for another dwelling, RHS may approve a transfer of the entire property. If the excess property can be sold separately as a minimum adequate site, RHS will approve assumption of only the dwelling and the minimum adequate site. If the value of the dwelling on the minimum adequate site is less than the amount of the outstanding RHS debt, the remaining debt will be secured by the excess property. The outstanding debt will be converted to an NP loan and reamortized over a period not to exceed 10 years or the final due date of the original promissory note, whichever is sooner.

§ 3550.164 Unauthorized assistance.

(a) *Definition.* Unauthorized assistance includes any loan, payment subsidy, deferred mortgage payment, or grant for which the recipient was not eligible.

(b) *Unauthorized assistance due to false information.*

(1) False information includes information that the recipient knew was incorrect or should have known was incorrect that was provided or omitted for the purposes of obtaining assistance for which the recipient was not eligible.

(2) If the recipient receives an unauthorized loan due to false information, RHS will adjust the account using the NP interest rate that was in effect when the loan was approved. The recipient must pay the account in full within 30 days.

(3) If the recipient receives unauthorized subsidy due to false information, RHS will require the recipient to repay it within 30 days. The account cannot be reamortized to include the unauthorized subsidy. If the recipient repays the unauthorized subsidy, the loan may be continued.

(c) *Unauthorized assistance due to inaccurate information.*

(1) Inaccurate information includes incorrect information inadvertently provided, used, or omitted without the intent to obtain benefits for which the recipient was not eligible.

(2) RHS will permit a recipient who receives an unauthorized loan due to inaccurate information to retain the loan under the following conditions.

(i) If the inaccurate information was related to the purpose of the loan or the recipient's eligibility, with the exception of income, or the income used

was incorrect, but the recipient still qualified as income-eligible, RHS will allow the recipient to continue the loan on existing terms.

(ii) If a section 502 recipient's income was above the moderate-income level, RHS will convert the loan to an NP loan, using the nonprogram interest rate in effect on the date the loan was approved.

(iii) If a section 504 recipient's income was above the very low-income level, RHS will apply the applicable 502 or nonprogram interest rate in effect on the date the loan was approved.

(iv) If an incorrect interest rate was used, RHS will adjust the account using the correct interest rate.

(3) If the recipient receives unauthorized subsidy due to inaccurate information, RHS will require the recipient to repay it within 30 days. If the recipient cannot repay it within 30 days, the account may be reamortized. If the recipient repays the unauthorized subsidy or reamortizes the loan, the loan may be continued.

(d) *Unauthorized grants.* Recipients may either repay the unauthorized assistance in a lump sum or execute a promissory note, regardless of whether the unauthorized assistance was due to false or inaccurate information. RHS may seek a judgment if the recipient refuses to repay the unauthorized assistance.

(e) *Account servicing.* RHS will adjust all accounts retroactively to establish the amount of unauthorized assistance. If the recipient does not repay the unauthorized assistance within 30 days, RHS may accelerate the loan. If the unauthorized assistance is due to inaccurate information and the recipient is unable to repay within 30 days, RHS may reamortize the loan.

(f) *Accounts with no security.* If an unauthorized loan or grant is unsecured, RHS may seek the best mortgage obtainable.

§§ 3550.165–3550.199 [Reserved]

§ 3550.200 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0166. Public reporting burden for this collection of information is estimated to vary from 5 minutes to 3 hours per response, with an average of 1½ hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to the Department of Agriculture, Clearance Officer, STOP 7602, 1400 Independence Avenue, SW., Washington, DC 20250–7602. You are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Subpart E—Special Servicing

§ 3550.201 Purpose of special servicing actions.

The Rural Housing Service (RHS) may approve special servicing actions to reduce the number of borrower failures that result in liquidation. Borrowers who have difficulty keeping their accounts current may be eligible for one or more available servicing options including: payment assistance; delinquency workout agreements that temporarily modify payment terms; protective advances of funds for taxes, insurance, and other approved costs; payment moratoriums; and reamortization of the loan.

§ 3550.202 Past due accounts.

An account is past due if the scheduled payment is not received by the due date, or as authorized by State law.

(a) *Late fee.* A late fee will be assessed if the full scheduled payment is not received by the 15th day after the due date.

(b) *Liquidation.*

(1) *For borrowers with monthly payments.* The account may be accelerated without further servicing when at least 3 scheduled payments are past due or an amount equal to at least 2 scheduled payments is past due for at least 3 consecutive months. In such cases RHS may pursue voluntary liquidation and foreclosure.

(2) *For borrowers with annual payments.* The account may be accelerated without further servicing when at least ¾ of 1 scheduled payment has not been received by its due date. In such cases, RHS may pursue voluntary liquidation and foreclosure.

§ 3550.203 General servicing actions.

Whenever any of the servicing actions described in this subpart result in reamortization of the account RHS may:

(a) Require a borrower who currently makes annual payments, but receives a monthly income, to convert to monthly payments.

(b) Require the creation and funding of an escrow account for real estate

taxes and insurance, if one does not already exist for any borrower with monthly payments.

(c) Convert the method of calculating interest for any account being charged daily simple interest to an amortized payment schedule.

§ 3550.204 Payment assistance.

Borrowers who are eligible may be offered payment assistance in accordance with subpart B of this part. Borrowers who are not eligible for payment assistance because the loan was approved before August 1, 1968, or the loan was made on above-moderate or nonprogram (NP) terms, may refinance the loan in order to obtain payment assistance if:

(a) The borrower is eligible to receive a loan with payment assistance;

(b) Due to circumstances beyond the borrower's control, the borrower is in danger of losing the property; and

(c) The property is program-eligible.

§ 3550.205 Delinquency workout agreements.

Borrowers with past due accounts may be offered the opportunity to avoid liquidation by entering into a delinquency workout agreement that specifies a plan for bringing the account current. To receive a delinquency workout agreement, the following requirements apply:

(a) A borrower who is able to do so will be required to pay the past-due amount in a single payment.

(b) A borrower who is unable to pay the past-due amount in a single payment must pay monthly all scheduled payments plus an agreed upon additional amount that brings the account current within 2 years or the remaining term of the loan, whichever is shorter.

(c) If a borrower becomes more than 30 days past due under the terms of a delinquency workout agreement, RHS may cancel the agreement.

§ 3550.206 Protective advances.

RHS may pay for fees or services and charge the cost against the borrower's account to protect the Government's interest.

(a) *Advances for taxes and insurance.* RHS may advance funds to pay real estate taxes, hazard and flood insurance premiums, and other related costs, as well as amounts needed to fund the current escrow cycle.

(b) *Advances for costs other than taxes and insurance.* Protective advances for costs other than taxes and insurance, such as emergency repairs, will be made only if the borrower cannot obtain a subsequent loan.

(c) Repayment arrangements.

(1) Advances for borrowers with multiple loans will be charged against the largest loan.

(2) Amounts advanced will be due with the next scheduled payment. RHS may schedule repayment consistent with the borrowers ability to repay or reamortize the loan.

(3) Advances will bear interest at the promissory note rate of the loan to which the advance was charged.

§ 3550.207 Payment moratorium.

RHS may defer a borrowers scheduled payments for up to 2 years. NP borrowers are not eligible for a payment moratorium.

(a) *Borrower eligibility.* For a borrower to be eligible for a moratorium, all of the following conditions must be met:

(1) Due to circumstances beyond the borrower's control, the borrower is temporarily unable to continue making scheduled payments because:

(i) The borrower's repayment income fell by at least 20 percent within the past 12 months;

(ii) The borrower must pay unexpected and unreimbursed expenses resulting from the illness, injury, or death of the borrower or a family member; or

(iii) The borrower must pay unexpected and unreimbursed expenses resulting from damage to the security property in cases where adequate hazard insurance was not available or was prohibitively expensive.

(2) The borrower occupies the dwelling, unless RHS determines that it is uninhabitable.

(3) The borrower's account is not currently accelerated.

(b) Reviews of borrower eligibility.

(1) Periodically RHS may require the borrower to submit financial information to demonstrate that the moratorium should be continued. The moratorium may be canceled if:

(i) The borrower does not respond to a request for financial information;

(ii) RHS receives information indicating that the moratorium is no longer required; or

(iii) In the case of a moratorium granted to pay unexpected or unreimbursed expenses, the borrower cannot show that an amount at least equal to the deferred payments has been applied toward the expenses.

(2) At least 30 days before the moratorium is scheduled to expire, RHS will require the borrower to provide financial information needed to determine whether the borrower is able to resume making scheduled payments.

(c) *Resumption of scheduled payments.* When the borrower is able to

resume scheduled payments, the loan will be reamortized to include the amount deferred during the moratorium and the borrower will be required to escrow. If the new monthly payment, after consideration of the maximum amount of payment subsidy available to the borrower, exceeds the borrower's repayment ability, all or part of the interest that has accrued during the moratorium may be forgiven.

(d) *Borrowers unable to resume scheduled payments.* If even after all appropriate servicing actions have been taken the borrower is unable to resume making scheduled payments after 2 consecutive years of being on a moratorium, the account will be liquidated.

§ 3550.208 Reamortization using promissory note interest rate.

Reamortization using the promissory note interest rate may be authorized when RHS determines that reamortization is required to enable the borrower to meet scheduled obligations, and only if the Government's lien priority is not adversely affected.

(a) *Permitted uses.* Reamortization at the promissory note interest rate may be used to accomplish a variety of servicing actions, including to:

(1) Repay unauthorized assistance due to inaccurate information.

(2) Repay principal and interest accrued and advances made during a moratorium.

(3) Bring current an account under a delinquency workout agreement after the borrower has demonstrated the willingness and ability to meet the terms of the loan and delinquency workout agreement and reamortization is in the borrower's and Government's best interests.

(4) Bring a delinquent account current in the case of an assumption where the due on sale clause is not triggered as described in § 3550.163(c).

(5) Cover the remaining debt when a portion of the security property is being transferred but the acquisition price does not cover the outstanding debt. The remaining balance will be reamortized for a period not to exceed 10 years or the final due date of the note being reamortized, whichever is sooner.

(b) *Payment term of reamortized loan.* Except as noted in paragraph (a)(6) of this section, the term of the reamortized loan may be extended to the maximum term for which the borrower was eligible at the time the loan was originally made, less the number of years the loan has been outstanding. In all cases, the term must not exceed the remaining security life of the property.

§ 3550.209 [Reserved]**§ 3550.210 Offsets.**

Any money that is or may become payable from the United States to an RHS borrower may be subject to administrative, salary, or Internal Revenue Service (IRS) offsets for the collection of a debt owed to RHS.

(a) *IRS offset.* RHS may take action to effect offset of claims due RHS against tax refunds due to RHS debtors under 26 U.S.C. 6402, in accordance with the provisions of 31 U.S.C. 3720A and 26 CFR 301.6402-6.

(b) *Salary offset.* Offset of claims due to RHS may be collected pursuant to the salary offset provisions in 7 CFR part 3, subpart C for a federal employee or other persons covered in that subpart.

(c) *Administrative offset.* RHS may take action to effect administrative offset to recover delinquent claims due to it in accordance with the procedures in 7 CFR part 3, subpart B.

(d) *Offset by other federal agencies.* Escrow funds and loan and grant funds held or payable by RHS are not subject to offset by other federal agencies.

§ 3550.211 Liquidation.

(a) *Policy.* When RHS determines that a borrower is unable or unwilling to meet loan obligations, RHS may accelerate the loan and, if necessary, acquire the security property. The borrower is responsible for all expenses associated with liquidation and acquisition. If the account is satisfied in full, the borrower will be released from liability. If the account is not satisfied in full, RHS may pursue any deficiency unless the borrower received a moratorium at any time during the life of the loan and faithfully tried to repay the loan.

(b) *Tribal allotted or trust land.* Liquidations involving a security interest in tribal allotted or trust land shall only be pursued after offering to transfer the account to an eligible tribal member, the tribe, or the Indian Housing Authority. Forced liquidation of RHS security interests in Indian trust lands or on tribal allotted land will be recommended only after the State Director has determined it is in the best interest of the Government.

(c) *Acceleration and foreclosure.* If RHS determines that foreclosure is in the best interest of the Government, RHS will send an acceleration notice to each borrower and any cosigner. If the borrower does not pay the full account balance and meet the other terms of the loan within 30 days of acceleration, RHS may foreclose. RHS will not accept partial payment of an accelerated loan

unless required to accept the payment by State law.

(d) *Voluntary liquidation.* Borrowers may voluntarily liquidate through:

(1) *Refinancing or sale.* The borrower may refinance or sell the security property for at least net recovery value and apply the proceeds to the account.

(2) *Deed in lieu of foreclosure.* RHS may accept a deed in lieu of foreclosure to convey title to the security property only after the debt has been accelerated and when it is in the Government's best interest.

(3) *Offer by third party.* If a junior lienholder or cosigner makes an offer in the amount of at least the net recovery value, RHS may assign the note and mortgage.

(e) *Bankruptcy.*

(1) When a petition in bankruptcy is filed by a borrower after acceleration, collection actions and foreclosure actions are suspended in accordance with the provisions of the Bankruptcy Code.

(2) RHS may accept conveyance of security property by the trustee in bankruptcy if the Bankruptcy Court has approved the transaction, RHS determines the conveyance is in the best interest of the Government, and RHS will acquire title free of all liens and encumbrances except RHS liens.

(3) Whenever possible in a Chapter 7 Bankruptcy, a reaffirmation agreement will be signed by the borrower and approved by the court prior to discharge, if RHS decides to continue with the borrower.

(f) *Junior lienholder foreclosure.* When a junior lienholder foreclosure does not result in payment in full of the RHS debt but the property is sold subject to the RHS lien, RHS may liquidate the account unless the new owner is eligible to assume the RHS debt and actually assumes the RHS debt.

(g) *Payment subsidy.* If the borrower is receiving payment subsidy, the payment subsidy agreement will not be canceled when the debt is accelerated, but will not be renewed unless the account is reinstated.

(h) *Eligibility for special servicing actions.* A borrower is not eligible for special servicing actions once the account has been accelerated.

(i) *Reporting.* RHS may report to IRS and credit reporting agencies any debt settled through liquidation.

§§ 3550.212-3550.249 [Reserved]**§ 3550.250 OMB control number.**

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget

(OMB) and have been assigned OMB control number 0575-0166. Public reporting burden for this collection of information is estimated to vary from 5 minutes to 3 hours per response, with an average of 1½ hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to the Department of Agriculture, Clearance Officer, STOP 7602, 1400 Independence Avenue, SW., Washington, DC 20250-7602. You are not required to respond to this collection of information unless it displays a currently valid OMB control number.

Subpart F—Post-Servicing Actions**§ 3550.251 Property management and disposition.**

(a) *Policy.* Rural Housing Service (RHS) will manage custodial property and Real Estate Owned (REO) property to protect the Government's interest, and may dispose of REO property through direct sales, sealed bid, or auction. RHS will follow affirmative fair housing marketing policies.

(b) *Custodial property.* RHS may take custodial possession of security property that has been abandoned, or for other reasons necessary to protect the Government's security. After taking custodial possession of a security property, RHS may maintain and repair the security property as needed to protect the Government's interest, pay required real estate taxes and assessments, and secure personal property left on the premises. Expenses will be charged to the borrower's account. Custodial property may be leased when it is in the Government's best interest and in such cases the borrower's account will be credited for income from the security property.

(c) *REO property.*

(1) *Classification.* When RHS takes title to a security property, it is classified as either program or nonprogram (NP) property. An REO property that is eligible for financing under the section 502 program, or which could reasonably be repaired to be eligible, is classified as program property. An REO property that cannot reasonably be repaired to be eligible as section 502 property, and property that has been improved to a point that it will no longer qualify as modest under section 502, is classified as NP property.

(2) *Disclosing decent, safe, and sanitary defects.* When RHS determines that an REO property to be sold is not decent, safe, and sanitary, or does not meet cost-effective energy conservation standards, it will disclose the reasons why. The deed by which such an REO property is conveyed will contain a covenant restricting it from residential use until it is decent, safe, and sanitary and meets the RHS cost-effective energy conservation standards. RHS will also notify any potential purchaser of any known lead-based paint hazards.

(3) *Property on Indian tribal allotted or trust land.* REO property which is located on Indian tribal allotted or trust land, will be sold or otherwise disposed of only to a member of the particular tribe having jurisdiction over the allotted or tribal land, to the tribe, or to an Indian housing authority serving the tribe on a first-come, first-served basis.

(4) *Reservation of program REO properties.*

(i) Program REO properties are reserved for program-eligible applicants and nonprofit organizations or public bodies providing transitional housing during the first 60 days after the date of the first notice of sale, and during the first 30 days following any reduction in price or any other change in credit terms or other sale terms. After the expiration of a reservation period, program REO properties can be bought by any buyer.

(ii) An offer on a program REO property from a buyer who does not qualify for a section 502 program loan may be submitted during a reservation period, but is considered to have been received on the day after the reservation period ends.

(iii) No offer is considered until 3 business days after the date the property is offered for sale. An offer received during the 3-day holding period is not considered until the 4th day, and is evaluated with any other offers actually received on the 4th day.

(5) *Priority of offers received the same day.*

(i) Offers received on the same business day are selected in the following order:

(A) Offers from program-eligible applicants, with a request for credit on program terms. All offers are evaluated as if they were submitted at the listed price, regardless of the offering price.

(B) Offers from nonprofits or public bodies for conversion to use as transitional housing or for other special purposes as specified in paragraph (d)(4) of this section.

(C) Cash offers, from highest to lowest.

(D) NP credit offers, from highest to lowest.

(ii) Acceptable offers of equal priority received on the same business day are selected by lot.

(iii) REO properties are not held off the market pending the outcome of an appeal of RHS rejection of a request for financing.

(6) *Sale by sealed bid or auction.* RHS may authorize the sale of an REO property by sealed bid or public auction when it is in the best interest of the Government. RHS will publicly solicit requests for sealed bids and publicize auctions. If a successful bidder is unable to settle the transaction under the terms of the offer, except for the financing contingency, any required bid deposit may be retained by RHS. If the highest bid is lower than the minimum acceptable bid established by RHS, or if no acceptable bids are received, RHS may negotiate a sale without further public notice.

(d) *Special purposes.*

(1) REO property may be purchased for conversion to multiple family housing.

(2) When a nonprofit organization or public body notifies RHS in writing of its intent to buy an REO property to provide transitional housing for the homeless, RHS may withdraw the property from the market for up to 30 days to give the entity an opportunity to execute a purchase contract. The listed price may be discounted for offers on a nonprogram REO property at any time, and on a program REO property after the 60-day reservation period. No down payment is required, and the loan term will be for a maximum of 30 years. Until RHS executes a sales agreement, an offer from a program-eligible applicant will receive priority, regardless of a nonprofit's interest in purchasing the REO property for use as transitional housing.

(3) NP properties may be leased to a nonprofit organization or public body to provide transitional housing for the homeless at an annual cost of one dollar. When an REO property is to be leased as transitional housing, RHS will make repairs needed to put the property in decent, safe, and sanitary condition. The lessee is responsible for all future repairs and maintenance.

(4) REO property may be sold under special provisions to nonprofit organizations or public bodies for the purpose of providing affordable housing to very low- and low-income families.

§ 3550.252 Debt settlement policies.

(a) *Applicability.* Debt settlement procedures may be initiated to collect any amounts due to RHS including:

(1) Balances remaining on loan accounts after all liquidation proceeds or credits have been applied;

(2) Subsidy recapture or grant amounts due; and

(3) Unauthorized assistance due.

(b) *Judgment.* RHS may seek a judgment whenever a judgment might enable RHS to collect all or a significant portion of an amount owed.

(c) *Multiple loans.* RHS does not settle debts for one loan while other RHS loans on the same security property remain active.

(d) *Cosigners and claims against estates.* RHS may use any and all remedies available under law to collect from any cosigner and from a deceased borrower's estate.

(e) *Reporting.* RHS will report to the Internal Revenue Service and credit reporting agencies any debt settled through cancellation, compromise, or adjustment.

(f) *Settlement during legal or investigative action.* Cases that are under investigation for fiscal irregularity or have been referred to the Office of the Inspector General, the Office of the General Counsel, or the U.S. Attorney will not be considered for debt settlement until final action by the investigating or prosecuting entity has been taken.

(g) *Offsets.* RHS may request offsets as described in § 3550.210 to collect amounts owed.

(h) *Escrow funds.* At liquidation all funds held in escrow or unapplied funds will be applied against the debt.

§ 3550.253 Settlement of a debt by compromise or adjustment.

Compromise or adjustment offers may be initiated by the debtor or by RHS. RHS will approve only those compromises and adjustments that are in the best interest of the Government.

(a) *Compromise.* A compromise is an agreement by RHS to release a debtor from liability upon receipt of a specified lump sum that is less than the total amount due.

(b) *Adjustments.* An adjustment is an agreement by RHS to release a debtor from liability generally upon receipt of an initial lump sum representing the maximum amount the debtor can afford to pay and periodic additional payments over a period of up to 5 years.

(c) *Timing of offers.*

(1) For a settlement offer to be considered, secured debts must be fully matured under the terms of the debt instrument or must have been accelerated by RHS.

(2) Unsecured debts owed after the sale of the security property may be proposed for compromise or adjustment

at any time. Debts that were never secured may be proposed for compromise or adjustment when they are due and payable.

(d) *Retention of security property.* The debtor may retain the security property if the compromise payment is at least equal to the net recovery value, and it is in the best interest of the Government to allow the debtor to retain the security property.

§§ 3550.254–3550.299 [Reserved]

§ 3550.300 OMB control number.

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regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0166. Public reporting burden for this collection of information is estimated to vary from 5 minutes to 3 hours per response, with an average of 1½ hours per response, including time for review instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including

suggestions for reducing this burden to the Department of Agriculture, Clearance Officer, STOP 7602, 1400 Independence Avenue, SW., Washington, DC 20250–7602.

Dated: November 14, 1996.

Jill Long Thompson,

Undersecretary, Rural Development.

Dated: November 15, 1996.

James W. Schroeder,

Acting Undersecretary, Farm and Foreign Agricultural Services.

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