USDA Rural Development refocuses on Sec. 538

By Donna Kimura

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The U.S. Department of Agriculture's Rural Development division is making a push for multifamily developers to use its Sec. 538 guaranteed loan program.

One of the regions leading the rededicated commitment to the program is California, where a new awareness campaign is under way.

"Sec. 538 has surfaced as a growing program with an opportunity to become even larger," said Jeff Deiss, multifamily housing program director for USDA Rural Development in California.

Several recent changes have made the program more flexible and appealing, according to Deiss. For example, Sec. 538 used to be restricted to new construction projects, but it has been expanded to be used with acquisition and rehab deals when at least $15,000 per unit of rehab work is involved. Officials are considering lowering that amount to allow more deals to qualify under the program.

Sec. 538 is also compatible with tax-exempt bond and low-income housing tax credit projects. For 9% tax credit deals, the program can be used to guarantee the gap financing, while on 4% tax credit projects it can be used to guarantee the bond and/or the gap financing.

To date, Moody's Investors Service has given an A1 rating to senior bond transactions backed by Sec. 538 guarantees.

The USDA has also been working with Freddie Mac, Fannie Mae and Ginnie Mae to make the program more attractive in the secondary market.

Sec. 538 has been around for several years but got off to a slow start. Activity has been increasing each year, according to officials. Last year, the program provided $100 million in guarantees nationwide. The same amount has been budgeted this year.

The program is designed for developers building multifamily housing in rural areas. Sec. 538 guarantees up to 90% of a loan made by a lender.

Developers benefit through flexible financing features such as a high loan-to-value ratio, which is 90% for for-profit corporations and 97% for a nonprofit. The amortization period can be up to 40 years. Use of Sec. 538 does not activate the Davis-Bacon Act wage requirements.

"The affordability criteria is not unduly burdensome," added Michael Kelley, Sec. 538 program coordinator in Davis, Calif.

There's no minimum or maximum size for a loan. The typical loan has been in the $10 million range, according to Deiss.

Guarantees can be placed on a combined construction and permanent loan or just on the permanent loan.

Projects must be in rural areas, typically unincorporated areas and cities with fewer than 20,000 residents. Eligible tenants are those with incomes no greater than 115% of the area median income (AMI). The average rent plus utility allowance must not exceed 30% of AMI.

Lenders must apply to qualify for the program, but Deiss said that Fannie Mae, Freddie Mac and Department of Housing and Urban Development lenders should easily qualify. USDA charges a $2,500 application fee. In addition, there is a one-time guarantee fee, equal to 1% of the guaranteed amount, that is due at guarantee closing, plus an annual servicing fee of 0.5% on the loan balance owing as of Dec. 31 of each year. ■