

Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF AGRICULTURE

Rural Housing Service

7 CFR Part 3550

RIN 0575-AB17; RIN 0575-AB80; RIN 0575-AB99; RIN 0575-AC00

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

AGENCY: Rural Housing Service, United States Department of Agriculture (USDA).

ACTION: Proposed rule.

SUMMARY: The Rural Housing Service (RHS), formerly the Rural Housing and Community Development Service (RHCDS), a successor agency to the Farmers Home Administration (FmHA), proposes to streamline and reengineer its regulations and to utilize private sector processes and techniques in the administration of its direct Single Family Housing (SFH) portfolio. This action is taken to reduce regulations, improve customer service, and improve the agency's ability to achieve greater efficiency, flexibility, and effectiveness in managing its SFH portfolio. The agency is centralizing the servicing of its SFH portfolio loans to provide more timely and consistent supervised credit. The effect of this action is to provide better service and reduce the Code of Federal Regulations (CFR) coverage of the SFH program by an estimated 90 percent.

DATES: Comments must be received on or before June 7, 1996.

ADDRESSES: Submit written comments in duplicate to the Director, Regulations and Paperwork Management Division, Rural Housing Service, U.S. Department of Agriculture, Room 6348, South Agriculture Building, Washington, DC 20250. All written 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: Jean Leavitt, Senior Loan Specialist, Single

Family Housing Servicing and Property Management Division, RHS, room 5307, South Agriculture Building, Washington, DC, 20250, telephone (202) 720-1452.

SUPPLEMENTARY INFORMATION:

Classification

This proposed 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.

Executive Order 12778

This proposed rule has been reviewed under Executive Order 12778, Civil Justice Reform. If this proposed rule is adopted: (1) unless otherwise specifically provided 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 except as specifically prescribed in the rule; and (3) administrative proceedings of the National Appeals (7 CFR Part 11) must be exhausted before bringing suit.

Unfunded Mandate Reform Act

Title II of the Unfunded Mandate Reform Act of 1995 (UMRA), Public Law 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, federal agencies generally must prepare a written statement, including 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 16 separate regulations totaling 290 pages in the CFR.

Earlier this year, RHS 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 16 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 16 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%.

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 the proposed 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 proposed 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.

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 Loans and Grants (Section 504 Rural Housing Loans and Grants).

Intergovernmental Consultation

These programs are not subject to the provision of Executive Order 12372 which requires intergovernmental consultation with state and local officials. See 7 CFR part 3015, subpart V (48 FR 29112, June 24, 1983) and FmHA Instruction 1940-J, "Intergovernmental Review of Farmers Home Administration Programs and Activities."

Background Information

An Overview

The RHS is taking the next steps in the reengineering and reinvention of the manner in which direct Section 502 and Section 504 loans and grants 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 proposed 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.

The RHS has over 725,000 direct Section 502 and 504 loans with approximately 625,000 customers in its portfolio. With our Fiscal Year (FY) 1996 direct section 502 and 504 loan appropriation, the Agency anticipates making 35,000 new direct SFH loans this year. The accounting system established by FmHA to maintain its vast farm, housing, community and

business loan programs is severely outdated and 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 services 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. The Agency intends to begin implementing this system on October 1, 1996 with two pilot states. Other states will be phased into the DLOS system through FY 1996 with full implementation anticipated by September 30, 1997. Further information on the implementation of the system follows.

The centralized servicing unit will be 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 will be

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 borrowers 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 undertaken a major redevelopment and consolidation of FmHA regulations affecting the direct Section 502 and 504 programs. At the current time, direct SFH customers are affected, in part, by the following regulations:

- 7 CFR Part 1910, Subpart A—Receiving and Processing Applications.
- 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 B—Collections.
- 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 is consolidating 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 Federal Register. This streamlining makes the regulation more concise and much easier to read and understand. The Agency is developing a separate handbook with administrative matters such as what forms must be filed and where to submit loan requests and the agency's internal processing procedures. This handbook 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 will be implemented over a one year period. Two pilot states will start the process and other states will be added to DLOS over the next 12 months. The 12 month implementation period is critical to ensure for the orderly transfer of account information on 725,000 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. When RHS publishes this Proposed Rule in final, it intends to remove from the CFR the following regulations:

- 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 Account.
- 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.

These regulations deal 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 will be amended at the time of our final rulemaking action to clearly indicate that they no longer apply to the direct SFH programs:

- 7 CFR Part 1910, Subpart A—Receiving and Processing Applications.
- 7 CFR Part 1951, Subpart B—Collections.
- 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.

After the effective date of the final rule, the direct SFH program will be guided by 7 CFR Part 3550. The proposed handbook will provide RHS field personnel and its customers with administrative guidance in states under the DLOS system. In states not yet under the DLOS system, RHS field personnel and its customers will be guided by current FmHA Instructions. These current FmHA Instructions will serve as the handbook for states not under the DLOS system. Where current FmHA Instructions may differ from 7 CFR Part 3550, RHS will make changes to the

current FmHA Instructions to reflect such changes concurrently with publication of the Final Rule.

For example, the proposed regulations provide for a different manner in which interest credit recapture is calculated. Currently, guidance for calculating interest credit recapture is published in 7 CFR Part 1951, Subpart I. The formula for determining recapture is very complex requiring the calculation of the average interest rate and number of months the borrower has lived in the property. In addition, the borrower is not given credit for improvements made to the security property. The proposed rule, in brief, provides credit for improvements and limits recapture to 50% of value appreciation regardless of average interest rate and the length of time the borrower has lived in the property.

When the proposed rule is published in final, RHS intends to remove 7 CFR Part 1951, Subpart I from the CFR. Part 3550 will contain the guidance on calculation of interest credit recapture, and the proposed handbook will provide administrative guidance on handling recapture under the new DLOS computer system. This process will work in states with access to the DLOS computer system. However, in states without access to DLOS, they will be unable to use the proposed handbook. These states will continue to be guided by FmHA Instruction 1951-I which is a duplicate of 7 CFR Part 1951, Subpart I. Although RHS will remove 7 CFR Part 1951, Subpart I from the CFR, the FmHA Instruction will continue to be used in states not under the DLOS computer system until DLOS is fully implemented. RHS will amend FmHA Instruction 1951-I to include the new guidance on calculation of interest credit recapture. In this manner, RHS can ensure that its customers receive equal access to program benefits. Everyone will be guided by 7 CFR Part 3550, and in the aforementioned situation, states under DLOS will look to the proposed handbook for administrative guidance, and states not under DLOS will look to FmHA Instruction 1951-I for administrative guidance. After full implementation of DLOS, all states will operate under the proposed handbook and applicable FmHA Instructions will be removed from field use.

This proposed method will ensure that all borrowers have access to the same program benefits. However, some changes proposed 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 proposed 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, borrowers in states under DLOS will be subject to a late fee. Borrowers in states under the PLAS system will not be subject to a late fee until they are put under the DLOS system. 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 725,000 loans to the new system. Where 7 CFR 3550 provides a customer with any additional program benefits, RHS will ensure that all customers are provided access to these benefits regardless of whether their state is under DLOS.

Technical enhancements to improve program delivery:

(a) Section 502 Loan Origination

Funding Priorities

RHS has clarified the funding priorities for applications needing immediate assistance. Previously, there were four categories which all were eligible for priority funding. These categories for priority funding were hardship applications, self-help housing applications, participation loan applications, and applications for servicing type loans. However, the agency recognizes the need for more explicit guidance in selection of competing applications for limited resources. In the interest of better serving our active borrowers, the agency proposes to provide first priority to active borrowers needing subsequent loans to correct health and safety hazards. The agency is compelled to provide decent, safe and sanitary housing to active borrowers and protect the government's security interest. Second priority is a consolidated grouping giving preference to an application for a hardship loan, Real Estate Owned (REO), a loan related to the transfer of an existing RHS property, a self-help loan and a leveraging loan made in conjunction with funding from the other sources.

Maximum Loan Amount

In order to minimize the impact of instituting escrow accounts for borrowers, the maximum loan amount can include the cost of the charge to establish an escrow account. The amount of the loan can exceed the appraised value by the cost of an appraisal and the cost to establish the escrow account. The agency considered

this a fair practice for the very low- and low-income customers we serve.

Deferred Mortgage Payments

A technical clarification was made which states that the amount deferred will be up to 25 percent of the payment due at one percent when a borrower qualifies for a deferred mortgage.

(b) Section 504 Originations

Net Family Assets

A technical clarification has been made to define net family assets the same as in Section 502. This change will provide consistency in the treatment of assets between the 502 and the 504 program.

Loan and Grant Purposes

Loan and grant funds may be used to refinance a debt incurred for the installation as well as the assessment of utilities, prior to the date of application.

Eligibility of Mobile and Manufactured Homes

The requirement that a mobile or manufactured home must need repairs to remove health and safety hazards as a condition for 504 assistance has been removed. This revision is consistent with meeting program objectives.

(c) Tax Service and the Escrow of Taxes and Insurance

Section 501(e) of the Housing Act of 1949 (42 U.S.C. § 1471(e)) mandates the Agency to establish procedures under which SFH borrowers are required to escrow for the payment of real estate taxes, assessments and insurance.

RHS currently does not maintain escrow accounts for payment of real estate taxes for any of its SFH borrowers. With few exceptions (such as the borrower's name and mailing address) the current loan servicing system (PLAS) has minimal on-line data concerning the borrower and property. Information essential to the escrow process is not maintained on-line in the current system. This loan data is instead, currently maintained in the hard copy files retained in each county office. The primary responsibility for verifying that borrowers have complied with the terms of their mortgage and made the appropriate real estate tax payments resides with the county offices. Methods used to insure that taxes have been paid vary from office to office. These methods include (1) sending listings to tax collectors for tax verification (2) reviewing local newspapers for tax sales and (3) requesting borrowers to provide proof of tax payment. Previously, once taxes have been found to be delinquent, the

county office staff informed the borrower of the default and requested the taxes to be paid. In the event of the borrower's unwillingness or inability to pay the delinquent taxes, RHS at its option advanced funds for this purpose and charged the advance to the borrower's account. This decentralized method of monitoring and processing delinquent taxes has not been successful in assisting borrowers before they default on the payment of their taxes. With the escrowing of taxes and insurance the agency does not have to advance funds to pay delinquent taxes and borrowers are not put in a position of having a large tax or insurance payment due without adequate funds to pay it.

The agency intends to utilize a nationwide tax service to obtain annual tax information on the RHS loan portfolio, and to obtain tax bills for loans that are escrowed loans. It is common industry practice to use a tax service and to require all borrowers to pay a one-time cost of the service. Other major government housing lenders such as Federal Housing Administration and Department of Veteran Affairs utilize a tax service.

The process of converting existing loans to a tax service will be phased-in as states are included in the DLOS system. A small, tax service fee which is estimated to be approximately \$20 will be charged to each borrower to establish the escrow account. Each existing SFH borrower agreed, as one of the terms of the security instruments they executed (mortgage or deed of trust), to pay fees and charges established by the agency in its regulations. Existing borrowers will be given the option to either pay the fee or add the fee to the principal balance of their loan. Borrowers who receive loans after the effective date of this regulation will be charged a tax service fee which is estimated to be approximately \$60 to be paid at loan closing. To minimize the impact on our very-low and low income customers, this fee can be included as part of the loan. These tax service fees are consistent with industry standards.

The tax service will be responsible for: (1) conducting a search for delinquent taxes on all existing loans that are converted to the new loan servicing system; (2) reporting delinquent taxes to the agency during the life of the loan and (3) assuming responsibility for any forfeiture that results from properties being sold at a tax sale if the tax servicer does not inform RHS of delinquent taxes on the properties so sold. The tax servicer will also be responsible for procuring the tax bills on all escrowed loans and paying

the taxes from the borrower's escrow account. The tax service is responsible for any penalty, loss of discount or incorrect disbursement should they fail to provide accurate and timely information.

Escrow accounts will be established for all new direct 502 loans approved after October 27, 1995, except for participation loans where another lender will be establishing an escrow account. Borrowers whose loans were approved after October 27, 1995, agreed to the escrow of taxes and insurance when they received their loan. Section 504 loan recipients may be required to escrow if their current lender does not escrow. As existing loans are converted to escrow, the accounting system used by the agency to credit borrower payments will change from Daily Simple Interest to a Pre-amortized Schedule payment. There are two conditions under which escrow accounts for existing loans will be established:

(1) The borrower requests that an escrow account be established. Existing borrowers will be allowed to voluntarily establish an escrow account once their loan has been converted to the DLOS system.

(2) RHS requires that an escrow account be established. RHS will require that an escrow account be established for a given loan if either of the following conditions exists:

(i) A borrower defaults on the responsibility to pay either the real estate taxes or hazard insurance premiums in a timely manner; or

(ii) A borrower defaults on regular monthly payments and requests RHS assistance to cure the default.

In both cases (1) and (2) above, the borrower may add the cost of the tax service fee, and initial escrow to their loan and have the account reamortized. This will minimize costs to our customers. The tax service will enhance the agency's ability to provide supervised credit in rural America and assist more customers in becoming successful homeowners.

(d) Regular Servicing

(1) *Application of payments.* If less than the full scheduled payment is received the payment will be held in suspense and not applied. For borrowers who remain under daily simple interest, interest will continue to accrue until the full payment is received. For borrowers under a predetermined amortized schedule, no additional interest will accrue against the scheduled payment that is due, however, the borrower may be charged

a late fee. Full scheduled payments will be applied as follows:

- (i) Protective advances due.
- (ii) Accrued interest due.
- (iii) Principal due.
- (iv) Escrow for taxes and insurance.
- (v) Fees or charges applied to the account.

(2) *Payment Subsidies.* RHS currently provides two types of payment subsidies to borrowers. Interest credit assistance was provided to borrowers whose loans were approved prior to FY 1996. The interest rate on these loans could be reduced as low as 1% to allow borrowers to pay 20% of their income for payments, taxes and insurance. Payment assistance has been provided to borrowers whose loans were approved after October 1, 1995. Under payment assistance, borrowers must pay 22, 24, or 26% of their income towards payments, taxes and insurance. The percentage is determined by the borrower's income. Interest credit assistance and payment assistance are herein referred to as payment subsidies.

Payment subsidy guidelines are being modified to provide that if a borrower's income should increase or decrease, a new 12-month agreement may be prepared, if the amount of assistance changes by at least \$10 per month. Currently, there is no dollar threshold which has created an administrative burden on the agency and its customers.

To assist borrowers who are currently receiving interest credit, the agency will allow them to continue to stay under the interest credit program provided they continuously remain eligible. A borrower who has stopped receiving interest credit and at a later date qualifies for a payment subsidy will be converted to payment assistance. Currently, a borrower who is receiving interest credit assistance is required to convert to payment assistance if they obtain a subsequent loan or the account is reamortized. This has caused a hardship for several borrowers whose payments significantly increase because of the conversion.

(3) *Late Fees.* A late charge fee will be assessed if the scheduled payment is not received by the 15th day after the due date. Initially, the agency intends to set the late charge fee at 4% of the borrower's scheduled payment. This is an industry standard incentive to encourage borrowers to pay on time, thereby reducing delinquencies and helping borrowers to maintain a good credit history.

(4) *Returned Check Fee.* A returned check charge will be assessed for any check that is returned for nonsufficient funds. This is consistent with industry standards. Initially, the agency intends

to set the returned check fee at \$15. This fee is less than industry standards; however, a typical RHS borrower's mortgage payment is significantly lower than that of a typical industry standard mortgage payment. RHS feels the lower proposed returned check fee is more consistent with the borrower's ability to pay.

(5) *Final Payment.* The RHS will provide a written statement indicating the amount required to pay the account in full. A fee may be charged for payoff statements if more than two statements are requested on the same account in any 30 day period. Initially, the agency intends to set the fee at \$25 per statement which is consistent with industry standards.

(6) *Subsidiary recapture.* The RHS may now subordinate its lien to include funds obtained from the other lender to improve or make repairs to the dwelling if it is in the best interest of the government. Currently, RHS will only allow a subordination to include the unpaid principal and interest plus reasonable closing costs. If a borrower desired to obtain additional funds for improvements or repair, the lender had to agree to a third lien position which in many cases prevented the borrower from refinancing.

Further subordination (as in a case where recapture has previously been subordinated) of a lien securing a recapture receivable will now be allowed if the borrower is refinancing with no increase in the amount of the debt to which RHS has subordinated (except reasonable closing costs).

The recapture formula has been changed to (1) provide a value added credit for capital improvements (2) cease accrual or additional principal reduction attributed to subsidy (PRAS) and (3) limit recapture to 50 percent of value appreciation. This change eliminates the major complaint concerning recapture—nonconsideration of improvements made subsequent to loan closing. It also partially eliminates another major complaint—PRAS. PRAS is the accelerated principal write-down that occurred when subsidy was applied to the account by reducing the effective interest rate under the interest credit program. RHS intends to "freeze" PRAS on the same date for all borrowers who are subject to PRAS. At this time, we estimate such date to be October 1, 1996.

By "freezing" PRAS, only the amount of accumulated PRAS (as of the date of the "freeze") will be subject to recapture. Freezing PRAS is to the borrower's financial advantage because PRAS, as it presently operates,

continues to accrue even after a borrower no longer qualifies for subsidy. PRAS continues to accrue until approximately the 20th year in the life of the loan at which time it gradually decreases until the loan reaches maturity. To ensure that no borrower is adversely affected by this change, RHS will reduce the "frozen" PRAS starting in the loan's 15th year by an equal amount each year so the PRAS will be zero at loan maturity. For example, on an existing 33-year loan, PRAS was frozen on October 1, 1996 at \$5,000. In year 15 of this loan, 18 years would be remaining. PRAS would be reduced in year 15 by \$278 (\$5,000 divided by 18), and by an additional \$278 each year thereafter. If the borrower paid off the loan in year 19, there would be \$3,610 of PRAS subject to recapture [\$5,000 - \$1390 (\$278 times 5 years)].

These proposed changes will allow a borrower to better estimate their equity position and eliminate this often confusing aspect of the program. These proposed revisions to subsidy recapture will apply to all new and existing borrowers.

Borrowers who cease to occupy their dwelling will now have the amount of recapture due determined and given a choice of either paying the recapture amount or having it included in the unpaid balance and reamortized. Existing regulations were unclear when recapture was calculated and repaid.

Borrowers will also be given a discount on the recapture amount due if the recapture is repaid within 30 days of refinancing or payment of the last loan installment and the borrower continues to occupy the property.

(7) *Transfer of security and assumption of indebtedness.* The regulation has been clarified to provide that, unless it is in the government's best financial interests, RHS will not approve the assumption of a secured loan if the seller fails to repay any unsecured loans with USDA.

(e) Special Servicing Actions

(1) *Delinquency workout agreements.* All past due balances under workout agreements will be required to be repaid within 2 years or the remaining term of the loan whichever is shorter. Currently, Agency regulations encourage but do not require a 2-year payback. With more timely and consistent servicing, the Agency anticipates the amount of delinquencies will decrease and the two year timeframe is sufficient. Borrowers will become current on the account in a shorter period of time and restore their good credit history.

(2) *Moratorium.* Moratoriums will be granted for the borrower's full

scheduled payment to include principal, interest, taxes and insurance or for the borrower's scheduled payment for principal and interest, based on the borrower's repayment ability. Moratoriums will continue to be granted for a maximum of 2 years but will be reviewed semiannually. This will benefit borrowers that no longer meet moratorium conditions by reinstating scheduled payments at an earlier date thus reducing the arrearage that must be repaid at the end of the moratorium period. Borrowers not on escrow will be assisted by establishing an escrow account and convert to a preamortized schedule prior to reamortization at the end of the moratorium period.

(3) *Unauthorized assistance.* Unauthorized payment assistance can occur through RHS error, or incorrect or false information provided by the borrower. Borrowers who received unauthorized payment assistance by providing false information will not be allowed to reamortize their account to remove the delinquency that occurred when account adjustments were made and may be recommended for suspension or debarment. This will eliminate the inequity that currently exists between borrowers who received unauthorized payment assistance through no fault of their own and borrowers who provided false information.

(4) *Graduation of SFH loans.* The term "graduation" is being replaced with "refinancing" to other credit.

(5) *Debt Settlement.* These regulations are revised to encourage the use of offsets (Administrative, Salary and Internal Revenue) to affect collection.

(6) *Disposition of inventory property.* Consistent with industry standards, the term "inventory property" is being replaced with "REO."

Program property will now be made available to program applicants for 60 days instead of 45 days. This sale period is effective from the date of the notice of sale, and for any reduction in price or any other change in credit terms or other sale terms. This will allow program properties to be marketed for a greater period of time to those individuals most in need of housing.

When a nonprofit organization or public body notifies RHS in writing of its intent to buy property, RHS will withdraw the property from the market for up to 30 days to provide the entity with the opportunity to execute a sale contract. For program properties, the listed price will now be discounted after the 60 day reservation period for program applicants has elapsed. Nonprogram properties will continue to be discounted from the listed price at

any time. Initially, the Agency intends to set the discount at its current rate of 10%.

For properties listed with a real estate broker, offers will now be held for 3 business days after the date the property is offered for sale. Offers received during the holding period are considered received on the 4th business day and evaluated with any other offers received that day. This action is taken to provide all real estate brokers with a reasonable timeframe to receive the notice of listing and sell the property. Problems had occurred in areas with a high housing demand whereby sale information was obtained by real estate brokers at different times due to the difference in mailing periods.

(7) *Escrow of taxes and insurance.* Any remaining funds held in escrow or unapplied funds will be applied against the debt. Escrow disbursement will stop immediately upon debt settlement or release of security or at anytime RHS does not intend to take title.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995, the RHS announces its intention to seek Office of Management and Budget (OMB) approval of new reporting and recordkeeping requirements.

The RHS offers a supervised credit program to extend financial assistance to construct, improve, alter, repair, replace or rehabilitate dwellings, which will provide modest, decent, safe, and sanitary housing to eligible individuals living in rural areas. To assist individuals in obtaining affordable housing, a borrower's house payment may be subsidized to an interest rate as low as 1% and under the deferred mortgage program the subsidy can be reduced further. The amount of subsidy is based on the borrower's household income. The information requested by RHS is vital to be able to process applications for RHS assistance and make prudent credit and program decisions. It includes borrower financial information such as household income, assets and liabilities and monthly expenses. Without this information the Agency is unable to determine if a borrower would qualify for any services or if assistance has been granted that the borrower may not have been eligible for. In addition, proper liquidation and debt settlement decisions are made.

Another integral part of Agency lending requires borrowers to refinance to other credit when they are able to do so. If a borrower is unable to find other credit available at reasonable rates and terms, the Agency will continue to review the borrower for possible

refinancing at periodic intervals. If it is determined that all loan servicing efforts have failed to produce a successful outcome the account will be liquidated through voluntary liquidation or foreclosure. The agency may also accept a deed in lieu of foreclosure if it is in the best interest of the Government.

As mentioned in the "Implementation Proposal," RHS field staff in states under the DLOS system will be utilizing the proposed Handbook for administrative operations of the program. RHS field staff in states not under the DLOS system will be utilizing existing FmHA Instructions for administrative operations, until they come under DLOS at which time they will use the proposed Handbook. The information collection requirements for existing FmHA Instructions has been previously approved by OMB. Therefore, public burden for the direct SFH programs will be contained in Part 3550, the proposed Handbook and existing FmHA Instructions. RHS intends to establish a new consolidated information collection docket for Part 3550, which will contain all burden related to the direct SFH programs.

Public Burden in the Handbook

RHS is currently developing the proposed Handbook while aggressively analyzing all existing burden imposed upon the public to obtain and retain SFH program assistance. A Task Force of RHS employees at the local, state and national level has been established and is working with the DLOS team to eliminate all unnecessary burden. This significant effort includes input from the private sector manufacturers of the DLOS system. The system which RHS has already purchased includes many industry standard forms. Wherever possible, RHS intends to utilize these industry standard forms, eliminate duplicative FmHA forms and make full use of our new expanded automation capabilities. For example, most forms which a current RHS borrower must complete can be system generated and contain all relevant system information such as the borrower's account number, address, property description, real estate taxes, insurance, income data, etc., thereby reducing unnecessary burden imposed on our customers. This will reduce the time it takes the public to complete required information, reduce the need to stock forms throughout Rural Economic and Community Development (RECD) offices, and result in cost savings to the public. RHS is confident that existing information collection dockets can be reduced.

The proposed Handbook will be available for public comment with

regard only to its information collection requirements on or about July 1, 1996. RHS will publish a Notice in the Federal Register, with a 60-day comment period, when the Handbook is available and its specific information collection requirements.

Public Burden in Part 3550

At this time, the Agency is requesting OMB clearance of the following burden:

- Form FmHA 1940-43, "Notice of Right To Cancel": Federal law requires that all parties entering into a transaction which results in a mortgage on their present home be notified of and given the right to cancel the transaction. Form FmHA 1940-43 provides the means for such a transaction to be canceled by the potential borrower. This form has been used by FmHA for many years, but was inadvertently omitted from previous paperwork burden packages. In order to meet our legal responsibilities and ensure that all potential borrowers are properly notified of their rights, this form has been included in this regulation. This form will now be generated electronically through the DLOS system.
- Form RECD 3550-1, "Borrower's Certification and Authorization." This is an industry standard form on which an applicant certifies that all information furnished in connection with the loan transaction is true and correct, and provides authorization from the applicant for the release and verification of any information contained in the loan application. This form will prove to be a time-saver for the applicant as well as the Agency, and will allow for the elimination of several existing FmHA forms when DLOS is implemented nationwide.
- Form RECD 3550-2, "Request for Verification of Gift/Gift Letter." This will be an automated form which will assist the applicant in providing required information should the applicant plan to receive monetary gifts to cover costs in connection with the loan, i.e. loan closing costs. Currently, the applicant must either provide some type of documentation or use an informal statement prepared by the RHS field office staff. The burden on the applicant to provide some type of documentation will be alleviated because this form will be system generated and require minimal work for the applicant.
- Form RECD 3550-4, "Employment Certification/Payment Assistance. This form will serve as a supplement to Form RECD 1944-14, "Payment Assistance/Deferred Mortgage Assistance Agreement." In conjunction with the execution of Form RECD 1944-14,

borrowers will sign this form verifying that they will notify RHS when they change or obtain employment.

- Form RECD 3550-6, "Notice to Borrower of Special Flood Hazard and Federal Disaster Assistance." This is an industry standard form. When applicable, the system will automatically generate this form which will notify the applicant that the property being financed is located in a flood hazard area. The form will require the signature of the applicant.

- Form RECD 3550-7, "Mortgage Loan Commitment." This is an industry standard form, will be system generated and notifies the applicant of loan approval and stipulates any special conditions of the loan approval. The applicant signs the form agreeing to the terms set forth in the commitment.

- Form RECD 3550-9, "Initial Escrow Account Disclosure Statement." This is an industry standard form, is system generated and provides an applicant/borrower with a breakdown of his or her escrow payments.

- Form RECD 3550-10, "Condominium Rider," and Form RECD 3550-11, "Planned Unit Development Rider," will be used only for the few loans the Agency provides on condominiums or planned unit developments (PUDs). These automated forms will be used as a supplement to the mortgage or deed of trust to specifically define condominium and PUD covenants. The borrower's signature will be required.

- Form RECD 3550-12, "Subsidy Repayment Agreement," is a new form which replaces Exhibit A, "Subsidy Repayment Agreement," to 7 CFR part 1951 subpart I. Borrowers are required to repay to the Government any subsidy received in connection with section 502 of the Housing Act upon disposition or nonoccupancy of the security property. This form, which is being reduced in excess of 50%, informs the borrower of this obligation to RHS.

- Standard Form (SF) 5510, "Authorization Agreement for Preauthorized Payments," is added to provide borrowers with the convenience of having their monthly mortgage payments automatically deducted from their bank account. This is a Standard Form widely used throughout the financial community.

- Paragraph 3550.9(b). This paragraph requires that applicants must disclose any known relationship or association with an RHS employee. This provision ensures impartiality in program decisions and reduces the potential for employee conflict of interest. This disclosure is made on Form FmHA 410-

4 which is part of the information collection package.

- Paragraph 3550.53(g). This paragraph requires that applicants must provide financial data to demonstrate that they have adequate repayment ability for the requested loan. An applicant must provide a financial statement listing all recurring monthly debts. This information is critical to ensure prudent loan underwriting and is an industry standard. This financial statement is included on Form FmHA 410-4 which is part of the information collection package.

- Paragraphs 3550.55 and 3550.106. These paragraphs require that all persons applying for RHS loans must file a written application in a format specified by RHS. RHS currently utilizes Form FmHA 410-4, an industry standard application form for this purpose. The information in the application is critical to ensure that the applicant qualifies for the assistance requested. Form FmHA 410-4 is part of the information collection package.

- Paragraphs 3550.55(b)(3) and 3550.106(b)(4). These paragraphs provide RHS with the ability to periodically request that an applicant reconfirm their interest in obtaining assistance. The request is generally made in writing, and the applicant may call or write RHS to reconfirm their interest. In many RHS offices, a backlog exists of applications due to loan requests exceeding available loan funds. To ensure the most timely and efficient processing of active applications, RHS must periodically update an applicant's continued interest in the program.

- Paragraph 3550.55(b)(4). This paragraph provides RHS with the opportunity to request additional information to support an applicant's loan request when RHS receives information which may indicate that the eligibility determination may have been in error. This information is critical to ensure applicant's are eligible for assistance which they may be granted.

- Paragraphs 3550.61 and 3550.112. These paragraphs require that borrowers must furnish and continually maintain hazard and flood insurance on property securing RHS loans. This is an industry standard and is necessary to protect the borrower's and government's best financial interests in the property.

- Paragraph 3550.68. This paragraph describes the two forms of payment subsidies available to RHS direct Section 502 borrowers. Payment subsidies reduce the borrower's payment to a level consistent with their income.

Payment subsidies are subject to recapture and this paragraph requires

that borrowers execute Form RECD 3550-12, "Subsidy Repayment Agreement," acknowledging they understand that subsidy must be repaid. The agreement also provides information on how and when the subsidy must be repaid. This is necessary to ensure that borrowers are fully aware of their financial obligations under the program. Form RECD 3550-12 is part of the information collection package.

- Paragraphs 3550.68(e), 3550.69(c) and 3550.157(a)(3). These paragraphs require that a borrower inform RHS whenever an adult member of the household changes or obtains employment so that RHS can determine whether a review of the borrower's circumstances is required. This provision, which is required throughout the direct SFH programs, is critical to ensure that a borrower remains eligible for the assistance they are receiving. If the borrower's income should change, it may affect their eligibility for decreased or increased assistance. This requirement is accomplished when an applicant or borrower executes Form RECD 3550-4, which is part of the information collection package.

- Paragraph 3550.73(f). This paragraph requires that a manufactured home dealer-contractor must sign a construction contract which will cover both the unit and site development work. This is an industry standard and protects the government and borrower's best interests. Form FmHA 1924-6, "Construction Contract," is used for this purpose and is part of the information collection package.

- Paragraph 3550.73(g). This paragraph requires that all persons furnishing materials and labor in connection with a construction contract must sign a release of claimants document. Again, this is an industry standard form and documents to the homebuyer and lender that all persons have been paid. It precludes mechanics liens from being filed against the property and protects the best financial interest of the homeowner and lender. Form FmHA 1924-10, "Release of Claimants," is used for this purpose and is part of the information collection package.

- Paragraph 3550.73(h). This paragraph requires that a dealer-contractor must provide a warranty on a manufactured home. Again, this is an industry standard and ensures the homeowner that their new home is warranted in case of defects. The paragraph further requires the dealer-contractor to furnish the homeowner with a copy of all manufacturer's warranties. This would be for

appliances, heating systems, etc., and it again warrants such items from defect and provides the homeowner with information regarding the product and who to contact for further information. Form FmHA 1924-11, "Builders Warranty," is used for this purpose and is part of the information collection package.

- Paragraph 3550.112(d)(2). This paragraph requires when borrowers file a claim under hazard and flood insurance, that they notify RHS of any loss or damage to the security property. Under this supervised credit program, RHS requires notification of insurable losses to protect the governments financial interest in the property and to assist our customers with any advice or counsel on ensuring that damages are corrected in a workmanlike manner.

- Paragraph 3550.113. Under the Section 504 grant program, if a person obtains a 504 grant, and sells the property within 3 years, the grant must be repaid. This paragraph requires grant recipients to sign a grant agreement acknowledging this regulatory requirement. The intent is to ensure that the recipient understands this provision and provides the government with documentation to secure any proceeds if the property is sold.

- Paragraph 3550.158(b). This paragraph requires that borrowers on active military duty, whose interest rates are reduced to 6% pursuant to the Soldiers and Sailors Relief Act, must notify RHS when they are no longer in active status. The reduced interest rate is only available to persons in active military duty. The borrower must notify RHS when they are no longer on active status so that the interest rate may be changed back to the rate specified in the Promissory Note. This is to ensure that borrowers do not receive benefits to which they are not entitled.

- Paragraph 3550.159(a). This paragraph requires borrowers who wish to lease mineral rights on security property to obtain authorization from RHS. This is an industry standard. Lenders require such authorization to ensure that the property will remain suitable as a residence, and their security interests are not adversely affected.

- Paragraph 3550.159(b). This paragraph requires borrowers who wish RHS to subordinate its lien to obtain the Agency's consent. This is an industry standard. Lenders require such authorization to ensure that their security interests are not adversely affected.

- Paragraph 3550.159(c). This paragraph requires borrowers who wish to obtain a partial release from RHS for

the sale or exchange of security property or granting of a right-of-way across the security property, must obtain approval from RHS. This is an industry standard. Lenders require such authorization to ensure that the property will remain suitable, and their security interests are not adversely affected.

- Paragraph 3550.159(d). This paragraph requires borrowers who wish to lease the security property must obtain RHS consent. RHS requires prior consent to ensure that the borrower does not receive payment assistance to which they would no longer be eligible if they cease to occupy the property, to know the whereabouts of the borrower, and to ensure that the government's security interests are not adversely affected.

- Paragraph 3550.160. RHS credit is not intended to replace or supplant private credit. Borrowers agree, a condition of obtaining assistance, that they must refinance to other credit should it become available. This paragraph requires that borrowers must periodically provide RHS with financial data to ascertain their potential to secure other credit. The borrower must complete a financial statement which would document their income and debts. This information is used by RHS to determine if the borrower, as required by statute, must refinance with another lender.

- Paragraph 3550.160(c)(3). This paragraph provides a borrower, who has been requested to refinance, the opportunity to provide RHS with additional information to document their inability to refinance to other credit. This provision exists to give the borrower every opportunity to dispute RHS's decision prior to their application for other credit. Most private lenders charge application and related fees to submit an application. This opportunity may preclude the borrower from incurring this expense if additional information may change the RHS decision.

- Paragraph 3550.160(d). This paragraph requires that borrowers who were requested to refinance to other credit, and are unable to secure other financing, must provide documentation to RHS on their inability to refinance. This is critical to ensure that the borrower made a good faith effort to refinance and document that the borrower cannot move to other credit.

- Paragraph 3550.164(d). This paragraph requires that a recipient of unauthorized assistance be notified in writing and given the opportunity to provide information to alter the RHS determination that the assistance they received was unauthorized. This provision exists to provide the borrower

with every opportunity to refute the RHS action being taken.

- Paragraph 3550.207(b). This paragraph requires that borrowers on a moratorium (temporary stop on mortgage payments) must provide RHS with financial information to demonstrate that the moratorium should be continued. This is to ensure that a borrower does not receive assistance to which they are no longer entitled.

- Paragraph 3550.253. This paragraph provides guidance on settlement of a debt by compromise or adjustment. The provisions allows such action to be initiated by RHS or the applicant for the settlement actions. The debtor's offer and a financial statement is required. This is an industry standard and necessary to settle debts still owed to a lender. Form FmHA 1956-1, "Request for Debt Settlement," is used for this purpose and is part of the information collection package.

Public Burden in Existing FmHA Regulations

As mentioned, public burden for the direct SFH programs is currently approved in several information collection dockets. These existing information collection dockets will be handled as follows:

- 7 CFR Part 1910, Subpart A—Receiving and Processing Applications. RHS will make a technical correction to the existing approved information collection docket (0575-0134) at the final rule stage to transfer only the public burden for the direct Section 502 and 504 loan and grant programs to the information collection docket for 7 CFR Part 3550. Every effort will be made streamline and eliminate any unnecessary public burden for the direct SFH programs before the technical correction is made.

- 7 CFR Part 1944, Subpart A—Section 502 Rural Housing Loan Policies, Procedures, and Authorizations. RHS will transfer the existing approved information collection docket (0575-0059) at the final rule stage to the information collection docket for 7 CFR Part 3550. It should be noted that RHS reduced the burden in this regulation by 250,000 hours in October 1995.

Every effort will be made streamline and eliminate any unnecessary public burden for the direct SFH programs before the transfer is accomplished.

- 7 CFR Part 1944, Subpart J—Section 504 Rural Housing Loans and Grants. RHS will transfer the existing approved information collection docket (0575-0062) to the information collection docket for 7 CFR Part 3550. Every effort will be made streamline and eliminate

any unnecessary public burden for the direct SFH programs before the transfer is accomplished.

- 7 CFR Part 1951, Subpart C—Offsets of Federal Payments to FmHA

Borrowers. RHS will make a technical correction to the existing approved information collection docket (0575-0119) at the final rule stage to transfer only the public burden for the direct Section 502 and 504 loan and grant programs to the information collection docket for 7 CFR Part 3550. Every effort will be made streamline and eliminate any unnecessary public burden for the direct SFH programs before the technical correction is made.

- 7 CFR Part 1951, Subpart F—Analyzing Credit Needs and Graduation of Borrowers. RHS will make a technical correction to the existing approved information collection docket (0575-0093) at the final rule stage to transfer only the public burden for the direct Section 502 and 504 loan and grant programs to the information collection docket for 7 CFR Part 3550. Every effort will be made streamline and eliminate any unnecessary public burden for the direct SFH programs before the technical correction is made.

- 7 CFR Part 1951, Subpart G—Borrower Supervision, Servicing and Collection of Single Family Housing Loan Accounts. RHS will transfer the existing approved information collection docket (0575-0060) to the information collection docket for 7 CFR Part 3550. RHS will also be proposing a reduction in the existing information collection docket. For example, with the establishment of the centralized servicing unit borrowers past due on their payment will receive timely and consistent servicing of their accounts. With prompt servicing, fewer borrowers will become seriously delinquent on their accounts thereby reducing the number of workout agreements executed by borrowers. Every additional effort will be made streamline and eliminate any unnecessary public burden for the direct SFH programs before the transfer is made.

- 7 CFR Part 1951, Subpart M—Servicing Cases Where Unauthorized Loan or Other Financial Assistance Was Received—Single Family Housing. RHS will transfer the existing approved information collection docket (0575-0105) to the information collection docket for 7 CFR Part 3550. RHS will also be proposing a reduction in the existing information collection docket. For example, when RHS has agreed to continue with the loan of a borrower who otherwise would not qualify for a SFH loan either because the loan was made for an unauthorized purpose or

the borrower was not eligible for financial assistance the borrower will no longer be required to repay all of subsidy recapture up to 100% of the proceeds available. These borrowers will now have recapture calculated in the same manner as other SFH borrowers. Every additional effort will be made streamline and eliminate any unnecessary public burden for the direct SFH programs before the transfer is made.

- 7 CFR Part 1955, Subpart A—Liquidation of Loans Secured by Real Estate and Acquisition of Real and Chattel Property. RHS will make a technical correction to the existing approved information collection docket (0575–0109) at the final rule stage to transfer only the public burden for the direct Section 502 and 504 loan and grant programs to the information collection docket for 7 CFR Part 3550. Every effort will be made streamline and eliminate any unnecessary public burden for the direct SFH programs before the technical correction is made.

- 7 CFR Part 1955, Subpart B—Management of Property. RHS will make a technical correction to the existing approved information collection docket (0575–0110) at the final rule stage to transfer only the public burden for the direct Section 502 and 504 loan and grant programs to the information collection docket for 7 CFR Part 3550. Every effort will be made streamline and eliminate any unnecessary public burden for the direct SFH programs before the technical correction is made.

- 7 CFR Part 1956, Subpart B—Debt Settlement—Farmer Programs and Housing. RHS will make a technical correction to the existing approved information collection docket (0575–0118) at the final rule stage to transfer only the public burden for the direct Section 502 and 504 loan and grant programs to the information collection docket for 7 CFR Part 3550. Every effort will be made streamline and eliminate any unnecessary public burden for the direct SFH programs before the technical correction is made.

Estimate of Burden: Public reporting burden for this collection of information is estimated to range from 5 minutes to 3 hours response.

Respondents: Applicants seeking financial assistance through RHS to purchase adequate housing in rural America and borrowers who have received such assistance.

Estimated Number of Respondents: 822,570.

Estimated Number of Responses per Respondent: 1.5.

Estimated Total Annual Burden on Respondents: 217,195.

The complete text of the subject regulations is published herein for public review and comment. Additional copies of the proposed regulations or copies of the referenced forms may be obtained from the Director, Regulations and Paperwork Management Division, at (202) 720–9725. Comments are invited on: (a) whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (b) the accuracy of the agency's estimate of the burden of the proposed collection of information including the validity of the methodology and assumptions used; (c) ways to enhance the quality, utility and clarity of the information to be collected; and (d) ways to minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology.

Comments must be received on or before June 7, 1996, to be assured of consideration. All responses to this notice will be summarized, included in the request for OMB approval, and will become a matter of public record. Comments should be submitted to the Desk Officer for Agriculture, Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, D.C. 20503 and to the Director, Regulations and Paperwork Management Division, U.S. Department of Agriculture, RECD, Ag. Box 0743, Washington, DC 20250. A comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication of this rule.

List of Subjects in 7 CFR Part 3550

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

Therefore, chapter XXXV, title 7, Code of Federal Regulations is added to read as follows:

CHAPTER XXXV—RURAL HOUSING SERVICE, UNITED STATES DEPARTMENT OF AGRICULTURE

PART 3550—SINGLE FAMILY HOUSING

Subpart A—General

Sec.

- 3550.1 Applicability.
- 3550.2 Purpose.
- 3550.3 Equal opportunity and fair housing.
- 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.
- 3550.11–3550.50 [Reserved]

Subpart B—Section 502 Origination

- 3550.51 Program objectives.
- 3550.52 Loan purposes.
- 3550.53 Borrower 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 Loan-to-value ratio.
- 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.
- 3550.75–3550.100 [Reserved]

Subpart C—Section 504 Origination

- 3550.101 Program objectives.
- 3550.102 Grant and loan purposes.
- 3550.103 Construction standards and requirements.
- 3550.104 Maximum loan and grant.
- 3550.105 Eligibility requirements.
- 3550.106 Applications.
- 3550.107 Ownership requirements.
- 3550.108 Loan rates and terms.
- 3550.109 Security requirements (loans only).
- 3550.110 Appraisals.
- 3550.111 Escrow account.
- 3550.112 Insurance (loans only).
- 3550.113 Repayment agreement (grants only).
- 3550.114–3550.150 [Reserved]

Subpart D—Regular Servicing

- 3550.151 Servicing goals.
- 3550.152 Loan payments.
- 3550.153 Fees and charges.
- 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.
- 3550.165–3550.200 [Reserved]

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 Work-out 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.
- 3550.212–3550.250 [Reserved]

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.
 - 3550.254–3550.300 [Reserved]
- Authority: 5 U.S.C. 301 and 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. It addresses the requirements of sections 502 and 504 of the Housing Act of 1949, as amended, and includes policies regarding both origination and servicing. Procedures for implementing the regulations in this part can be found in program handbooks, available in any Rural Economic Community Development (RECD) office. The provision on the expenditure of any funds under this part is contingent upon the availability of funds to the agency.

§ 3550.2 Purpose.

The purpose of the RHS single family direct 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 that do not currently own adequate housing, and that cannot obtain other credit, the opportunity to acquire, build, rehabilitate, improve or relocate dwellings in rural areas. The section 504 program offers loans to 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.

§ 3550.3 Equal opportunity and fair housing.

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 12466, and Executive Order 11063, as amended by Executive Order 12259 as applicable. The Civil Rights Compliance Requirements of the U.S. Department of Agriculture are spelled out in 7 CFR part 1901, subpart E.

§ 3550.4 Reviews and appeals.

(a) *Participant rights.* Whenever RHS makes a decision that will adversely affect a participant, RHS will inform the participant that the decision can be reviewed by the next level supervisor, and indicate whether the decision can be appealed to the National Appeals Division (NAD) according to the regulations set forth in 7 CFR part 11. Nonprogram (NP) participants are not entitled to appeal rights except with regard to denial of NP loan assistance.

(b) *Non-appealable decisions.* The following types of decisions are not appealable.

(1) Decisions made by parties outside of RHS, even when those decisions are used as a basis for RHS decisions.

(2) Decisions that do not meet the definition of an "adverse decision" under 7 CFR part 11.

(3) Decisions involving parties who do not meet the definition of "participant" under 7 CFR part 11.

(4) Decisions with regard to subject matters not covered by 7 CFR part 11.

(5) Interest rates as set forth in agency procedures, except appeals alleging application of the incorrect interest rate.

(6) Refusal to request an administrative waiver permitted by program regulations.

(7) Denials of assistance due to lack of funds.

(c) *Next-level review.* Any adverse decision, whether appealable or non-appealable, may be reviewed by the next-level supervisor.

(d) *NAD Review.* (1) A participant may request that NAD review the agency's findings of non-appealability. In cases where the adverse decision is based on both appealable and non-appealable actions, the adverse action is not appealable.

(2) A participant may request that NAD review any decision that is appealable.

(3) NAD will review the participant's request in accordance with 7 CFR part 11.

(e) *Actions pending the outcome of an appeal.* (1) Assistance will not be discontinued pending the outcome of an appeal of any adverse decision.

(2) Real Estate Owned (REO) properties will not be held off the market pending appeal of a decision to deny credit.

§ 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 goals in a manner that will protect, enhance, and restore environmental quality.

(b) *Regulatory references.* Processing and servicing actions under this part will be undertaken consistent 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 may affect RHS implementation of certain provisions of this part, 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.

A State Director 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.

(a) *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 by RHS employees who:

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

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

(c) *RHS employee responsibility.* A RHS employee must disclose any known relationship or association with an applicant, regardless of whether the relationship or association is known to others. Loans may not be used by RHS employees and loan closing agents, or members of their families to purchase REO property, security property from a borrower, or security property at a foreclosure sale.

§ 3550.10 Definitions.

Acceleration. Demand for immediate repayment of the entire balance of a debt if the security instruments are breached or other conditions for repayment occur.

Adjusted annual income. Used to determine whether an applicant is income-eligible. Adjusted income provides for deductions to account for varying household circumstances and expenses. See § 3550.54 of subpart B of

this part for a complete description of adjusted income.

Adjustment. An agreement by RHS to release a debtor from liability upon receipt of a reduced amount paid as an initial lump sum and periodic additional payments over a period of up to 5 years.

Amortized payment. Equal monthly payments under a fully amortized mortgage loan which provides for the scheduled payment of interest and principal over the term of the loan. The proportion of the principal is reduced, and the proportion represented by the principal repayment increases correspondingly.

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 to RHS under the section 502 or 504 programs.

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

Co-signer. 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 co-signer 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.

Compromise. 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.

Conditional commitment. A determination by RHS 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.

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

Custodial property. Borrower-owned real property that serves as security for a RHS loan that has been taken into possession by RHS 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% of their principal and interest payments at 1% for up to 15 years. The deferred amounts are due on sale.

Deficient housing. A dwelling that lacks complete plumbing; lacks adequate heating; is dilapidated or structurally unsound; or has an overcrowding situation that will be corrected with loan funds.

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; or
- (2) Two or more persons who are living together, at least one 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 surviving 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.

Escrow account. An account maintained by RHS 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 or unit which is: more than 1 year old; or less than 1 year old but the dwelling

is not covered by an approved 10-year warranty plan.

False information. Information that the recipient knew or should have known was incorrect at the time it was provided.

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

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

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

Inaccurate information. Incorrect information inadvertently provided by a recipient without intent to obtain benefits fraudulently.

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 subsidy that reduces the effective interest rate of a loan. (See § 3550.68(d) of subpart B of this part.) Since October 27, 1995, new subsidies have been provided through payment assistance.

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 from a non-RHS source closed simultaneously with a RHS loan or grant.

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 greater than the very low-income limit, but that does not exceed the HUD established low-income limit (generally

80% 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 which is built to Federally Manufactured Home Construction and Safety Standard (FMHCSS) and RHS Thermal Performance Standards (TPS) of 7 CFR part 1924, subpart A. It is transportable in one or more sections, which in the traveling mode is 10-body feet or more in width, and when erected on site is 400 or more square feet, 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. Permanent foundations are required.

Market value. The value of the property as determined by a current appraisal.

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 Public Law 96-399 (October 8, 1980).

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

Moratorium. A period of up to two years during which scheduled payments for principal and interest, or principal, interest and deposits to the escrow accounts are not required, but are subject to repayment at a later date.

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

Net family assets. Are considered in the calculation of annual income. See § 3550.54 of subpart B of this part for a complete description.

Net recovery value. The appraised value of the security property minus

anticipated liquidation expenses as determined by RHS.

New dwelling. A dwelling to be constructed or that is less than 1 year old and is covered by an approved 10-year warranty plan as described in subpart A of part 1924 of this title.

Nonprogram (NP) property. Property that does not meet the program eligibility requirements outlined in § 3550.56 and § 3550.57 of subpart B of this part.

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

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

Participant. For the purpose of 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 a RHS decision, in accordance with 7 CFR part 11.

Payment assistance. Subsidy used beginning October 27, 1995, to reduce mortgage payments. (See § 3550.68(c) of subpart B of this part.)

Payment subsidy. A general term which 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, has a record of such an impairment, or is regarded as having such an impairment. As used in this definition, the phrase:

(1) **Physical or mental impairment** includes—

(i) Any physiological disorder or condition, cosmetic disfigurement, or anatomical loss affecting one or more of the following body systems: neurological; musculoskeletal; special sense organs; respiratory, including speech organs; cardiovascular; reproductive; digestive; genitourinary; hemic and lymphatic; skin; and endocrine; or

(ii) Any mental or psychological disorder, such as mental retardation organic brain syndrome, emotional or mental illness, and specific learning disabilities. The term "physical or mental impairment" includes, but is not limited to, such diseases and conditions as orthopedic, visual, speech, and hearing impairments, cerebral palsy, epilepsy, muscular dystrophy, multiple sclerosis, cancer, heart disease, diabetes, mental retardation, emotional illness, HIV disease (whether symptomatic or

asymptomatic), and drug addiction and alcoholism.

(2) *Major life activities* include functions such as caring for one's self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, and working.

(3) *Has a record of such an impairment* means has a history of, or has been misclassified as having, a mental or physical impairment that substantially limits one or more major life activities.

(4) *Is regarded as having an impairment* means—

(i) Has a physical or mental impairment that does not substantially limit major life activities but is treated by the agency as constituting such a limitation;

(ii) Has a physical or mental impairment that substantially limits major life activities only as a result of the attitudes of others toward such impairment; or

(iii) Has none of the impairments defined in paragraph (1) of this definition but is treated by the agency as having such an impairment.

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

Primary loan. The oldest RHS loan on the property.

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

Program-eligible applicant. Person meeting the eligibility requirements described in § 3550.53 of subpart B of this part.

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

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 to protect the security interest of the government which 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.

RECD. Rural Economic Community Development, a mission area within the Department of Agriculture which includes the Rural Housing Service.

REO. 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 adjusted annual income. See § 3550.54 of subpart B of this part 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 (RHCD), a successor agency to the Farmers Home Administration (FmHA).

RHS interest rate. The current unsubsidized interest rate offered by RHS, available in any RECD office.

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, and

(A) Is not contained within a Metropolitan Statistical Area, and

(B) Has a serious lack of mortgage credit for low- and moderate-income households as determined by the Secretary of Agriculture and 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.

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, or other documented agreements between RHS and the borrower.

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 a RHS loan.

Total debt ratio. The amount paid by the borrower for principal, interest, taxes, insurance and any continuing obligations, divided by the 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.

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

Value appreciation. The current market value of an RHS financed property minus: the unpaid balance of the RHS debt; reasonable selling expenses (if any); and the original equity (if any) of the borrower.

Very low-income. An adjusted income that does not exceed the HUD-established very low income limit (generally 50% 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 priority extended to any person applying for a loan or grant under this part who has been honorably discharged, including clemency discharges, or released from the active forces of the United States Army, Navy, Air Force, Marine Corps, or Coast Guard, who served on active duty in such forces:

(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; or

(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.

§§ 3550.11–3550.50 [Reserved]

Subpart B—Section 502 Origination

§ 3550.51 Program objectives.

Section 502 of the Housing Act of 1949 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 encouraged to use section 502 funds in conjunction with funding

or financing from other sources, if possible. Sections 3550.52 through 3550.73 of this subpart set forth the requirements for originating loans or program terms. Section 3550.74 of this subpart describes the differences for origination of loans on nonprogram 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 a 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 § 3550.203 of subpart E of this part.

(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 fees, architectural and engineering fees, technical fees, title clearance fees, and loan closing fees; appraisal, surveying, environmental, and tax monitoring 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 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 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 and property insurance premiums.

(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 a RHS Real Estate Owned (REO) property.

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

(1) Refinance debts on a manufactured home.

(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 Borrower eligibility requirements.

(a) *Income eligibility.* The adjusted income of an applicant must not exceed the applicable low-income limit for the area, adjusted for household size

(available in any Rural Economic Community Development (RECD) office). Section 3550.54 of this subpart provides a detailed discussion of the calculation of adjusted income.

(b) *Citizenship status.* The applicant must be a natural person (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 Mariana Islands, the Federated States of Micronesia, the Republic of Palau, or the Republic of the Marshall Islands, or a noncitizen who qualifies as a legal alien as defined in § 3550.10 of subpart A of this part.

(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) In either case, 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.*

(1) Current homeowners with a non-RHS loan may receive RHS loan funds to refinance an existing loan under the conditions outlined in § 3550.52(b) of this subpart, or to purchase a new dwelling if the current dwelling cannot reasonably be brought up to local code requirements.

(2) Current homeowners with a RHS loan may receive additional loan funds to repair the dwelling.

(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 FmHA Instruction 1940-M, available in any RECD office.

(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 38 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 38 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.

(h) *Credit qualifications.* Applicants must be unable to secure the necessary credit from other sources upon 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 outstanding judgment obtained by the United States in a federal court, other than the United States Tax Court, demonstrates an unacceptable credit history.

(1) Indicators of unacceptable credit include:

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

(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 (IRS) 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)(ii) and (h)(2)(iii) of this section.

(v) Two or more rent payments paid 30 or more days late within the last two

years, or within the last year if the applicant has experienced no other credit problems in the past two years. This 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 six months.

(vii) Non-agency debts written off within the last 36 months.

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

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

(i) Lack of a credit history.

(ii) 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.

(iii) A judgment satisfied more than 12 months before the date of application, or foreclosure with no monetary loss that was completed 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.

(4) *Co-signers.* If an applicant does not meet the repayment ability requirements, the applicant can have another party join the application as a co-signer.

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

§ 3550.54 Calculation of income and assets.

(a) *Annual income.* Annual income is the full amount of income all adult household members living on the financed property are expected to receive over the next 12 months from the sources listed in paragraphs (a)(1) through (a)(8) of this section. Income from the sources listed in paragraphs (c) and (d) of this section is excluded from the calculation of annual income. Annual income is the base from which adjusted income and repayment income are calculated. The following is a complete list of the sources of income that may contribute to annual income.

(1) The gross amount, before any payroll deductions, of wages and

salaries, overtime pay, commissions, fees, tips, bonuses, and other compensations for personal services. If a cost of living allowance or a proposed increase in income is expected to take place on or before loan approval, loan closing, or the effective date of the payment assistance agreement, it will be included as income.

(2) The net income from the operation of a farm, business, or profession. The following provisions apply:

(i) Expenditures for business or farm expansion, capital improvements, or payments of principal on capital indebtedness shall not be used as deductions in determining income. A deduction is allowed in the manner prescribed by Internal Revenue Service (IRS) regulations only for interest paid in amortizing capital indebtedness.

(ii) Farm and nonfarm business losses are considered "0" in determining annual income.

(iii) A deduction, based on straight line depreciation, is allowed in the manner prescribed by IRS regulations for the exhaustion, wear and tear, and obsolescence of depreciable property used in the operation of a trade, farm, or business by a member of the household. The deduction must be based on an itemized schedule showing the amount of straight line depreciation.

(iv) Any withdrawal of cash or assets from the operation of a farm, business, or profession will be included in income, except to the extent the withdrawal is reimbursement of cash or assets invested in the operation by a member of the household.

(v) A deduction is allowed for verified business expenses, such as lodging, meals, and fuel, for business trips made by salaried employees who must meet these expenses without reimbursement.

(vi) Housing related expenses for the property being financed such as mortgage interest, real estate taxes, and insurance, which may be claimed as business expense deductions for income tax purposes, will not be deducted from annual income.

(3) Interest, dividends, and other net income of any kind from real or personal property, including:

(i) The share received by adult members of the household from income distributed from a trust fund.

(ii) Any withdrawal of cash or assets from an investment except to the extent the withdrawal is reimbursement of cash or assets invested by a member of the household.

(iii) Where the household has net family assets in excess of \$5,000, the greater of the actual income derived from all net family assets or a percentage of the value of such assets

based on the current passbook savings rate, as determined by RHS.

(4) The full amount of periodic payments received from Social Security (including Social Security received by adults on behalf of minors or by minors intended for their own support), annuities, insurance policies, retirement funds, pensions, disability or death benefits, and other similar types of periodic receipts. Amounts received from the United States Government which are attributable to underpayment of benefits for one or more prior months shall be excluded in the calculation of annual income as provided in 42 U.S.C. 1382b(a)(7).

(5) Payments in lieu of earnings, such as unemployment and disability compensation, worker's compensation, and severance pay.

(6) Public assistance, unless exempted by federal statute.

(7) Periodic allowances, such as:

(i) Alimony and child support awarded in a divorce decree or separation agreement, unless the applicant certifies the payments are not received, and the applicant provides documentation to RHS that a reasonable effort has been made to collect the payments through the official entity responsible for enforcing such payments; or

(ii) Recurring monetary gifts or contributions from someone who is not a member of the household.

(8) All regular pay, special pay (except for persons exposed to hostile fire), and allowances of a member of the armed forces who is the applicant or spouse, whether or not that family member lives in the home.

(b) *Adjusted income.* Adjusted income is the household's annual income, as defined in paragraph (a) of this section, less any of the following deductions for which the household is eligible.

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.

(1) A deduction as determined under section 501(b)(5) of the Housing Act of 1949, as amended, for each family member, not including an applicant or spouse, who is under 18 years of age, 18 or older with a disability, or a full-time student.

(2) A deduction as determined under section 501(b)(5) of the Housing Act of 1949, as amended, for any elderly family.

(3) For non-elderly households, a deduction of 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 any other source, and

(iii) Are in excess of three percent of annual income.

(4) For elderly households only, a deduction of the sum of expenses related to household members with disabilities that are necessary to enable a family member to work and medical expenses that:

(i) Will not be reimbursed by insurance or any other source, and

(ii) Is in excess of three percent of annual income.

(5) A deduction of expenses for the care of minors 12 or under that enable a family member to work or to further the applicant's education.

(c) *Repayment income.* Repayment income is used in calculating the household's principal, interest, taxes, and insurance (PITI) and Total Debt ratios, which, in turn, indicate repayment ability. Repayment income is the household's annual income, as defined in paragraph (a) of this section, plus income from any of the following additional sources.

(1) Payments received for the care of foster children or foster adults (usually individuals with disabilities, unrelated to the applicant, who are unable to live alone).

(2) Amounts granted specifically for, or in reimbursement of, the cost of medical expenses.

(3) Earnings in excess of an amount determined under section 501(b)(5) of the Housing Act of 1949, as amended, for each full-time student 18 years old or older, excluding the head of household and spouse.

(4) Any earned income tax credit.

(5) Adoption assistance payments in excess of an amount determined under section 501(b)(5) of the Housing Act of 1949, as amended, per adopted child.

(6) Amounts received by the family in the form of refunds or rebates under state or local law for property taxes paid on the dwelling unit.

(7) 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.

(8) Any other revenue that a federal statute exempts.

(d) *Income exclusions.* Sources of income excluded from both annual and repayment income include:

(1) Income of live-in aides.

(2) Income from employment of minors, including foster children.

(3) Student financial aid paid directly to the student or the educational institution.

(e) *Net family assets.* (1) The value of equity in real property, other than the dwelling or site; cash on hand; savings; checking accounts; demand deposits; and the market value of stocks, bonds, and other forms of capital investments, including voluntary retirement plans that are accessible to the applicant such as individual retirement accounts (IRAs), 401(k) plans, and Keogh accounts, as well as amounts that can be withdrawn from other retirement and pension funds without retiring or terminating employment, but exclude:

(i) Interests 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 such as furniture and automotive,

(iv) The assets that are a part of the business, trade, or farming operation in the case of any member of the household who is actively engaged in such operation, and

(v) The value of a trust fund that has been established where the trust is not revocable by, or under the control of, any member of the household, so long as the fund continues to be held in trust.

(2) The value of any business or household assets disposed of by a member of the household for less than fair market value (including disposition in trust, but not in a foreclosure or bankruptcy sale) during the two years preceding the date of application, in excess of the consideration received therefore. In the case of a disposition as part of a separation or divorce settlement, the disposition shall not be considered to be for less than fair market value if the household member receives important consideration not measurable in dollar terms.

§ 3550.55 Applications.

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

(b) *Agency processing of applications.* (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 time frame.

(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, 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) *Funding priorities.* When funding is insufficient to serve all program-eligible applicants, applications will be considered and funded using the funding priorities specified in this paragraph. Within priority categories, applications will be processed and funded 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 veteran's preference.

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

(2) Second priority will be given to applicants who qualify for any of the following preferences:

(i) Hardship circumstances including applicants living in deficient housing for more than six 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.

(ii) Loans related to the sale of an REO property.

(iii) Loans related to the transfer of an existing RHS property.

(iv) Loans for the construction of dwellings in an RHS-approved Mutual Self-Help project.

(v) Loans that will leverage funding or financing from other sources.

(3) Applications from applicants who do not qualify for priority consideration in paragraphs(c)(1) or (c)(2) of this section.

§ 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 subpart C of part 1924 of this title 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.

§ 3550.57 Dwelling requirements.

(a) *Modest dwelling.* The property must be one 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 (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.

(d) *New dwellings.* Construction must meet the requirements in subpart A of part 1924 of this title.

(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 of subpart A of part 1924 of this title.

§ 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) *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 borrower.

(b) *Secure leasehold interest.* 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 two years longer than the loan term. In no case may the unexpired term be less than 15 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. 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.* Generally, 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.* Generally 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.

(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. Liens junior to the RHS lien will 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 the property's market value.

(3) The provisions of subpart B of part 1927 of this title 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 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.

(a) At loan settlement, or 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.

(b) RHS will estimate the amount of funds due on the basis of current data and reasonable estimates of future expenditures.

(c) Escrow accounts will be administered in accordance with the Real Estate Settlement and Procedures Act of 1974 (RESPA) and section 501(e) of the Housing Act of 1949.

§ 3550.61 Insurance.

(a) *Borrower responsibility.* Until the loan is paid in full the borrower 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. Borrowers who are required to have insurance may be required to escrow funds to ensure payment.

(b) *Amount.* Essential buildings must be insured in an amount at least equal to their depreciated replacement value.

(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)/ 0 as determined by the Federal Emergency Management Agency (FEMA). If flood insurance 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 one percent of the insurance coverage, whichever is greater. The deductible for any one 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) 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 subpart A of part 1924 of this title.

(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) Applied as an extra payment if the borrower has less than 20 percent equity in the property.

(v) Released to the borrower if the borrower has 20 percent or more equity in the property.

(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. Other real estate that is mortgaged as additional security will be appraised when it represents a substantial portion of the security for the loan. Appraisals must be made in accordance with the Uniform Standards of Professional Appraisal Practices (USPAP) and subpart C of part 1922 of this title.

(b) *Fees.* RHS will charge a fee for each loan application that requires an appraisal. The appraisal fee will be waived on appraisals done for subsequent loans needed to make minimal, essential repairs. 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.

A loan may not exceed the limit established by section 203(b) of the

National Housing Act, except by the amount of the RHS appraisal fee and the required contribution to an escrow account for taxes and insurance, unless RHS authorizes an exception.

(a) *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.

(b) *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.

§ 3550.64 Down payment.

Applicants are required to contribute a portion of net family assets toward purchase of the property. Elderly families must use any net family assets in excess of \$10,000 for this purpose; non-elderly families must use net family assets in excess of \$7,500. Applicants may contribute assets in addition to the required down payment to further reduce the amount to be financed.

§ 3550.65 Loan-to-value ratio.

(a) *General requirements.* Except as noted in paragraph (c) of this section, total indebtedness, including the RHS loan plus other liens, may exceed the market value of the security property only as needed to cover the amount of the RHS appraisal fee and the required contribution to establish an escrow account for taxes and insurance.

(b) *Loans limited to 90% of the market value.* Loans for new dwellings are limited to 90% of the market value plus the amount of the RHS appraisal fee and the required contribution to establish an escrow account for taxes and insurance unless:

(1) RHS has issued a conditional commitment for the property,

(2) The loan will be closed prior to the start of construction, so that RHS can ensure that the construction conforms to subpart A of part 1924 of the title, or

(3) Documentation is provided indicating that the construction was inspected by either the Federal Housing Administration (FHA) or Department of Veterans Affairs (VA) and meets the requirements imposed by either agency.

(c) *Loan in excess of market value.* Total indebtedness, including the RHS loan plus other liens, may exceed the market value of the property when:

(1) RHS makes a subsequent loan for closing costs only, simultaneously with the sale of a REO property or a transfer.

The total indebtedness may exceed the lesser of the sales price or market value of the security property by up to one percent, plus the required contribution to establish an escrow account for taxes and insurance.

(2) RHS makes a subsequent loan for repairs necessary to protect the government's security interest. The excess amount may not exceed the cost of the essential repairs, reasonable closing costs, and the required contribution to establish an escrow account for taxes and insurance.

(3) RHS refinances the loan of an existing RHS borrower. The excess can be no more than is necessary to refinance the borrower's outstanding indebtedness plus closing costs associated with the new loan, and the required contribution to establish an escrow account for taxes and insurance.

§ 3550.66 Interest rate.

Loans will be written using the RHS interest rate in effect at loan approval or loan closing, whichever is lower. Information about current interest rates is available in any RECD 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 for initial and subsequent loans.
- (b) Thirty-eight years for initial loans if the applicant's adjusted annual income does not exceed 60 percent of area median and the longer term is necessary to show repayment ability. The repayment period of subsequent loans for these borrowers may be up to the lesser of the remaining term or 33 years.

(c) Ten years for loans not exceeding \$2,500 that are not secured by a mortgage.

§ 3550.68 Payment subsidies.

RHS currently administers two types of payment subsidies. Before October 27, 1995 RHS assistance was provided in the form of interest credit. Since that time, subsidies have been provided in the form of payment assistance. Payment subsidies are subject to recapture when the borrower transfers title or ceases to occupy the property. Borrowers must sign a subsidy repayment agreement at the time subsidy is received.

(a) *Eligibility for payment subsidies.*
 (1) To be eligible to receive payment subsidy, an applicant or borrower must agree to personally occupy the property.

(2) An applicant may receive payment assistance for initial loans or assumptions at new rates and terms if the applicant's adjusted annual income does not exceed either the applicable low-income limit at the time of loan approval, or the applicable moderate-income limit at the time of loan closing. The loan for which payment assistance is being requested must have term of at least 25 years.

(3) A borrower receiving a payment subsidy on an initial loan may receive a payment subsidy on a subsequent loan if the borrower's income does not exceed the moderate-income limit.

(4) A borrower not receiving a payment subsidy is eligible for payment assistance if the borrower's adjusted annual income does not exceed the applicable moderate-income limit.

(5) A payment subsidy may be granted when a loan is assumed on the terms of the promissory note only if the original

loan was approved on or after August 1, 1968.

(b) *Conversion from interest credit to payment assistance.* 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 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 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.

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

- (i) Very low-income borrowers must pay a minimum of 22 percent;
- (ii) Low-income borrowers with adjusted annual income below 65 percent of median income must pay a minimum of 24 percent; and
- (iii) Low-income borrowers with adjusted annual incomes between 65 and 80 percent of median income must pay a minimum of 26 percent.

(2) The equivalent interest rate is determined by a comparison of the borrower's adjusted annual income to the 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		EQUIVALENT INTEREST RATE
When the applicant's adjusted income is:		
Equal to or more than (percent):	BUT less than:	THEN the equivalent interest rate is (percent)*
00	50.01% of median income	1
50.01	55% of median income	2
55	60% of median income	3
60	65% of median income	4
65	70% of median income	5
70	75% of median income	6
75	80.01% of median income	6.5
80.01	50% of median income	7.5
90	100% of median income	8.5
100	110% of median income	9
110	or more than median income	9.5

* 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) 20 percent of the borrower's adjusted annual 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 so that RHS can determine whether a review of the borrower's 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 one percent for up to 15 years. 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 applicant's 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 qualifies for an equivalent interest rate of one percent.

(4) 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 applicant's 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 applicant's 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 applicant's 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, even if income decreases at a later date.

(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 so that RHS can determine whether a review of the borrower's circumstances is required. Adjustments to deferred mortgage assistance will be effective as of the date of income change.

§ 3550.70 Conditional commitments.

A conditional commitment is a determination by RHS that a dwelling to 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 applicable HUD section 203(b) limit. The conditional commitment does not reserve funds, does not guarantee funding, nor does it 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 of this subpart, 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. Anyone who receives five or more conditional commitments during a 12-month period must obtain RHS approval of an affirmative marketing plan;

(5) Comply with the requirements of subpart E of part 1901 of this title and all applicable laws, regulations, and Executive Orders relating to equal opportunity.

(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 six 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 pre-sold and 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 RHS 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.

(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 cancelled 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;

(2) The property is still eligible and has not been optioned by a RHS applicant;

(3) The requested changes are justifiable and appropriate.

(h) *Builder's warranty.* The builder or seller, as appropriate, must execute either a 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) *Approval.* The unit is in a project approved or accepted by HUD, the Federal National Mortgage Association (Fannie Mae), or the Federal Home Loan Mortgage Corporation (Freddie Mac).

(b) *Compliance with statutes.* 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 or assignment 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 3 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 not 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.

(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's 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 under section 502 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) *Loan purposes.* RHS may finance the following when a real estate mortgage covers both the unit and the site:

- (1) An eligible new unit for an eligible site owned by the applicant.
- (2) An eligible new unit and an eligible site.

(3) Site development work in accordance with subpart A of part 1924 of this title.

(4) Subsequent loans for equity or repair with a transfer or credit sale, or a subsequent loan for repair of a unit if the unit is currently financed with a section 502 loan.

(5) Transportation and set-up costs if an eligible new unit is financed.

(b) *Loan restrictions.* 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 a RHS REO property.

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

(3) Existing debts owed by the applicant.

(4) Alteration or remodeling of the unit after the initial loan is made.

(5) 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.

(6) Repairs not associated with transfer or credit sale, or a unit currently financed with a section 502 RH loan.

(c) *Dealer-contractors.* No loans will be made on a manufactured home sold by any entity that is not an approved dealer-contractor.

(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 FMHCSS and subpart A of part 1924 of this title. 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 § 1924.6 of subpart A of part 1924 of this title 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 subpart A of part 1924 of this title, 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 must sign

a Release by Claimants document, as specified in § 1924.6 of subpart A of part 1924 of this title, except the manufacturer of the unit. The manufacturer of the unit must furnish an executed manufacturer's certificate of origin that the unit is free and clear of all legal encumbrances. The use of a Release by Claimants document is optional in a State if the State Director has issued a State Supplement not requiring its use. However, in all States the certificate of origin is required.

(h) *Warranty requirements.* A dealer-contractor must provide a warranty in accordance with the provisions of § 1924.12 of subpart A of part 1924 of this title. 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.

RHS may provide credit on nonprogram (NP) terms to allow applicants to assume existing RHS debt on new rates and terms. If additional funds are required to purchase the property, the applicant must obtain them from another source. 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 subpart.

(a) *NP loan purpose.* NP loans may be offered to expedite:

- (1) Sale of a REO property.
- (2) Assumption of an existing program loan.
- (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) *Rates and terms.* (1) 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 a 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 RHS interest rate in effect at the time of loan approval.

(3) NP borrowers are not eligible for program benefits such as payment assistance, deferred mortgage 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 on purchase price in the case of credit sales, or, in the case of assumptions, on the lower of market value of the property or debt incurred. The downpayment will also be based upon whether the applicant intends to personally occupy the property or use it for other purposes.

(3) NP applicants cannot finance loan closing costs.

(4) Loans will be secured only by the property purchased.

(5) RHS may require a NP applicant to pay a one-time tax service fee to cover the cost of monitoring the property's tax status.

(d) *Reduced restrictions.* (1) NP applicants need not be unable to obtain other credit in order to receive a 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.

(4) Liquidation may be delayed for up to 90 days to permit a NP borrower to liquidate voluntarily.

(e) *Waiver of fees.* 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, down payment, and appraisal fee may be waived.

§§ 3550.75–3550.100 [Reserved]

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. 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.

Dwellings repaired with section 504 funds must be modest.

(a) *Grant funds.* Grant funds may be used only to pay costs for repairs and improvements which 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 RHS.

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

(c) *Eligibility of mobile and manufactured homes.* Necessary repairs 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 Rural Housing Service (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 connection fees, assessments, or the pro rata installation costs for required utilities, if not funded by another source.

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

(3) 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, if applicable.

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

(e) *Limitations 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 of such poor condition that when the repairs are completed, the dwelling will continue to be a major hazard.

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

(4) Pay for off-site improvements except for the necessary installation 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.

§ 3550.103 Construction standards and requirements.

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

(b) *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 subpart A of part 1924 of this title.

§ 3550.104 Maximum loan and grant.

(a) *Maximum loan permitted.* The sum of all outstanding section 504 loans to one borrower or on one dwelling may not exceed \$20,000.

(1) Transferees assuming a 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 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 owner-occupant is \$7,500.

§ 3550.105 Eligibility requirements.

To be eligible, applicants must meet the following requirements:

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

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

(c) *Income eligibility.* At the time of loan or grant approval, the adjusted

income of an applicant must not exceed the applicable very low-income limit adjusted for household size (available in any Rural Economic Community Development (RECD) office). Section 3550.54 of subpart B of this part 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 of subpart A of this part.

(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. Applicants must use assets in excess of \$7,500 for loan or grant purposes before assistance will be provided. 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) *Credit qualifications.* Applicants must be unable to secure the necessary credit from other sources upon 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 outstanding judgment obtained by the United States in a federal court, other than the United States Tax Court demonstrates an unacceptable credit history.

(1) Indicators of unacceptable credit include:

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

(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 (IRS) 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 (f)(2)(ii) and (f)(2)(iii) of this section.

(v) Two or more rent payments paid 30 or more days late within the last two years, or within the last year if the applicant has experienced no other credit problems in the past two years. This requirement 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 six months.

(vii) Non-agency debts written off within the last 36 months.

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

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

(i) Lack of a credit history.

(ii) 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.

(iii) A judgment satisfied more than 12 months before the date of application, or foreclosure with no monetary loss that was completed 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.

(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 RECD office.

§ 3550.106 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) Applications for assistance to remove health and safety hazards will receive priority for funding.

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

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

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

(5) Applicants who are eligible will be notified in writing. If additional information becomes available which indicates the original eligibility determination may have been made in error or that circumstances have

changed, RHS may reconsider the application.

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

§ 3550.107 Ownership requirements.

The applicant must have an acceptable ownership interest in the property.

(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 two years beyond the term of the promissory note. For grants, the remaining lease period must be at least five years.

(c) *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.

(d) *Undivided interest in the property.* 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) *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, persons with any remainder interests generally must be signatories to the mortgage. All of the remainder interests need not be included in the mortgage if 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.

(f) *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 Loan rates and terms.

(a) *Interest rate.* The interest rate for all section 504 loans will be one 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.

§ 3550.109 Security requirements (loans only).

Any loan of \$2,500 or more will be secured by a mortgage on the property (or any 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.

(b) Subsequent loans will be secured by a mortgage when the total section 504 debt is \$2,500 or more.

(c) Title clearance and the use of legal services in accordance with subpart B of part 1927 are not required:

(1) For loans of \$7,500 or less that are scheduled for repayment in not more than 15 years or

(2) For subsequent loans made for minimal essential repairs necessary to protect the government's interest.

§ 3550.110 Appraisals.

An appraisal of the real estate or leasehold interest is required when security is taken and the total section

504 indebtedness will be more than \$15,000. Appraisals must be made in accordance with the Uniform Standards of Professional Appraisal Practices (USPAP) and subpart C of part 1922 of this title.

§ 3550.111 Escrow account.

RHS may require that 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.

(a) At loan settlement, or 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.

(b) RHS will estimate the amount of funds due on the basis of current data and reasonable estimates of future expenditures.

(c) Escrow accounts will be administered in accordance with the Real Estate Settlement and Procedures Act of 1974 (RESPA) and section 501(e) of the Housing Act of 1949.

§ 3550.112 Insurance (loans only).

(a) *Borrower responsibility.* Until the loan is paid in full the borrower must furnish and continually maintain insurance on security property, with companies, in amounts, and on terms and conditions acceptable to RHS.

(b) *Amount.* Essential buildings must be insured in an amount at least equal to their depreciated replacement value.

(c) *Flood insurance.* RHS may require that flood insurance be obtained and maintained for the life of the loan for all property located in Special Flood Hazard Areas (SFHAs) as determined by the Federal Emergency Management Agency (FEMA). If flood insurance 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 one percent of the insurance coverage, whichever is greater. The deductible for any one 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) Loss payments must 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 subpart A of part 1924 of this title.

(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) Applied as an extra payment if the borrower has less than 20 percent equity in the property.
 - (v) Released to the borrower if the borrower has 20 percent or more equity in the property.
- (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.

§ 3550.113 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 to the government if the property is sold in less than 3 years from the date of grant closing.

§§ 3550.114–3550.150 [Reserved]

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.

§ 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, new payment assistance, or servicing action that benefits the borrower is approved. Suitable forms of payment are: check, money order, or bank draft. Cash payments will be accepted only if accompanied by a fee to cover conversion to a money order.

(b) *Application of payments.* If a borrower makes less than the full 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 full scheduled payment, the full 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.
- (5) Fees or charges applied to the account.

(c) *Multiple loans.* When a borrower with multiple loans for the same property makes less than the full scheduled payment on all loans, any payment will first be applied to the amount due on the primary loan, then applied to other loans in the order of declining principal balance. 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 and designate on their billing statements whether the extra funds are to be applied to the principal or escrow. Extra payments do not relieve borrowers of the obligation to make the next scheduled payment.

§ 3550.153 Fees and charges.

RHS may assess reasonable fees and charges including a tax service fee, fees for late payments, and charges 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 a 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 the Real Estate Settlement and Procedures Act of 1974 (RESPA) and section 501(e) of the Housing Act of 1949. When the analysis discloses a shortage, RHS may allow the shortage to exist until the next escrow analysis, or may adjust the borrower's monthly payment.

§ 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 borrower's account in the form of a protective advance.

§ 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 meet the requirements of § 3550.53(a), (b), and (c) of subpart B of this part.

(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. If RHS determines that a borrower has received less than the appropriate amount of payment subsidy, the borrower's account will be credited with the difference between the amount received and the correct amount.

(3) The borrower must notify RHS whenever an adult member of the household becomes employed or changes employment. The household may also report decreases in income. If the change in the household's income will cause the level of assistance to change by at least \$10 per month, 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 and who meet the requirements of § 3550.53(a), (b), and (c) of subpart B of this part. 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) *Unauthorized assistance.* When RHS determines that a borrower has

received more than the appropriate amount of payment subsidy, the account will be serviced in accordance with § 3550.164 of this subpart.

§ 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.

(a) *Amount of Assistance.* If a borrower qualifies for payment subsidy after reduction of the interest rate to six percent, the amount of payment assistance received during the period of active military duty will be the difference between the amount due at the Equivalent Interest Rate 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 as extra payments.

(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 assigns it to RHS to be applied as extra payments.

(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 a 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 subpart A of part 1924 of this title or directed by the other lender in a manner which is consistent with that subpart.

(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 on the loan, exclusive of the recapture amount, 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 as determined by a current appraisal.

(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 one year old or if it does not reflect market value, and the amount of consideration exceeds \$2,000. 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 subpart G of part 1940 of this title must be met.

(6) When exchange of all or part of the security is involved, title clearance must be obtained before release of the existing security.

(7) For the sale of a portion of the security payment, when payment is received and verified, the release may be delivered.

(8) 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 subpart A of part 1924 of this title and supervised to ensure that the proceeds are used as planned.

(d) *Lease of security property.* A borrower must furnish RHS with a copy of any lease or proposed lease. If the lease is for a term of more than three years or contains an option to purchase, RHS may liquidate the loan.

§ 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. If RHS agrees that the borrower is not a candidate for refinancing with private credit, RHS will withdraw the request.

(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.

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 repairs or improvements to the security property.

(f) *Application for additional credit or assistance.* A borrower who has been asked to refinance with private credit will not be considered for additional credit or assistance until the refinancing issue is resolved unless such additional assistance 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) *Written 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 two statements are requested in any 30 day period.

(d) *Suitable forms of payment.* Suitable forms of payment are: check, money order, or bank draft. Cash payments will be accepted only if accompanied by 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 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 of subsidy 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% of the difference between the value appreciation in the property and the added value of capital improvements to the property.

(2) The value appreciation of a property with a cross-collateralized loan is based on the market value of 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, exclusive of recapture, is paid in full, 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 may receive a discount on the recapture amount due if the recapture amount is repaid within 30 days of refinancing or payment of the last loan installment, and the borrower continues to occupy the property.

(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.* 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 and the RHS loan, exclusive of recapture, is paid in full, the deferred recapture amount may be assumed by a new RHS borrower and 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 of 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.* 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 nonprogram 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) The applicant may request that the interest rate charged by RHS be the rate in effect either at the time of loan approval or at closing, whichever is lower. If the applicant does not specify, the rate in effect at the time of loan approval will be used.

(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 co-signer, 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 a 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) *Types of unauthorized assistance.* Unauthorized assistance includes:

(1) A loan or grant made to a recipient who did not qualify for the assistance, or made for an ineligible purpose.

(2) Subsidy in excess of \$10 per month or \$120 per year for which the recipient was not eligible.

(b) *Recipients who provide false information.* (1) False information is information provided by the recipient that the recipient knew was incorrect at the time it was provided, and was provided with the intent to obtain benefits that would not have been obtainable based upon correct information.

(2) If false information related to recipient eligibility or the purpose of the loan or grant results in the borrower receiving unauthorized assistance, RHS will accelerate any loan and require repayment of any subsidy or grant.

(3) If false information related to the amount of subsidy results in the recipient receiving unauthorized assistance, the recipient will be required to repay all excess subsidy received. The account may not be reamortized to include this excessive subsidy.

(4) RHS may suspend or debar any recipient who provides false information.

(c) *Recipients who provide inaccurate information and unauthorized assistance received as a result of RHS error.* (1) Inaccurate information is incorrect information inadvertently provided by the recipient without intent to obtain benefits fraudulently.

(2) Recipients who provide inaccurate information related to eligibility or the purpose of the loan or grant will be permitted to retain the loan.

(3) The recipient will be required to repay all excess subsidy received based on inaccurate information. If a recipient is unable to repay the excess subsidy in a lump sum, the account may be reamortized.

(d) *Repayment terms.* If a recipient cannot repay the unauthorized amount within a reasonable period, RHS may reamortize the loan. Refusal to repay will result in acceleration of the loan.

§§ 3550.165–3550.200 [Reserved]**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; work-out agreements that temporarily modify payment terms; protective advances of funds for taxes, insurance and other approved costs; payment moratoriums; and reamortization at promissory note or new interest rates.

§ 3550.202 Past due accounts.

An account is past due if the full scheduled payment is not received by the due date.

(a) *Late charges.* A late charge will be assessed if the full scheduled payment is not received by the 15th day after the due date.

(b) *Liquidation.* The account may be liquidated without further servicing when at least three full scheduled payments are past due or an amount equal to at least two full scheduled payments is past due for at least three consecutive months. 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 the creation and funding of an escrow account for real estate taxes and insurance, if one does not already exist.

(b) Convert the method of calculating interest for any account being charged daily simple interest to a preamortized 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 is an above-moderate or nonprogram loan, may refinance the loan if:

(a) The borrower is now 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 Work-out agreements.

Borrowers with past due accounts may be offered the opportunity to avoid liquidation by entering into a written work-out agreement that specifies a plan for bringing the account current. To receive a work-out agreement, the following requirements apply:

(a) A borrower who currently makes annual payments but receives monthly income must convert to monthly payments.

(b) A borrower who is able to do so will be required to pay the past-due amount in a single payment.

(c) 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 two years or the remaining term of the loan, whichever is shorter.

(d) If a borrower becomes more than 30 days past due under the terms of a work-out 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 protective advance will be made only if the borrower cannot obtain a subsequent loan.

(a) *Advances for taxes and insurance.* RHS may advance funds to pay real estate taxes, hazard and flood insurance premiums, and other related costs.

(1) Monthly payments to the escrow account will be adjusted to ensure recovery of this advance within 12 months.

(2) A borrower without an established escrow account will be required to establish such an account. RHS may advance amounts needed to pay taxes and insurance due as well as to fund the borrower's contribution to the current escrow cycle. Amounts advanced may be reamortized or repaid by the borrower in a lump sum due with the next scheduled installment.

(b) *Advances for costs other than taxes and insurance.* Advances for costs other than real estate taxes and hazard insurance will bear interest at the promissory note rate of the loan against which they are being charged. Advances for borrowers with multiple loans will be charged against the primary loan.

§ 3550.207 Payment moratorium.

RHS may defer for up to two years payments for either principal, interest, and contributions to the escrow account for taxes and insurance, or payments for only principal and interest.

(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 last year,

(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 monthly payments.

(c) *Resumption of monthly payments.* When the borrower is able to resume scheduled monthly payments, the loan will be reamortized to include the amount deferred during the moratorium. 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 monthly payments.* If even after all appropriate servicing actions have been taken the borrower is unable to resume making scheduled payments after two consecutive years of being on a

moratorium, the account should 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 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.
- (2) Repay principal and interest accrued and advances made during a moratorium.
- (3) Reinstate an accelerated account.
- (4) Bring current an account under a work-out agreement after the borrower has demonstrated the willingness and ability to meet the terms of the loan and work-out agreement.

(5) Bring a delinquent account current at the time an assumption is processed on the terms of the promissory note.

(6) 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 standard term that was available 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. When reamortizing using the promissory note interest rate, the loan term cannot be extended to 38 years.

§ 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 by a federal employee may be collected pursuant to the salary offset provisions in 7 CFR part 3, subpart C.

(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.* 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 liquidate the debt and, if necessary, acquire the security property. The borrower is responsible for all expenses associated with liquidation and acquisition. After the security property is liquidated, RHS will credit the borrower's account. 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.

(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 co-signer. If the borrower does not pay the full account balance or meet the other terms of the loan within 30 days of acceleration, RHS may foreclose.

(d) *Cancelling acceleration.* In the case of an account accelerated because the security property has been sold or transferred without RHS consent, acceleration cannot be canceled. In all other cases, the borrower may offer to cure a default after acceleration. RHS will not accept an offer to cure a default after acceleration unless it is in the government's best interest. Methods for curing the default include:

(1) *Voluntary liquidation.* The borrower may refinance or sell the security property at net recovery value and apply the proceeds to the account. Foreclosure action will not be delayed pending voluntary liquidation unless a copy of a firm funding commitment is provided to RHS indicating that closing will occur within 90 days. An extension of time may be allowed to complete a transaction provided:

(i) The security property is listed with a real estate broker for not more than the net recovery value as determined by RHS.

(ii) A sales contract has been entered into and assumption of the RHS loan, or a loan from another lender, is pending, or

(iii) The borrower has applied to a lender for a long-term loan to pay RHS in full.

(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 co-signer makes an offer in the amount of 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. The borrower may be considered for a moratorium or for payment assistance.

(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 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.

§§ 3550.212-3550.250 [Reserved]

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 provide public notice of all sales of REO property, and 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) When RHS takes title to a security property, it is classified as either program or nonprogram (NP) property. A 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. A 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) When RHS determines that a REO property to be sold is not decent, safe and sanitary, or does not meet cost-effective energy conservation standards, its known defects will be disclosed. The deed by which such a 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.

(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 three business days after the date the property is offered for sale. An offer received during the three-day holding period is not considered until the fourth day, and is evaluated with any other offers actually received on the fourth 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) RHS may authorize the sale of a 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 a REO property to provide transitional housing for the homeless, RHS will stop marketing the property 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 a 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. Such sales must be consistent with section 510(e) of the Housing Act of 1949 and in the best interests of the government.

§ 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 generally does not settle debts for one loan while other RHS loans on the same security property remain active.

(d) *Co-signers and claims against estates.* RHS may use any and all remedies available under law to collect from any co-signer and from a deceased borrower's estate.

(e) *Joint debtors.* Settlements will not be approved for one joint debtor unless approved for all debtors.

(f) *Reporting.* RHS will report to IRS and credit reporting agencies any debt settled through cancellation, compromise or adjustment.

(g) *Settlement during legal or investigative action.* Cases that are under investigation for fiscal irregularity or have been referred to the Office of Inspector General (OIG), the Office of the General Counsel (OGC) or the U.S. Attorney will not be considered for debt settlement until final action by the

investigating or prosecuting entity has been taken.

(h) *Offsets.* RHS may request offsets as described in § 3550.210 of subpart E of this part to collect amounts owed.

(i) *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 upon receipt of a reduced amount paid as an initial lump sum and periodic additional payments over a period of up to five 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 or the initial payment made as part of an adjustment offer 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.

§ 3550.254–3550.300 [Reserved]

Dated: March 8, 1996.

Inga Smulkstys,

Acting Under Secretary, Rural Economic and Community Development.

[FR Doc. 96–8492 Filed 4–5–96; 8:45 am]

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NUCLEAR REGULATORY COMMISSION

10 CFR Part 50

RIN 3150–AF41

Financial Assurance Requirements for Decommissioning Nuclear Power Reactors

AGENCY: Nuclear Regulatory Commission.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Nuclear Regulatory Commission is considering amending its regulations relating to financial assurance requirements for the decommissioning of nuclear power plants. Potential deregulation of the power generating industry has created uncertainty with respect to whether current NRC regulations concerning decommissioning funds and the financial mechanisms will require a modification to account for utility reorganizations not contemplated when current financial assurance requirements were promulgated. Additionally, the NRC is considering requiring power reactor licensees to periodically report on the status of their decommissioning funds. Allowing credit for earnings on decommissioning trust funds during extended storage will also be considered. This advance notice of proposed rulemaking is issued to invite public comment on issues pertaining to the form and content of the NRC's nuclear power reactor decommissioning financial assurance requirements as they relate to electric utility deregulation.

DATES: Submit comments by June 24, 1996. Comments received after this date will be considered if it is practical to do so, but the Commission is able to assure consideration only for comments received on or before this date.

ADDRESSES: Mail comments to: The Secretary of the Commission, U.S. Nuclear Regulatory Commission, Washington, DC 20555–0001, Attention: Docketing and Service Branch.

Deliver comments to: 11555 Rockville Pike, Rockville, Maryland, between 7:45 a.m. and 4:15 p.m. Federal workdays.

For information on submitting comments electronically, see the discussion under Electronic Access in the Supplementary Information Section.

Examine copies of comments received at: The NRC Public Document Room, 2120 L Street NW. (Lower Level), Washington, DC.

FOR FURTHER INFORMATION CONTACT:

Brian J. Richter, Office of Nuclear Regulatory Research, U.S. Nuclear Regulatory Commission, Washington, DC 20555–0001, telephone (301) 415–6221, e-mail bjr@nrc.gov.

SUPPLEMENTARY INFORMATION:

Background

Requirements pertaining to financial assurance for the decommissioning of nuclear power reactors are contained in § 50.75. Under § 50.75(e)(3), the NRC allows power reactor licensees, who are

defined as “electric utilities”¹ under § 50.2, to set aside funds annually over the estimated life of the reactor for decommissioning. The NRC provided more flexibility to its electric utility licensees than other licensees because electric utilities have existed in a highly structured environment regulated by State public utility commissions (PUCs) or the Federal Energy Regulatory Commission (FERC). Under § 50.75(e)(2), the NRC requires licensees other than electric utilities to set aside an external sinking fund coupled with a surety method or insurance for any unfunded balance. However, with the advent of deregulation, the distinction between electric utility licensees and other licensees will likely be reduced or eliminated. Thus, the NRC needs to clarify the definition of “electric utility” and to require additional assurance of those licensees whose power reactor costs are no longer regulated.

Typically, power reactor licensees place decommissioning funds in external trust or escrow accounts that are reserved for decommissioning activities.² Under the definition of external sinking fund, power reactor licensees must accumulate all the funds estimated to be needed for decommissioning by the time their facilities are permanently shut down. Although § 50.75(e) also allows power reactor licensees to use surety bonds, letters of credit, and prepayment to provide funding assurance, virtually all power reactor licensees use the external sinking fund method of assurance.

In addition, § 50.75(e)(3)(iv) provides that an electric utility that is a Federal Government licensee need only provide assurance in the form of a statement of intent indicating that decommissioning funds will be obtained when necessary.

¹ “Electric utility means any entity that generates or distributes electricity and which recovers the cost of this electricity, either directly or indirectly, through rates established by the entity itself or by a separate regulatory authority. Investor-owned utilities, including generation or distribution subsidiaries, public utility districts, municipalities, rural electric cooperatives, and State and Federal agencies, including associations of any of the foregoing, are included within the meaning of “electric utility.”

² Many licensees that have established decommissioning trust funds for their power reactors are making deposits into their trust accounts both for decommissioning costs as defined under § 50.2 and for other decommissioning-associated costs such as interim spent fuel management and storage and “green field” costs. The NRC allows licensees to deposit funds in the same trust account as long as the trust has sub-accounts that clearly delineate the purposes of the sub-account. A trust or sub-account established to provide assurance of NRC-defined decommissioning costs should be stipulated to cover NRC-defined decommissioning costs before any other purpose.