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CHAPTER 1: INTRODUCTION

SECTION 1: INTRODUCTION TO THE PROJECT SERVICING HANDBOOK

1.1 ABOUT THIS HANDBOOK

This handbook provides Loan Servicers with guidance about the Agency's procedures for servicing actions involving borrowers receiving loans or grants for Multi-Family Housing projects. Its goal is to help Loan Servicers in Field Offices perform consistent, effective servicing of projects financed by the Agency to ensure that they are operated in accordance with applicable regulatory and administrative requirements.

This handbook presents the Agency's project servicing procedures for:

- Section 515 Multi-Family Housing projects:
  - ◊ Rural rental housing (including congregate housing and group homes); and
  - ◊ Rural cooperative housing.
- Section 514/516 Farm Labor Housing projects:
  - ◊ Off-farm labor housing; and
  - ◊ On-farm labor housing.

The guidance provided by this handbook is intended to be consistent with all applicable laws, Executive Orders, and departmental regulations, including other Agency regulations. Nothing contained in this handbook should be construed to supersede, rescind, or otherwise amend such laws, Executive Orders, and regulations.

1.2 COMPANION MULTI-FAMILY HOUSING HANDBOOKS

This handbook is the third in a series of three handbooks that describe the requirements and procedures for the Agency's Multi-Family Housing direct loan and grant programs. The two companion handbooks are:

- **HB-1-3560: Loan Origination.** This handbook covers the requirements and procedures for processing loan and grant applications for Multi-Family Housing projects, selecting projects for Agency funding, and closing the loans and grants for these projects.
- **HB-2-3560: Asset Management.** This handbook covers the requirements and procedures regarding the ongoing management of Multi-Family Housing projects and the Agency's oversight of borrower performance.

1.3 USING THIS HANDBOOK

The handbook is organized to allow the reader to look up information on specific topics easily. Several graphic tools and conventions have been used to make information easier to find and understand.

A. Citations and Text Boxes

- **Regulatory citations.** The regulation for Agency Multi-Family Housing programs is provided in 7 CFR Part 3560. The text of that regulation is included in **Appendix 1**. To help readers locate the regulatory authority for procedures described here, references to this regulation in paragraph headings appear in italicized brackets, for example: *[7 CFR 3560.51]*. Other regulations or RD Instructions are simply referenced.

- **Form references.** Agency forms and Agency guide, form, and system letters are shown in *italics.* All forms referenced in this handbook can be found in **Appendix 3** and all letters can be found in **Appendix 3**.

- **Examples and exhibits.** Text boxes labeled as examples provide a specific illustration of a concept described in the text. Exhibits illustrate key points and are numbered in sequence, using the chapter number and a sequence number; for example, Exhibit 3-1 is the first exhibit in Chapter 3.

B. Attachments and Appendices

- **Attachments.** Attachments at the end of each chapter contain technical information that is specific to the topics covered in the chapter. Attachments are referenced in sequence using the chapter number and a sequence letter; for example, Attachment 4-A is the first attachment in Chapter 4.

- **Appendices.** Appendices at the end of the handbook include forms and other reference materials that relate to multiple chapters.

C. Terminology

Because terminology may vary from State to State and may change over time, this handbook uses certain standard terminology to provide consistency.

- **Agency.** The term “Agency” is used throughout this handbook to refer to the Rural Housing Service (RHS) within the U.S. Department of Agriculture (USDA) that is responsible for administration of the Multi-Family Housing programs.

- **Approval Official.** This term is used whenever someone other than the Loan Servicer must approve an action.

- **Borrower.** The term "borrower" refers to one or more individuals who are receiving Agency assistance through a Multi-Family Housing program in the form of a loan or a grant.

- **Field Office.** Because the number of offices and the nature of the work conducted in each office may vary from state to state, the term "Field Office" is used throughout this handbook to refer to the office that is originating or servicing the loan.

- **Loan Servicers.** This term refers to Field Office Staff with responsibility for ensuring that multi-family housing borrowers comply with program requirements and for servicing loan accounts.

- **Management Agent.** A "management agent" is an entity that contracts with the borrower to perform the management functions necessary to effectively operate a multi-family housing project.

- **State Director.** This term is used to refer to the Director of the State Office or the Agency staff person to whom the State Director has delegated decisionmaking authority for a specific aspect of the program. Unless otherwise specified, each State Director may determine which actions may be approved at the Field Office and which must be approved at the State Office.

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SECTION 2: OVERVIEW OF THE AGENCY'S MULTI-FAMILY HOUSING PROGRAMS

1.4 GOALS OF RHS MULTI-FAMILY HOUSING PROGRAMS

The purpose of the Agency's Multi-Family Housing programs is to provide adequate, affordable, decent, safe, and sanitary rental units for very low-, low-, and moderate-income households in rural areas. In providing this service, the Agency strives to meet several goals.

- **Customer service.** The Agency is committed to providing customer-friendly, streamlined service. The Agency 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.

- **Partnerships.** The Agency seeks to enhance its ability to serve eligible households by working with its partners, such as borrowers, property management agents, tenants, other lenders, nonprofit organizations, and State and Local agencies.

- **Effective use of resources.** As publicly funded initiatives, the Agency's Multi-Family Housing programs must use tax dollars efficiently. The Agency aims to minimize administrative costs, underwrite loans responsibly, and leverage funding with private sources of credit to the extent possible.

1.5 SECTION 515 PROGRAM—OVERVIEW

The Section 515 direct loan program *[7 CFR Part 3560]* provides financing to support the development of rental units in rural areas that need housing affordable for very low-, low-, and moderate-income households, and where this housing is unlikely to be provided through other means.

Section 515 loans can be used to build, acquire and rehabilitate, or improve dwellings in rural areas. The term for loans is tied to the expected useful life of the property, and the standard term for an initial Section 515 loan is 30 years with a 50-year amortization period. However, the term for subsequent loans and loans for special types of properties, such as manufactured housing, may be made for a shorter term based on the project's expected useful life.

Each loan is made at a note rate established by the Agency as prescribed in RD Instruction 440.1. Borrowers approved for initial and/or subsequent loans receive interest credit that reduces the effective interest rate for the Agency's financing, thereby lowering the property's rents. In return for this below-market rate financing, the borrower agrees to lease the project's rental units to income-eligible households at rents approved by the Agency.

1.6 SECTION 514/516 PROGRAMS—OVERVIEW

Section 514/516 direct loan and grant programs provide funds to support the development of adequate, affordable housing for farmworkers that is unlikely to be provided through other means.

A. Section 514 Loans and Section 516 Grants for Off-Farm Housing

Section 514 loans and Section 516 grants can be used for the same purposes as Section 515 loans to finance rental housing for farmworkers. Unlike Section 515 projects, off-farm labor housing projects may be built outside rural areas, as long as the project addresses a need for affordable housing for farmworkers. These projects are eligible for financing at terms comparable to Section 515 loans, a grant to cover a significant share of the development cost, or a loan/grant combination finance package. Tenants not only must be income-eligible, but also receive priority based on the proportion of their income received from farmwork.

B. Section 514 Loans for On-Farm Housing

Section 514 loans can also be used to finance the development of adequate housing for farmworkers involved in a specific farm operation—On-Farm Labor Housing projects. These projects are treated as part of the farming operation, and the occupants do not pay shelter cost (rent & utilities) unless the shelter cost is approved by the Agency

Labor housing borrowers who are providing shelter for domestic farm housing that is restricted for use by eligible residents supporting the borrower's farming operation may choose to provide that housing to residents without imposing charges for rent or utilities or may choose to impose charges for rent, utilities, or rent and utilities subject to Agency approval. All other labor housing borrowers who are providing shelter in support of farming operations in the community at large are expected to operate the program in accordance with Agency regulations governing the approval of charges for rent, utilities, or rent and utilities subject to Agency approval.

SECTION 3: GENERAL PROGRAM REQUIREMENTS

1.7 CIVIL RIGHTS *[7 CFR 3560.2]*

The Agency 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. The civil rights compliance requirements for the Agency are contained in RD Instruction 1901-E. Exhibit 1-1 lists the applicable Federal laws and Executive Orders and highlights their key aspects.

Exhibit 1-1

Major Civil Rights Laws Affecting the Multi-Family Housing Loan and Grant Programs

- **Equal Credit Opportunity Act (ECOA).** Prohibits discrimination in the extension of credit on the basis of race, color, religion, national origin, sex, marital status, age, income from public assistance, and exercise of rights under the Consumer Credit Protection Act.
- **Title VI of the Civil Rights Act of 1964.** Prohibits discrimination in a Federally assisted program on the basis of race, color, and national origin.
- **Title VIII of the Civil Rights Act of 1968** (also known as the Fair Housing Act of 1988, as amended). Prohibits discrimination in the sale, rental, or financing of housing on the basis of race, color, religion, sex, national origin, familial status, or disability.
- **Section 504 of the Rehabilitation Act of 1973.** Prohibits discrimination in a Federally assisted program on the basis of disability.
- **Age Discrimination Act of 1975.** Prohibits discrimination in a Federally assisted program on the basis of age.
- **Title IX of the Education Amendments of 1972.** Prohibits discrimination on the basis of sex in education programs and activities receiving Federal financial assistance from Rural Development.
- **Executive Order 11063 as Amended by Executive Order 12259.** Prohibits discrimination in housing or residential property financing to any Federally assisted activity against individuals on the basis of race, color, religion, sex, or national origin.
- **Executive Order 11246.** Prohibits discrimination in employment by construction contractors (and subcontractors) receiving Federally assisted construction contracts in excess of $10,000. Provides for equal employment opportunity without regard to race, color, religion, sex, and national origin.
- **Executive Order 12898**. Requires each Federal agency to make achieving environmental justice a part of its mission by identifying and addressing disproportionately high and adverse human health or environmental effects of its programs, policies, and activities on minority and low-income populations.

A. Nondiscrimination

The various civil rights laws prohibit the denial of loans, grants, services, and benefits provided under the Section 515 and 514/516 programs to any person on the basis of race, color, national origin, sex, religion, marital status, familial status, age, physical or mental disability, or source of income, or because the applicant has, in good faith, exercised any right under the Consumer Credit Protection Act (15 U.S.C. 1601). Discrimination in employment practices also is prohibited. These same requirements also apply to program participants. Agency oversight of borrower compliance with civil rights laws is covered in Chapter 4 of HB-2-3560. Civil rights complaints filed by tenants are handled by the Agency in accordance with RD Instruction 2000-GGG.

Effective management and consistent procedures are good business practices that help ensure that all applicants are treated fairly. Poor program implementation, whether discrimination is intended, has possible civil rights consequences.

Key Civil Rights Issues for Project Servicing

- Access;
- Consistency and fairness of treatment;
- Disparate impacts, intended or unintended; and
- Record keeping.

B. Reasonable Accommodations for Persons with Disabilities

In addition to avoiding discrimination, the Agency and loan and grant recipients must make reasonable accommodations to permit persons with disabilities to apply for and benefit from Agency programs. Reasonable accommodations may include providing modifications to the dwellings and facilities so that they are physically accessible. Reasonable accommodations may also include effective communication and outreach tools so that all applicants can obtain program information (e.g., a Telecommunications Device for the Deaf [TDD]).

C. Limited English Proficiency *[7 CFR 3560.2]*

Borrowers and grantees must take reasonable steps to ensure that Limited English Proficiency (LEP) persons receive the language assistance necessary to afford them meaningful access to USDA programs and activities, free of charge. Failure to ensure that LEP persons can effectively participate in or benefit from federally assisted programs and activities may violate the prohibition under Title VI of the Civil Rights Act of 1964, 42 U.S.C. 2000d, and Title VI regulations against national origin discrimination. USDA has issued guidance to clarify the responsibilities of recipients and subrecipients who receive financial assistance from USDA and assist them in fulfilling their responsibilities to LEP persons under Title VI of the Civil Rights Act, as amended, and implementing regulations.

D. Civil Rights Impact Analysis

Agency employees will conduct civil rights impact analyses in accordance with RD Instruction 2006-P, to determine whether proposed policy actions, if approved and implemented, will negatively and disproportionately affect employees, program

beneficiaries, or applicants for employment or program benefits due to race, national origin, or other protected basis.

1.8 REVIEWS AND APPEALS *[7 CFR 3560.9]*

Decisions that are not made in favor of a program participant (applicant or borrower) are known as adverse decisions. Adverse decisions must be based upon regulations that are published in the Code of Federal Regulations (CFR). For the direct Multi-Family Housing programs, any adverse decisions must be based upon 7 CFR Part 3560 and not the administrative guidance contained in this handbook. Adverse decisions include: (1) administrative actions taken by Agency officials, and (2) the Agency's failure to take required actions within timeframes specified in statutes or regulations or within a reasonable time if no deadline is specified. **Appendix 2** of this handbook contains 7 CFR Part 11, which is the regulation of the National Appeals Division (NAD) and provides procedures that both Agency officials and program participants must follow when an appeal is made. *Handbook Letter 101 (3560), Standardized Adverse Decision Letter,* will be used for all adverse decisions unless another format is prescribed in this handbook.

A. Informing Program Participants of Their Rights

Whenever an Agency official makes a decision that will adversely affect a program participant, the official must inform the participant in writing that an informal review with the person who made the decision may be requested. If the decision is appealable, the participant will also be informed of their rights to seek mediation or Alternative Dispute Resolution (ADR) and to request a hearing with NAD; **Attachment 1-B** is used for this purpose. If the decision cannot be appealed, participants will be informed of their rights to have NAD review the accuracy of the Agency's finding that the decision cannot be appealed; **Attachment 1-C** is used for this purpose. Mediation or ADR rights are not provided on decisions that cannot be appealed. **Attachment 1-C** is used for this purpose.

Letters notifying participants of adverse decisions must contain the required information regarding an informal meeting, mediation or ADR, rights to NAD, and civil rights. **Attachment 1-A** includes only the specific civil rights language that must be contained in any adverse decision letter. **Attachments 1-B** through **1-I** contain, as necessary, the civil rights language and include information on requesting an informal review, mediation or ADR, and rights to NAD. The attachments are all titled to assist Field Office Staff in selecting the correct attachment for the decision being made. The attachments do not need to be used when a form, handbook letter, or other document already includes the appropriate participant rights.

B. Adverse Decisions That Cannot Be Appealed

Certain decisions made by the Agency cannot be appealed. In these cases, the participant is still provided the opportunity for an informal review; however, rights to an NAD appeal and rights to mediation or ADR are not offered. Participants will be informed through the use of **Attachment 1-C** that they may request an informal review

and write to NAD for a review of the accuracy of the Agency's determination that the case cannot be appealed. Decisions that cannot be appealed include:

- Decisions made by parties outside the Agency, even when these decisions are used as a basis for Agency decisions (such as when an applicant disagrees with a private lender's decision not to provide credit for a leveraged loan);
- An official's refusal to request an administrative waiver under the provisions of Paragraph 1.12 of this handbook, or a waiver authorized by any applicable regulation;
- Denials of credit due to lack of funds; and
- Rural area designations.

When one or more of the reasons for an adverse decision are reasons that cannot be appealed, the adverse decision cannot be appealed. In these cases, the letter containing the adverse decision will include only the items that cannot be appealed as the reason why the decision cannot be appealed. If other reasons also exist for the adverse decision, they will be listed separately in the decision letter as other reasons the assistance could not be granted.

C. Informal Review

Participants who want to request an informal review with the person who made the decision must do so within 15 days of the date of the Agency's letter notifying the participant of the adverse decision. The participant must make a request for an informal review in writing, and the request will be retained in the participant's case file. The informal review can be conducted, at the discretion of the Agency, by telephone or through a face-to-face meeting. The informal review can also be conducted by a representative of the person who made the decision. The purpose of the informal review is to further explain the Agency's reasons for the adverse decision, listen to why the participant feels the decision may be incorrect, and obtain any further information from the participant to support their request. The review must be completed within 45 days of the request, and the participant is notified in writing of the results. The State Director may require that the decision be reviewed by the next-level supervisor or other designated Rural Development Staff before the participant is notified of the decision. **Attachment 1-D** will be used if the adverse decision is not reversed as a result of the informal review. If the decision is reversed, a letter will be sent to the participant notifying them of the decision and next steps.

Participants may skip an informal review and, if applicable, request mediation or ADR, or an NAD appeal. In doing so, participants automatically waive their rights to an informal review.

D. Mediation or ADR

Adverse decisions that are appealable to NAD also require that the participant be given the opportunity to seek mediation or ADR prior to having a hearing with NAD. The

purpose of mediation or ADR is to resolve disputes through the use of a neutral mediator. State Directors may wish to consider issuing a State Supplement, outlining the coordination required between the Field Office and State Office on handling mediation and ADR requests.

Participants may skip mediation or ADR and request a NAD appeal. In doing so, they automatically waive their rights to mediation or ADR.

1. Requests for Mediation or ADR

After receiving **Attachment 1-B** or **1-D**, a program participant may request mediation or ADR services. Upon receipt of the program participant's request for mediation or ADR, **Attachment 1-E, 1-G**, or **1-H** is sent to the participant to start the process. The Attachments used depends upon whether the State in which the action applies is covered by a USDA-sponsored mediation program. These Attachments are generally sent by the State Director since costs are involved; however, they can be sent directly by the Field Office at the discretion of the State Director.

2. Cost of Mediation or ADR

There are generally costs associated with participation in mediation or ADR. When there are costs, they will be shared equally between the Agency and the program participant, if Agency funds are available. Where Agency funds are not available, the Agency will participate in mediation or ADR if requested by the program participant; however, the program participant will be notified in advance of the portion of the cost that the Agency will pay (if any) and their estimated cost for this service. The State Director will ensure that all participants requesting mediation or ADR in their State are treated consistently and pay the same percentage of the cost toward this service. The State Director may also consent to pay a larger percentage (up to 100 percent) of the cost of mediation or ADR for participants with incomes below the poverty level. The Agency will notify the mediation or ADR sources of how the cost of such service will be paid. **Attachments 1-E, 1-F, 1-G,** and **1-H** include language to meet this requirement.

3. Mediation in States with a USDA-Sponsored Mediation Program

Many States have a USDA-sponsored mediation program. These programs are funded, in part, by USDA and were established primarily to mediate cases originating from the Farm Service Agency (FSA). If program participants are unsure if a USDA-sponsored mediation program exists in their State, they should contact their State Director. In States with a USDA-sponsored mediation program, program participants who are provided appeal rights generally will be referred to the USDA-sponsored mediation program. ADR is not applicable in these States. **Attachment 1-E** may be sent to the program participant to acknowledge their request, and **Attachment 1-F** may be used to refer the case to the USDA-sponsored mediation program. In States where alternative mediation sources are readily available at a lower cost than the USDA-sponsored mediation program, the State will follow the guidance for States without a

USDA-sponsored mediation program, and include the USDA-sponsored mediation program on the list of acceptable providers.

4. Mediation or ADR in States without a USDA-Sponsored Mediation Program

In States without a USDA-sponsored mediation program, Agency officials are responsible for maintaining a list of mediators or ADR providers. The State Office will generally maintain this list as program participants are referred to the State Director to initiate mediation or ADR. FSA can generally provide a list of acceptable mediation or ADR sources in a State. Other contacts include the American Association of Arbitrators (AAA) or State bar association. When making contacts with these sources, the Agency must request the services of a mediator and not an arbitrator. (A mediator resolves disputes by negotiating a resolution through mutual agreement; an arbitrator resolves disputes through hearing both parties and then rendering a binding decision and should not be used.) The list of mediators will contain the approximate cost of each service provider, if known. States may handle the list of mediation and ADR sources as follows:

- The State may select a mediator or ADR provider from the list, provided there is not a significant variation in the cost of service providers. The list will be maintained alphabetically and sources selected in sequential order. **Attachment 1-G** may be sent to the program participant to acknowledge their request for mediation or ADR, and **Attachment 1-F** may be used to refer the case to the provider. States will need to maintain documentation to ensure that mediators and ADR providers receive and equal number of referrals. If there is a significant variation in cost among service providers, this option will not be used.

- The State may provide the list of mediators or ADR providers to the participant and request the participant to select the source or provide the name of another acceptable source of mediation or ADR. The list will contain the approximate cost of each service provider, if known. **Attachment 1-H** is used for this purpose and provides the participant with 10 days to select a service provider. After selection, **Attachment 1-F** will be used to refer the case to the mediator or ADR provider. If the program participant does not provide the name of a mediator or ADR provider within 10 days, their request for mediation or ADR will be considered withdrawn. Withdrawal or cancellation of mediation or ADR does not extinguish the participant's right to an appeal with NAD.

5. Timing of Mediation or ADR

Mediation or ADR must be completed within 45 days after the case is referred to the mediation or ADR source, unless the complexity of the case warrants a longer timeframe and all parties agree to a specific timeframe. A mediator or ADR provider will generally conduct a teleconference between the parties prior to accepting a case to determine if the case can be mediated. The Agency encourages the use of a pre-mediation conference since many adverse decisions in the Multi-Family Housing program may not lend themselves to mediation. Regardless, the Agency will not refuse to participate in

mediation or ADR if requested to do so by the program participant.

Mediation or ADR occurs prior to having a hearing with NAD. Requests for mediation or ADR made prior to filing an appeal with NAD stop the clock on the 30-day period during which a participant may appeal to NAD. After mediation or ADR has concluded, any days that remain from the 30-day period are available to the participant to request an appeal to NAD. **Attachment 1-I** is used for this purpose. The person completing **Attachment 1-I** will need to determine the number of days the participant took to request mediation or ADR. Hearing dates for participants who request mediation or ADR after filing an appeal must be selected with 45 days of the conclusion of mediation or ADR. Participants may also request mediation or ADR after filing an appeal with NAD but prior to the hearing.

E. Appeal

Participants who wish to appeal an adverse decision must submit a written request to NAD within 30 days of receiving notice of an adverse decision. The request must be signed by the participant and include: (1) a copy of the adverse decision to be appealed, and (2) a brief statement describing why the participant believes the decision is wrong.

Upon receiving a notice from NAD that an appeal has been filed, the Field Office will promptly provide NAD with a copy of the Agency record, specific references in 7 CFR Part 3560 to support the adverse decision, and any other pertinent information. A copy will also be provided to the program participant.

In accordance with NAD regulations, the program participant has the right to a face-to-face hearing in the participant's State of residence. The program participant also has the right to request that the hearing be handled by teleconference. An adverse decision made by the Agency may result in an appeal hearing and require a face-to-face hearing. In these cases, the Appeal Coordinator may request the State Director to provide Field Office Staff to attend the hearing and represent the Agency. The Appeals Coordinator will provide sufficient documentation and phone resources to the person selected by the State Director to adequately represent the Agency in the case.

NAD will notify the participant and the Agency once it has made a final determination. If NAD reverses the Agency's decision, the next loan processing action that would have occurred had no adverse decision been made must be taken within 30 days after the effective date of the notice from NAD; unless the Agency requests a review of the case by the Director of NAD. See **Appendix 2** for more guidance on Director Reviews and other information regarding appeals.

1.9 CONFLICT OF INTEREST *[7 CFR 3560.10]*

All Agency employees must strive to maintain the highest levels of honesty, integrity, and impartiality in conducting their activities on behalf of the Agency. The Agency's conflict of

interest requirements are described in RD Instruction 1900-D. To reduce the potential for conflicts of interest, all processing, approval, servicing, or review activity must be conducted by Agency employees who:

- Are not the recipient (applicant or borrower), a recipient's family member, or a close known relative of the recipient;
- Do not have an immediate working relationship with the recipient, the Agency employee related to the recipient, or the Agency employee who would normally conduct the activity; and
- Do not have a business or close personal association with the recipient.

A. Borrower Disclosure

Borrowers must disclose any known relationship or association with Agency employees.

B. Agency Employee Disclosure

Agency employees must disclose any known relationship or association with a borrower, regardless of whether the relationship is known to others.

C. Disposition of Real Estate Owned Properties

Agency employees and members of their families are precluded from purchasing real estate owned (REO) property, assumptions from Agency borrowers, or security property sold at a foreclosure sale. Closing agents and members of their families are precluded from purchasing properties in which they have been professionally involved.

1.10 OTHER FEDERAL REQUIREMENTS

A. Environmental Requirements *[7 CFR 3560.3 and 3560.4]*

The Agency considers environmental quality equally with economic, social, and other factors in its program development and decision making processes. Both the Loan Originators and Loan Servicers are responsible for effectively integrating Agency environmental policies and procedures with loan and grant origination and servicing activities. It is particularly important for Loan Servicers to be aware of environmental requirements concerning sites, especially during the liquidation process, when the Agency needs to ensure that it will not acquire property with an environmental liability. The Loan Servicer should also be aware of mitigation measures contained in the Agency's environmental review. Where mitigation measures require an on-going effort of owner and management (such as maintaining the condition of a historic building or not building on portions of the site) these should be a part of servicing. Agency environmental policies and procedures and historic preservation requirements can be found in RD Instruction 1940-G and 1904-G. Agency-assisted properties must meet current Agency guidance on lead-based paint requirements and 1904-G.

B. Construction Standards

Sites and dwellings developed or rehabilitated with Section 515 or Section 514/516 funds must meet the construction standards described or referenced in RD Instructions 1924-A and 1924-C. Existing dwellings must be decent, safe, and sanitary and must meet all applicable State and Local codes. Certain state construction codes and requirements may influence RD Instructions 1924-A and 1924-C.

C. Lobby Restrictions

RD Instruction 1940-Q prohibits applicants and recipients of Agency assistance from using appropriated funds for lobbying the Federal Government in connection with a specific award. This instruction also requires that entities that request or receive loans or grants must disclose the expenditure of any funds, other than appropriated funds, for lobbying activities using Exhibit A-1 from RD Instruction 1940-Q.

D. Administrative Requirements

Agency employees must comply with Agency and departmental administrative requirements.

1. Procurement

Goods and services procured to support Agency activities such as appraisals, inspections, broker services, and property management services must conform with the policies and procedures of RD Instruction 2024-A.

2. File Management

Files and other Agency records must be maintained in accordance with RD Instruction 2033-A. Additional information is provided in Chapter 9 of HB-2-3560.

3. Handling Funds

Project funds must be handled in accordance with RD Instruction 1902-A.

1.11 EXCEPTION AUTHORITY *[7 CFR 3560.8]*

Exceptions to any requirement of this handbook or 7 CFR Part 3560 may be approved in individual cases by the Administrator if application of the requirement or failure to take action would adversely affect the Government's interest or conflict with the objectives and spirit of the authorizing statute. Any exception must be consistent with the authorizing statute and other applicable laws.

Requests for exceptions are submitted to the Administrator, through the Deputy Administrator, Multi-Family Housing, and may be initiated by the State Director; the Deputy Administrator, Multi-Family Housing; the Director, Multi-Family Housing Processing Division; or the Director, Multi-Family Housing Portfolio Management Division.

The exception request must provide clear and convincing evidence of the need for the exception. At a minimum the request must include:

- A full explanation of the circumstances, including an explanation of the adverse effect on the Government's interest;
- A discussion of proposed alternatives considered; and
- A discussion of how the adverse effects will be eliminated or minimized if the exception is granted.

Requests to the Administrator for exceptions regarding architectural and engineering, environmental, or civil rights issues will include the review and comments of the appropriate National Office Technical Staff.

ATTACHMENT 1-A

EQUAL CREDIT OPPORTUNITY ACT (ECOA)

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, martial status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this assistance is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580.

The Fair Housing Act prohibits discrimination in real estate related transactions or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1-B

ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF AN ADVERSE DECISION THAT IS APPEALABLE

The decision described in the attached letter did not grant you the assistance you requested or will terminate or reduce the assistance you are currently receiving. If you believe this decision or the facts used in this case are in error, you may pursue any or all of the following three options.

Option 1 - Informal Review

If you have questions concerning this decision or the facts used making it and desire further explanation, you may write this office to request an informal review. ***There is no cost for an informal review.*** This written request must be received no later than 15 calendar days from the date of the attached letter. You must present any new information, evidence, and possible alternatives along with your request. You may also have a representative or legal counsel participate in the process, at your cost. The informal review may be conducted by telephone or in person, at the discretion of the Agency. Please include a daytime phone number in your request to arrange for the review. You may skip this step in the informal process and select one of the following two options. If you do, you will automatically waive your right to an informal review.

Option 2 - Mediation or Alternative Dispute Resolution (ADR)

You have the right to request mediation or other forms of ADR for the issues that are available for mediation. ***You will have to pay for at least 50 percent of the cost of mediation or ADR.*** Rural Development will pay for the other 50 percent of the cost, provided the Agency has sufficient resources from its appropriated funds. If the Agency does not have sufficient resources, you will be advised how much, if any, the Agency can contribute to the cost of mediation or ADR. If you need the information to assist you in deciding whether to seek mediation or ADR, you may contact the Rural Development State Director listed below.

If you elect to seek mediation or ADR, your written request for this service must be sent to the Rural Development State Director listed below and must be postmarked no later than 30 days from the date of the attached letter. The Rural Development State Director will advise you of the estimated cost of mediation or ADR, the extent to which the Agency can contribute to the cost, and the process and procedures for this service. In states with a USDA-sponsored mediation program, you will generally be referred to such service. In states without a USDA-sponsored mediation program, you will be provided with the name or names of mediators. You will be advised directly by the mediation or ADR source if they can mediate your case. Once you request mediation or ADR, it stops the running of the 30-day period in which you may request an appeal (described in Option 3). If mediation or ADR does not result in resolution of these issues, you have the right to continue with a request for an appeal hearing as set forth in Option 3.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation or ADR. You may skip mediation or ADR and request an appeal hearing. However, in doing so, you will automatically waive your rights to an informal meeting, mediation, or ADR.

Rural Development State Director address:

Option 3 - Request an Appeal

You may request an appeal hearing by the NAD rather than an informal review, mediation, or ADR. ***There is no cost for an appeal.*** Your request for an appeal must be made no later than 30 days from the date you receive the attached letter. You must write the Assistant Director, NAD, for your region at the following address:

NAD Assistant Director address:

Your request for an NAD hearing must state the reasons why you believe the decision is wrong, be personally signed by you, and must include a copy of the attached letter. A copy of your request must also be sent to the Rural Development State Director at the address listed under Option 2.

You have the right to an appeal hearing within 45 days of the receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file,

any written statements or evidence you may provide and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, because of race, color, religion, sex, disability, familial status, or national origin. The federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development (HUD). If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1-C

ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF AN ADVERSE DECISION THAT CANNOT BE APPEALED

The decision described in the attached letter did not grant you the assistance you requested or will terminate or reduce the assistance you are currently receiving.

If you have questions concerning this decision or the facts used in making it and desire further explanation, you may write this office to request an informal review. This written request must be received no later than 15 calendar days from the date of the attached letter. You must present any new information, evidence, and possible alternatives along with your request. You may also have a representative or legal counsel participate in the process, at your cost. The informal review may be conducted by telephone or in person, at the discretion of the Agency. Please include a daytime phone number in your request to arrange for the review.

Applicants and borrowers generally have a right to appeal adverse decisions, but decisions based on certain reasons cannot be appealed. We have determined that reasons for the decision cannot be appealed under our regulations. You may, however, write the Assistant Director, NAD for a review of the accuracy of our finding that the decision cannot be appealed. Your request must be made no later than 30 days from the date you receive the attached letter.

NAD Assistant Director address:

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580.

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1-D

ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF UNFAVORABLE DECISION REACHED AS A RESULT OF AN INFORMAL REVIEW

We appreciated the opportunity to review the facts relative to your request for assistance. We regret that the decision in the attached letter did not grant the assistance you requested or will terminate or reduce the assistance you are currently receiving. If you believe that facts used in this case are in error, you may pursue any or all of the following two options.

Option 1 - Mediation or Alternative Dispute Resolution (ADR)

You have the right to request mediation or other forms of ADR for the issues that are available for mediation. ***You will have to pay for at least 50 percent of the cost of mediation or ADR.*** Rural Development will pay for the other 50 percent of the cost, provided the Agency has sufficient resources from its appropriated funds. If the Agency does not have sufficient resources, you will be advised how much, if any, the Agency can contribute to the cost of mediation or ADR. If you need information to assist you in deciding whether to seek mediation or ADR, you may contact the Rural Development State Director listed below.

If you elect to seek mediation or ADR, your written request for this service must be sent to the Rural Development State Director listed below and must be postmarked no later than 30 days from the date of the attached letter. The Rural Development State Director will advise you of the estimated cost of mediation or ADR, the extent to which the Agency can contribute to the cost, and the process and procedures for this service. In states with a USDA-sponsored mediation program, you will generally be referred to this service. In states without a USDA-sponsored mediation program, you will be provided with the name or names of mediators. You will be advised directly by the mediation or ADR source if they can mediate your case. Once you request mediation or ADR, it stops the running of the 30-day period in which you may request an appeal (described in Option 2). If mediation or ADR does not result in resolution of these issues, you have the right to continue with a request for an appeal hearing as set forth in Option 2.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the National Appeals Division (NAD); however, an NAD appeal hearing would take place after mediation or ADR. You may skip mediation or ADR and request an appeal hearing. However, in doing so, you will automatically waive your rights to an informal meeting, mediation, or ADR.

Rural Development State Director address:

Option 2 - Request an Appeal

You may request an appeal hearing by the National Appeals Division (NAD) rather than an informal review or mediation. ***There is no cost for an appeal.*** Your request for an appeal must be made no later than 30 days from the date you receive the attached letter. You must write the Assistant Director, NAD, for your region at the following address:

NAD Assistant Director address:

The request for an NAD hearing must state the reasons why you believe the decision is wrong, be personally signed by you, and must include a copy of the attached letter. A copy of your request must also be sent to the Rural Development State Director at the address listed under Option 1.

You have the right to an appeal hearing within 45 days of the receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing, you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file, any written statements or evidence you may provide and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant’s income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance

with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1-E

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION IN STATES WITH A USDA-SPONSORED MEDIATION PROGRAM

This replies to your request for mediation or alternative dispute resolution services. The state in which you requested assistance has an impartial USDA-sponsored mediation program available. Your request for mediation has been sent to:

You will be contacted directly by the USDA-sponsored mediation program to determine if they can mediate the issues in your case.

As indicated in our adverse decision letter, there may be a cost for mediation services. The cost estimated for this service is:

> $ _____ You will be advised directly by the USDA-sponsored mediation program of the full cost of mediation. This is only an estimate and may vary depending on the issues and complexity of the case. If you decide not to pursue mediation, you must immediately contact this office and the USDA-sponsored program to cancel your request

Rural Development will:

> _____ Contribute 50 percent towards the cost. The balance of the cast will have to be paid from your own resources.
>
> _____ Cannot contribute towards the cost as the Agency does not have financial resources for these services. You must pay the full cost of mediation from your own personal resources.
>
> _____ Contribute _____ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation is concluded, you will be notified of the results and the number of days remaining to request an appeal, if applicable. If you request mediation prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation does not take the

place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation.

Remember, if you decide not to pursue mediation, you must immediately contact this office and the USDA-sponsored mediation program to cancel your request. You will be responsible for any costs incurred by the mediation or ADR source up until the time of your cancellation. Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.

ATTACHMENT 1-F

ATTACHMENT FOR REQUESTING MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) SERVICES

TO:

FROM:

SUBJECT: Request for Mediation or ADR Services

CUSTOMER:

The above-subject Rural Development customer has received an adverse decision from our Agency and has requested mediation or ADR services. Attached is a copy of the adverse decision letter and the customer's request for your service.

Informal Review:

___ The customer was provided with the opportunity for an informal review with the Agency; however, chose not to exercise this option.

___ An informal review was conducted; however, the Agency did not reverse its decision.

___ This case is under the jurisdiction of our State Office.

Payment for Service:

___ The customer and Agency will split the cost of this service 50/50.

___ The customer will pay the full cost of mediation or ADR.

___ The Agency will pay _____ towards mediation or ADR. The customer will pay the balance.

If the Agency is paying for any portion of the cost of this service, the bill for the Agency's portion should be submitted to this office. The customer is solely responsible for their portion of the cost of this service and should be bill directly.

Jurisdiction of case:

___ The adverse decision in this case was made by the following office. You should contact this office for further information on the case:

___ The adverse decision in this case was made by the ___[insert appropriate name]___. You may contact the Appeals Coordinator for further information on the case and to arrange for mediation or ADR:

USDA, Rural Development

Appeals Coordinator

ATTN: _____

_____, _____ _____

(___) ___-____, extension _____

Mediation or ADR must be completed within 45 days; unless the complexity of the case requires a longer time frame and all parties agree to a specific time frame. We also request a teleconference prior to your acceptance of this case to determine if the adverse decision lends itself to mediation or ADR.

ATTACHMENT 1-G

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) OF SERVICE PROVIDER

This replies to your request for mediation or alternative dispute resolution services. Your request has been sent to:

You will be contacted directly by the above to determine if they can mediate the issues in your case.

As indicated in our adverse decision letter, there may be a cost for these services. The estimated cost for this service is:

> $ _____ You will be advised directly by the mediation or ADR source of the full cost of this service. This is only an estimate and may vary depending upon the issues and complexity of the case. If you decide not to pursue mediation or ADR, you must immediately contact this office and the above-mentioned mediation or ADR provider.

Rural Development will:

> _____ Contribute 50 percent towards the cost. The balance of the cost will have to be paid from your own resources.
>
> _____ Cannot contribute towards the cost as the Agency does not have the financial resources. You must pay the full cost from your own personal resources.
>
> _____ Contribute _____ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the date you received notice of the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation or ADR.

Remember, if you decide not to pursue mediation or ADR, you must immediately contact this office and the mediation or ADR provider to cancel your request. You will be responsible for

any costs incurred by the mediation or ADR source up until the time of your cancellation. Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.

ATTACHMENT 1-H

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) OF POTENTIAL SERVICE PROVIDERS

This replies to your request for mediation or ADR services. Attached you will find a list of mediation and ADR providers. You will need to select one of the sources from the list, or you may provide the name of another independent mediation or ADR source. You must provide this office, in writing, with the name of the provider within 10 days. Rural Development will then contact the source and provide photocopies of the adverse decision letter and any other relevant information. We will also request that the mediation or ADR provider conduct a teleconference between the parties.

If we do not receive your selection of a mediator or ADR provider within 10 days, we will consider such inaction to be your notice to cancel your request for mediation or ADR. You may continue to pursue an appeal to the NAD as outlined in our original adverse decision letter.

As indicated in our original adverse decision letter, there may be a cost for these services. The estimated cost for this service is:

> $ _____ You will be advised directly by the mediation or ADR source of the full cost of this service. This is only an estimate and may vary depending upon the issues and complexity of the case. If you decide not to pursue mediation or ADR, you must immediately contact this office and the above-mentioned mediation or ADR provider.

Rural Development will:

> _____ Contribute 50 percent towards the cost. The balance of the cost will have to be paid from your own resources.
>
> _____ Cannot contribute towards the cost as the Agency does not have the financial resources. You must pay the full cost from your own personal resources.
>
> _____ Contribute _____ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the date you received notice of the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to NAD; however, an NAD appeal hearing would take place after mediation or ADR.

Remember, if you decide not to pursue mediation or ADR, you must immediately contact this office to cancel your request. Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.

ATTACHMENT 1-I

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) DID NOT RESULT IN RESOLUTION OF ISSUES

We regret that we are unable to grant the assistance you requested or will terminate or reduce the assistance you requested. Mediation or ADR did not result in resolution of the issues.

If you believe the decision or facts used in the case are in error, you may pursue your right to an appeal by the NAD. ***There is no cost for an appeal.*** The number of days in which you have to request an appeal depends upon whether you previously requested an appeal to NAD prior to entering into mediation or ADR. ***Please follow the guidance in the paragraph indicated with an "X".***

___ You requested an appeal hearing to NAD prior to entering into mediation or ADR. You must write to the Assistant Director of NAD at the following address to schedule the appeal hearing:

NAD Assistant Director address:

___ You did not request an appeal hearing to NAD prior to entering into mediation or ADR. You must write to the Assistant Director of NAD at the following address. Your request must be postmarked within ____ days from receipt of this letter. This represents the difference between 30 days and the number of days you took after the adverse decision to request mediation or ADR. Use the NAD Assistant Director address is listed above.

Information regarding appeals

You have the right to an appeal hearing within 45 days of NAD's receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file,

any written statements or evidence you may provide, and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

cc: NAD Assistant Director

CHAPTER 2: MULTI-FAMILY HOUSING PROGRAMS AND LOAN SERVICING

2.1 INTRODUCTION

This chapter introduces key aspects of the Section 515 Rural Rental Housing and Section 514/516 Farm Labor Housing programs. Under these programs, the Agency provides direct loans and grants to support the development of affordable rental housing that serves rural areas. The Section 538 Multi-Family Housing Guarantee program—the Agency's third Multi-Family Housing program that guarantees loans made by private lenders—is covered in a separate regulation *[7 CFR Part 3565]* and HB-1-3565.

This chapter also describes the key project servicing procedures that the Agency uses to administer the terms of the Agency loan or grant agreement for the program. These procedures provide Loan Servicers with a consistent basis for conducting servicing actions and assisting borrowers in meeting their responsibilities.

Section 1 of this chapter introduces the types of loans and other forms of assistance available through the Section 515 program and the Agency's objectives in providing this assistance. Section 2 of this chapter describes the loans, grants, and other assistance available to increase the supply of affordable housing specifically targeted toward farm labor. The chapter concludes with Section 3, which introduces the major project servicing activities, as well as the key parties involved.

SECTION 1: SECTION 515 PROGRAM

2.2 OVERVIEW

The Section 515 program offers direct loans to eligible borrowers to provide economically designed and constructed housing and related facilities for very low-, low-, and moderate-income households; elderly households; and persons with disabilities living in rural areas. This section of the chapter describes:

- The types of projects allowed;
- The types of loans available; and
- Rental assistance available from the Agency.

2.3 TYPES OF PROJECTS

There are four basic types of rental projects that can be developed using Section 515 loans:

- Family projects;
- Elderly projects;

- Congregate projects; and
- Group homes.

In addition, Section 515 loans can be used to finance rural cooperative housing projects. The Agency also allows mixed projects that contain both family and elderly units.

The housing must be economical and must not include elaborate features, but it must be adequate to meet tenants' needs. The project should be of average quality and cost. With the exception of off-farm labor housing, all projects must be developed in locations that qualify as rural areas.

A. Family Projects

A family housing project is a rental property developed for occupancy by eligible very low-, low-, or moderate-income households.

B. Elderly Projects

An elderly project is a rental property that is developed for occupancy solely by eligible elderly households that include a tenant or cotenant that is disabled or age 62 years or older.

C. Congregate Projects

Congregate projects are rental properties developed for occupancy by eligible very low-, low-, and moderate income elderly households that need meals or other services to assist them in performing activities of daily living. Congregate projects consist of private apartments and central dining facilities in which a number of allowable preestablished services are provided to tenants. These projects are <u>not</u> designed to be nursing homes and, therefore, are not allowed to pay for the cost of medical- or healthcare-related services.

D. Group Homes

A group home is housing that is occupied by eligible very low-, low-, or moderate-income elderly persons or individuals with disabilities who share living space within a rental unit and in which a resident assistant may be required.

E. Rural Cooperative Housing

Section 515 loans may be used to finance rural cooperative housing projects operated by nonprofit consumer cooperatives for the benefit of eligible very low-, low- and moderate-income members.

F. Mixed Projects

Mixed projects are properties developed with a portion of the units designated as family units and the remainder of the units established as elderly units. At the time the project is developed, the borrower must designate the units that will be operated as family units and those that will be operated as elderly units.

2.4 TYPES OF LOANS

The rules governing the origination of Section 515 loans differ slightly, depending upon the type of loan being made. The types of loans available under Section 515 include:

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

This section describes the three types of loans and how they differ. The first two types are discussed in further detail in HB-1-3560. The requirements and procedures for assumed loans and equity loans are covered in Chapter 7.

A. Initial Loans

Initial loans are made to projects with no existing Agency loan. Most initial loans are made to build new properties. However, the Agency makes initial loans for the rehabilitation of existing properties when it is in the Agency's best interest.

The interest rate for these loans is set at the note rate established by the Agency in RD Instruction 440.1. The Agency then provides interest credit assistance, which reduces the effective interest rate to 1 percent[1]. Interest credit is only provided for units occupied by eligible tenants paying at least 30 percent of their income for rent. The administration of interest credit is covered in this handbook and HB-2-3560.

The Agency establishes the term of these loans to correspond to the expected useful life of the property. The maximum term is 30 years with an amortization period not to exceed 50 years. Generally, initial loans are made for a term of 50 years, with the exception of properties where the expected useful life is a shorter period (e.g., manufactured housing).

[1] Some existing projects do not receive interest credit, while others receive interest credit that reduces the interest rate to three percent. However, all initial loans made by the Agency following the publication of this handbook will receive interest credit as described here.

B. Subsequent Loans

Subsequent loans can be issued during the term of an Agency loan to help an existing borrower pay for repairs or improvements to the property or in conjunction with the transfer of a property where the purchaser is assuming the initial Agency loan. The key differences between processing requirements for subsequent and initial Section 515 loans are discussed in Chapter 10 of HB-1-3560. Guidance regarding the requirements and procedures for processing project transfers is covered in Chapter 7. Subsequent loans may also be used to finance equity to avert prepayment of the project.

C. Assumed Loans

Section 515 loans may be assumed in conjunction with the transfer of ownership of the property. The terms and conditions of the assumption depend upon the needs of the project at the time of the transfer. The procedures for processing transfers and assumptions are presented in Chapter 5.

1. New Rates and Terms Assumption

Most assumptions of Section 515 loans are new rates and terms assumptions—that is, the purchaser assumes responsibility for all or a portion of the remaining debt. To conserve the Agency's budgetary resources, the transaction does not involve paying off the old loan and issuing a new initial loan. Instead, the purchaser assumes the outstanding debt, which is reamortized at new rates and terms. New rates and terms assumptions are used when the purchaser will experience financial difficulties under the terms of the initial loan or when a change in rates and terms is necessary to facilitate the transfer. Purchasers may apply for subsequent loans to make up the difference between the amount of debt assumed and the purchase price or to address physical needs at the project.

2. Same Rates and Terms Assumption

Transfers may also take place in conjunction with a same rates and terms assumption. Under this type of assumption, the existing note terms, including the interest rate and the remaining repayment period, do not change.

2.5 AGENCY RENTAL ASSISTANCE

Owners of projects located in areas where prospective tenants are likely to be rent overburdened or existing tenants are already overburdened can apply for rental assistance administered by the Agency. This rental subsidy assists tenants by allowing them to pay 30 percent of adjusted income for rent, thereby reducing the financial burden on the household. The Agency pays the difference between the tenant contribution and the approved shelter costs for the unit through the rental assistance contract with the borrower.

2.6 PREFERENCE FOR PROJECTS THAT LEVERAGE OTHER FUNDS

To maximize the number of units produced with Section 515 loan funds, the Agency gives preference to project applications for new loans that leverage other funds, thereby reducing the amount of Section 515 loan funds needed to develop the project. The greater the leveraging proposed in a project application, the greater the preference for funding. Examples of funds that count as leveraged funds include borrower resources beyond the minimum required amount, equity generated by the sale of low-income housing tax credits (LIHTCs), a second loan from another lender, or a grant from a State or Local public agency or other source.

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SECTION 2: SECTION 514/516 PROGRAM

2.7 TYPES OF PROJECTS

The Section 514/516 Farm Labor Housing program provides funds to support the development of housing for farm labor. Section 514/516 assistance differs from the Section 515 loans in the following ways:

- The objective of the program is to provide housing for farmworkers;
- There are no rural restrictions; and
- Agency grants are available to support the development of these projects.

Section 514/516 assistance may be used for off-farm labor housing projects and Section 514 assistance may be used only for on-farm labor housing projects. Only Section 514 assistance may be used in conjunction with Federal LIHTCs.

A. Off-Farm Labor Housing

The Agency is authorized to make loans and grants for financing off-farm labor housing to broad-based nonprofit organizations; nonprofit organizations of farmworkers; Federally recognized Indian tribes, agencies, or political subdivisions of State or Local Government; and public agencies, such as local housing authorities. Section 514 loans can be made to limited partnerships in which the general partner is a nonprofit entity.

B. On-Farm Labor Housing

On-farm labor housing is designed to provide adequate housing for farmworkers involved in a specific farming operation. Individual farmers, family farm corporations or partnerships, or associations of farmers may develop these projects but must operate them on a nonprofit basis. To qualify for occupancy, an individual or a household must simply be employed as part of the farming operation. There is no income restriction governing occupancy. However, immediate family members of individuals with an ownership interest in the farm are prohibited from living in this housing.

2.8 LOANS AND GRANTS

The Agency offers loans and grants to finance Farm Labor Housing projects. Chapter 12 of HB-1-3560 provides more information about the origination process for these loans and grants.

A. Farm Labor Housing Loans

Section 514 loans for farm labor housing projects are very similar to Section 515 loans, but they differ in two important ways:

- These loans carry a 1 percent effective interest rate (i.e., there is no interest credit).

- The maximum term for these loans is 33 years.

These loans can be used to finance either Off-Farm or On-Farm Labor Housing projects.

At one time, loans for both types of projects were processed on a first-come, first-served basis. Today, lending decisions regarding loans for off-farm labor housing projects are handled through a competitive Notice of Funding Availability (NOFA) process, while loans for on-farm labor housing projects are still processed in the order that they are received.

B. Farm Labor Housing Grants

Section 516 grants may only be used to support the development of off-farm labor housing projects. These grants may be used for the same purposes as Section 514 loans when there is reasonable doubt that the housing would not be provided without the grant.

2.9 RENTAL ASSISTANCE

Applicants for Section 514/516 assistance for off-farm labor housing projects may also apply for rental assistance administered by the Agency. The requirements for obtaining rental assistance are the same as for Section 515 projects. On-farm labor housing projects are not eligible for this rental assistance.

2.10 PREFERENCE FOR PROJECTS THAT LEVERAGE OTHER FUNDS

Like the Section 515 program, the Agency gives preference to applications for off-farm labor housing projects that leverage other sources of funds. There is no leveraging preference for on-farm labor housing applications.

SECTION 3: OVERVIEW OF MULTI-FAMILY PROJECT SERVICING

2.11 KEY PROJECT SERVICING ACTIVITIES AND THIS HANDBOOK

The goal of the Agency's servicing efforts is to ensure that projects fulfill the terms of their loan or grant agreement and provide fair, consistent processing of servicing requests. Project servicing involves the following activities:

- Account servicing;
- Reviewing requested changes in the ownership entity;
- Evaluating and processing project transfer requests;
- Addressing security restructuring requests;
- Identifying and recapturing unauthorized assistance;
- Addressing borrower defaults and evaluating workout agreements;
- Processing loan restructuring requests;
- Foreclosing and liquidating projects in default;
- Managing and disposing of inventory property; and
- Evaluating and processing prepayment requests.

This handbook presents the program requirements in each of these areas and describes the Agency's procedures for fulfilling its responsibilities.

In addressing each topic area, the handbook first presents the requirements and procedures for Section 515 rental projects and then discusses differences or additional requirements for other types of projects (e.g., congregate housing, farm labor housing, cooperatives).

2.12 PROJECT SERVICING PROCEDURES FOR MULTI-FAMILY HOUSING PROJECTS

Chapters 3 through 13 describe the program requirements for Section 515 projects.

A. Automated Systems (Chapter 3)

This chapter describes the Agency's four primary automated information management systems—Industry Interface, the Automated Multi-Family Housing Accounting System (AMAS), the Multi-Family Integrated System (MFIS), and the

Prepayment Tracking and Concurrence (Pre-Trac)—including their purpose and capabilities, staff responsibilities, and training and certification requirements.

B. Account Servicing (Chapter 4)

This chapter covers routine transactions involving the borrower's repayment of the loan obligation, including payment processing, tracking project accounts, and final payments.

C. Ownership and Organizational Changes (Chapter 5)

Changes in the borrower entity require Agency notification and, in specific cases, Agency consent. This chapter outlines the requirements regarding borrower requests involving these changes and the procedures for addressing these changes.

D. Determination of Project Suitability (Chapter 6)

When there are loan repayment or compliance problems with a project and the Agency is considering special servicing actions, or prior to making a subsequent loan, the Loan Servicer must determine that the property remains suitable as a program property. This chapter is designed to assist the Agency and the Loan Servicer in particular, to make an analysis of a project's suitability and to determine that it meets the principles and objectives of the Agency.

E. Transfers of Project Ownership (Chapter 7)

When borrowers seek to transfer their projects to a new ownership entity, the transfer must be performed in a manner consistent with the program requirements to ensure that the project continues to address program objectives and the Agency's security interests are protected. This chapter explains the requirements and procedures for completing project transfers.

F. Security Restructuring Requests (Chapter 8)

As project conditions change over time, it may become necessary to request a restructuring of the security for the loan. The Agency's requirements and procedures for filing these requests are covered in this chapter.

G. Unauthorized Assistance (Chapter 9)

If borrowers or tenants receive assistance for which they are ineligible, the Agency will take steps to recapture this unauthorized assistance. This chapter discusses the Agency's requirements and procedures for identifying and collecting unauthorized assistance.

H. Compliance Violations, Defaults, and Workout Agreements (Chapter 10)

The Agency will monitor borrower performance using the procedures presented in Chapter 9 of HB-2-3560. Borrowers who fail to comply with program requirements will be notified of compliance violations and the need to correct the deficiencies. This chapter describes the servicing actions in response to compliance violations and the additional servicing actions taken by the Agency in the event violations go uncorrected and the borrower falls into default.

I. Loan Restructuring (Chapter 11)

When borrowers encounter changes or difficulties beyond their control that affect the financial viability of the project, they may ask for the Agency to approve restructuring of its financing as one course of financial relief for the project. Also, borrowers with more than one Agency loan may be able to request restructuring changes that simplify administration of the loans. This chapter presents the requirements and procedures for Agency review and approval of these requests.

J. Account Foreclosure and Liquidation (Chapter 12)

When borrowers go into default under the terms of their loan agreement, the Agency will review the case and determine whether to accelerate the loan and initiate foreclosure proceedings. The procedures for making this determination are covered in this chapter.

K. Other Special Cases (Chapter 13)

There are a number of special circumstances that borrowers may face during the life of a loan that require special servicing actions by the Agency. The special cases covered in this chapter include bankruptcy, death of a borrower, abandonment, and valueless liens.

L. Management and Disposal of Real Estate Owned Property (Chapter 14)

Real estate owned (REO) property consists of projects where the Agency has assumed ownership as a result of foreclosure. This chapter presents Agency procedures for managing and disposing of these projects in a manner that is in the best interest of the government and of any tenants of the projects.

M. Project Preservation (Chapter 15)

Borrowers receiving loans prior to December 15, 1989 may prepay their loan obligations under the terms of their loan agreements. In an effort to preserve such units as affordable housing, the statute for the program directs the Agency to make reasonable efforts to extend the low-income use of the project. This chapter presents the requirements and procedures for borrower requests and Agency evaluation of such requests.

CHAPTER 3: AUTOMATED SYSTEMS

3.1 INTRODUCTION

Many of the Agency's account servicing activities are dependent on data submitted to the Agency by tenants and borrowers. These data are tracked by Loan Servicers using the Agency's automated systems. This section describes the Agency's four primary automated information management systems—the Management Agent Interactive Network Connection (MINC), the Automated Multi-Family Housing Accounting System (AMAS), the Multi-Family Information System (MFIS), and the Prepayment Tracking and Concurrence (Pre-Trac)—including their purpose and capabilities, staff responsibilities, and training and certification requirements.

It is important to understand that while this section identifies the specific activities that may be accomplished using the various automated systems, many of the activities listed for a particular system cannot be accomplished without inputs from one or more of the others. For instance, monthly loan payment amounts are tracked using AMAS, but those amounts cannot be determined without inputs from MFIS. Similarly, while MFIS is used to identify and track the status of borrower noncompliance, the standards by which compliance is measured come from AMAS.

Every Rural Housing Service (RHS) employee is required to be familiar with each of the Agency's automated systems. This includes gaining familiarity with not only the basic information in this chapter, but the more detailed user manuals for each system and periodic training offered to staff.

3.2 MANAGEMENT INTERACTIVE NETWORK CONNECTION

MINC is a database used by the Agency to reduce the cost of compliance and increase the effectiveness of supervisory actions in the Multi-Family Housing program.

A. Background

Before a borrower can submit a payment to the Agency for review and processing, the Agency needs to determine and inform the borrower of the correct payment amount. Before the payment amount can be determined, the borrower needs to collect and submit to the Agency the tenant data that is used in the calculation of rental assistance, interest credit, and ultimately, the "net" payment amount that must be submitted by the borrower. To make the required calculations, tenant data are entered into MFIS, and the outputs from MFIS are ultimately entered into AMAS for tracking. It is crucial that tenant data be correct, because about $1 billion in tenant subsidy is awarded annually based on each tenant's status.

Traditionally, borrowers have submitted tenant data to the Agency by mailing paper copies to the Servicing Office each month to reflect current occupancy status. In recent years, the Agency has been moving away from paper submissions toward electronic submissions through an automated interface with borrowers—MINC.

B. Purpose and Capabilities

MINC enables management agents to transmit tenant data electronically, via the Internet. In addition to tenant data, management agents can transmit *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance*, and *Form RD 3560-10, Borrower Balance Sheet*. Data that are transmitted correctly, and contain changes that are within the allowable parameters, are automatically uploaded into MFIS. Data that are transmitted incorrectly, or that does not comply with Agency regulations, are "rejected" by MINC. Questionable data transactions, containing changes requiring review by the Loan Services, are held in a "pending" status in the MFIS electronic transmission web page. Borrower mail is sent to the management agent, detailing the result of each transaction transmitted such as accepted, rejected, pending, etc. The Loan Servicer reviews all transmitted transactions, through the use of a "Daily Report," to determine if there is any action necessary on the Agency's part. MINC provides the capability or Borrowers to view, approve and submit their *Form RD 3560-29* to the Agency. If the borrower discovers any discrepancies in the report, a correcting transaction is transmitted or the Servicing Office is contacted for guidance. Once the report is determined to be correct, the borrower approves and submits the payment.

C. Staff Responsibilities

In accordance with 7 CFR Part 3560, all borrowers are required to electronically transmit their tenant and financial data and process their payments, for projects with eight units or more. The Servicing Office Staff should contact all borrowers/management agents, and provide them with instructions for accessing and using MINC. The steps involved in this process are as follows:

- Contact the borrower/management agent, and verify that the taxpayer identification number on file with the Agency is correct for the management agent;

- Validate that all projects for said management agent are associated to the taxpayer identification number;

- Inform the borrower/management agent to access the MINC Web site at https://usdaminc.sc.egov.usda.gov, and print a copy of the training handbook; and

- Instruct the borrower/management agent to follow the step-by-step instructions contained in the training handbook to obtain a MINC access code and password. The help manual should be consulted for any problems they encounter while completing this process. In the event that questions still exist after having consulted the help manual, the borrower/management agent should then contact the Servicing Office for assistance.

The borrower/management agent will be required to electronically accept an automated version of the Trading Partner Agreement (TPA) while obtaining their MINC access code and password. The date of acceptance is stored within the system should this information be needed at a later date.

The Servicing Office goals are to:

- Maintain project information on MFIS, completing primary processing of submissions of changes to tenant data between the first and tenth days of each month;
- Provide MFIS reports in a timely manner, or as requested by the borrower/management agent; and
- Confirm the receipt of data transmission when asked.

The Servicing Office should refer borrowers/management agents to vendors to troubleshoot software as needed. Some borrowers/management agents with small projects do not use vendor software; instead, they transmit through MINC using the "Fill-a-Form" option and may need more assistance from the Servicing Office. Any automation or program-related issues that are discovered by the Servicing Office should be reported to the State Office.

D. Benefits of MINC

MINC benefits all parties involved. Electronic submission of data saves borrowers the burden and cost of generating and mailing paper documentation to the Agency. The Agency saves the burden and cost of handling mail, sorting and copying paper documentation, and reentering tenant data by hand. Freeing staff from clerical tasks allows them to focus on analytical responsibilities, such as reviewing occupancy patterns to uncover civil rights violations, tenant fraud, unacceptable management practices, and warning signs of occupancy problems.

In addition, MINC allows borrowers more time to meet deadlines. Changes submitted through MINC are required to be filed by the tenth of the month, an extension of 10 days. For borrowers, this provides more time to ensure that their information is assembled properly, and is complete and accurate. More accurate information results in fewer mistakes to correct with the borrower. Even if there are mistakes, MINC allows for next-day response by the Agency. As a result, corrections can be made while the borrower's memory is still fresh.

MINC also reduces the chance that borrowers will be charged overage for late certifications, which can result in a substantial penalty for borrowers, management agents, and site managers. Extended submission deadlines and faster turnaround on submission reviews reduce the possibility of overage being charged for late data.

MINC reduces the chance that borrowers will be charged a late fee due to the receipt of their mortgage payment being delayed by delivery issues such as mail routing errors and incorrect postage. Borrowers have the ability to review the accuracy of their *Form RD 3560-29* online, making any corrections and approving it for processing. Borrowers who are required to submit a payment with their *Form RD 3560-29* can sign up for Pre-Authorized Debit (PAD), which electronically transfers the funds owed from the borrower's bank account to Rural Development. Borrowers who receive an RA check

must be signed up for Electronic Funds Transfer (EFT), whereby the RA due to the borrower is transferred from the Agency to the project's operating account.

E. Staff Training and Certification Requirements

Beyond gaining familiarity with the functions of the system, there are few formal training or certification requirements for Loan Servicers using MINC.

3.3 AUTOMATED MULTI-FAMILY HOUSING ACCOUNTING SYSTEM

A. Purpose and Capabilities

AMAS maintains loan account information, tracks loan status, and disburses project subsidy. AMAS has been operational since 1985 and is located on the U.S. Department of Agriculture (USDA) Kansas City mainframe. The Systems Development Division in St. Louis administers AMAS.

AMAS is the Agency's primary financial accounting system. Any data relating to a borrower's account (e.g., payment amount, payment due date, account status) are tracked using AMAS. In addition, payment entry, verification, and reconciliation are accomplished using AMAS.

B. Staff Responsibilities

Loan Servicers using AMAS are responsible for the following activities:

- Closing loans, including reamortized loans;
- Disbursing loan funds;
- Determining note, rental assistance, and interest credit payment amounts;
- Determining payment due dates;
- Verify loan payment processing;
- Converting accounts from Daily Interest Accrual System (DIAS) to Predetermined Amortization Schedule System (PASS);
- Determining current loan balances for transfer;
- Obligating loan funds;
- Adjusting accounts in response to unauthorized assistance;
- Processing recaptured unauthorized assistance;
- Adjusting accounts for interest rate changes;

- Tracking rental assistance;
- Tracking inventory property status and acquisitions;
- Tracking Servicing Office and overall Agency loan and subsidy totals;
- Tracking and correcting account discrepancies; and
- Tracking account payment history.

C. Staff Training and Certification Requirements

Loan Servicers must be certified by the State Director to process payments in AMAS. The AMAS Coordinator in each State is responsible for the payment processing certification process and will make recommendations to the State Director, based on certification examination. Each Field Office should have at least two certified staff who can process payments. Uncertified staff may access the view-only screens within the system, but cannot alter any of the data.

1. Basic Skills Required

The basic areas a Loan Servicer must master to receive certification include the following:

- The employee must successfully review and process payments for three call dates;
- The employee must understand the process for verifying that payment processed in MFIS is updated correctly in AMAS; and
- For offices on the wholesale lockbox system, the employee must properly prepare the Field Office Remittance Reconciliation Report and all related forms for submission to the wholesale lockbox.

2. Procedures for Certification Training

The procedures for certification training are as follows:

- The employee will be trained by the AMAS Coordinator, or by a qualified State Office or Field Office employee. The training must cover the following areas:
  - ◊ Release *Form RD 3560-29* for borrower's review;
  - ◊ Reviewing and processing the borrower's payment transmittal;
  - ◊ Establish and maintain PAD accounts;
  - ◊ Understanding the payment logic;

◊ Signing onto the AMAS Cash System (AMAS-CSH);

◊ Inputting regular payments and special collections into MFIS;

◊ Handle any pending transactions in AMAS; and

◊ Submitting checks, cash, and accounting data to the Finance Office.

- The trainee will make copies of all the records related to preparing the test collections and will include them in an envelope as if they were being mailed to the Finance Office. The envelope will be marked "Payment Certification for (trainee name)" and submitted to the AMAS Coordinator.

3. Recommendation of Certification

The AMAS Coordinator will review the balanced blocks and the accounting data envelope prepared for the examination. When the employee has demonstrated an understanding of the payment process and proficiency in all steps listed above, the AMAS Coordinator will recommend certification to the State Director. The State Director will:

- Instruct the IRM to notify the Security Officer in the Finance Office to add AMAS payment process to the employee's user identification number; and

- Notify the Loan Servicer and employee, by letter, of the employee's certification to process payments. The letter must list the possible reasons for withdrawal of certification.

4. Monitoring Payment Processing

After certification, the AMAS Coordinator will periodically monitor Field Office payment processing activities to ensure that payments are being input properly and verified. For newly certified employees, monitoring should be daily for a 30-day period. For experienced employees, monitoring should be no less than monthly, provided monitoring reports do not indicate any of the problems that could lead to withdrawal of certification.

A log of each monitoring activity should be kept by the AMAS Coordinator for documentation using *Form RD 3560-64, Online Payment Certification Monitoring Log*.

5. Withdrawal of Certification and Recertification

Certification may be withdrawn from an employee if the effective date of the payment and the call date differ by more than 3 days and there is not sufficient justification (e.g., office was closed on the regularly scheduled work day that the payment was received; weekend and holidays caused a 3-day delay before the payment could be processed).

After the third occurrence of any of the above errors in a 12-month period, the State Director will notify the Loan Servicer and employee in writing that certification may be withdrawn. The notice will include plans and requirements for remedial training.

The State Director will withdraw certification after the fourth occurrence in a 12-month period of any of the above errors. The State Director will notify the Loan Servicer and employee in writing, with a copy to the IRM for the State. The IRM will notify the Security Office in the Finance Office to remove online payment authority from the employee's identification number.

6. Retraining

An employee should be retrained immediately when a payment processing problem occurs as a result of an employee error. This training should cover the areas causing problems and should prevent recurrence of the error. After certification has been withdrawn, the State Director must determine whether it is desirable for the employee to process payments. If so, the retraining should be performed immediately. The employee may be recertified if retraining has been completed, the employee demonstrates the necessary skills to process payments, the AMAS Coordinator recommends recertification, and the State Director concurs.

3.4 MULTI-FAMILY INFORMATION SYSTEM

A. Purpose and Capabilities

MFIS assists Servicing Offices in monitoring the Multi-Family Housing program, maintains data on clients, and provides comprehensive and flexible reporting. MFIS was designed to improve management and supervision routines in Servicing Offices. It is the monitoring and scheduling systems being used by the Servicing Offices and provides the analytical tools to review budgets and financial information. MFIS has a classification system that uses information entered during normal supervisory activities to identify projects needing additional servicing attention.

MFIS is used by the Agency to track tenant data, and it is employed mainly to ensure that each tenant receives the correct amount of subsidy. MFIS uses the tenant data to calculate tenant rents and rental assistance, which drive many subsequent account servicing activities. MFIS is also the source for occupancy statistics used to describe Multi-Family Housing program beneficiaries.

MFIS is the primary tool used by the Agency to track the status of borrowers' compliance with loan agreements and all other program requirements. Account status data from AMAS are transferred to MFIS, where Loan Servicers use them to monitor the status of borrower compliance. For instance, the system holds data on project classification based on compliance status (i.e., Classification codes A, B, C, or D). In addition, the system tracks the status of project budgets (i.e., when they are due, when they are received, and when they are approved).

The goal of using MFIS for tracking is to identify borrower compliance violations, as well as to track the status of servicing letters, workout agreements, and other Agency servicing actions. For instance, MFIS tracks the 15-day period for responses to servicing letters or monitoring letters and alerts staff to the need for follow-up when that period has expired.

MFIS also is used to track each state's performance in meeting Agency goals, and evaluate those states that may need additional assistance in determining solutions to problem accounts and the effectiveness of actions previously taken. Many states use the information from MFIS in monthly staff meetings and to provide information to borrowers. MFIS allows for timely assembly of this information with minimal effort from the Servicing Offices.

All regular borrower payments are processed through MFIS. MFIS maintains a collection history for each borrower.

B. Major Components of MFIS

The MFIS home page displays icons that each represents a Web page of their own that link to each other and are capable of interacting by accessing the data contained therein. The five main icons a Servicing Office should be concerned with are Projects, Project Payments, Customers, Reports, Electronic Transmissions, and Message Board. Each web page contains links for data input and analysis of important multi-family housing portfolio issues such as borrower compliance with their loan agreement/resolution, management efficiency, financial stability, occupancy trends, rent structures, and identities-of-interest, as well as program strengths and deficiencies. Moreover, MFIS archives a history of the multi-family housing portfolio nationwide, providing information necessary for determining the need for program changes and/or enhancements as well as funding needs.

- **Projects.** This page is used when working on information specific to a single project. It contains the data on the borrower, management agent, project tenants, type of project, and the like. Basically it contains all information that was formerly contained on the Management Card System for each project. Any incorrect information on this page could lead to improper calculations on *Form RD 3560-29, Notice of Payment Due Report*, that the borrower uses to make their monthly/annual installment from, thus causing unnecessary delinquencies.

  The Projects page is also where the Loan Servicer maintains information concerning borrower/management agent compliance with Agency regulations. One link on this page is Supervisory Activities. Supervisory Activities, when properly populated, can serve as an excellent tickler system to let the Servicing Official know when action is needed on their part. The same is true for the link Servicing Efforts, Findings, Financial Instruments, and Rents. When all components are analyzed, a clear and concise picture of the needs of the project can easily be determined.

- **Project Payments.** This page is used to perform activities related to payment processing. These functions include scheduling the release of Form Rd 3560-29 to borrowers, processing payments, and review payments. In addition, users can view and make adjustments for a specific pay period, monitor uncollectible returns, review and edit RA Obligations tracking for projects receiving RA units due to an obligation or transfer of units. The Project Payments page can be a very valuable tool when evaluating the feasibility of various servicing actions, providing collection history for a specific project at any given time.

- **Customers.** This page should be used when working on information across projects or specific only to the borrower, key member, or management agent. This is the page used to enter the key members of the borrower and management agent. It also allows the user to access all of the projects managed by a particular management agent, enabling an identical change to multiple projects with ease.

- **Reports.** This page contains predesigned reports by category, such as borrower, financials, findings, management agent, project, project summary, tenant, and tracking. Under each category, several different reports that may be generated are listed. The user is allowed to complete various data fields to allow one to zero in on the particular information that is desired. *The accuracy of these reports is based on the information that has been input into the Projects and Customer Web pages.*

- **Electronic Transmissions.** This page allows the MFIS user to view the individual transactions that have been electronically transmitted by the borrower/management agent. It is an important tool in assisting the borrower/management agent in correctly transmitting the data necessary to reflect the correct tenant and/or financial data.

- **Message Board.** Below the icons for the individual Web pages is a link to the message board. Each user of MFIS is encouraged to view the message board on a regular basis. This shows information on changes that have been made to the system. Step-by-step instructions for the input of all requested and/or required data are provided in the training manuals that are accessible from the message board.

C. Staff Responsibilities

Loan Servicers are responsible for populating all data fields contained in the MFIS system with accurate and current information. The upgrading of the MFIS system is an ongoing process. It is extremely important that the information contained in MFIS III for each borrower/management agent/project be input and accurate.

3.5 PREPAYMENT TRACKING AND CONCURRENCE

Pre-Trac is a Web-based automated application that allows the Agency to significantly reduce the reporting burden required to process and monitor Multi-Family Housing prepayment activity. This means that the Agency enters prepayment-tracking information once for use by all administrative levels. State and Servicing Offices use Pre-Trac to process all prepayment

requests to meet the Agency's requirements. Pre-Trac is designed to lead the user through the statutorily prescribed prepayment process.

The Office of Rental Housing Preservation (ORHP) uses Pre-Trac to issue all concurrence and authorizations of incentives to avert prepayment, and equity loans and prepayments. See Chapter 15 for more detailed information on using Pre-Trac.

3.6 FURTHER INFORMATION

Because there is a detailed users' manual for each of the Agency's automated systems, the discussion provided here is intended to be more of a basic introduction to the systems and their uses and requirements than an exhaustive step-by-step tutorial. Agency staff requiring more detailed information on any of the automated systems should refer to the relevant users' manual.

CHAPTER 4: ACCOUNT SERVICING

4.1 INTRODUCTION

To ensure that program objectives are met and that borrowers do not default on their loans, the Agency has specific procedures for servicing borrower accounts. These procedures are designed to ensure that loan payments are received on time and in the proper amounts; payments are properly applied to the appropriate account; past due accounts are serviced correctly; late fees are assessed for late payments; and procedures for final loan payments are followed. Diligent management of the account servicing process through promptly and accurately recording payments and tracking late payments is an effective method to reduce unnecessary delinquencies.

This chapter presents the Agency's procedures for servicing borrower accounts. It describes the procedures that all Loan Servicers must follow when servicing accounts to protect the Government's interest in the loan and the property.

4.2 OVERVIEW

Agency regulations in 7 CFR 3560.401 through 7 CFR 3560.403 establish borrowers' responsibilities and the actions the Agency may take to collect timely loan payments from borrowers, protect its interests and the security of its loan, and assist borrowers in meeting the objectives and requirements of the loan. These regulations require that borrowers repay their loans to the Agency according to the specific provisions of their debt instruments and operate their facilities in accordance with requirements of the rule and other applicable Federal, State, and Local laws. The Agency may reject any servicing request by a borrower if it is not in the best interest of the Government or tenants.

Most servicing requirements and procedures are the same for Daily Interest Accrual System (DIAS) accounts and Predetermined Amortization Schedule System (PASS) accounts, with the exception of the assessment of late fees, which only applies to PASS accounts. Payments under DIAS are not assessed late fees because additional interest is charged automatically, based on the number of days the past due balance is outstanding.

SECTION 1: ACCOUNT SERVICING REQUIREMENTS
[7 CFR 3560.403 AND 7 CFR 3560.404]

The Agency's regular account servicing requirements cover the following major topic areas: loan payments, late fees, waivers, servicing past due accounts, conversion of accounts from DIAS to PASS, and final loan payments. This section describes the regulatory requirements for each area.

4.3 LOAN PAYMENTS

Borrower loan payments are due on the <u>first day of each month</u> unless otherwise established in the debt instrument executed with the Agency. A borrower is in default of loan

agreements when the Agency has not received the full payment by the first day of the month. The Agency is under no obligation to offer borrowers loan servicing other than actions consistent with debt instruments and other agreements. However, the Agency does not pursue legal action to cure the default until a borrower is 60 days delinquent. If a borrower with a PASS account has not paid the full amount by the tenth day of the month, a late fee may be incurred.

4.4 LATE FEES (PASS ACCOUNTS ONLY)

The Agency will charge a fee for late payments under PASS accounts, equal to 6 percent of the note installment. Late fees are charged if any portion of a note payment exceeding $15 is late (i.e., outstanding after the tenth day of the month). The Agency may charge late fees only once for each regular installment or portion thereof.

Late fees are an owner expense and, as such, may not be charged to the project. The amount of the late fees is not appealable. The Finance Office notifies all late borrowers with PASS accounts of late fees and the payment due, not including overage and rental assistance calculations. The Loan Servicer should follow up with the borrower on this notification in an effort to collect the amount due before an account becomes 30 days past due.

4.5 LATE FEE WAIVERS

The State Office may waive late fees only for circumstances beyond a borrower's control or when granting the waiver is in the best interest of the Government. Waivers are issued at the Agency's discretion and Field Office Staff are under no obligation to grant waivers.

4.6 PAST DUE ACCOUNTS

A. Past Due Payments

The Agency considers a borrower to be delinquent if any past due amount remains after the payment due date. If a delinquency exists, the Agency immediately contacts the borrower and attempts to collect the amount due.

B. Interest on Past Due Payments (PASS Accounts Only)

When a regular payment continues to be past due on the first day of the month following the payment due date, the Agency charges interest at the note rate on the unpaid delinquent principal amount. Interest is charged from the date the principal was due until all applicable payments are current in accordance with the number of full installments required by the *Form RD 3560-52, Promissory Note*, and is in addition to the scheduled interest of the regular payment. The interest on delinquent principal, the unpaid delinquent principal, any applicable late fees, and recoverable cost charges are added to the regular payment amount due for the next month to determine the total amount due as of the first of the month following the delinquency.

Example – Determining Days for Past Due Accounts

If a borrower fails to make a scheduled payment in full due on June 1, the following example demonstrates how the Agency calculates past due charges:

June 1 – Payment due date.

June 2 – Payment is 1 day past due. No Agency action taken.

June 11 – Payment is 11 days past due. Late charge applied on overdue payments.

June 30 – Borrower is delinquent and 30 days past due. Agency begins special servicing actions in accordance with Chapters 10 and 12.

C. Special Servicing Action

Borrowers with accounts 30 days past due may be subject to the special servicing provisions outlined in Chapters 10 and 12 of this handbook.

4.7 CONVERSION FROM DIAS TO PASS

To facilitate and standardize its servicing efforts, the Agency requires that all new loans be closed and serviced using PASS. The only exceptions are off-farm and on-farm labor housing loans, which may be closed on either DIAS or PASS. Farm labor loans may be closed on DIAS if the farm operation is such that the annual payment corresponds to the timing of usual farm income.

Borrowers with DIAS accounts, except for farm labor housing loans, must convert to PASS if they request servicing actions that involve a change in the terms of their loan (e.g., credit sales, reamortizations, equity incentive loans, loan consolidations, and project transfers) or if they request subsequent loans.

4.8 FINAL LOAN PAYMENTS

Before the Loan Servicer begins the final loan payment process, they must determine if the final loan payment is a prepayment, as covered in Chapter 15.

A borrower's final loan payment must include repayment of all outstanding obligations to the Agency. The Agency will apply any remaining supervised funds to the borrower's account

or return such funds to the borrower following acceptance of final payment. At the borrower's request, the Agency will provide a written statement indicating the amount necessary to pay the account in full.

Suitable forms of payment include cashier's check, money order, or bank draft. If a borrower uses forms of payment that require special handling, the borrower is responsible for the cost of such handling. When payment is provided in a form that is not the equivalent of cash, the Agency will consider a payment to be received at the time the funds have been successfully transferred to the Agency. This can now be accomplished electronically through Pre-Authorized Debit (PAD).

The Agency will release security instruments when full payment of all outstanding obligations to the Agency have been received and accepted. If the Agency and the borrower agree to settle the account for less than the full amount owed, the Agency may release security instruments when the borrower has paid all agreed-upon obligations in full. Recording costs for the release of the security instruments will be the responsibility of the borrower, except where State law requires the mortgagee to record or file the satisfaction.

If the entire principal of the loan is refunded after the loan is closed, the borrower must pay interest from the date of the note to the date of receipt of the refund.

The Agency may collect any account balance that results from an error by the Agency in handling final payments.

SECTION 2: PROCESSING TENANT CERTIFICATIONS

4.9 OVERVIEW

For borrowers to qualify for interest credit or rental assistance, they must demonstrate that their tenants meet the income and household size eligibility limits delineated by the Agency. This section describes the Agency's policies and procedures for processing tenant certifications, including verification that the information is true and accurate.

4.10 REQUIREMENTS OF THE RULE

For each occupied unit under lease, borrowers must have a current tenant certification or recertification on file with the Agency to be eligible for interest credit or rental assistance. The Agency may charge borrowers overage and withhold rental assistance payments for units without a valid and current tenant certification. These requirements protect the Government's interest by ensuring that only eligible units benefit from Agency subsidy payments. They also protect tenants' interest by reserving subsidy benefits for those who actually qualify for them.

4.11 GENERAL PROCEDURES

A. Timely Submission and Overage Charges for Late Submissions

Borrowers must submit tenant certifications for new tenants and required recertifications for existing tenants no later than the tenth day of the month for the certification to be effective for that month. This deadline applies regardless of whether the certifications are being submitted through electronic transmission or in hard copy. Tenant certifications received after the tenth day of the month will be considered late. Borrowers are not eligible for interest credit or rental assistance for units with late certifications, and the Agency will charge the appropriate amount of overage until valid certifications are received in a timely manner for all units.

The tenth-day-of-the-month deadline applies regardless of whether the late certification in question relates to a new certification or a recertification. Any changes to tenant certifications that are effective as of the first day of the month must be submitted to the Agency by the tenth day of that month for the affected units to qualify for interest credit or rental assistance. If the changes are submitted after the tenth day of the month, the Agency will charge overage and the changes will be effective the first day of the following month. The Agency may remove a management agent if there is a pattern of failure to submit tenant certifications on time that results in excessive overage charges.

B. Waivers of Overage

The State Director may grant a waiver of overage charges resulting only from the late submission of tenant certifications in the following instances:

- Circumstances existed that were beyond the borrower's control (e.g., natural disaster or undetected transmission failures due to network interruption);

- It would place an unfair burden on the borrower;
- It is in the best financial interest of the Government to grant the waiver; or
- The charges were a result of an Agency error.

In order for a waiver of overage charge to be considered, the borrower must submit a written request to the Servicing Office justifying the reasons for the waiver. For each waiver requested, the borrower must provide a written explanation of the circumstances that caused the late submission of the tenant certification, proof that these circumstances were beyond the borrower's control and a description of the actions taken to prevent the situation from occurring in the future.

To recommend the approval of a request for waiver of overage, the Servicing Official will attach a completed copy of *Form RD 3560-23, Multi-Family Housing Waiver of Overage*, to the borrower's request and forward to the State Office. Only the State Director has the authority to grant a waiver of overage. Once the waiver is approved, the State Office is responsible for making the appropriate entries in AMAS and MFIS.

If a request for waiver of overage is denied, the charge must be paid as a borrower expense. With prior Agency approval, nonprofit borrowers and cooperatives may treat the charge as a project expense. If a request for an overage waiver is denied, the borrower will be given appeal rights.

C. Verification and Processing of Certifications

Borrowers are required to provide the data for all tenant certification forms to the Servicing Office through electronic transmission via MINC, except in the case of projects with eight units or more, which may submit hard copies. The Servicing Office process these transmissions through the Industry Interface page of MFIS, providing assistance where needed with rejected entries. In the event of the receipt of hard copies of *Form RD 3560-8*, the Servicing Office will process manually the data into MFIS. MFIS calculates interest credit and rental assistance due the borrower, as well as overage due the Agency in cases of late certifications. These calculations are reflected on *Form RD 3560-29*. All subsidy payments are based on tenants' occupying the units as of the first day of the month prior to the payment due date. For example, a payment due on July 1 is based on tenants' occupying the units June 1.

The Loan Servicer verifies the accuracy of the tenant data transmitted by the borrower through a random review of selected tenant files during the Supervisory Visit. Corrective action is initiated for any discrepancies revealed during this review.

D. Approval of Subsidy

The Agency will certify for interest credit or rental assistance only those tenants with current tenant certifications showing on MFIS when payments are being processed. MFIS retains a copy of *Form RD 3560-29*, to document the approved subsidies.

SECTION 3: LOAN PAYMENT PROCESSING

4.12 OVERVIEW

The Agency processes loan payments and subsidy requests according to the servicing and collection requirements of the individual loan. The requirements are established by the loan agreement or loan resolution, and *Form RD 3560-52*. There are a number of steps common to the processing of any loan payment, as outlined below.

4.13 NOTIFICATION TO BORROWERS OF PAYMENTS DUE

A. Factors Used to Determine Payment Amount

The amount of each borrower's monthly payment is automatically calculated by MFIS based on the tenant information received from the borrower and summarized on *Form RD 3560-29*. The Servicing Office releases this form to MINC on or about the seventeenth day of the month, where borrowers are able to view and approve the information for processing.

B. Calculating Payment Amount

To determine the amount of the payment that is due from the borrower, MFIS sums the total of the following components:

- Audit receivables (e.g., excess rental assistance, unauthorized assistance) as determined by MFIS;
- Late fees as determined by AMAS;
- Unamortized cost items (e.g., taxes, insurance, protective advances) as determined by AMAS;
- Amortized cost item loan installments as determined by AMAS and reflected on the MFIS *Form RD 3560-29* (included in the project payment) and in the project payment amount on *Form RD 3560-29*;
- Overage; and
- Debt service (i.e., interest and principal as determined by AMAS).

Note that audit receivables and cost items may be either unamortized or amortized. If they are amortized, a borrower may have up to five years to pay under the terms of an approved work-out agreement (see Chapter 10 for more information on workout agreements).

The Agency will count only those tenants who have current tenant certifications on MFIS for interest credit or rental assistance when processing payments. For a project receiving rental assistance, the rental assistance amount is applied as a credit to the total

amount due as calculated on the project worksheet. The remaining balance is the net amount due.

Exhibit 4-1 illustrates how rental assistance and overage are calculated and the impact they have on the tenant's rent and the borrower's loan payment. If the amount of rental assistance exceeds the borrower's loan payment, the Agency will make a rental assistance payment to the borrower. In accordance with the Debt Collection Improvement Act of 1996, the Agency is required to send rental assistance checks via an electronic funds transfer to the borrower's bank account.

Exhibit 4-1

Overage and Rental Assistance

30% of Tenant Monthly Adjusted Income	Rental Assistance	Basic Rent	Note Rent	Overage	Actual Rent Paid by Tenant
$180	Not available ($0)	$200	$500	$0	Tenant pays Basic Rent, $200. Tenant is rent overburdened.
$180	$20	$200	$500	$0	Tenant pays $180.
$200	$0	$200	$500	$0	Tenant pays Basic Rent, $200.
$230	$0	$200	$500	$30	Tenant pays $230; $30 is considered overage.
$500	$0	$200	$500	$300	Tenant pays $500; $300 is considered overage.

C. Borrower Verification Of Payment Data

Form RD 3560-29 is released to MINC for verification by the borrower on or about the seventeenth day of the month. It is the borrower's responsibility to access this form and verify that the data contained therein is accurate. Should discrepancies be found, the borrower must transmit corrected data through MINC or contact the Servicing Office for assistance.

4.14 PAYMENT DUE DATES

The regular payment due date is established in the Agency *Form RD 3560-52* for the project and is generally the first day of each month. The first regular amortized payment after loan closing for transfers, reamortizations, voluntary conversions, credit sales, or loans closed after interim financing must be at least 1 month from closing. For example, if a loan is closed on January 31, the first regular amortized payment will be due March 1. For multiple advance loans, the first payment must be at least 1 month after the final advance.

4.15 PROCEDURES FOR PROCESSING PAYMENTS

A. Overview

Loan Servicers are responsible for administering the requirements for payment processing under the guidance and supervision of the State Director. Key steps in processing regular payments and advance regular payments are listed in Exhibit 4-2.

Exhibit 4-2

Key Steps in Processing Loan Payments

- Process payments that are submitted to the Servicing Office through MFIS.
- Review payments for accuracy, balance totals, access the accounting system, and enter appropriate amounts in the proper fields;
- When a payment is processed, the system will apply subsidy credit to the loan account before any payment or other credit is applied to the account. Subsidy credit will be applied first to accrued interest and then to principal after all interest is paid. Subsidy credit will not be applied to late fees, audit receivables, or recoverable cost charges;
- After a payment has been processed, any change in application that does not involve changes in cash may be made in the Servicing Office by properly trained and certified staff. If changes need to be made in a cash field, the AMAS Coordinator in the State Office can process the charge after performing a cursory review of account information; and
- Make modifications to the payment as necessary. Some examples of situations where modifications might be made include wrong date of credit, key punch errors, incorrect recording of rental assistance, and duplicate payments (see AMAS instructions for more information).

When a borrower remits a payment, AMAS will net enough rental assistance to bring the account status current and pay any unpaid overage, late fees, or interest on delinquent principal based on the date payment is received. If the account is on or ahead of schedule when the payment is received, enough rental assistance will be netted to pay one full installment and any unpaid overage, interest, or other obligation.

B. Borrower Submission

Borrowers must prepare and submit *Form RD 3560-29* providing the following information:

- Only tenants' occupying units the first day of the month prior to the payment due date;
- Interest credit and rental assistance only for tenants with current tenant certifications;
- Overage up to the market rent that must be paid to the Agency by the borrower for tenants without current tenant certifications unless there is a formal eviction in process. In that case, the payment will be based on the expired tenant certification; and
- The borrower may subtract any rental assistance due the project (supported by current tenant certifications) from the payment due and remit a net payment. Calculations

supporting the net payment must be shown on Part I of *Form RD 3560-29*. AMAS will net enough rental assistance to bring the account status current and pay any unpaid overage, late fees, or interest on delinquent principal based on the payment receipt date.

- If the RA due the borrower exceeds the balance of scheduled loan payments, delinquent payments and other charges, no additional payment is due from the borrower and an RA check for the excess will be issued.

Examples

Example 1: Borrower Olson shows on *Form RD 3560-29* for the month of May a loan payment due to the Agency of $1,865 and RA due from the Agency of $3,600. The Finance Office sends Olson a check for $1,735.
Example 2: Borrower Johnson shows on *Form RD 3560-29* for the month of May a loan payment of $2,200 due to the Agency and RA of $1,200 due from the Agency. Johnson must attach a check made out to the Agency in the amount of $1,000.

C. Application of Payments

1. Regular Payments

The Agency has developed specific priorities for applying regular payments. Exhibit 4-3 lists these priorities in descending order.

AMAS also will apply regular payments on projects with an initial and subsequent loan according to the priorities in Exhibit 4-3. Each priority item will be paid for all project loans before moving to the next item. AMAS will apply payments for each priority item in accordance with the loan number, beginning with the initial loan and ending with the highest-numbered subsequent loan.

Exhibit 4-3

Priorities for Application of Borrower Payments to Outstanding Obligations

From highest to lowest, the priorities are:

- Amortized audit receivables;
- Unamortized audit receivables;
- All project late fees due;
- Amortized recoverable costs due;
- Unamortized recoverable costs due;
- Overage;
- All other interest due;
- Principal; and
- Any remaining regular payment, which will be applied as an advance regular payment unless specifically designated otherwise.

2. Advance Payments and Additional Principal Payments

The Agency also has established specific procedures for applying advance payments and additional principal payments. Advance regular payments are applied as such only

when the loan account is current. The payment effective date will be the due date of the next regular payment that is not fully paid. Extra payments are applied as principal to the last installment to become due under the note. Voluntary additional principal payments will only be credited to the account when all regularly scheduled payments on the account have been paid. These payments are credited to all principal, as of the payment effective date, and do not affect the payment status of the loan. Any amount paid by the borrower in excess of the amount owed will be refunded to the borrower if the excess amount is over $10.

4.16 ASSESSMENT OF LATE FEES

Payments for loans closed on PASS and DIAS are due on the first day of the month. The Agency charges late fees on PASS payments received after the tenth day of the month. The Finance Office automatically notifies each borrower of late fees for PASS payments that were outstanding as of the tenth day of the month. On or about the eleventh day of each month, *Form RD 3560-29A, Multiple Family Housing Statement of Payment Due*, will be mailed to each borrower who is 30 days past due and/or owes late fees, showing the current monthly payment due, unpaid late fees, and past due payments due on the first day of the following month. This payoff statement will be determined from current Finance Office records but will not reflect overage due from the borrower or rental assistance due the borrower. A copy is also mailed to the Servicing Office.

Late fees collected by the Finance Office are deposited in the Rural Housing Insurance Fund (RHIF).

A. Agency Approval of Waivers Procedures for Granting Late Fee Waivers

Waivers to late fee charges may be granted only as follows:

- The State Director may grant a waiver for as many late fee charges as are justified by the facts of the case, based on a determination that the late fees would place an unfair burden on the borrower. For each waiver requested, the borrower must provide a written explanation of the circumstances that caused the late payment, proof that they were beyond the borrower's control, and a description of what actions will be taken to bring the account current. Waivers are granted on a case-by-case basis;

- There are only two circumstances under which the Agency will grant a waiver to late fees. The first is when the borrower is a board-managed nonprofit or cooperative, because they are the only entities on which the assessment of late fees would place an unfair burden. The second is where the Agency has agreed to accept deferred payments or partial payments as part of an approved workout agreement. In such cases, the State Director can grant as many waivers as are justified by the facts of the case (i.e., there is no annual limit on the number of waivers that may be granted);

- As noted above, late fees are an owner expense. As a result, they may not be charged to the project, except in the case of cooperatives, which can pay late fees from project expenses in cases where the fees are not waived;

- The Agency will not grant a waiver solely to correct a delinquency; and
- The State Director may authorize late fee waivers in cases where Agency error (e.g., an incorrect statement of the date a payment is due) leads directly to the late payment.

B. Required Submissions from Borrower to Receive a Waiver

Borrowers must submit a number of items to the Agency in order to receive a waiver. These include:

- A written explanation of the circumstances that caused the late payment;
- A description of the factors beyond the borrower's control (e.g., natural disaster); and
- A description of the actions that will be taken to bring the account current.

If the late payment is due to Agency error, the borrower need not submit the above-listed items. In such cases, providing notification to the Agency of its error will suffice, and loan services will promptly correct the error in the appropriate automated system(s).

C. Notification upon Granting A Waiver

When a waiver to late fees is granted, the State Director will notify the Servicing Office and the borrower on *Form RD 3560-28, Multi-Family Housing Exception to Late Fees*, completed according to the Forms Manual Insert (FMI), and enter the change into AMAS and MFIS.

D. Denying Waivers

When an application for a late fee waiver is denied, the State Director must give the borrower appeal rights under 7 CFR Part 11.

4.17 SPECIAL CIRCUMSTANCES

A. Reapplication of Payments

Loan Servicers may approve, with the authorization of the State Director, reapplication of payments between accounts when payments have been applied in error. However, no change may be made if the loan is paid in full, the canceled note or notes have been returned to the borrower, and the security instruments have been satisfied. The AMAS Coordinator will enter changes through Field Office terminals.

B. Overpayments and Refunds

Loan Servicers will process overpayments and refunds to borrowers according to the procedures outlined in 7 CFR 3560.401 through 7 CFR 3560.404, Account Servicing Policies.

C. Recoverable and Nonrecoverable Cost Items

The Loan Servicer will service recoverable and nonrecoverable cost items according to the procedures outlined in 7 CFR 3560.403 and RD Instruction 2024-A.

SECTION 4: ACCOUNT TRACKING AND SERVICING

4.18 OVERVIEW

The Agency must track borrower accounts to ensure that all payments are up-to-date and to identify any problems that could lead to delinquencies or defaults. Any transaction that affects an account must be tracked to ensure that it has been processed correctly and that it has not had a negative impact on the interests of the borrower, tenants, or the Government.

The Agency has sought to facilitate and standardize the account tracking process by requiring that all new loans, and many existing loans, be closed and serviced using PASS.

4.19 ACCOUNT TRACKING PROCEDURES

A. Conditions for Conversion from DIAS to PASS

Conversion of accounts from DIAS to PASS may be either voluntary or involuntary. An involuntary conversion may occur at the time of a servicing action such as a subsequent loan, transfer, or reamortization. In such cases, the Servicing Office completes *Form RD 3560-50, Conversion Agreement*, and submits it to the State AMAS Coordinator for entry into AMAS. The terms for the converted loan will be the same as for the original loan.

B. Procedures for Conversion from DIAS to PASS

The following actions must be taken to convert an account from DIAS to PASS:

- The Loan Servicer will complete *Form RD 3560-50*, except for loans converted on *Form RD 3560-21, Assumption Agreement*, or *Form RD 3560-16, Reamortization Agreement* (which converts the account to PASS);

- When the borrower will continue to receive interest credit following conversion, the current interest credit plan type will be passed through to the PASS loan. A new *Form RD 3560-9, Interest Credit and Rental Assistance Agreement*, must be prepared by the borrower and the Loan Servicer to reflect the PASS payment and subsidy amount;

- The Loan Servicer will document on the back of the original note or assumption agreement that the payment schedule was modified; and

- The Loan Servicer will establish principal balance converted to PASS according to the FMI for *Forms RD 3560-21* or *3560-16*, and specific requirements based on whether the transaction is on the same terms or new terms.

C. Account Reviews

The foundation for proper and timely debt payment is sound budgeting and monthly review of income and expenses by the borrower and, as necessary, by Loan Servicers. Account maintenance must begin with initial planning and must be an integral part of ongoing analysis, planning, and follow-up management assistance.

Loan Servicers must review each loan account at least monthly by accessing AMAS and carefully reviewing the status screens showing account status and other relevant account information. Accounts that are 30 days past due are subject to special servicing actions, as outlined in Paragraph 4.21 and in Chapter 10 of this handbook.

4.20 SERVICING ACCOUNTS THAT ARE 30 DAYS PAST DUE

When tracking borrowers' accounts, Loan Servicers must identify all accounts that are 30 days past due. The Loan Servicer will service these delinquent accounts according to the procedures in this handbook, with guidance and assistance as necessary from the State Director. If a borrower's delinquency is not corrected by the time the account is 60 days past due, the Agency initiates legal action to cure the borrower's default. In such cases, Loan Servicers will follow the procedures described in Chapter 10 and any additional procedures established by the State Director for the particular type of loan.

4.21 SPECIAL CIRCUMSTANCES

A. Same Terms Transfers

Same terms transfers, when the transferor has been converted to PASS, must take place in a current loan status on the date of the transfer. Borrowers must bring current any delinquent principal and interest before the conversion can occur.

B. Overpayments and Advance Regular Payments

Overpayments and advance regular payments made on PASS accounts result in the creation of a "future paid" status account under AMAS. Loan Servicers must reverse and apply such advance payments to the transferor's principal balance prior to determining the loan balance to be transferred. If the future payments have been made through RA, they must be refunded to the transferor and reapplied in the form of cash on the loan balance.

SECTION 5: FINAL LOAN PAYMENT *[7 CFR 3560.404]*

4.22 OVERVIEW

Because the final payment on an Agency loan signifies the end of the borrower—Agency relationship and opens a number of legal questions, it is important that the Agency has specific requirements and procedures for accepting and processing final loan payments. The Agency's procedures ensure that payments are received in the proper amount and suitable form, that security instruments are released only when all obligations are satisfied, and that special circumstances are handled appropriately.

Before the Loan Servicer begins the final loan payment process, they must determine if the final loan payment is a prepayment, as covered in Chapter 15. If the final payment is an advanced payment of the account, the borrower must complete the prepayment process as outlined in 7 CFR part 3560, subpart N, and Chapter 15 of this handbook before the Agency will process a final loan payment.

4.23 PROCESSING FINAL LOAN PAYMENTS

There are a number of steps that Loan Servicers must follow when accepting and processing a final loan payment.

A. Payment Amount Determined

Loan Servicers will obtain and provide to the borrower the amount to be collected for payment in full of all loans by accessing the relevant AMAS status inquiry screens on the Field Office terminal. Loan Servicers will furnish requests for payoff balances on all accounts in writing. Such requests require verification of the payoff amount by two employees in the Field Office.

B. Funds from Supervised Bank Account

When a borrower is ready to pay a loan in full, Loan Servicers must withdraw any funds remaining in the supervised bank account for the initial loan and remit this amount for application to the borrower's account. *Note:* This requirement does not include the supervised bank account for reserves. Any amount remaining in the reserve account above the required level and unused is the borrower's money and may be released to the borrower following receipt of the initial payment.

C. Forms Processed

When the Field Office receives final payment, the Loan Servicer processes it in AMAS as a paid-in-full payment. The payment must be loan specific.

D. Payments Applied

Loan Servicers apply final payments on the next payment due date or the final due date shown on *Form RD 3560-52,* assumption agreement, or reamortization agreement, whichever is sooner.

E. Security Documents Released

1. General

When the Finance Office verifies that all amounts owed to the Government have been paid in full, or a compromise or adjusted agreement has been accepted and approved by the appropriate official, it will release security documents to the borrower, along with *Form RD 140-4, Transmittal of Documents*.

If the Agency receives final payment in cash, U.S. Treasury check, cashier's check, certified check, money order, or bank draft, Loan Servicers will give the security documents to the borrower at the time of final payment. If not, the Agency will release the documents after a 30-day waiting period.

2. Loans Secured by Both Real Estate and Chattels

If a loan secured by both real estate and chattels is paid in full, the chattel security instrument will be satisfied or released by the Loan Servicer in accordance with RD Instruction 1962-A.

3. Loans Where Mortgagee Is Required to Record or File a Satisfaction

If State law requires the mortgagee to record or file a satisfaction, the Agency will do so consistent with the State supplement. The Agency will deliver the form of satisfaction to the borrower for recordation at the borrower's expense.

4. Loans to Insured Borrowers Whose Note and Security Instrument Are Held by a Lender

For an insured borrower whose note and security instrument are held by a lender, the Loan Servicer will deliver to the borrower the note and other documents upon receipt from the lender of *Form RD 3560-52,* marked "paid in full," the original security instrument, and the instruments of satisfaction or release.

F. Release of Interest in Insurance

When the borrower's loan has been paid in full and the satisfaction or release of the mortgage has been executed, the Loan Servicer is authorized to release the mortgagee interest in the insurance policy as provided in Chapter 3 of HB-2-3560.

G. Special Circumstances

1. Refunded Principal

If the entire principal of the loan is refunded after the loan is closed, the borrower must pay interest from the date of the note to the date of the receipt of the refund.

2. Overpayment

If the borrower's final loan payment is greater than the amount due to close the loan, the Agency will process a refund to the borrower 30 days after receipt of the final payment.

3. Agency Error in Handling Final Payments

If the Agency makes an error in handling final payments and the error results in an account balance, the Loan Servicer may attempt to collect that amount from the borrower.

4. Note-Only Cases

When a loan is evidenced only by a note (i.e., no security instruments are evident) and the note is paid in full, the Agency will deliver the note to the borrower.

5. Other Situations

If a situation develops that is not covered by regulations, the Loan Servicer forwards the borrower's case file to the State Director, who may offer assistance and special instructions after consultation with the Office of General Counsel (OGC).

H. State Supplements

The State Director, with the advice of OGC, will issue a State supplement and the necessary forms for releasing or satisfying real estate security instruments. Any unusual cases that are not covered by the State supplement will be handled in accordance with advice from OGC.

I. Redelegation of Authority

Field Office Directors are authorized to redelegate to Field Office Staff the authority to execute releases and satisfactions associated with final payments, provided it is determined that the individual to whom such authority is being redelegated has had sufficient training and experience to properly exercise such authority.

CHAPTER 5: OWNERSHIP AND ORGANIZATION CHANGES *[7 CFR 3560.405]*

5.1 INTRODUCTION

During the term of an Agency loan, changing circumstances may lead borrowers to seek Agency approval of a change in the structure of the ownership entity. For instance, partnerships may dissolve, or substitute individuals or entities may obtain an ownership interest in a property due to business reorganizations, retirements, or other reasons. To address these situations, the Agency has developed requirements and procedures for receiving notification of and reviewing proposed changes, as well as granting approval for such changes to ensure that the Agency's security interest is protected.

This chapter covers the Agency's requirements regarding changes in a borrower's ownership structure and Agency procedures for reviewing and accepting such changes.

5.2 OVERVIEW OF CHANGES REQUIRING PRIOR AGENCY CONSENT

The Agency imposes specific requirements on certain proposed changes in the structure of the borrower entity to ensure the adequacy of the new or substitute interests and thus protect the interests of tenants and the Government.

The Agency requires that borrowers obtain prior Agency consent to organizational changes involving the controlling interests of the borrower entity to ensure that such changes will continue to serve the needs of tenants and protect the interest of the Government. For example, if one partner in a borrower entity decides to sell their interest to a new individual from outside the existing organizational structure, the Agency needs to review that individual's prior history and qualifications to ensure that the person is eligible to participate in the program (i.e., is not under suspension, debarred, under Office of the Inspector General (OIG) review, or known to be in default on any Agency loan[s]). The purpose of this review is to evaluate that the borrower entity will continue to be eligible under program requirements and that any changes in the organizational structure do not adversely affect the Agency's security interests.

5.3 REQUIREMENTS FOR OBTAINING AGENCY CONSENT

A. Overview

Certain changes in the structure and ownership interests in the borrower entity require Agency consent before they become effective. These include:

- Any changes in the controlling interests of the borrower entity;
- Changes in the ownership interests of the borrower entity that involve the transfer of stock to any individual or organization not previously listed in the ownership documents submitted to the Agency; or

- A 100 percent change in membership interest where the tax ID remains the same and the organizational entity remains the same during any 12-month period.

Examples of such changes include changes in general partners, addition of new general partners, proprietorship as a result of death, divorce, or other applicable ownership changes.

B. Written Request

Requests for Agency consent to organizational changes must be submitted in writing, along with *Form RD 3560-1, Application for Partial Release, Subordination, or Consent*, to the Servicing Office. Each request must describe the proposed changes in the organizational structure of the borrower entity and provide the information shown in Exhibit 5-1 for each new or substitute ownership interest or member in the borrower entity.

The information included with the written request must demonstrate that the proposed change will not adversely affect the Agency's security interest in the property by illustrating that all key individuals would meet loan approval requirements.

Exhibit 5-1

Required Content of Requests for Agency Consent to Changes in Borrower Entity

- *Form RD 3560-1, Application for Partial Release, Subordination, or Consent;*
- The names, addresses, and taxpayer identification numbers of individuals with controlling interests in the new or substitute entity;
- Certification that the new interests and/or members are not suspended, debarred, or in default on Agency loan(s);
- The organizational role of the new interest/member or changes in roles of existing individuals;
- Résumé, including experience managing real estate, business experience, and education;
- Identity-of-interest (*Forms RD 3560-30, Certification of No Identity of Interest (IOI), and 3560-31, Identity of Interest Disclosure/Qualification Certificate*);
- Personal financial statement;
- Percentage of ownership of the new interest/members in the borrower entity;
- Proposed amendments to organizational documents;
- Previous participation certification;
- Opinion of the borrower's attorney stating that the changes are in accordance with reapproved organizational documents, are permitted by law, and comply with Agency regulations; and
- Credit report fee, if applicable.

C. Assumption of All Applicable Responsibilities by New Interests

If any portion of the controlling interest in the borrower entity is transferred to an individual or organization not previously holding a controlling interest, the new individual or organization must agree to assume the responsibilities and obligations established under the terms of the *Form RD 3560-52, Promissory Note* with the Agency, the mortgage, the loan agreement/resolution, and any applicable partnership documents for the entity.

D. Assumption of Liability by Substitute General Partner

In the case of substitution of any general partner, the substitute general partner must agree to assume the responsibilities and obligations of the original general partner under the terms of the Agency *Form RD 3560-52*, mortgage, and the borrower's partnership agreement.

In consultation with the Office of General Counsel (OGC), the State Director may require the substitute partner to sign an agreement to assume all applicable responsibilities. This agreement is placed in the case file.

E. Satisfaction of Eligibility Requirements

All proposed new individuals in the ownership entity must meet applicable eligibility requirements for borrowers under 7 CFR 3560.55. For further information on eligibility requirements, see Chapter 4 of HB-1-3560.

5.4 BORROWER REQUESTS FOR CONSENT

Borrowers must submit their written requests for Agency consent to organizational changes at least 45 days prior to the desired effective date of the change. Borrower requests must contain the information listed in Exhibit 5-1.

5.5 AGENCY REVIEW OF BORROWER REQUESTS

A. Overview

To ensure that all changes to borrower entities protect the interests of tenants and the Government, the Agency has developed procedures for review and approval of proposed changes. By preventing changes that do not further program objectives, the review process ensures that program implementation is consistent with Agency mandates.

Loan Servicers need to take all actions necessary to determine that the changes will have no adverse impact on the loan or property. These actions will vary based on the nature of the changes to the borrower entity.

The Agency may reject such requests if the borrower fails to adequately demonstrate that the proposed change will not adversely affect the interests of the Agency or the tenants of the property.

B. Loan Servicer and State Director Actions

Loan Servicers first review borrower submissions for completeness. Next, they perform a review to determine whether the new individuals or organizations proposed meet eligibility criteria (i.e., the same criteria required to qualify for a new Agency loan as set forth in the HB-1-3560). To determine that approval of the transaction will not adversely affect the objectives of the loan or the property, the State Director must consider past performance, experience, qualifications, and abilities of any individual or organization obtaining an interest in the borrower organization. Finally, Loan Servicers review all documentation to determine if the substitute general partners propose to assume all liability that had been assumed by the withdrawing entity.

When the initial review has been completed, Loan Servicers process and submit *Form RD 3560-1* to the State Director, who either approves or rejects the proposed transfers or changes. In cases where proposed membership changes are not covered in the organizational documents or appear to be in conflict with applicable regulatory requirements, Loan Servicers may submit case files to OGC for review and concurrence regarding a borrower's legal sufficiency to assume the proposed role in the new organization. OGC does not override the decisions made by Loan Servicers with regard to organizational changes.

5.6 DOCUMENTATION OF CHANGES

To ensure that there is a running history of all changes made to the organization of a borrower entity, the Agency requires that all changes be adequately documented through both written notification to borrowers and maintenance of case files. Loan Servicers must respond to all requests for Agency consent to changes in a formal letter, a copy of which is placed in the borrower's case file. Documentation allows the Agency to track the legality of the changes and the suitability of any new individuals or organizations added to the borrower entity over time. All changes must be entered into the MFIS so that the automated system is always up to date.

CHAPTER 6: DETERMINATION OF PROJECT SUITABILITY

6.1 INTRODUCTION

When there are loan repayment or compliance problems with a project and the Agency is considering special servicing actions, or prior to making a subsequent loan, the Loan Servicer must determine that the project remains suitable as a program property. To remain a suitable project, there must be a need for the project and the physical property cannot be obsolete. If a project is suitable, it is in the best interest of the Government to proceed with the servicing action. However, if the Agency determines that a project is no longer suitable, the Agency may designate it as non-program rather than spend limited Agency resources on a project that does not fulfill the goals of the program.

This chapter is designed to assist the Agency and the Loan Servicer in particular, to make an analysis of a project's suitability and make a determination that meets the principles and objectives of the Agency. This chapter also provides guidance on implementing appropriate actions when a project is no longer suitable:

6.2 WHEN TO CONSIDER SUITABILITY

The Loan Servicer should conduct a suitability analysis when the borrower and project meet one of the following conditions.

- When there are loan repayment or compliance problems with a property and the Agency is considering special servicing, including a transfer or liquidation action; or

- When the borrower requests a subsequent loan.

There are exceptions to the conditions above that do not require the Loan Servicer to consider suitability.

- When a project is clearly suitable and there are no loan repayment or compliance issues that threaten the financial viability of the project, a suitability analysis is not necessary. For example, if the Loan Servicer is processing a limited review transfer, in accordance with Chapter 7, or the Loan Servicer has determined that there are no compliance violations or increased risks to the Agency, then there are clearly no suitability issues that require further analysis.

- When a borrower requests to prepay a loan the Agency should not conduct a suitability analysis. In this case, the Loan Servicer must proceed with the borrower in accordance with Chapter 15.

- When a case has been referred to the Office of General Counsel (OGC) or the U.S. Attorney for action, the Agency may not consider suitability. The Agency does not pursue actions separate from the legal actions of OGC or the U.S. Attorney.

6.3 KEY STEPS TO COMPLETING A SUITABILITY REVIEW

The Agency completes five major steps to move through the process of making a suitability determination and implementing the appropriate actions based on the analysis. The Loan Servicer has primary responsibility for the first three steps of conducting the analysis of need and obsolescence. If the initial analysis indicates that the property may not be suitable, the State Office, with assistance from OGC and the National Office as necessary, is responsible for the next two steps, in which a final determination of suitability is made and the resulting course of action is approved. These steps are listed in Exhibit 6-1.

Exhibit 6-1

Key Steps to Complete a Suitability Review

1. Analysis of ownership
2. Determination of need
   - A. Information gathering
   - B. Analysis
     - i. Impact on tenants
     - ii. Economic viability
     - iii. Impact on the community
   - C. Determination
3. Determination of obsolescence
   - A. Information gathering
   - B. Analysis
     - i. Health and safety
     - ii. Physical characteristics
     - iii. Need
   - C. Determination
4. Determination of suitability
5. Implementation of the suitability determination

If the primary suitability issue concerns obsolescence, the Loan Servicer must consider need to determine the impact on tenants. The amount of information and analysis needed to complete each step may be different. The appropriate type of review depends on the level of documentation the Agency has on file and the level of analysis required to make a final determination.

6.4 ANALYSIS OF OWNERSHIP

The analysis of project suitability must first consider the ownership of the property to confirm that it is acceptable. Key questions to answer include:

- Is the present ownership entity still legally operational?

- Is the ownership entity cooperative? (Is the ownership entity responsive to Agency requests for information and does it take action when the Agency identifies issues and deficiencies?)

- Is the ownership entity financially solvent?

- Is competent management being provided?

The answer to all four questions should be yes. If not, improvements must be made for a project to be deemed suitable.

6.5 DETERMINATION OF NEED

To make a determination of need, the Loan Servicer goes through a process of information gathering and analysis before making a determination of need.

A. Information gathering

The Loan Servicer should have the following information to determine need:

- The Agency should obtain a market study. If the Agency has a market study covering the project area that is less than 12 months old, the Loan Servicer may use this market study and update any information as necessary;

- If not included in the market survey, the Loan Servicer may need to obtain local economic indicators, such as local employment and economic trends to judge the short- and long-term prospects for change;

- The Loan Servicer should have the project's updated budget, including a record of accounts receivable and accounts payable;

- The Loan Servicer may ask the borrower to prepare documentation stating the borrower's intentions for the property and the proposed rents if it becomes a non-program property; and

- The Loan Servicer should also seek community input to get information on the community's interest in retaining the project and the community perception of the need for the project.

B. Analysis

There are two components to the analysis of need, impact and economic viability. The Loan Servicer must consider both components to determine if there is a need for a project.

1. Impact

The Loan Servicer must determine if a non-program designation would have a negative impact on tenants. This analysis is the same impact analysis as conducted in response to a prepayment request. See Chapter 15, paragraph 15.22 of this handbook for a detailed discussion on determining impact. The objective of this analysis is to determine if tenants will lose their units, suffer from rent overburden, or be unable to find comparable housing in the community.

The Loan Servicer should use the market study and proposed non-program rent information to consider the following:

- The tenant's ability to stay in the project. This analysis depends on the proposed use of the project after a non-program designation and conventional rents for comparable units;
- The availability of alternative housing if the proposed use of the project or increase in rents will cause rent overburden. The alternative housing must be comparable in size, amenities, and rent to keep project tenants in the local community; and
- If the project has rental assistance, the Loan Servicer must identify comparable units with rental assistance (RA) or other rental subsidies, such as HUD Section 8.

Exhibit 6-2 provides an overview of the full analysis of impact.

Exhibit 6-2

Analysis of Impact on Tenants

Step 1: Answer the following questions about rents and loss of units.

A. Will a non-program designation result in an increase in tenant payments, and, if so, will this new payment be higher than 30 percent of the current tenants' incomes?

OR

B. Will a non-program designation result in a loss of units?

If the answer to both A and B is no, there is no adverse impact on tenants.
If the answer to either A <u>or</u> B is yes, proceed to Step 2.

Step 2: Answer the following questions about the availability of alternative housing:

C. Are there sufficient comparable vacant units in the market area (as indicated by the market study) for displaced tenants to find alternative housing?

AND

D. Are the tenant payments in these units equal to or less than the greater of their current rent or 30 percent of their income?

If the answer to both C and D is yes, there is no adverse impact on tenants.
If the answer to either C <u>or</u> D is no, there is an adverse impact on tenants.

2. Economic Viability

The Loan Servicer must determine if the project is economically viable. If the property cannot generate sufficient income to pay essential expenses, fund accounts, and make loan payments—despite appropriate loan servicing actions, budgeting, and marketing—the property may no longer be economically viable. Economic viability problems are usually associated with a change in local economic conditions and the inability of the project to maintain a sufficient occupancy rate even with aggressive marketing. For example, if a 20-unit project has a 50 percent vacancy rate and has been steadily losing tenants as the area's population declines due to the closing of a factory, the property may not be economically viable. It may not be in the Agency's interest to spend limited resources on a project that cannot meet the financial requirements of the program. Physical characteristics of a property that impact on viability are considered under obsolescence, but utilize the same basic analysis.

Types of questions to consider regarding economic viability include:

- Has the market changed due to changing demographics or local economic conditions such that there is no longer demand for the units?
- Is there a need for a different bedroom mix than the property has to offer?
- In the case of on-farm Labor Housing, is the operator still farming?
- Have there been significant vacancies that cannot be reduced with aggressive marketing?

To make the determination of economic viability, the Loan Servicer should:

- Determine whether the borrower's budget, rents and marketing plans are appropriate in accordance with Chapters 4 and 7 of HB-2-3560.
- Determine that special servicing, including utilizing all appropriate workout tools in accordance with Chapter 10, and increased rental assistance, if available, will not allow the project to be viable. Any increase in rental assistance must be reasonable and approved in accordance with Chapter 8 of HB-2-3560. If the cost to the Agency of special servicing exceeds replacement costs—for example, a write down plus a subsequent loan is greater than new construction costs—the special servicing is not in the Agency's best interest.
- Determine that, based upon the market study, local economic conditions will not significantly improve in the next one to two years. The market study should identify any known changes in the local economy to assist the Loan Servicer in understanding the short- and medium-term impacts. For example, if a new factory or large business is relocating to the local area, or has announced plans to close, these plans will affect the local economy.

- Determine that the borrower, given occupancy levels and any servicing actions, cannot pay essential expenses, adequately fund accounts, and pay the borrower's monthly loan payment in full.

If the Loan Servicer makes all these determinations, the project is economically unviable.

C. Determination

Based on the analysis concerning the need for the project, the Loan Servicer makes one of the following determinations:

1. If a non-program designation would have an adverse impact on tenants and the project is economically viable, then the project is needed.

2. If a non-program designation would not have an adverse impact on tenants and the project is economically viable, then the project is not needed. However, any resulting outcome of the suitability determination should not provide an undue financial reward to the borrower.

3. If a non-program designation would have an adverse impact on tenants and the project is not economically viable, then the project is not needed. However, the Agency cannot remove the property from the program until the Agency finds affordable and comparable housing for all the tenants.

4. If a non-program designation would not have an adverse impact on tenants and the project is not economically viable, then the project is not needed.

6.6 DETERMINATION OF SITE OR BUILDING OBSOLESCENCE

To make a determination of obsolescence, the Loan Servicer should go through the following process to determine if the property (i.e., the site and the building) poses a health or safety threat, has physical characteristics that cannot be addressed economically, or faces adverse local economic conditions. The Loan Servicer must also consider the issue of need when determining if a project is obsolete. The outcome of the need determination does not affect the result of the obsolescence determination, but it may influence how the Agency implements the result.

A. Information gathering

The type of information the Loan Servicer needs to determine if a property is obsolete depends on the nature of the suitability problem. In most cases, the Loan Servicer will need several of the following:

- Data on environmental conditions. The need for an environmental review, assessment, or due diligence is based on the condition of the property and must be conducted in accordance with RD Instruction 1940-G. Due diligence is to be accomplished prior to appraisal to assure that any adverse conditions are considered

in valuation. In cases where contamination is found, the State Environmental Coordinator should be consulted on further actions;

- A physical inspection. The Loan Servicer and State Architect, if appropriate, may conduct a unit-by-unit physical inspection of the property with a cost estimate to fully understand the problem and to determine whether repairs or rehabilitation may resolve the problem;

- Market study. A market study is most appropriate when the problems are related to external factors. It is also necessary as part of the need assessment;

- Cost Estimate. A professional may be needed to determine the feasibility of repairs, and to obtain a cost estimate. The State Architect should be consulted for review of estimates;

- Cost estimates for new construction in the project's area. New construction cost estimates are critical to determine the Agency's financial interest; and

- Borrower's intentions. The Loan Servicer may ask the borrower to prepare documentation stating the borrower's intentions for the property and the borrower's proposed rents if it is designated non-program.

B. Analysis

There are three reasons a property may be considered obsolete:

- The property poses a health or safety risk to the tenants;

- The building has structural or design characteristics that make the project economically unviable; or

- The site is no longer economically viable because of local economic conditions (such as the transportation infrastructure).

The Loan Servicer must also determine that the problem either cannot be solved through special servicing, workout agreement, or a subsequent loan or that solving the problem is not in the Agency's best financial interest. Exhibit 6-3 lists helpful questions to use in making this determination.

Exhibit 6-3

Factors Influencing Obsolescence

Site

- Has economic obsolescence adversely affected the community?
- Does the community have adequate medical, transportation, and school systems?
- Is the site itself located in a solid residential neighborhood that is a viable part of the community?
- Does the site have frontage along at least one-fourth of the perimeter?
- Does the topography of the site lend itself to optimal accessibility?
- Does the site have environmental hazards or commercial influences that adversely affect it?

Building

- Is the building structurally sound?
- Are there obsolescence factors that are economically unfeasible to correct such as the building design, poor quality of construction, environmental hazards, or structural deterioration?
- Does a unit-by-unit inspection with cost estimate for rehabilitation, deferred maintenance, and wheelchair accessibility demonstrate that the costs of this work are not feasible in the project budget?
- Can the property be rehabilitated to bring it into compliance with applicable building codes or must an exception to code requirements be obtained from local authorities?
- What is the estimated economic useful life of the property after rehabilitation?

1. Health or Safety

Health or safety issues are most often identified or documented during a physical inspection or environmental assessment of the property. While a majority of violations can be fixed through maintenance, repairs, or even a subsequent loan to pay for rehabilitation, some violations are more difficult to resolve.

Any compliance violation that is identified on the physical inspection report may be classified as a health or safety issue. However, most of these violations will never lead to a concern of suitability. For example, broken windows, a leaking roof, or exposed wiring are all easily corrected if funds are available. Health or safety issues that do affect suitability will likely pertain to the entire project and either cannot be repaired, or repair is too costly. For example, a property with a damaged and unstable foundation may not be repairable or repaired at an expense beyond what is fiscally responsible.

2. Physical Characteristics

Physical characteristics that make the project obsolete or economically infeasible are usually documented either through a physical inspection or with a market study.

Example

For a project that may need on-site laundry facilities to improve the project's marketability, the borrower may be able to receive a subsequent loan for rehabilitation, if necessary, to resolve the problem; therefore, the property is not obsolete. However, if a factory is built near the property, even if there are no negative health or safety factors, the quality of life will suffer due to an increase in noise, odor, or other factors. Such developments may make it difficult to market the property and cause it to become obsolete in the local market.

3. Local Economic Conditions

Local economic conditions that can affect a project's viability are generally addressed in the market study and generally cannot be fixed through any changes to or investments in the property. For example, if a community lacks sufficient transportation, medical, and school systems or if the local neighborhood has changed in character so that it is no longer a desirable residential site, the project may be rendered obsolete:

4. Need

Before making a final determination on whether the property is obsolete, the Loan Servicer must consider if there is a need for the project. A determination of need does not influence whether the property is obsolete, but it may influence the Agency's response to a finding of obsolescence.

The Loan Servicer determines the need for the project, with an emphasis on determining if a non-program designation will have an adverse impact on tenants, in accordance with Paragraph 6.5.

C. Determination

For health or safety issues, physical characteristics, or economic conditions related to the building or site, the Loan Servicer must document that the condition does exist and one of the following statements is true in order to declare the property obsolete.

1. The issue cannot be resolved through special servicing, workout agreement, or a subsequent loan;

2. The total cost to resolve the issue, including subsequent loans and special servicing, is greater than the cost of building a new project; or

3. The size of the rehabilitation loan, or other financing, makes the project economically unviable.

For example, in the scenario of a property unknowingly built on poor soils, the physical inspection and core soil sample can confirm the threat to tenants and damage to the property. The Loan Servicer will need a professional to determine if the problem can be corrected and provide a cost estimate.

If the problem can be resolved, the Loan Servicer must determine the total amount of a subsequent loan plus any increased rental assistance, write-off amount, or other special servicing costs. For example, if the property requires a rehabilitation loan of $1 million, and a debt write-off of $500,000, and the cost of new construction is $1.4 million, it is not in the Agency's financial interest to fund the rehabilitation.

The professional may state that the foundation may be repaired at 60 percent of the cost of new construction. However, if the property currently struggles to make the necessary loan payments, rents are as high as the market and program policies allow, and no rental assistance or other special servicing funds are available, the additional debt may make the project economically unviable.

6.7 DETERMINING IF THE PROPERTY IS SUITABLE

If the Loan Servicer determines that there is no need for the project and/or the project is obsolete, the Loan Servicer should prepare the case file with all the documentation from the suitability analysis with a recommendation and forward the analysis and recommendation to the State Office. The State Office may seek advice from OGC and the National Office as necessary to determine if it agrees with the Loan Servicer's analysis and recommendation. If the State Office determines that a borrower should be offered prepayment, the State Office must send the suitability analysis to the National Office for approval. If the Loan Servicer's analysis indicates that the project is suitable, the Loan Servicer may proceed with the servicing action and does not need to forward the case file to the State Office.

A. Tenant Notification

When the Loan Servicer sends the case file to the State Office, the Loan Servicer should provide written notification to the tenants informing them that the Agency is reviewing the project's suitability. The Agency should hold a meeting with the tenants to explain the implications of a possible non-program designation and explain how the process will proceed. Additional notifications should be provided to tenants when the Agency makes a final determination and, if applicable, when a final date has been set for designating the property as non-program.

B. No Longer Suitable Determination

In making its determination of whether a property is no longer suitable, the State Office should consider how the factors of need and obsolescence influence the Agency's decision. There are four possible outcomes when considering these factors as outlined in Exhibit 6-4:

Exhibit 6-4

Determining if a Property is Suitable

There are four possible combinations of whether there is a need for a property and whether the property is obsolete.

1. If there is a need for the project and the property is not obsolete, the property is suitable.
2. If there is a need for the project and the property is obsolete, then the property is no longer suitable.
3. If there is no need for the project and the property is not obsolete, the property is no longer suitable, and prepayment, with National Office approval, is the preferred outcome.
4. If there is no need for the project and the property is obsolete, the property is no longer suitable.

If the Agency determines that the property is no longer suitable to remain in the program, then the Agency must determine if the property should be designated as a non-program property or a different course of action is more appropriate.

C. Borrower Responsiveness

The State Office should consider what, if any, role the borrower played in creating or perpetuating the need or obsolescence problem. The State Office should also consider borrower responsiveness in trying to overcome suitability problems. A finding that a project is no longer suitable and the resulting decision to designate the property as a non-program property should be used primarily when the suitability problem was not intentionally caused by the borrower and the borrower made a good faith effort to overcome the problem. However, when it is in the Agency's best interest, the Agency may make a non-program designation if the borrower was responsible for or unresponsive to the problem. The Agency should minimize any financial gain such a borrower may receive through a non-program designation.

D. Other Factors

The Agency may determine that even though there is no need for a project or the property can be considered obsolete, it is in the Agency's best interest to keep the property in the program. In most cases, the Agency is making a decision to continue to put resources into the property in order to maintain it as a suitable program property. Such factors that may lead to this decision include when there is a significant negative

impact on a community, which the Agency cannot mitigate without undue expense, or when a non-program determination is not in the Agency's best interest.

E. Take a Different Course of Action

The Agency may determine that if a property is no longer suitable for the program, it is in their interest to take a different course of action, rather than declaring a property as non-program. The Agency may:

- Continue with special servicing actions, including developing a workout agreement in accordance with Chapter 10;
- Request the borrower to transfer the property in accordance with Chapter 7;
- Consider changing the use of the project. A change from family housing to elderly, a change to congregate or cooperative housing, for example, may provide a positive opportunity for salvaging a project and serving the community;
- Request the borrower to change the management agent in accordance with Chapter 3 of HB-2-3560; or
- Initiate liquidation in accordance with Chapter 12.

6.8 REGULAR VS. EXPEDITED REVIEW

A. Preliminary Determination

For both the questions of need and obsolescence, the Loan Servicer determines whether to conduct a regular or expedited review. For example, the Loan Servicer may determine that no review of obsolescence is necessary, but feels that a full review of need is required. Another option may be to conduct an expedited review of need and a full review of obsolescence factors. In all cases, the Loan Servicer must consider the impact on the tenants.

B. Regular Review

A regular review is most appropriate when the Loan Servicer does not have sufficient information on the suitability problems to make a determination. A regular review allows the Loan Servicer to obtain the necessary documentation so the Loan Servicer has a full understanding of the suitability issues and can conduct an in-depth analysis to recommend the most appropriate outcome. Among the issues the Loan Servicer must have sufficient documentation on to determine suitability are:

- What is the nature of the suitability problem or issue?
- What would be the impact on tenants if the property were removed from the program?

- Is the suitability problem permanent or short-term?
- Will special servicing resolve the problem?
- What is the availability of resources, such as rental assistance, subsequent loan funds, and owner funds?
- What actions has the borrower taken to resolve the problem?

If the Loan Servicer cannot answer these questions and show supporting documentation in the case file, the Loan Servicer should conduct a regular review.

C. Expedited Review

An expedited review is most appropriate when the Loan Servicer already has significant documentation on the suitability problem and the resolution is readily apparent. For example, if the Agency has documentation that a property was unknowingly built on sand and the damaged foundation is causing a significant health and safety threat to tenants, an expedited review may be appropriate. In this situation, while it may be apparent that the property in no longer suitable, the process of implementing the decision and ensuring that all tenants find alternative housing that is affordable, adequate, and appropriate, may be a difficult and time-consuming process.

To conduct an expedited review, the project should meet the following criteria:

- The Agency has substantial documentation on the project's suitability issues;
- The outcome of the analysis is readily apparent and independently verifiable; and
- The cause of the problem and the suitability outcome determination will likely not be disputed.

6.9 CHANGING A PROJECT'S DESIGNATION TO NON-PROGRAM

To implement the determination that a program is no longer suitable, the State Office must act in a manner to protect the Agency and the property's tenants. The basic steps in the process of designating a property as non-program when there is an adverse impact on tenants are the same as when there is no adverse impact. However, when there is an adverse impact, the Agency will need to take additional measures to ensure that all tenants receive decent, safe, and affordable housing. This process of assisting tenants will likely delay the implementation of a non-program designation.

A. Determine Implementation Plan

In making a determination of the most appropriate means to remove a property from the program, the Agency must balance the following interests:

- Act in the financial interest of the Agency by obtaining the greatest net recovery;

- Act to protect the interest of the tenants by ensuring they have decent, safe, and affordable housing; and

- Act to protect the integrity of the program by ensuring that the non-program designation does not provide undue rewards to the borrower.

Based on these interests, the Agency must choose the most appropriate of the following options to remove the property from the program:

- Allow the borrower to prepay the loan in accordance with Chapter 15. The National Office must approve all prepayment agreements;

- Allow the borrower to retain the property as a non-program property and repay the loan on non-program rates and terms.

B. Assist Tenants

Based on the impact of the non-program designation on tenants, the Agency must assist all tenants to find decent, safe, and affordable housing in the area of the project. Even if there should be no adverse impact on tenants, the Agency should work with all tenants to ensure that everyone is properly housed. All tenants must have decent, safe, and affordable housing before the Agency designates a property as a non-program property. The Agency should take the following steps to assist tenants, as necessary.

- Work with other federal, state and local agencies to find alternative housing and subsidies;

- Provide *Handbook Letter 201 (3560), Letter of Priority Entitlement (LOPE)* letters to tenants. If tenants have RA, the RA may be transferred with the tenant to any other eligible project; and

- Provide other assistance and guidance, as appropriate, to assist tenants find alternative housing.

C. Designate the Property as Non-Program

After all tenants are assured of continued decent, safe, and affordable housing, the Agency may complete the chosen means of implementation and designate the property as non-program. The State Office should work with the National Office, OGC, and the St. Louis Office, as necessary, to complete the appropriate transactions.

CHAPTER 7: TRANSFERS OF PROJECT OWNERSHIP *[7 CFR 3560.406]*

7.1 INTRODUCTION

During the term of an Agency loan, borrowers may determine that it is in their best interest to transfer a project to another owner. Changes in a borrower's circumstances or changes in the local market are common factors that may lead a borrower to seek a transfer. The Agency may approve a transfer of ownership of the property if the transferee and the project meet certain criteria, and if the transaction is in the best interest of the Agency and the tenants.

In many ways, transfers are similar to approving a new loan. The Agency must ensure that the transferee meets the same eligibility criteria and has the financial capacity and management experience to be a project borrower. In addition, the Agency must verify that the project and the use of the property continue to meet the program's purpose of providing adequate, affordable, decent, safe, and sanitary rental units for very low-, low-, and moderate-income households in rural areas. To protect the Agency's security interests in transfer, the Loan Servicer must perform the same underwriting evaluations that are outlined in Chapters 4 and 5 of HB-1-3560.

However, transfers are also different than approving a new loan. In a transfer, the Agency must also consider the impact on the tenants. While transfers offer an opportunity to improve the quality of housing through improved maintenance, rehabilitation, or better management, a transfer may also increase the risk of loan default or poorer housing conditions unless the Agency carefully evaluates the transfer and the transferee.

This chapter presents the requirements regarding project transfers and Agency procedures for reviewing and approving such actions. For purposes of the chapter, the term "applicant" or "transferee" is used to refer to the entity that wishes to acquire the property and "borrower" or "transferor" refers to the current borrower or the entity transferring the property. For additional guidance on transfers, assumptions and other servicing authorities, see **Attachment A** of this chapter and Chapter 11 of this Handbook.

SECTION 1: OVERVIEW

7.2 AGENCY OBJECTIVE

The fundamental question the Loan Servicer should ask when evaluating a transfer request is:

Will the project and the Agency be better, or at least no worse, off as a result of the transfer?

In answering this question, the Loan Servicer tries to ensure that the transfer meets two Agency objectives:

1. Improve or maintain the likelihood of loan repayment; and
2. Improve or maintain the quality of housing for the tenants.

It is essential that the Loan Servicer can justify that the transfer meets both of these conditions without incurring unreasonable costs to the Agency before recommending to the State Office that the transfer be approved. If a transfer is inadequate in meeting one of the objectives, the Loan Servicer should work with the transferee and the borrower to resolve issues of concern.

7.3 KEY ANALYTICAL CONCEPTS

In evaluating all the components of a transfer request, the Loan Servicer should ask and answer several basic questions to determine if the transfer meets the Agency's objectives. Answering these questions will form the analytical foundation for the assessment that would enable the Loan Servicer to identify potential problems or issues so the Agency, the transferee, and the borrower can address these problems or issues before completing the transfer.

Different steps in the transfer process will answer or begin to answer different questions. By the end of the analytical process, the Loan Servicer should be able to answer and document the answers to these questions, which can serve as the basis for making a recommendation to approve a transfer.

A. Eligibility

The same questions and documentation concerning eligibility that a borrower must answer during the Loan Origination process, the transferee, too, must satisfy. These requirements set the basic standards all borrowers and projects must meet to ensure that the Agency provides Government funds in accordance with the program's statutory requirements. The project's eligibility was documented during the loan origination process; however, the Loan Servicer does need to confirm that the project will remain eligible after the transfer.

- Does the transfer meet program eligibility requirements?
- Is the transferee eligible?
- Will the project remain eligible?

B. Feasibility

The questions of feasibility require more in-depth analysis by the Loan Servicer. Feasibility is also a concept used for Loan Origination and is used to gain a better understanding of the transferee and the transferee's plans for the project. The Loan Servicer needs enough information to determine that the transferee and the project can be successful if the transfer is approved.

- Is the transfer feasible?
- Does the transferee demonstrate adequate project management capability?

- Are the property and any proposed repairs in compliance with program requirements?
- Are the financial arrangements, budgets, and rents feasible?

C. Improve or Maintain Risk Levels

These questions build on the concept of feasibility to include a comparison with the existing borrower. Because a transfer involves existing tenants and an existing property, the Agency must go beyond the questions of feasibility to ensure that the tenants and the Agency will not face increased risks due to the transfer.

- Does the transfer improve or do no harm?
- Will the tenants be better or at least no worse off?
- Will the Agency be better, or at least no worse, off?

7.4 DEFINITION OF TRANSFER

The Agency defines transfers to include projects for which 100 percent of the ownership interest in a borrower entity is sold or transferred to new individuals or a new entity within a 12-month period. Thus, a transfer occurs whenever there is a change in a project's ownership through:

- A change in the legal entity, such that the transferee is considered to be a distinct and separate legal entity from the original borrower; or
- The title is transferred to a new owner, and the new owner assumes all liability for the debt.

Borrowers can request to transfer their project to another separate and distinct entity where the members are involved in both the transferring and the assuming entities, as long as the new entity is legally organized, meets applicable Agency requirements as outlined in Section 7.5 and in accordance with Paragraph 7.11.E.

7.5 CONDITIONS WHEN A TRANSFER MAY OCCUR

To ensure that projects continue to further the objectives of the program and that the Agency's security is protected, Agency consent is required for all project transfers *[7 CFR part 3560.406 (b)]*.

The Agency will consider transfers only when the transferee documents in their initial written transfer request that at least one of the following conditions are met:

- The transfer is needed to remove a hardship to the current borrower that was caused by circumstances beyond the borrower's control;
- The transfer is a result of a court order requiring the division of security property;

- The transfer is being requested as an alternative to prepayment;
- The transfer will do no harm to the Agency or tenants; or
- Other circumstances exist which make the transfer in the best interest of the Government and the tenants of the project.

If the State Director determines that hardship is present, the transfer may occur without penalty to the borrower. When hardship is not present and the loan is less than five years old, the current borrower is ineligible for further loans for the remainder of the five years, unless a waiver is granted under the Administrator's exception authority. Hardship may result from:

- Illness or death of the borrower;
- Serious financial difficulties beyond a borrower's control that cause the borrower to shut down their business operation; or
- Inability of the borrower to obtain necessary credit on terms that would facilitate refinancing the debt and allow for operation of the project at affordable rents.

Some transfers, made for the purpose of revitalizing or preserving the existing program portfolio, may involve extensive rehabilitation and the commitment of new resources from the Agency and/or third parties. For these revitalization transfers, Loan Servicers must follow the supplemental guidance provided by the National Office for this type of transfer. This guidance will address existing Agency servicing authorities and ways to effectively utilize third party financial resources. This guidance must be followed whenever the Agency seeks to find solutions to extend and enhance the use of any multi-family housing property that continues to serve the affordable housing needs in its community.

7.6 KEY STEPS TO COMPLETING A TRANSFER

The Loan Servicer completes six steps to move through the process of receiving a transfer application, evaluating the offer, and closing the transfer. These steps are listed in Exhibit 7-1.

Exhibit 7-1

Key Steps to Conduct a Transfer

1. Preliminary Assessment
2. Processing Transfer Application and Determining Eligibility
3. Evaluating the Transferee
4. Evaluating the Project
5. Making the Decision
6. Processing and Closing the Transfer

The Loan Servicer must complete all of the steps in Exhibit 7-1 for each transfer; however, the Loan Servicer may find that some steps in the process may be completed more quickly for some borrowers than others. When a transfer involves a transferee with a record as a

good borrower and there are no compliance violations or other issues associated with the transfer, the Loan Servicer will be able to move through the transfer process more rapidly. The Loan Servicer may determine that specific elements of a transfer may allow for a limited review process, while other components call for more in-depth analysis.

This chapter presents the regular transfer review process and does not present a separate limited transfer review process. The Loan Servicer must demonstrate in the case file that the transfer application addresses the issues of eligibility, feasibility, and risk. These will be documented through the same forms, reports and other documents, but the level of supporting information and review in verifying that these documents meet the Agency's objectives may differ.

SECTION 2: PRELIMINARY ASSESSMENT

Prior to requesting a full transfer application and conducting a regular review, the Agency requires a preliminary assessment of the proposed transfer. The Agency has developed requirements governing the review of initial project transfer requests to:

- Prevent ineligible transfers or applications;
- Identify potential issues or concerns early in the process so they may be adequately addressed;
- Establish a working relationship with the transferee to ensure an efficient review process; and
- Determine whether to pursue a regular or limited transfer review process.

7.7 REQUIRED DOCUMENTATION FOR THE INITIAL TRANSFER REQUEST

Prior to submitting an initial transfer request, either the borrower or transferee will likely contact the Loan Servicer to discuss what documentation is required as part of a transfer. The Loan Servicer should provide the transferee with the list of required documents to submit an initial request (Exhibit 7-2) and should explain that additional information will be required after the preliminary assessment. In addition, the Loan Servicer should explain and provide any documentation necessary to assist the transferee in understanding the Agency's eligibility requirements and the basis on which a transfer application is evaluated.

The initial request to the Agency for a transfer should come from the transferee, although the borrower will probably participate in developing the request by making available relevant information.

Exhibit 7-2

Information/Documents for an Initial Transfer Request

1. A copy of the transfer agreement between the parties, *Form RD 3560-20, Multi-Family Housing Transfer and Assumption Review and Recommendation* which should include the following elements:
   – Description of the transaction (i.e., purchase or sales agreement); and
   – Description of the new entity structure.
2. Identification of any identity-of-interest between the current borrower and the transferee.
3. Description of any other Agency assistance currently or previously received by the transferee, *Form HUD 2530/Form RD 1944-37, Previous Participation Certification.*
4. Financial statement from the parties.
5. Organizational documents.
6. Identification of any additional funds that will be allocated to the project and the planned purpose for the funds.
7. Project operating budgets covering the first year of operation following the transfer or sale.
8. Description of the transferee's experience (i.e., résumé).
9. Identification of all immediate and long-term repair and rehabilitation needs.

7.8 INITIAL AGENCY DETERMINATION

The Loan Servicer will evaluate the transferee's submission to make a preliminary determination whether the transfer can meet the objectives of the Agency. Upon receipt of the initial request, the Loan Servicer should arrange a meeting with the transferee and borrower to discuss the initial application and the transferee's plans for the property in more detail.

A. Application Meeting

The Loan Servicer should meet with the transferee and the borrower after submission of the initial transfer request. The transferee and borrower may choose to hold this meeting after submission of the formal application, but it is recommended that the meeting be held as early in the transfer process as possible. At this meeting the Loan Servicer will discuss the following issues so that the aspiring owner and management agent can demonstrate that they have the background and experience necessary to successfully manage the property:

- The transferee must have the ability and intention to operate the housing project for the purposes for which the original loan was made;
- The transferee must meet Agency eligibility criteria and the Loan Servicer should raise any eligibility issues based on the initial application;
- Whether other credit is available to the borrower or transferee;
- The transferee must show proper organization before transfer of ownership;
- Whether an appraisal is needed;

- Amount of indebtedness to be assumed;
- The transferee's capital needs/development plan;
- Whether the original owner can receive an equity payment;
- The amount of a subsequent loan, if applicable;
- Requirements of existing loan agreements/resolutions and mortgage; and
- Whether the transfer will be on the same terms or new terms.

At this time, the Loan Servicer should inform the transferee that the transferee's initial investment and return on investment will remain the same as what had been provided to the borrower unless:

1. The transferee is a non-profit entity, which is not eligible to receive a return on investment; or
2. The transferee contributes additional funds for repair or rehabilitation, and the Agency agrees to recognize a higher initial investment.

B. Review Eligibility

Prior to the meeting, the Loan Servicer should review the transferee's submission to identify any potential eligibility issues. The Loan Servicer uses the same eligibility requirements as described in Chapter 4 of HB-1-3560. The Loan Servicer should note what additional documentation is needed to verify eligibility when the transferee submits the full application. If any potential problems or eligibility issues are noted, such as a change in project use, the Loan Servicer should raise these concerns with the transferees as soon as possible. Any eligibility issues should be addressed before proceeding to a full application.

C. Consider Feasibility

It will not be possible for the Loan Servicer to make a final determination on the questions of feasibility based on the initial request. However, by reviewing the documents submitted and meeting with the transferee and borrower, the Loan Servicer can begin to assess the feasibility of a transfer. At this initial stage the Loan Servicer should begin considering the following issues:

- Will the transfer fully satisfy the borrower's existing loan or will there be a shortfall? If there may be a shortfall, what are the borrower's intentions to address any outstanding balance?
- Is the transferee planning to make substantial repairs or undertake rehabilitation of the property, and do the transferee's initial plans seem reasonable?

- Does the transfer call for equity distributions to the existing owner?

- Is the transferee going to request a subsequent loan? Does the proposed amount of the subsequent loan seem reasonable and sufficient based on the Loan Servicer's expertise and knowledge of the project?

- Will a writedown be required as part of the transfer? See Chapter 11 for more information on writedowns.

- Are there any other conditions in the transfer agreement or the proposed budget the Agency or the project's tenants may find objectionable?

D. Consider Market Conditions

Depending on the circumstances surrounding the project, the Loan Servicer may want to consider and discuss with the transferee the local market conditions and their potential impact on the project. If the project is in an area experiencing economic changes, the Loan Servicer should discuss the transferee's thoughts and plans for ensuring that the project remains viable or improves its occupancy rates.

E. Analyze Project Suitability

The Loan Servicer should refer to Chapter 6 to determine if additional analysis is required to verify that there is still a need for the project and the project is not obsolete. If the Loan Servicer determines to further analyze the project's suitability, a full application from the transferee should not be requested until the suitability analysis indicates that the property should remain a program property.

7.9 INITIAL DETERMINATION

A. Decision to Proceed

If the Loan Servicer establishes that there are no eligibility issues identified in the initial application, that the transferee can overcome potential market factors, and that there are no suitability issues, the transferee will be invited to submit a full application for the transfer. If the Loan Servicer identifies issues of concern during the initial review, the Loan Servicer should present these concerns to the transferee and/or borrower. The Loan Servicer should require the issue to be addressed either prior to requesting a full application, or as part of the full application.

B. Regular vs. Limited Review

Based on the preliminary analysis, the Loan Servicer should be able to determine if specific components of the transfer can be completed through a limited review process or if a regular review is needed. A Loan Servicer may be able to use the limited review process:

- For a transferee who is an existing borrower with an approved record-keeping system, the Loan Servicer may only need to have it confirmed that the transferee will use the approved system at the transferred project;

- For a project with no maintenance violations and when the transferee is not proposing any repairs or rehabilitation, the Loan Servicer must still conduct the physical inspection, but there will be no repair and rehabilitation plans to review and approve; and

- If the transferee is not requesting a rent increase, the reserve fund is fully funded, and the project has no violations, the Loan Servicer may not need a market study or need to consider whether rents are within CRCU.

C. Inviting the Complete Application

On determining to invite a formal application for transfer, the Loan Servicer will send a letter to the transferee informing them of the Agency's decisions. The letter to the transferee must include the following information:

- A list of the information that must be submitted to complete the application from Exhibit 7-3; and

- A request that the information be provided within 60 days and at least 45 days prior to the proposed ownership transfer or sale date.

Exhibit 7-3

Information to Be Submitted to Complete Transfer Application

1. Credit report
2. Establishment of citizenship with social security or tax identification number
3. *Form HUD 935.2 Affirmative Fair Housing Marketing Plan*
4. Management plan
5. Management profile*
6. Management certification*
7. Evidence of insurance coverage*
8. Transferee attorney's opinion regarding legal sufficiency and compliance of lease with State/local laws, ordinances and Agency regulations*
9. Narrative statement of proposed record-keeping system*
10. Assurance agreement
11. Letter from transferee's attorney as to legal sufficiency of organizational documents*
12. Current preliminary title report
13. *Form RD 440-34 Option to Purchase Real Estate Property* or other forms of purchase agreement

14. *Form RD 400-1 Equal Opportunity Agreement*
15. Identification of all immediate and long-term repair and rehabilitation needs.
16 Cost estimate and statement of work (specifications) if rehabilitation required *Form RD 1924-13 Estimate and Certificate of Actual Cost*, and
17. Written description from transferee regarding physical condition of the property

* When conducting a limited review, these items may already be on file and may only need reverification or updating, as deemed appropriate by the Loan Servicer.

SECTION 3: PROCESSING TRANSFER APPLICATION AND DETERMINING ELIGIBILITY

7.10 RECEIVING A COMPLETE APPLICATION *[7 CFR 3560.406(c) and (d)]*

For the application to be considered complete and therefore eligible for further review, the application must include all of the information listed in Exhibit 7-3 and all the information requested in the letter to the transferee inviting them to submit a formal application. The Loan Servicer must inform the transferee promptly if the application is incomplete, and give the transferee a 15-day deadline to furnish the missing information. Once the application is complete, the Loan Servicer will conduct the evaluation of the transfer request within 30 days.

7.11 DETERMINE TRANSFEREE ELIGIBILITY

The Loan Servicer will evaluate the transferee's eligibility based on the items submitted as part of the initial request and the completed application. The Agency's evaluation will verify that the transferee and the property satisfy the general eligibility, identify-of-interest, legal capability, and insurance requirements. If there are any deficiencies, the transferee and borrower must develop a plan, approved by the Agency, before the Agency will consider approving the transfer.

The Loan Servicer must verify the transferee's and the project's eligibility before the Agency can approve the transfer. The Loan Servicer should refer to HB-1-3560, Chapters 4 and Chapter 5, for detailed information on verifying eligibility.

A. Citizenship Requirements

Refer to HB-1-3560, Paragraph 4.16 A for a detailed discussion on establishing citizenship.

B. Organizational Requirements

Refer to HB-1-3560, Paragraph 4.16 B for a detailed discussion on reviewing organizational documents and for specific requirements for limited partnerships, nonprofit organizations, and limited liability corporations.

C. Legal Capability

The Loan Servicer must make a determination of the transferee's legal capability to successfully assume and operate the project for the life of the Agency loan. This determination will be based on the attorney's letter and organizational documents submitted as part of the application. The Loan Servicer should obtain the Office of General Counsel (OGC) concurrence as needed to make such a determination. If there are any deficiencies, the transferee must take appropriate corrective action.

D. Requirements for Existing Borrowers

If the transferee is an existing borrower, refer to HB-1-3560, Paragraph 4.16 D, for a detailed discussion on further eligibility requirements for existing or previous borrowers. The transferee must:

- Be in compliance with all program requirements, or have been in compliance with an approved workout agreement for a minimum of six months for all other projects owned by members of the assuming entity;

- Have documented evidence that the conditions that resulted in the workout agreement were beyond the borrower's control and were not due to inappropriate actions by the borrower; and

- Be free of any adverse audit or investigation findings conducted by the Office of the Inspector General (OIG), with any audit or investigation closed or disposed of to the satisfaction of OIG. If there is an open audit or an investigation is underway, the Loan Servicer will contact OIG to determine if there are potential eligibility issues that may affect the transfer.

E. Identity-of-Interest

During the preliminary assessment the Loan Servicer should have determined if the transfer involves an identity-of-interest. Loan Servicers must not approve identity-of-interest transfers until the State Office can certify that the following conditions are met:

- The account is current;

- The reserve account is on schedule, less any authorized withdrawals;

- The taxes and insurance account is on schedule, and all outstanding bills are paid;

- The tenant security deposit account is fully funded;

- All unacceptable maintenance items outstanding have been completed;

- Management is satisfactory and there is an approved management plan and management agreement, if applicable; and

- The transferee is in compliance with equal opportunity and fair housing requirements.

Completion of this step ensures that identity-of-interest transferees receive appropriate Agency assistance in restoring security properties to compliance through transfers.

F. Insurance

The Loan Servicer must review the evidence of insurance coverage submitted in the

application to verify that the transferee has obtained all required types of coverage and in the proper amounts. If there is any deficiency, the tranferee must be required to take appropriate corrective action.

Completion of this step ensures that the Agency's security properties will be protected from all damage and loss following transfers.

G. Site Control

The transferee's documentation must show control of the land. Control can be in the form of a deed (ownership), an option to purchase from the borrower, or purchase contract. Refer to HB-1-3560, Paragraph 4.12 F, for detailed information on verifying site control.

7.12 PROJECT ELIGIBILITY

The Loan Servicer should refer to HB-1-3560, Paragraphs 4.17 and 5.8 for detailed information on verifying project eligibility. The major components of project eligibility were verified during the loan origination process and are not affected by a transfer. However, the Loan Servicer should take the necessary steps to ensure that the project remains an eligible property.

The Loan Servicer must review the transferee's certification that the project will continue to be used to advance program goals and objectives (i.e., providing housing for low- and moderate-income tenants) and, if necessary, a restrictive-use agreement *[7 CFR part 3560.406 (g)]*. The Loan Servicer must document in writing that the site is residential in character and the property location enhances the value of the asset. If there are any questions or deficiencies, the Loan Servicer must instruct the transferee to provide the needed clarification.

Completion of this step ensures that properties will continue to advance Agency objectives following transfers.

7.13 NON-PROGRAM TRANSFERS *[7 CFR 3560.406 (l)]*

Housing projects may be transferred or sold to entities that do not meet borrower eligibility requirements for the type of loans being assumed. However, such a transfer or sale will only be considered when it is determined by the Agency to be in the best interest of the Federal Government and the objectives of the original loan can no longer be met. The following special rates, terms, and conditions will apply to such situations:

- The transferee makes a down payment of at least 10 percent of the remaining loan balance to be assumed;
- The transferee has the ability to pay the Agency debt; and
- Monthly or annual installments will be amortized over the term of the loan and the interest rate will be at a rate of interest at least one percent higher than the interest rate offered to eligible borrowers.

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SECTION 4: EVALUATING THE TRANSFEREE

After the Loan Servicer has established that the transferee is eligible, the Loan Servicer must determine if the transferee has the financial and management capacity to successfully operate the project. For a transferee that is an existing borrower with a record of few, if any, compliance violations and missed payments, the eligibility verification process will answer many of the questions about the transferee's capacity. However, for new borrowers, or those with limited experience with the program, the evaluation of the transferee is critical to determine that the transferee has the necessary financial capacity, and management skills and experience to operate a property successfully.

7.14 FINANCIAL REQUIREMENTS

Refer to HB-1-3560, Paragraph 4.18 C, for a detailed discussion on reviewing the transferee's financial capability. The credit report and financial statement are the two primary documents the Loan Servicer uses to determine financial capacity. As part of this financial review, the Loan Servicer must verify that:

- The transferee possesses the financial capacity to carry out the obligations required for the loan;
- The transferee is unable to obtain sufficient credit elsewhere at rates that would allow for project rents within the payment ability of eligible residents, if applying for a subsequent loan; and
- The transferee has the financial ability to meet the program's requirements.

7.15 MANAGEMENT CAPACITY

The transferee must demonstrate that it will provide professional management to ensure successful operation of the project. The Loan Servicer should refer to HB-1-3560, Paragraph 5.9 E, for guidance on analyzing overall management capacity, or Chapter 3 of HB-2-3560 for detailed information on analyzing the management plan and the management certification.

7.16 ANALYSIS

In reviewing and evaluating the transferee's financial capability and property management experience, if the Loan Servicer identifies any problems or issues of concern, the Loan Servicer should request the transferee to respond to the problem or concern. The transferee's response must be sufficient for the Loan Servicer to determine that the property will be managed in accordance with program standards, and the transferee can meet all financial responsibilities.

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SECTION 5: EVALUATING THE PROJECT

7.17 PROJECT COMPLIANCE AND FINANCIAL FEASIBILITY

Two key elements of the Loan Servicer's review are to determine that (1) the project is, or will be; in compliance with program requirements and (2) the financial aspects of the transaction are feasible after the transfer. This issue of compliance applies to the physical property and feasibility to the financial components of the project, including budgets, rents, and loan structure. The level of review and key analytical questions the Loan Servicer should focus upon will vary from transfer to transfer and will depend on the existence of compliance issues, necessary repairs, and rehabilitation, or whether a subsequent loan is being requested. After the existing conditions of the property and the transferee's plans for resolving any issues and financing the project are understood, the Loan Servicer must determine if the project will be feasible and meets the objectives of the program.

7.18 PHYSICAL INSPECTION

The transferee's application should include a detailed plan outlining the transferee's repair and rehabilitation plans and their expected costs based on an identification of all immediate and long-term repair and rehabilitation needs. The Loan Servicer will make an on-site inspection of each vacant unit and 10 percent of the remaining units in the project being transferred. When substantial rehabilitation issues are involved, the Loan Servicer will inspect all units. The State Architect and Civil Rights Coordinator are encouraged to participate in the on-site inspections. The inspection is to ensure that the transferee's plans are adequate to ensure that the Agency's decent, safe, and sanitary criteria are met. The inspection will also help the Agency assess compliance with applicable civil rights, disability, and environmental requirements. The Loan Servicer will conduct a compliance review if one had not been completed in the past 12 months prior to the physical inspection. Pictures of any deficiencies will be made part of the applicant's file.

A. Finalize Detailed Repair and Rehabilitation Plans and Costs *[7 CFR 3560.406 (d)(7)]*

The Agency and the transferee must agree to and document all necessary repairs to make the housing decent, safe, and sanitary. If all needed repairs cannot be made prior to the transfer, the funds needed for the repairs will be escrowed and a plan for such repairs developed. The plan will identify each repair, the time frame for completion, an estimate of costs for each item, who will do the work, and any identity-of-interest between the transferee and the parties doing the work or providing materials or services. The Agency must concur with the plan as part of the approval of the transfer.

If the transferee is proposing to rehabilitate either some or all of the units in the project, the Agency and the transferee must agree on the rehabilitation plan, time lines, an estimate of costs for each item, who will do the work, and any identity-of-interest between the transferee and the parties doing the work or providing materials or services. If any tenants will be temporarily relocated during the rehabilitation, the transferee must have a detailed plan, acceptable to the Agency, for providing housing and services to

these tenants. The Agency must concur with the plan as part of the approval of the transfer.

The level of review and documentation of a transferee's repair and rehabilitation plans must be adequate based on the level of repairs and rehabilitation required for the property. The objectives of the analysis are to ensure that the property is in full compliance with program requirements, the plans meet the best interest of the tenants, and the transferee has the financial and management capacity to fulfill the plans.

Improvements or repairs are paid from the sources listed in Exhibit 7-4.

The Agency will review the reserve requirements for the housing project and may adjust them, if necessary, to adequately cover the cost of addressing the project's capital needs. If current levels of reserve contributions are inadequate to meet the property's capital needs, Loan Servicers must follow the supplemental guidance provided by the National Office for procedures in reviewing these cases and determining the amount of any change in the reserve contribution while ensuring the continued feasibility of the project.

Exhibit 7-4

Funding Sources for Repairs

- Transferee's cash contribution;
- Syndication proceeds (as negotiated);
- Reserve amount being transferred (if the amount remaining will be adequate to meet near-term repair and expense needs);
- Transferor funds;
- Third-party funding sources;
- Junior liens;
- Subordination; and
- Agency loan funds (as a last resort and only to the extent needed for essential repairs to ensure that the housing is decent, safe, and sanitary).

B. Civil Rights and Disability Compliance

The Civil Rights Coordinator, or designee, will conduct a civil rights and disability compliance review, provided one has not been completed in the past 12 months. This review is conducted during the physical inspection. This review must be conducted to ensure that the project complies with the Americans with Disability Act, Section 504(c), which covers accessibility requirements, and the Title VI of the Fair Housing Act of 1968.

The transferee must take action to mitigate any civil rights and disability concerns identified. Any project where civil rights and disability concerns have been identified will not be approved for transfer without review by the Civil Rights Coordinator.

The transfer file must include the civil rights and disability review by the Civil Rights Coordinator. Examples of civil rights deficiencies include, but are not limited to, the following:

- Failure to market units in accordance with *Form HUD 935-2*;
- Inconsistent treatment of applicants when screening for occupancy;
- Inconsistent treatment of tenants when assigning units;
- Borrower failure to have documented the self-assessment review of civil rights and disability practices;
- Improper waiting lists and tenant selection routines; and
- Handicapped accessibility concerns.

C. Environmental Review *[7 CFR 3560.406 (d)(4)]*

1. Environmental Review under the National Environmental Policy Act (NEPA)

Agency approval of a transfer will normally qualify as a categorical exclusion and will not require preparation of any environmental review document, provided the proposed transfer will not alter the purpose, operation, location, or design of the project as originally approved. If the transfer includes additional financial assistance, the appropriate level of environmental review will be completed in accordance with RD Instruction 1940-G and Chapter 3, Section 3 of HB-1-3560.

2. Due Diligence

When additional financial assistance is involved, due diligence will be performed for a transfer in accordance with the procedures identified in Chapter 3, Section 3 of HB-1-3560. Normally, due diligence will be completed in conjunction with the appraisal, if one is being done.

3. Form FEMA 81-93, Standard Flood Hazard Determination

Form FEMA 81-93 will be completed for all transfers.

4. Correction of Deficiencies and Documentation

Both the NEPA review and the due diligence report, as appropriate, will be made a part of the transfer file. Any outstanding concerns noted in either document must be

resolved prior to approval of the requested action. The State Environmental Coordinator should be consulted for further evaluation and guidance on any such problems.

7.19 FINANCIAL FEASIBILITY

A. Budget/Reasonable Rents *[7 CFR 3560.406 (d)(2)]*

The Loan Servicer must review the budget submitted by the transferee to determine whether the budget provides for reasonable rents that the persons eligible for the units in question can afford. The submission from the transferee should include information on market rents for comparable units in the area, if the transferee is proposing a rent increase. The proposed basic rents for the project upon completion of the transfer must satisfy the CRCU standard *[7 CFR 3560.406(d)(2)]* as discussed in Chapter 4 of HB-2-3560.

The Loan Servicer should be particularly diligent in analyzing the budget and proposed rents when the transferee will also receive a subsequent loan or other third-party financing, or there are significant repairs or rehabilitation plans. The Loan Servicer must consider both the short-term impact of whether the transferee can make loan payments immediately following the transfer and the long-term feasibility of the budget and rents to allow for a successful project. If there is any deficiency in the budget or rent structure, the transferee must take appropriate corrective action.

In addition, the Loan Servicer should review the budget to determine if the project life-cycle costs and reserve levels are adequate to allow for the necessary maintenance of the property over the remaining life of the project. If there are any deficiencies, the borrower must take appropriate corrective action.

B. Loan Structure

The Loan Servicer and the transferee should agree on the structure of the transferee's loan and take the necessary steps to ensure a smooth closing process.

1. New Term or Same Terms [7 CFR 3560.406 (j)]

Loan Servicers will review the account to determine which type of transfer needs to occur. The Agency generally completes transfers on new terms. Even if the transferee is just "stepping into the shoes" of the borrower, in most cases the Agency will change the term of the loan from 50 years to 30 years. The loan may be re-amortized over a period not to exceed 50 years or the remaining economic life of the property as determined by the appraisal report of the property, whichever is less. The Agency does allow transfers at same rates and terms even if the transfer does involve an increase in rents. In order for this type of transfer to take place, it is incumbent upon the borrower to demonstrate how a transfer under same rates and terms is in the best interest of the government. For example, if the new owner under a transfer has applied for tax credits and to qualify for 9 percent credits it is necessary to retain same rates and terms, it could be justified to allow a same rates and terms transfer. Before making a recommendation on the transfer, the

Loan Servicer should determine if the transfer will be on new terms or the same terms and address any issues or obstacles that this may present.

2. Subsequent Loan [7 CFR 3560.406 (h)]

The Agency may provide a subsequent loan or approve one from a third-party source in conjunction with an ownership transfer or sale of a housing project. The subsequent loan may be in the form of a senior, junior, or parity lien, or a soft second. In any case, the Government must be in a secure position. If the transferee is requesting a subsequent loan, the Loan Servicer should refer to Chapter 10 of HB-1-3560 to ensure that the transferee's application is complete and being processed. The Loan Servicer should verify:

- The subsequent loan process will be completed to coincide with the transfer closing to ensure a smooth closing process, and

- The subsequent loan and its impact are accurately reflected in the transferee's budget and repair and rehabilitation plans.

3. Closing the Existing Loan

The Loan Servicer and the existing borrower must agree on the close-out of the existing loan before making a recommendation on the transfer. This is particularly important if the transfer will result in a loan shortfall or the borrower is requesting an equity payment.

Equity may be provided in cash or through a loan. If a full equity payment to the transferor is not paid at the time of the ownership transfer or sale or has not been paid through an Agency equity loan or third-party equity loan to the borrower that is approved by the Agency, the transferee must certify that equity payments due to the borrower will be paid from source other than project fund. These sources must be identified.

The Loan Servicer should ensure that the agreed-upon resolution of a shortfall maximizes the borrower's repayment ability and avoids or minimizes loss to the Government, unless it is in the Agency's best interest to accept an option that is less than the lowest-cost option. The Loan Servicer should ensure that the necessary actions to resolve any issues with the existing borrower are completed, or far enough along in the process, to allow for the completion of the transfer. The Loan Servicer should:

- Determine if the transfer will result in a shortfall on the existing loan. If a writedown is needed, see Chapter 11 for more information;

- Initiate the debt settlement process, in accordance with Chapter 12, if appropriate; and

- Determine if the Agency should pursue legal remedies against the borrov HB-3-3560

For equity payments, the Loan Servicer must determine if the borrower is entitled to equity payment *[7 CFR 3560.40 (e)* and *(f)]*. No compensation, equity, or syndication

proceeds will be paid to the transferor by the transferee in connection with any transfer unless all of the following conditions are met:

- The account is current;
- The reserve account is on schedule, less any authorized withdrawals;
- The taxes and insurance account is funded and all outstanding bills paid;
- The security deposit account is fully funded;
- There are no outstanding serious maintenance items uncompleted, or an approved plan of action has been developed;
- Management is satisfactory, and there is an approved management plan and management agreement, if applicable;
- The project has been operated in compliance with equal opportunity and fair housing requirements;
- No project funds have been misappropriated; and
- The account will be classified as an "A" project in the MFIS system or if an acceptable workout agreement has been developed, classified as a "B" project.

7.20 ANALYSIS

In reviewing and evaluating the physical and financial plans for the property, the Loan Servicer must determine that the transferee's plans are feasible. This means the property must be able to meet and maintain the Agency's standards for decent, safe, and sanitary housing and continue to meet all of the program's budget, rent, and other financial requirements. If during the analysis of the property, the Loan Servicer determines the transferee's plans or proposals are not feasible, the transferee must either resolve the issue or agree to a resolution that is approved by the Agency before the transfer can be completed.

SECTION 6: MAKING THE DECISION

7.21 ASSESS THE OVERALL RISK AND THE IMPACT ON THE AGENCY AND TENANTS

The Loan Servicer compiles the evaluation of the eligibility, transferee, and the property and decides whether to recommend the transfer. Regardless of the level of detail the Loan Servicer went into in evaluating the transfer, the questions and process that the Loan Servicer must follow remain the same. Based on the transferee's application, and the Loan Servicer's knowledge of the existing borrower and property condition, the Loan Servicer should ask two questions:

- Is the potential for financial loss to the Agency better or no worse than with the existing borrower?

- Will housing conditions be better or no worse than under the current borrower?

The Loan Servicer must be able to answer these questions and explain the answers through the transfer application and case file documentation. The Loan Servicer must answer "yes" to both questions in order to recommend the transfer. If the Loan Servicer answers "no" to one or both questions, they must continue to work with the transferee to resolve any outstanding issues before recommending the transfer. The information the Loan Servicer receives as part of the application and documentation completed during the review process will account for most of the documentation required. However, the Loan Servicer should include a narrative statement in the case file explaining how the Loan Servicer reached the conclusion that the transfer meets the objectives of the Agency.

7.22 COMPLETE AND VERIFY APPLICABLE FORMS

Throughout the review process, the Loan Servicer must prepare relevant forms to facilitate the transfer and ensure that each form is prepared correctly. The forms listed below must be filled out to complete a transfer:

- To transfer multiple housing loans to borrowers assuming the obligations, Loan Servicers must prepare *Form RD 3560-21*. They should give a signed copy of this form to the transferee, keep another signed copy in the Field Office case file, and retain the original form in the Field Office.

- To transfer rental assistance, Loan Servicers need to prepare *Form RD 3560-55, MFH Transfer of RA.*

- To record borrower eligibility to receive interest credit or rental assistance, Loan Servicers need to prepare *Form RD 3560-9.*

When the transfer docket forms are completed, the Loan Servicer must determine that:

- The proposed transfer conforms to the applicable procedural requirements and that determinations of hardship status, eligibility, etc., are clearly documented in the case file;
- Each form is prepared correctly according to the Forms Manual Insert (FMI) or other appropriate regulations; and
- Items such as names, addresses, and the amount of the indebtedness to be assumed are the same on all forms in which those items appear.

7.23 TRANSMIT THE DOCUMENT TO STATE OFFICE AND OGC FOR REVIEW

When the Loan Servicer determines that all conditions have been met and is ready to recommend approval of the transfer, the Loan Servicer forwards the application docket and the official case file, with comments and recommendations to the State Office.

A. State Office Review

The State Office reviews the documents. If the State Director agrees that all applicable conditions are met, the State Director forwards the docket to OGC for review and for closing instructions. All materials related to the case may be forwarded to the National Office for review and approval authorization if necessary.

B. Decision to Approve the Transfer

If the transfer is approved, OGC will issue closing instructions. The State Office forwards any comments and conditions to the Field Office and gives them authority to issue *Handbook Letter 102 (3560), Letter of Conditions, Loan Approval, or Obligation of Funds* to the transferee. The transferee will return the executed Notice of Intent to Meet Conditions within 10 days of receipt. After receipt, the Field Office will schedule a meeting with the transferee to execute the obligating documents.

C. Issue Letter of Conditions/Closing Instructions

Upon a determination that the transfer is allowable and meets all applicable criteria, the Agency will submit to the transferee a letter of conditions and closing instructions from OGC that will put the transfer into effect.

7.24 AGENCY APPROVAL

If the Agency decides to grant approval to a transfer request, it will proceed directly to the processing steps described in Section 7 of this chapter.

7.25 AGENCY DISAPPROVAL/REJECTION

If the Agency denies a request for a transfer, the Agency must send a formal letter to the transferee indicating the reasons for the decision and informing the transferee of appeal rights. A copy of this letter must be placed in the case file.

SECTION 7: PROCESSING AND CLOSING THE TRANSFER

Once the Agency has made the decision to approve a transfer and issue closing instructions, it must undertake a number of steps to implement the transfer. The steps the Agency takes to process and close a transfer on new terms and same terms are similar to each other.

7.26 CONDUCT APPRAISAL OF SECURITY PROPERTY *[7 CFR 3560.406 (d)(3)]*

An appraisal is often necessary to ensure that the Agency's security requirements will be met under the new loan. The appraisal must be conducted in accordance with Chapter 8 of HB-1-3560.

When the total value of the loans as part of a transfer is $100,000 or less, the Agency may determine the value of the security through either:

- An Agency review of monitoring reports; or
- An appraisal paid for by the borrower, conducted in accordance with Chapter 7 of HB-1-3560.

When the total value of the loans as part of a transfer is greater than $100,000, the Agency must determine the value of the security through an appraisal obtained by the Agency and conducted in accordance with Chapter 7 of HB-1-3560.

The value of the project covered by the Agency loans to be assumed by the transferee must be sufficient to ensure that all Agency loans being assumed and all subsequent loans offered as a part of the transfer can be secured to a level that fully protects the Agency. Soft second loans that are not dependent on project revenue for payment are not included in this determination.

7.27 DETERMINE THE APPROPRIATE INTEREST RATE

Transfers on new terms are subject to the interest rate conditions described below. If rents are increased due to the transfer, the transfer will be done under new rates and terms if the Agency determines that this is in the best interest of the Government.

A. General

The interest rate charged for all loans, except Labor Housing loans, will be the current rate being charged for those loans at the time of loan closing or the interest rate at the

time of approval (i.e., the date *Form RD 3560-51 Obligation – Fund Analysis*, is approved), whichever is less.

B. Labor Housing Loans

The interest rate on Labor Housing loans will be the rate specified in the note, generally 1 percent, except those on farm loans at the exception rate when credit elsewhere is available.

7.28 PROCESSING REQUIREMENTS *[7 CFR 3560.406 (k)]*

The Agency has established specific requirements for processing project transfers to assure that the obligations and responsibilities of the transferor are formally passed to the transferee and that the Agency's security interests are protected. Specifically, these requirements ensure that:

- All accounts, property, and subsidy are properly assigned to the transferee;
- A proper loan agreement or loan resolution for the type of transferee is in effect and secured in the mortgage and deed of trust;
- The transferor is released from liability when all Agency security is transferred and the total outstanding debt is assumed; and
- Applicable restrictive-use provisions are attached to the transferred loans.

Loan Servicers should take the steps summarized in Exhibit 7-5 when processing transfers.

Exhibit 7-5

Basic Steps for Processing Transfers

1. Determine current loan balances for transfer;
2. Verify that the application docket is complete;
3. Review applicable requirements with the transferee;
4. Write the transfer agreement;
5. Obligate the subsequent loan, if applicable;
6. Approve the transfer;
7. Close the transfer;
8. Assign lease to transferee;
9. Shift accounts, funds, and assets to transferee;
10. Provide copies of documents to transferee;
11. Inform new borrower of administrative responsibilities;
12. Schedule a follow-up servicing visit; and
13. Address special circumstances as needed.

7.29 PROCEDURES FOR PROCESSING TRANSFERS

A. Determine Current Loan Balances for Transfer

1. Determine the Loan Balance

To determine the current loan balance for transfer, the Loan Servicer must execute *Form RD 3560-21* according to the FMI. The unpaid principal balance and accrued interest to be shown on *Form RD 3560-21* is determined by accessing the project account recorded via field terminal. The Loan Servicer will advise the transferee of:

- The total amount paid as of the closing date that has not been credited to the account;
- The payment required to place the account on schedule as of the previous installment due date;
- Any payment required to bring any monthly or annual payment current; and
- The amount needed to bring the reserve account current less any authorized withdrawals.

The Loan Servicer must base the amount of indebtedness to be assumed on current appraisal regulations. In the case of a transfer with assumption of less than the full debt, the Loan Servicer will attach the *Form RD 3560-52, Promissory Note* to the transfer agreement and place it in the transferee's file.

2. Adjustments to the Account

Same terms transfers, when the transferor has been converted to Predetermined Amortization Schedule System (PASS), must take place in a current loan status on the date of transfer. Thus, transferors must bring any delinquent principal and interest current prior to the transfer.

Overpayments and advance regular payments made on PASS accounts result in the creation of a "future paid" status account under Automated Multi-Family Housing Accounting System (AMAS). These advance payments must be reversed off and applied to the transferor's principal balance by the Loan Servicer prior to determining the loan balance to be transferred. If the future payments have been made through rental assistance, they must be refunded to the transferor and reapplied in the form of cash on the loan balance.

B. Verify that the Application Docket is Complete

1. Basic Components of the Docket

The Loan Servicer should use the Application Checklist and supporting documentation **(Attachment 7-B)**, to determine if all the items have been submitted by the transferee.

2. Other Supplemental Documentation

Other transfer docket items may include:

- Mortgagee title policy;
- Title evidence or report of lien search;
- Foreclosure notice agreement;
- Original or certified copy of deed to any property;
- Purchase contract or other instrument of ownership;
- Assignment of HUD Section 8 Housing Assistance Payments contract; and
- Information on prior or junior mortgage(s).

Completion of this step ensures that the entire history of the transfer, from initial request through final approval, is adequately and legally documented. Maintenance of this history allows the Agency to hold transferees accountable for compliance with all agreements signed during the transfer process.

C. Review Applicable Requirements with Transferee

After closing instructions have been issued but before the transfer is closed, the Loan Servicer carefully reviews with the transferee the applicable loan program regulations and loan agreement or resolution, if this was not fully completed during the preliminary request meeting in accordance with Paragraph 7.8.

D. Write the Transfer Agreement

The Loan Servicer will use *Form RD 3560-20* to record the agreements between the transferor and transferee. The agreement will show all agreements involved relating to equity, including:

- Disposition of syndication proceeds between the transferee and transferor;
- Method and source of payment;
- Payment of recoverable cost items;
- Disposition of future paid payments
- Assignment of project accounts and leases; and
- Disposition of any equipment purchased with loan or project funds.

The agreement should include any agreements to correct any compliance problems, such as delinquent payments, underfunded reserves, or deferred maintenance. If health and safety, civil rights, disability, or environmental deficiencies were identified in the inspection, the transferee must include an action plan for immediate corrective measures. These agreements should state which party would be responsible for taking corrective action, and indicate the source of funds. Additional information may be attached to *Form RD 3560-20* as needed to ensure that all agreements are documented.

E. Prepare to Close the Transfer and Obligate the Subsequent Loan, if Applicable

To prepare to close the transfer and obligate any subsequent loan that is part of the transfer, the Loan Servicer must prepare *Form RD 3560-51,* and *Forms RD 3560-33, Loan Agreement, 3560-34, Loan Agreement,* or *3560-35, Loan Resolution* if changes must be made to the existing loan agreement, or the transfer is a new terms transfer.

The Loan Servicer enters the required data on borrower and project characteristics into the appropriate AMAS screens, although they should not enter the data to establish the borrower/project until the project receives final approval. The numbers generated by AMAS are used to identify the transferee when completing the transfer closing documents.

In addition, the Loan Servicer must ensure that the proper type of loan agreement or loan resolution is in effect and secured in the mortgage or deed of trust at the time of transfer. The balance of debt assumed must be scheduled for repayment in two years or less for RHS accounts and usually ten years or less for other types of multiple family loan account. The State Director may approve longer terms.

F. Close the Transfer

The Agency will close the transfer according to the closing instructions received from OGC. After the transfer is approved, the Loan servicer enters the transfer into AMAS and calculates the transfer balance using the Servicing Balance Worksheet. The transferee has now become the new borrower.

Upon completion of the transfer, there must be no liens, judgments, or other claims against the security being transferred other than those by the Agency and those to which the Agency has previously agreed, unless prior written approval is obtained from the National Office.

The parties to the transfer are responsible for obtaining legal services necessary to accomplish the transfer. A profit or limited profit organization transferee may use any designated attorney or title insurance company to close the transfer according to the applicable closing instructions from OGC. The attorney or title insurance company and their principals or employees must not be members, officers, directors, trustees, stockholders or partners of the transferee or transferor entity. Nonprofit organization transferees may use a designated attorney who is a member of their organization if the cost is reasonable, typical for the area, and is earned.

G. Release from Liability

The Agency may release the borrower from liability from any debts owed to the Agency when the housing project, and all equipment, related facilities, and housing project financial accounts have been transferred or sold to the transferee and the transferor's outstanding Agency debts have been assumed or satisfied.

If all of a transferor's outstanding Agency debt is not assumed or paid off at the time of the transfer or sale, the Agency will not release a borrower from liability unless the Agency determines that the borrower is unable to pay the remaining debt from assets taken as security through the debt settlement procedures. Refer to Chapter 12 for debt settlement procedures.

H. Assign Leases to Transferee

All leases must be assigned to the transferee no later than the date of closing.

I. Shift Accounts, Funds, and Assets to Transferee

1. General

Following the assignment of leases, responsibility for the accounts, funds, and assets listed below is shifted from the transferor to the transferee:

- Project operating accounts;
- Reserve account;
- Tenant security deposits;
- Supervised bank accounts;
- Any funds remaining in rental assistance contract; and
- Equipment purchased with project funds.

During a project transfer, the transferor may retain the project's reserve if the transferee funds the reserve account in an amount sufficient to meet the project's immediate needs.

2. Rental Assistance Agreement

When a transferee assumes a rental assistance agreement, the Loan Servicer will complete *Form RD 3560-55* and attach it to *Form RD 3560-27, Rental Assistance Agreement*. In addition, they will attach a copy of *Form RD 3560-55* and forward it to the St. Louis Office. If the transferee does not assume an existing agreement, Loan Servicers will suspend the agreement by memorandum to the St. Louis Office.

3. Other Agreements

If a project operates under the HUD Section 8 program, the Housing Assistance Payment contract must also be assigned to the transferee with prior HUD approval.

When the full amount of the debt is being assumed and an amount has been advanced for insurance premiums or any other purpose, the transfer will not be completed until the Finance Office has charged the advance to the transferor's account.

J. Provide Copies of Documents to Transferee

At a time no later than the transfer closing, the Agency will provide to the transferee copies of the security instruments executed by the transferor or previous borrower to originally secure the loan.

K. Inform Borrower of Administrative Responsibilities

Following completion of a transfer, the transferee has several reporting and other administrative responsibilities that need to be satisfied. The Loan Servicer must inform the transferee of these requirements shortly after the transfer is closed.

1. Reporting

Following the transfer, transferees must submit quarterly project financial reports to the Agency to demonstrate the financial viability of the project.

2. Tenant Certifications

Transferees must ensure that current executed tenant certifications are on file with the Agency or provided for each tenant following the transfer.

3. Identification of All Creditors

At completion of the transfer, transferees must establish that there are no liens, judgments, or other claims against the security being transferred other than those by the Agency and those to which the Agency has previously agreed.

L. Schedule a Follow-up Servicing Visit

The Loan Servicer should schedule a servicing visit within 90 days of closing to verify the transferee's compliance with all applicable program requirements.

M. Address Special Circumstances as Needed

1. Deceased Borrower

When the spouse of a deceased individual borrower is not currently liable for the debt, the Loan Servicer can complete a transfer and assumption to the spouse using *Form RD 3560-21*, on the same rates and terms if the account is current, or on new terms if it is

not current. The Loan Servicer should obtain OGC advice and instructions before completing such a transfer.

2. Nonequity Compensation

In some cases, compensation may be paid to the transferor by the transferee when there is no equity in the project, in order to bring about the transfer. The State Director may ask the National Office to authorize nonequity compensation. Transferors will receive no payment for regular equity or equity in conjunction with a prepayment action unless all Agency loans against the project are assumed in full or the payment to the transferor is applied in total against non–Agency prior liens. This situation is most appropriate when it is in the Agency's best interest to get a project away from a "bad" borrower and nonequity compensation is less expensive than liquidating the property.

3. Payments Received while Transfer Pending

During the period that a transfer is pending in the Field Office, the St. Louis Office will continue to apply to the transferor's account any payments received. Such payments include any down payments made in connection with the transfer for reducing the amount of the debt to be assumed. Any payment on the account not included in the latest transaction record should be deducted from the total amount of principal and interest calculated from the latest information available before the assumption agreement is completed and signed.

- **Identification.** Payments received on the date of the transfer will be remitted as regular payments. The payments will be credited to the transferor's borrower and the project number when the payment should be credited prior to the transfer. The payments will be credited to the transferee's borrower and project number when the payment should be credited after the transfer.

- **Payment.** When a payment is due on the assumption agreement shortly after the transfer is completed, the payment should, if possible, be collected at the time of the transfer and remitted in the transferee's name.

4. Uncompleted Transfer

If for any reason a transfer will not be completed after approval, the Loan Servicer will immediately notify the State Office of the reason.

7.30 MONITORING REHABILITATION WORK

The Agency will monitor all repairs and approve payments using the procedures outlined in Chapter 9 of HB-1-3560. Completing this step allows the Agency to verify that the property will be restored to a decent, safe, and sanitary condition.

ATTACHMENT 7-A: REVITALIZATION GUIDANCE

This Attachment provides guidance on using the Agency's regulatory authorities to revitalize and preserve the existing MFH portfolio through transfers and assumptions. Prolonged reduced program funding, the portfolio's increasing age, and existing owners seeking viable program exit strategies are key reasons why exceptional efforts are now needed to revitalize the portfolio. It will take extensive cooperation by existing owners, potential purchasers, non-Agency housing financiers and the Agency to help preserve this irreplaceable affordable rental housing option in rural America.

The Agency will seek to find solutions to extend and enhance the use of each MFH property that continues to serve the affordable housing needs in its community. This Attachment establishes guidance for revitalizing MFH projects using the transfer authority of this Instruction.

Revitalization principles. The goal of revitalization is to refocus resources on existing properties so they can meet affordable rental housing needs well into the future. Basic revitalization principles are summarized below:

1. There is a need for the property in the community.

2. When the transaction is complete the property will be in the hands of eligible owners.

3. The transaction will address the physical needs of the property.

4. Existing tenants will not be displaced because of increased post transaction rents.

5. Post transaction basic rents will not exceed comparable market rents.

6. Any equity loan amount will be supported by a market value appraisal.

7. The Office of Rental Housing Preservation (ORHP) concurs with equity loan amounts or increased return to owner (RTO) and coordinates the approval of waivers, National Office approvals or revitalization related policy issues.

Use effective processing strategies. The Agency must work effectively to help purchasers to meet timeframes and other requirements of third party funding sources. Key methods to foster cooperation and efficiencies within State Office jurisdictions are described later in this attachment. These methods include:

1. The State MFH Preservation Contact coordinates State revitalization activity.

2. Develop and maintain standard transfer processing guidance and checklists.

3. For each transaction, establish an up-front understanding for assessing capital needs, establishing the scope of rehabilitation and determining the appraised value.

4. Develop a good working relationship with third party funding sources.

5. Understand processing timeframes and requirements for third party funding sources.

6. Process and approve transactions to assist owners to meet timeframes and other requirements of third party funding sources.

Fully use servicing authorities. The Agency must creatively consider and use when practicable other servicing authorities to facilitate revitalization. These authorities include:

1. Subordination for third party equity or rehabilitation loans.
2. Accept parity or junior liens for equity or rehabilitation purposes.
3. Accept pre or post transaction consolidations to facilitate efficient management.
4. Reamoritization of existing Agency debt to reduce debt service.
5. Reallocate unused rental assistance (RA) units to assure affordability by existing tenants.
6. Allow for a post-transaction asset management fee to a nonprofit or public body.
7. Other waivers and National Office approvals as necessary.

REVITALIZATION PRINCIPLES

1. **There is a need for the property in the community.** Prior to entering into a revitalization process, the Agency must be satisfied that favorable patterns in housing and population statistics indicate the property will be needed to provide affordable rental housing to eligible tenants in the community.

   (a) The determination of need will be documented in the case file. More complete documentation will be required if vacancy exceeds 10 percent during the most recent 12 months.

   (b) 7 CFR part 3560, subpart N may also be used during the transfer process for guidance in making this determination.

2. **When the transaction is complete the property will be in the hands of eligible owners.** The post transaction owner must be capable and willing to operate the revitalized property in accordance with the purpose and intent of the Rural Rental Housing (RRH) program and be considered eligible within program requirements.

   (a) An applicant will be considered to be ineligible if the applicant or any member of the applicant entity is currently in noncompliance with existing Rural Development regulations including equal opportunity, fair housing and accessibility requirements, has an outstanding finding of non-compliance issued by the Agency, or an unclosed Office of Inspector General (OIG) audit or investigation.

   (b) The State Director may waive this requirement if the outstanding finding or unclosed OIG audit or investigation is being addressed through a workout or transition plan in effect for at least 6 months, or if the State Director determines that the existing default is due to circumstances beyond the applicant or any member of the applicant entity's control. State Directors are to consult with other State Directors when the default has occurred in another state.

3. **The transaction will address the physical needs of the property.** All physical needs of the property must be identified and addressed during a revitalization transfer regardless of the source of funding.

   (a) <u>Identifying the property's physical needs.</u>

   - If a full physical inspection or a compliance review has not been conducted with in the last 12 months, then the Agency will conduct one. Pictures of any finding of deficiencies or non-compliance will be included in the applicant's file.

   - When repair and rehabilitation issues are anticipated, an independent Comprehensive Needs Assessment (CNA) is to be obtained to determine both the immediate needed repairs and any necessary adjustments to the reserve account for long-term project viability. The cost of a CNA may be funded from the project's reserve or operating account if funds are available and the cost and quality of the CNA are deemed acceptable by the Agency prior to execution of any contractual agreement by the borrower. While a CNA may also be referred to as a "life cycle cost analysis or "physical needs assessment," at a minimum to be considered acceptable, a CNA must include:

- ➢ A physical inspection of the site, architectural features, common areas and all electrical and mechanical systems.
- ➢ A unit-by-unit inspection.
- ➢ Identify repair or replacement needs.
- ➢ Provide a cost estimate of the repair and replacement expenses.
- ➢ Provide at least a 10-year analysis of the timing and funding for identified needs which includes reasonable assumptions regarding inflation.

- If the cost or availability of qualified independent contractors prevents or delays the completion of a CNA, the Agency may perform this function.
  - ➢ A contracted CNA should be financially feasible for any project over 20 units.
  - ➢ When the Agency performs the CNA it will be done with the participation of the State Architect or if unavailable a contract Architect or State Architect form a neighboring state.
  - ➢ A CNA should generally be completed within 12 months prior to the revitalization transaction.
- When substantial repair rehabilitation issues are anticipated, the State Architect and Civil Rights Coordinator are to participate in the CNA or other on-site inspection.

- All necessary repairs to assure that the housing will be decent, safe and sanitary, and other improvements proposed by the applicant to enhance long-term viability of the housing must be identified and agreed to by the Agency. Any needed property improvement to bring the property into conformance with Fair Housing, Americans with Disabilities Act (ADA), or Section 504 requirements must be included in the rehabilitation plan.
  - 7 CFR part 3560.59 may be used as a guide in determining what Rural Development considers maintenance and rehabilitation of MFH project. This is a guide; flexibility should be used to protect the Government's interest to enhance the long-term viability of the housing and handicapped accessibility.
  - The requirements of RD Instruction 1940-G must be met.

(b) <u>Addressing identified need.</u>

- The transferee must provide a plan for any repairs or enhancements as part of the application package. The plan must identify each repair or enhancement item, the timeframe for completion, estimate of costs for each item, funding source for each phase of completion, who will do the work, and any Identity of Interest between the transferee and the party doing the work or providing materials and services.

- A preliminary plan may be presented to the Agency prior to the final determination of physical needs as outlined above to help assess the feasibility of the proposal. After a final identification and agreement on needs, Rural Development must concur with the final plan as part of the approval of the transfer. Costs in the final plan will be evaluated by the Agency using a cost data sources recognized by the housing industry. When Low Income Housing Tax Credits (LIHTC) are a part of the transaction the Agency may accept a sources and uses analysis prepared by the LIHTC issuer or perform a SAUCE analysis to review the sources and uses of transaction funding. A SAUCE analysis is not required for transfers that do not include LIHTC sources.

- A plan must be developed to address how tenants will be relocated if necessary to rehabilitate the project.

(c) Funding for repair and rehabilitation needs when equity is part of the transaction.

- When equity is paid in cash or on terms in accordance with the provisions of 7 CFR part 3560, subpart N the priority sources for all repairs or enhancements are as follows:

  - Transferor's equity payment, including any syndication proceeds the transferee pays to the transferor.

  - Contributions by the transferee.

  - Reserve account funds being transferred, provided post transaction reserve account levels and funding is adjusted in accordance with a CNA.

  - Agency or third party loan funds.

- When equity is paid via the prepayment incentive provision of 7 CFR part 3560, subpart N, or when an equity loan is allowed through 7 CFR part 3560, subpart I, funding for deferred maintenance will be from the first two sources identified above. Funding for repair and rehab other than deferred maintenance may be from any of the sources identified above, but may not be required to be from the transferor’s equity payment.

  - Deferred maintenance for the purposes of conditioning the receipt of equity loans is limited to specific items identified in previous Agency inspections where the borrower has had the opportunity and resources available to take corrective actions and did not.

  - Deferred maintenance does not include routine repair and replacement that results from normal wear and tear on the physical asset.

- ➢ Any amount of deferred maintenance to be part of an incentive or equity offer will be identified and considered during the ORHP concurrence process.

(d) <u>During all revitalization transfers, post transaction project feasibility must be considered and documented through an Agency approved budget.</u>

- The three basic principles are that basic rents do not exceed comparable market rents, all physical needs must be addressed, and there must be adequate security for all debt secured by the property.

- When rehabilitation and repairs are not immediately needed at the time of the transaction, funding to the reserve account may be increased in accordance with CNA determined requirements to meet those needs. Increases to reserve account funding will be included in the estimation of post transaction rents and may affect the revitalization transaction's feasibility. 7 CFR part 3560.309 (k) provides guidance to any change to reserve account requirements.

4. **Existing tenants will not be displaced because of increased post transaction rents.** For any revitalization transfer, if transaction costs cause rents to increase, the Agency will review the transaction's impact on tenants not receiving RA to minimize the possibility of displacement caused by rent overburden.

   (a) If a project is being processed as a prepayment request or a sale to a non-profit or public body within 7 CFR part 3560, subpart N process, the Agency will provide RA to all affected tenants. RA will pay the difference between the tenant contribution and higher post transaction rents. Once incentive RA is provided, 7 CFR part 3560, subpart N anticipates that RA will remain available for eligible tenants to meet increased rents. Before transferring these units under the unused RA authority of 7 CFR part 3560.259, the State MFH Preservation Contact will obtain concurrence from ORHP.

   (b) If a project is being processed under the transfer authority of 7 CFR part 3560, subpart I, the Agency is not obligated to provide RA as under a prepayment incentive. Agency approval of non-prepayment transfers may be provided only when the Agency determines that the potential for tenant displacement is minimal based on a review of the potential impact of post transaction rents on existing tenants.

- If unused RA is available the State Director using the authority of 7 CFR part 3560.259 may provide it.

- To help protect tenants from rent overburden, borrowers should contact local public housing authorities to determine if Section 8 vouchers from the Department of Housing and Urban Development (HUD) are available to protect tenants who face higher rents.

- Borrowers also may fund temporary rental incentives from non-project to ease the transition to post transaction rents.

5. **Post transaction basic rents will not exceed comparable market rents.** Comparable rents will be established using the results of the Agency approved market value appraisal. All project equity, rehabilitation, Agency or non-Agency debt service, reserve deposits, operating costs and return on investment (ROI) must be reflected in project basic rents which may not

exceed comparable market rents. When an equity loan is provided, ORHP concurrence will include a review to assure that comparable rents are not exceeded.

6. **Any equity loan amount will be identified by a market value appraisal**. Chapter 7 of HB-1-3560 provides guidance on appraisal preparation. When determining the equity loan amount, funds available in the reserve account will be added to the appraised market value of the project.

   - The Agency may accept a third party appraisal if after Agency review it is determined to meet Agency standards.

   - If a repair or rehabilitation loan is contemplated as part of a revitalization transaction, the appraisal should be ordered to also provide an opinion on the property's prospective market value subject to restricted rents plus the value of favorable financing.

(a) For all equity payments at the time of transfer, 7 CFR part 3560, subpart I establishes guidelines for the payment of equity as part of a transfer when the following conditions exists:

   - All unpaid Agency project debt is assumed.

   - The taxes and insurance account is funded on schedule and all outstanding bills have been paid.

   - All Agency loan payments are current.

   - The reserve account is on schedule, less any authorized withdrawal.

   - When these conditions cannot be met, the State Director may request an Administrator's waiver to authorize an equity payment only when all other alternatives, including liquidation, would not be in the best interests of the Government and tenants. Requests for an Administrator's exception must conform to the provisions found in 7 CFR part 3560.8.

(b) For all equity payments at the time of transfer that meet the conditions of 7 CFR part 3560, subpart I, the State Director may approve the payment with no further approval from the National Office.

(c) For all equity **loans** at the time of transfer, to facilitate the revitalization of existing MFH projects, the Agency may consider allowing for an equity payment to be in the form of a loan to be funded from project income.

   - ORHP will concur with any equity loan amount.

   - The loan may be up to 100 percent of equity for nonprofit entities that agree to restrictive-use provisions for the remaining useful life of the project or limited profit entities that agree to 30 years restrictive-use provisions. The loan may be up to 90% for limited profit entities that agree to 20 year restrictive use provisions.

7. ORHP will concur with any equity loan amount or increased RTO and coordinate the approval of any waivers, National Office approvals or policy issues.

(a) When submitting information for ORHP approval of a revitalization transfers involving an equity loan, or increased return to owner (RTO) the request must provide a copy of the ORHP incentive calculation worksheet, and other information sufficient to describe the financial terms and impact of the transaction. Updating PRE-TRAC is required only for revitalization transactions that are a result of a prepayment request.

(b) The amount of the borrower's initial investment may be adjusted to reflect cash contributions by the new borrower for the "hard costs" of repair and rehabilitation. Cash contributions do not include loan funds, regardless of the source or expectation of repayment. ORHP concurrence will be obtained when the RTO increased as part of a revitalization transaction.

EFFECTIVE PROCESSING STRATEGIES

1. **The State Multi-Family Housing (MFH) Preservation Contact coordinates State revitalization activity.** Individuals previously identified by their State Director as the designated MFH Preservation Contact will also coordinate revitalization efforts. Any change in designation or identification information should be sent to ORHP.

2. **Develop and maintain standard transfer processing guidance and checklists.** State Directors and housing staff should familiarize themselves with transfer and assumption authorities covered by 7 CFR part 3560, subpart I and the guidance outlined in this Attachment.

(a) Transfer and Assumption Policies.

- 7 CFR part 3560, subpart I describes the policies for approving all transfers of real estate security and the assumption of loans. The requirements of this section allow borrowers to transfer their project to another separate and distinct entity in which members are participants in both the transferring and the assuming entities. The transferee must be legally organized and meet the requirements of 7 CFR part 3560.55 and the guidance of this Attachment.

- Caution should be used in distinguishing a transfer from a change in membership. Changes involving 100 percent membership changes or changes in the entity, such that the new entity is considered a separate and distinct legal entity from the original borrower, must be treated as a transfer and processed in accordance with 7 CFR part 3560, subpart I. For example, when a borrower entity receives a new Tax ID number from the Internal Revenue Service (IRS), the entity change would be considered a transfer.

- Changes to membership including substitution of General Partners are to be conducted in accordance with 7 CFR part 3560.55 and may be approved when it can be demonstrated that the change will not adversely affect the operations of the project. The incoming partner should be able to further prove that the transaction will be in the best interest of the Government.

(b) Structuring a Transfer Agreement.

- *Form RD 3560-20, "Transfer of Real Estate Security,"* will be used to record the agreements between the transferor and transferee. The purchase contract between the buyer and seller should be attached as an addendum if necessary to fully disclose the transaction.

- The agreement will be prepared to show all transactions involved relating to equity including disposition of syndication proceeds between the transferee and transferor, method and source of payment, payment of recoverable costs items, disposition of future paid payments, assignment of project accounts, leases and disposition of any

equipment purchased with loan or project funds. The Agency expects the transfer to result in post transaction balances in the project's operating, reserve, taxes and insurance and tenant security deposit accounts to at least equal pre-transaction levels.

- The agreement must document any necessary actions to bring the project into compliance with regulations and loan instruments, such as delinquent payments, under funded reserves, accessibility issues and deferred maintenance. If there are health and safety deficiencies identified, an action plan for immediate steps to take corrective measures must be included. These agreements must state which party will be responsible and the source of funds. Additional information may be attached to *Form RD 3560-20* as needed to ensure that all agreements are documented.

- The proposed debt (existing debt being assumed and any additional debt) shall be counted for determining the security value limitations set out in 7 CFR part 3560.63. Soft second mortgages secured only by proceeds from a future sale of the property may be excluded from the debt ceiling and security value calculations.

- In all cases, appraisals will be required when new debt is added or when the transfer will be using new rates and terms. The amount of indebtedness to be assumed will be based on an appraisal that complies with the Uniform Standards of Professional Appraisal Practices (USPAP). In no instances will appraisals be inflated to defer loan losses and write-offs, avoid adverse tax consequences, or support a higher tax credit basis.

- The account will be classified as an "A" project in the Multi-Family Housing Information System (MFIS) or if an acceptable workout plan has been developed, classified as a "B" project. When the provisions of the transfer agreement will correct all outstanding findings, the agreement may be considered to be an acceptable workout plan for MFIS entry and reclassification after the transaction.

(c) <u>Develop and provide a transfer processing checklist.</u>

- The checklist should be consistent with the requirements of 7 CFR part 3560.405 but also include any additional requirements in accordance with State Law.

- **Attachment B-1** may be used as a guide for a transfer processing checklist.

(d) <u>The State MFH Preservation Coordinator is to provide a completed **Attachment B-2** for each transfer completed in his or her State.</u>

3. For each transaction, establish an up-front understanding for assessing capital needs, establishing the scope of rehabilitation and determining the appraised value.

(a) An initial meeting should be held with the borrower, potential purchaser and all interested parties, including third party financers to determine the most effective means to bring about the conclusion of the revitalization transfer.

(b) An agreement should be reached on how all parties will reach a preliminary understanding of the feasibility of the anticipated transaction. This includes how the borrower or purchaser will obtain initial estimates of operating expenses, needed repairs, and market rents. A goal should be to establish a process where only one formal CNA, description of the scope of work and appraisal is necessary.

4. **Develop a good working relationship with third party funding sources.** The State MFH Preservation Coordinator should meet with third party funding sources active within their jurisdiction on a regular basis to exchange ideas and information related to MFH portfolio revitalization efforts. When possible, a memorandum of understanding should be in place with the providers of LIHTC.

(a) The National Office is working closely with Government Sponsored Entities (GSE) such as Fannie Mae and Freddie Mac to open up access to the secondary market to obtain funding for equity and rehabilitation for RRH projects. Both GSE's are developing guidance to lenders that can be used when working with the Agency. Borrowers are encouraged to participate with these programs.

(b) The State MFH Preservation Coordinator will be the main contact point in each State and should be familiar with GSE processing requirements. They should also be prepared to meet with designated lenders to explain our processing requirements and develop plans to efficiently coordinate actions and resources.

5. **Understand processing timeframes and requirements for third party funding sources**. The State MFH Preservation Coordinator should be assured that they possess the latest rules surrounding the operations of LIHTC and other processing requirements of third party funding sources or GSE's.

6. **Process and approve transactions to assist owners to meet timeframes and other requirements of third party funding sources**. Internal processing by the State and Servicing Offices should be conducted to meet this goal. ORHP should be notified if any waivers or additional or new authority is needed to help obtain third party housing resources.

ATTACHMENT 7-B-1

APPLICATION CHECKLIST

Part 1. Critical items needed

Please submit each of the following immediately once they become available. The buyer/transferee must submit one (1) original to the local AGENCY servicing office *and* one (1) copy of all of the "critical" documents to the State Office.

☐ 1. Forms SF 424 Application for Federal Assistance, *SF 424C Budget Information – Construction Programs*, and *SF 424D Assurances – Construction Programs*.

These forms can be obtained on line at: http://www.gsa.gov/

☐ 2. "MFH Transfer & Assumption Application Supplement" including the "Preservation Transfer Development Budget (See Attachment B-3)

☐ 3. Copy of executed purchase agreement, including any and all amendments.

☐ 4. Physical Needs Assessment.

☐ 5. *Optional, but strongly encouraged*. A professional market study, documenting comparable market rents is encouraged when an appraisal is not required

☐ 6. Appraisal. Please note, a *third* copy of the appraisal should be sent to your State Appraiser.

☐ 7. Copy of associated applications filed with any other financing source (and, if the financing is committed, a copy of the commitment letter – e.g., a preliminary reservation letter).

☐ 8. Preliminary title report.

☐ 9. Project budget. This budget form should set forth the project's current AGENCY-approved budget in the "Current Budget" columns and the project's proposed budget after acquisition in the Proposed Budget columns.

a) ☐ *Form RD 3560-7*. This form is available upon request from AGENCY in an Excel format or it may be obtained in a pdf format on line at: http://rdinit.usda.gov/regs/forms/3560-07.pdf

b) ☐ Narrative justification of changes in budget. *It is important that any and all differences between the current and proposed budget be fully explained and justified.*

☐ 10. Rehabilitation plan. The rehab work should be developed in light of the Comprehensive Needs Assessment (above). The rehab work should be categorized as follows: (i) all necessary repairs to address any deferred maintenance and assure that the housing will be decent, safe, & sanitary; (ii) any needed property improvement to bring the property into conformance with Fair Housing, Americans with Disabilities Act, or Section 504 requirements; (iii) other rehabilitation proposed to enhance long-term viability of the housing; and (iv) any other feasible upgrades that will increase its marketability. The plan must include tenant relocation costs if necessary to rehabilitate the project. The agency must concur with the plan as part of the approval of the transfer.

a) ☐ A detailed plan and timeline of all rehab work to be accomplished. The plan must identify each repair or enhancement item, the timeframe for completion, estimate of costs for each item, who will do the work, and any Identity of Interest between the transferee and the party doing the work or providing materials and services.

b) ☐ Form RD 1924-13. Complete the estimated cost columns. This form can be obtained on line at: http://rdinit.usda.gov/regs/forms/1924-13.pdf

☐ 11. Contact list. (See Attachment B-4.)

Part 2. Additional application materials needed as soon as possible

These "additional" documents should be submitted to the local AGENCY servicing office only. Copies do not need to be sent to the State Office.

From the seller:

☐ 12. Form RD 3560-1 – signed by the *seller*. This form can be obtained on line at: http://rdinit.usda.gov/regs/forms/3560-01.pdf

From the buyer/transferee:

☐ 13. Brief narrative or resume of applicant's experience in multi-family housing.

☐ 14. Current financial statements of the applicant and of all general partners and owners with a >10% ownership interest. An example of an appropriate certification is Attachment B-5. The certification should be attached to each financial statement. (Note: If the applicant is an entity that has not yet been formed, financial statements should be a *pro forma* financial statement of the applicant along with financial statements of the proposed principals.)

☐ 15. *If the buyer is a nonprofit or has a nonprofit general partner:* Most recent IRS Form 990, "Return of Organization Exempt from Income Tax" (with Schedules A & B).

☐ 16. Organizational documents as appropriate for applicant entity type – e.g., partnership agreement, articles of incorporation, by-laws, certificate of good standing, resolution to apply for this loan – along with a letter from the applicant's attorney certifying their legal sufficiency. (Note: If the applicant is an entity that has not yet been formed, drafts documents may be submitted instead.) If the borrower is a nonprofit, also provide:

a) ☐ Tax-exempt ruling from the IRS conferring 501(c)(3) or 501(c)(4) status.

b) ☐ List of members on Board of Directors.

☐ 17. *Form HUD 9832*, *Management Entity Profile* – signed by the applicant. This form can be obtained online at: http://www.hudclips.org/sub_nonhud/cgi/pdfforms/9832.pdf

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☐ 18. *Form HUD 2530/RD 1944-37* – signed by the applicant. This form can be obtained online at: http://www.hudclips.org/sub_nonhud/html/pdfforms/2530.pdf (fillable pdf format)

☐ 19. *Form RD 3560-30*, – signed by the applicant. This form can be obtained online at: http://rdinit.usda.gov/regs/forms/3560-30.pdf

☐ 20. *If there is any Identity of Interest:* *Form RD 3560-31*, – signed by the applicant. This form can be obtained online at: http://rdinit.usda.gov/regs/forms/3560-31.pdf

☐ 21. *Form RD 1910-11*, *Applicant Certification Federal Collection Policies for Consumer or Commercial Debts* – signed by the applicant. This form can be obtained online at: http://rdinit.usda.gov/regs/forms/1910-11.pdf

☐ 22. *Form AD 1047*, *Certification Regarding Debarment, Suspension and other Responsibility Matters* – signed by the applicant. This form can be obtained online at http://www.ocio.usda.gov/forms/ocio_forms.html

☐ 23. *Form RD 400-1*. This form can be obtained on line at: http://rdinit.usda.gov/regs/forms/0400-01.pdf (fillable pdf format)

☐ 24. *Form RD 400-4*, *Assurance Agreement*. This form can be obtained on line at: http://rdinit.usda.gov/regs/forms/0400-01.pdf (fillable pdf format)

☐ 25. RD Instruction 1940-Q, Exhibit A-1. This form is attached as Attachment B-6.

Information on other funding sources:

☐ 26. If the project will be receiving funding from other sources besides the requested AGENCY loan, for each source, attach a copy of any draft regulatory/loan agreements associated with the financing.

Project management information:

☐ 27. *Form HUD 935.2* – signed by the applicant. This form can be obtained online at: http://www.hudclips.org/sub_nonhud/cgi/pdfforms/935-2.pdf (fillable pdf format)

☐ 28. Proposed Management Agreement

☐ 29. Proposed Management Plan

☐ 30. Proposed lease & occupancy rules to be used at the project (with letter from attorney indicating legal sufficiency).

ATTACHMENT 7-B-2
MFH TRANSFER & ASSUMPTION
REVIEW & RECOMMENDATION

USDA has received an application for a preservation transfer and assumption outlined below:

Name of Project:	_____
Street Address of Project (w/zip code):	_____
Name of Project's Current Owner:	_____
Name of Project's Proposed Transferee:	_____
Name of Project's Management Agent	_____

The following information is verified correct:

USDA loan information:

As of: _____

Promissory Note dated	Original Loan Amount	Current Balance	Current? (yes/no)
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

Is project eligible to prepay? _____

Project's restrictive-use agreement expires/expired? _____

Project information:

[ ] Family [ ] Elderly [ ] Congregate

Rent information:

Bedroom size	# non-income units	# income units	Current Basic Rent	Post-Transfer Basic Rent	Estimated Market Rent in Area
0 bedroom	_____	_____	_____	_____	_____
1 bedroom	_____	_____	_____	_____	_____
2 bedroom	_____	_____	_____	_____	_____
3 bedroom	_____	_____	_____	_____	_____
4 bedroom	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
Total units	_____	_____			

If HUD subsidized, is project under Plan II? _____

Tenant Subsidy at project:

	Current	Post-Transfer
USDA Rental Assistance (RA)	_____	_____
HUD project-based Section 8	_____	_____
Other: _____	_____	_____
Other: _____	_____	_____
Total subsidized units:	_____	_____

Reserve account information

Current annual reserve transfer requirement: _____ (=_____ per unit)

As of: _____

Current reserve account balance	_____
Required reserve account balance	_____
Underfunded reserve	_____

Project condition & compliance information

MFIS classification: _____

Date of last supervisory visit: _____

Date of last walk-about physical inspection: _____

Date of last compliance review: _____

Note any accessibility issues unresolved at the project. Estimated cost to correct: _____

_____

Note any deferred maintenance issues unresolved at the project. Estimated cost to correct: _____

_____

[ ] The loan account is current.

[ ] The reserve account is on schedule, less authorized withdrawals.

[ ] The taxes and insurance account is on schedule and all outstanding bills paid.

[ ] The security deposit account is fully funded.

[ ] There are no outstanding maintenance items.

[ ] Management is satisfactory.

[ ] There are no open OIG audit findings or investigations against the borrower or related entities.

[ ] The borrower and members of the borrower entity are in compliance on all other projects or complying with an approved workout plan for a minimum of 6 months.

[ ] All necessary repairs to ensure that the housing will be decent, safe and sanitary, and other improvements proposed by the applicant to enhance long-term viability of the housing agreed to by USDA.

Last appraised value of project: _____ as of _____

1. The proposed transaction:
[ ] WILL [ ] WILL NOT prevent or make more difficult the successful operation of this property.

[ ] WILL [ ] WILL NOT reduce the efficiency of the property.

2. The proposed transaction will affect the value of this property as security of the loan as follows:
_____

3. The following [ ] damages [ ] benefits will result to this property from the transaction:
_____

Note any special transfer & assumption approval conditions recommended:

SOURCES AND USES OF FUNDS

Example Apartments transfer to Preservation Associates, LP

		PERMANENT SOURCES OF FUNDS:					
USE OF FUNDS		Tax Credits	USDA Assumption	Lender Name	Other	Other	Other
Total Acquisition Cost							
Total Rehab Costs							
Total Relocation Expenses							
Total New Construction Costs							
Total Architectural Costs							
Total Survey & Engineering							
Total Construction Interest & Fees							
Total Permanent Financing Costs							
Total Attorney Costs							
Total Reserve Costs							
Total Appraisal Costs							
Total Contingency							
Total Other Costs							
Total Developer Costs							
TOTAL PROJECT COST							

Balanced

Permanent Financing Detail (for all sources other than USDA & tax credits)

Funding Source	Loan Amount	Interest Rate	Amortization (yrs)	Term (yrs)	Monthly payment	indicate if residual receipts, deferred, etc.
Lender name						
Other						
Other						
Other						

Interim Financing Detail (for all sources other than USDA)

Funding Source	Loan Amount	Interest Rate	Amortization (yrs)	Term (yrs)	Monthly payment	indicate if residual receipts, deferred, etc.
Community Bank						
Other						

I hereby recommend that this application be approved.

Date _____ Recommended by:_____

_____
(Title)

Date _____ Approved by: _____

_____
(Title)

UNITED STATES DEPARTMENT OF AGRICULTURE

ATTACHMENT 7-B-3

MFH TRANSFER & ASSUMPTION APPLICATION SUPPLEMENT

Name of Project: _____
Street Address of Project (w/zip code): _____
Name of Project's Current Owner: _____

The following information supplements Form SF-424. This information is submitted along with an application to assume the USDA debt associated with the above-mentioned security property. A complete application is or will be submitted promptly.

The undersigned in accordance with the terms of the security instruments held by USDA Rural Development (hereafter referred to as "USDA") on their property applies for release or subordination of the liens of said security instruments and consent to the following transaction:

1. Transfer of the USDA security property in full as outlined below.
2. Assumption of the full balance of all USDA loans associated with the security property on new rates and terms,
3. Subordination of the USDA security instruments as outlined below.
4. Other (*explain*). _____

1. Applicant/Buyer/Transferee information

The following information is supplied about the applicant (i.e., the legal entity to acquire title to the property, *not* the developer/sponsor):

Applicant Legal Name: _____

Provide exact legal name of the entity that will take title to the real property and be USDA's borrower at the conclusion of the transaction – e.g., "Happy Valley Associates, LP, a Maryland limited partnership".

Type of organization: _____

e.g. limited partnership, general partnership, nonprofit, corporation, LLC, tribe, public body, cooperative, individual

Tax ID #: _____
Date of formation: _____
Official Mailing Address: _____
Developer/Sponsor Name: _____

(If there is a developer sponsoring the applicant entity.)

Primary contact person for this transaction: _____
Capacity: _____
Organization: _____
Address: _____
Phone: _____ Fax: _____ E-mail: _____

Disclose any identity of interest relationship between borrower/seller and transferee/buyer (if none, indicate this):

_____

2. Member/Owner information (*complete one*):

a. If applicant is a limited partnership: *(Please provide exact legal names)*

Role	Exact Legal Name	Tax ID #	Non-profit?	% Share	Mailing Address	Authorized signer & title
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____

b. If applicant is not a limited partnership: *(Please provide exact legal names)*

Role	Exact Legal Name	Tax ID #	Non-profit ?	% Share	Mailing Address	Authorized signer & title
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____

3. Transaction information

USDA Rural Development's approval is requested for the following preservation transfer & assumption:

Negotiated purchase price: $_____ (*Please attach copy of purchase agreement.*)
Purchase agreement _____ (*USDA typically needs 120 days to complete such transactions.*)

Proposed disposition of project & project assets:

RRH PROJECT ASSETS	Transferred to buyer? (yes/no, explain)*
Real property	_____
Furnishing, fixtures & equipment	_____
Replacement reserve account	_____
Tax & insurance escrow account	_____
General operating account	_____
Security deposit account	_____
Other: _____	_____

** Note: If any project assets are not transferred in their entirety, the buyer will be responsible for funding their full replacement value from equity funds.*

Timetable

Estimated timetable for acquisition, with key deadlines for funding commitments:

_____

This transfer must close by no later than _____ because _____

4. Sources & Uses of Funds

*Funding Uses **	Amount
Total acquisitions costs	$_____
Total rehab costs	$_____
Total all other costs	$_____
TOTAL PROJECT FUNDING	$_____

*Permanent Funding Sources **	Amount	Status? Date Committed or Pending	Anticipated rates & terms	Lien position proposed
Assumption of USDA loan	$_____	Pending	1%, 50-year amortization, 30-year term	_____
Borrower contribution	_____	_____	_____	n/a
9% Low-Income Housing Tax Credits	_____	_____	_____	n/a
4% Low-Income Housing Tax Credits	_____	_____	_____	n/a
Loan from: _____	_____	_____	_____	_____
Loan from: _____	_____	_____	_____	
Other: _____	_____	_____	_____	
Other: _____	_____	_____	_____	
Other: _____	_____	_____	_____	_____
Other: _____	_____	_____	_____	_____
TOTAL PROJECT FUNDING	$_____			

** See attached "Preservation Transfer Development Budget (Sources & Uses of Funds)" for details.*

5. Effect of transfer on affordability, rents, and tenant subsidy

Applicant/transferee/buyer will enter into a new restrictive use agreement with USDA for:
[ ] 30 years [ ] 20 years [ ] remaining useful life of project [ ] Other: _____

Rent information:

Bedroom size	# units	Current Basic Rent	Post-Transfer Basic Rent	Estimated Market Rent in Area
0 bedroom	_____	_____	_____	_____
1 bedroom	_____	_____	_____	_____
2 bedroom	_____	_____	_____	_____
3 bedroom	_____	_____	_____	_____
4 bedroom	_____	_____	_____	_____
_____	_____	_____	_____	_____
Manager unit(s)	_____			
Total units:	_____			

Tenant Subsidy at project:

	Current	Post-Transfer
USDA Rental Assistance (RA)	_____	_____
HUD project-based Section 8	_____	_____
RHCP	_____	_____
Other: _____	_____	_____
Other: _____	_____	_____
Total subsidized units:	_____	_____

If project currently lacks 100% subsidy coverage on income-producing units, explain plan to maintain affordability, obtain additional subsidy and avoid adverse impact on tenants. _____

6. Planned method of management and operation

Management services to be provided by:

ıct manager (*identify*) _____ [ ] Borrower [ ] Other: _____

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ıcussion of management plan:

_____

7. Certifications

Have you or any member, stockholder, partner or joint operator of the entity borrower been convicted under Federal or State law of planting, cultivating, growing, producing, harvesting, or storing a controlled substance since December 23 ,1985? (yes/no) _____

If this application is approved, the undersigned applicant(s) agree to comply with such terms as may be prescribed by USDA and to disposition of the proceeds as required by USDA pursuant to its regulations, including the method of applying payment to the applicant(s)' loan accounts. It is expressly understood that unless a separate written instrument of subordination is executed and delivered by USDA pursuant to this application, approval by USDA of this application will merely constitute and evidence its consent, as lienholder, to the proposed transaction without in any way subordinating its lien, releasing any of its security, modifying the payment terms of the loan, or otherwise affecting any rights of USDA.

The applicant(s) agrees that none of the funds obtained as a result of any subordination covered by this application will be used for a purpose that will contribute to excessive erosion of highly erodible land or the conversion of wetlands to produce an agricultural commodities, as explained in Exhibit M of subpart G of part 1940 of title 7 of the Code of Federal Regulations.

CERTIFICATION

I hereby certify that the information given above concerning agreements between us and the transferor/seller is correct and fully understood by us.

I/we certify the information is a true and accurate reflection of proposed transfer & assumption project. This information is given for the purpose of inducing the United States of America to make a loan or to enable the United States of America to make a determination of continued eligibility of the applicant for a loan as requested in the loan application of which this statement is a part.

Neither the applicant nor its principals are delinquent on any Federal debt nor barred from participating in Federal housing programs.

_____ Signed:_____

Date Applicant/Transferee

MFH Transfer Development Budget (Sources & Uses of Funds)

Project: **Sample Apartments preservation transfer to Preservation Associates, LP**

		PERMANENT SOURCES OF FUNDS:					
USE OF FUNDS:	**TOTAL**	Tax Credits	USDA assumption	Ruraltown Bank	City	Other	Other
Total Acquisition Cost	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Rehab Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Relocation Expenses	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total New Construction Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Architectural Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Survey & Engineering	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Construction Interest & Fees	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Permanent Financing Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Attorney Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Reserve Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Appraisal Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Contingency	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Other Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Developer Costs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
TOTAL PROJECT COST	**$ -**	$ -	$ -	$ -	$ -	$ -	$ -

Balanced

Permanent Financing Detail (for all sources other than USDA & tax credits)

Funding Source	Loan Amount	Interest Rate	Amortization (yrs)	Term (yrs)	Monthly payment	indicate if residual receipts, deferred, etc.
Ruraltown Bank	$ -	0.0000%	30	30	$ -	
City	$ -	0.0000%	30	30	$ -	residual receipts only
Other	$ -	0.0000%	30	30	$ -	
Other	$ -	0.0000%	30	30	$ -	

Interim Financing Detail (for all sources other than USDA)

Funding Source	Loan Amount	Interest Rate	Amortization (yrs)	Term (yrs)	Monthly payment	indicate if residual receipts, deferred, etc.

ATTACHMENT 7-B-4
MFH TRANSFER & ASSUMPTION CONTACTS LIST

Applicant's Representatives:

(Please indicate with "*" who is to be the applicant's primary contact person for this transaction.)

Applicant:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Developer:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Applicant's Consultant:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Applicant's Attorney:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Other:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Financing & Underwriting:

Interim Lender:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Permanent Lender:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Lender's Counsel:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Bond Issuer:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Bond Counsel:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Bond Underwriter:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Tax Credit Investor:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Tax Credit Investor's Counsel:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Other:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Other:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Professional Services:

Comprehensive Needs Assessment analyst:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Appraiser:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Market Study analyst:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Escrow:

Title Company to handle the transfer:

Escrow #:	_____
Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Other:

Escrow #:	_____
Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Construction:

Architect:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

General Contractor:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Other:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Operation & Management:

Current Property Manager:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

Proposed New Property Manager:

Name:	_____
Organization:	_____
Mailing Address:	_____

Phone: _____ Fax: _____ E-mail: _____

ATTACHMENT 7-B-5
MFH TRANSFER & ASSUMPTION FINANCIAL STATEMENT CERTIFICATION
Financial Statement Certification

(This certification is to be attached to all financial statements submitted to the Agency.)

Financial Statement of: _____

Date of Financial Statement: _____

I/we certify the attached is a true and accurate reflection of my/our financial condition as of the date stated herein. This statement is given for the purpose of inducing the United States of America to make a loan or to enable the United States of America to make a determination of continued eligibility of the applicant for a loan as requested in the loan application of which this statement is a part.

_____	_____
Signature	Date
_____	_____
Name	Title

ATTACHMENT 7-B-6
MFH TRANSFER & ASSUMPTION CERTIFICATION FOR CONTRACTS

CERTIFICATION FOR CONTRACTS, GRANTS AND LOANS

The undersigned certifies, to the best of his or her knowledge and belief, that:

1. No Federal appropriated funds have been paid or will be paid, by or on behalf of the undersigned, to any person for influencing or attempting to influence an officer or employee of any agency, a Member of Congress, an officer or employee of Congress, or an employee of a Member of Congress in connection with the awarding of any Federal contract, the making of any Federal grant or Federal loan, and the extension, continuation, renewal, amendment, or modification of any Federal contract, grant or loan.

2. If any funds other than Federal appropriated funds have been paid or will be paid to any person for influencing or attempting to influence an officer or employee of any agency, a Member of Congress, an officer or employee of Congress, or an employee of a Member of Congress in connection with this Federal contract, grant or loan, the undersigned shall complete and submit Standard Form - LLL, "Disclosure of Lobbying Activities," in accordance with its instructions.

3. The undersigned shall require that the language of this certification be included in the award documents for all subawards at all tiers (including contracts, subcontracts, and subgrants under grants and loans) and that all subrecipients shall certify and disclose accordingly.

This certification is a material representation of fact upon which reliance was placed when this transaction was made or entered into. Submission of this certification is a prerequisite for making or entering into this transaction imposed by section 1352, title 31, U.S. Code. Any person who fails to file the required certification shall be subject to a civil penalty of not less than $10,000 and not more than $100,000 for each such failure.

_____ _____
(signed) (date)

_____
(name)

_____
(title)

_____
(name of certifying entity)

CHAPTER 8: SECURITY RESTRUCTURING REQUESTS

8.1 INTRODUCTION

During the term of an Agency loan, borrowers may face unexpected expenses or other financial difficulties that require additional financing from other sources to adequately maintain and operate the project. In such cases, the Agency will consider restructuring the borrower's security, so long as doing so will not only help the property, but also be in the best interest of the tenants and the Government. Potential security restructuring activities that may be approved include subordinations and junior liens, disposition of security property, leasing of security property, and other liens against a property or other assets.

This chapter describes the requirements regarding such security restructuring requests and Agency procedures for reviewing and approving those requests.

SECTION 1: SUBORDINATIONS AND JUNIOR LIENS
[7 CFR 3560.409]

8.2 OVERVIEW

Borrowers may request a subordination or junior lien for any type of Agency loan. Prior Agency consent is required for all subordinations and junior liens.

Because the requirements and procedures for subordinations and junior liens are so similar, they have been combined in this section. Where necessary, specific differences between the requirements and procedures for the two are identified.

8.3 REQUIRED CONDITIONS

The State Director may grant consent to subordinations or junior liens if the borrower adequately documents that the request is consistent with the conditions listed in Exhibit 8-1.

If a junior lien is placed on any property without prior Agency consent, the State Director may pursue liquidation of the account.

Exhibit 8-1

Required Conditions for Subordinations or Junior Liens

- The action will enable the borrower to obtain credit to make needed improvements or repairs on the property in circumstances where a loan of the same type involved could be made and funds in the reserve account have been depleted. Repair costs should be reasonable and consistent with the local market;
- The action will improve the borrower's total financial condition or debt-paying ability;
- The borrower is unable to refinance the loan on terms that can reasonably be expected to be met yet still meet the intent of the program;
- The action will not result in an unauthorized rent increase for the project or result in basic rents that exceed the Conventional Rents for Comparable Units (CRCU) standard as discussed in Chapter 4 of HB-2-3560;
- The lienholder agrees in writing that foreclosure action under its lien will not be initiated before holding a discussion with the Loan Servicer, and after giving a reasonable period of notice to the Agency, and certifies that its operating plans are consistent with Agency requirements;
- Security for the subordination or junior lien appears adequate;
- The transaction must further loan objectives and not adversely affect the Agency's security;
- The total debt against the security after the transaction does not exceed the appraised value of the property and is within the State Director's approval authority;
- There is no future advance clause that would allow the lender to advance additional money and maintain the security or mortgage position; and
- All other applicable regulatory requirements have been met.

8.4 EVALUATING BORROWER REQUESTS FOR SUBORDINATIONS AND JUNIOR LIENS

The State Director will approve subordinations and junior liens only if they generally improve a borrower's financial condition and allow for completion of improvements or repairs in cases of underfunded reserve accounts. Loan Servicers need to ensure that the request does not alter project operations to make it ineligible under Agency requirements. In addition, the subordination must not adversely affect the Agency's ability to service the loan according to program regulations, and must be determined to be within the bounds of good judgment considering the intent, funding limitations, and respective program authorities. When evaluating borrower requests for subordinations or junior liens, Loan Servicers will review the request and check that the requirements listed in Exhibit 8-2 have been met.

In most cases, the Agency will not require an appraisal of the property when a subordination or junior lien is proposed. For subordinations, the Agency needs to look more closely at the amount of non–Agency debt being assumed and to determine whether its secondary lien position is sufficient security for the remaining outstanding debt. In some cases, this determination may require an appraisal. For junior liens, appraisals are almost never required, provided project budgets demonstrate that the project has a sufficient income to support

the increased debt. Appraisals are unnecessary in such cases because the Agency retains its lien position. In either case, the Agency needs to determine whether projects are still in compliance with the conventional rents for comparable units standard following the subordination or junior lien. The State Director decides when appraisals will be required.

All requests for consent to subordinations or junior liens that do not satisfy the criteria of Exhibit 8-2 must be submitted to the National Office with complete comments and recommendations from both the Loan Servicer and State Director, and all of the borrower's case files. The National Office will review such requests on a case-by-case basis, and appropriate authorization will be granted or withheld depending on the individual merits of the proposal and its compatibility with program requirements.

Loan Servicers should follow the procedures in Paragraph 8.5 when evaluating these requests.

Exhibit 8-2

Required Documentation for Subordinations or Junior Liens

Loan Servicers may approve borrower requests only if they adequately document that the following requirements have been satisfied:

- The account must be current;
- The debt must be adequately secured;
- The borrower must provide adequate management;
- The terms and conditions of the prior lien or junior lien must be such that the borrower can reasonably be expected to meet them as well as all other debts;
- The proposed use of funds must not adversely affect the borrower's ability to meet the objectives of the program. Indeed, it must improve the borrower's ability to repay the loan or be necessary to place the borrower's operation on a sound basis;
- Any proposed development must be planned and performed according to RD Instruction 1924-A, or in a manner directed by the other lienholder that meets the objectives of RD Instruction 1924-A;
- Funds to be used for development or enlargement of farm operations must be handled as prescribed for loan funds in RD Instruction 1902-A, except that if the lienholder will not permit the use of a supervised bank account, arrangements must be made to ensure that funds will be spent for planned purposes and must be approved by the Agency before being released;
- *Form FEMA 81-93* must be completed;
- Subordinations or junior liens need not cover the entire site;
- Subordinations or junior liens must be for a specific amount;
- Subordinations or junior liens must not adversely affect the Agency's ability to service the loan according to the requirements of this part; and
- New prior or junior lienholders must agree to provide notice of foreclosure to the Agency, as required in RD Instruction 1927-B. Any junior lienholder's consent to the foreclosure and use of proceeds will be obtained prior to approval of the foreclosure.

8.5 PROCEDURES FOR AUTHORIZATION OF SUBORDINATIONS AND JUNIOR LIENS

A. Borrower Requests

Loan Servicers should instruct the borrower that each request for subordinations or junior liens must be submitted on *Form RD 3560-1*, and provide a copy of the form to the Agency.

B. Processing Borrower Requests

Upon receipt of the completed form, Loan Servicers will make a preliminary feasibility determination regarding the request. Key areas that the Agency will analyze as part of this determination include:

- Rates and terms;
- Post-restructuring project budget;
- Current compliance status of the property; and
- Capacity (for nonprofit borrowers).

If Loan Servicers discover violations at the property, the request must not be approved without an Agency-approved work-out agreement.

C. Recommendations to State Director

If there are no violations at the property and all other applicable criteria are met, Loan Servicers forward a properly completed and executed copy of *Form RD 3560-1* to the State Director. Accompanying *Form RD 3560-1* should be a memo containing all information needed to justify approval or disapproval of the request, including an agreement from any new prior lienholder to provide the Agency advance notice of foreclosure. As appropriate, Loan Servicers will also obtain junior lienholder consent to any transaction and use of proceeds prior to approval of the transaction. When all required documentation has been assembled, the Loan Servicer will forward the subordination and junior lien request to the State Director for review.

D. Final Decision

If the State Director or designee agrees with the Field Office determination, they will forward the subordination or junior lien request to the Office of General Counsel (OGC) for review of legal sufficiency and closing comments. After OGC review, the closing process will begin. The State Director or designee should obtain OGC guidance in the preparation of documents necessary to effect the subordination.

All subordination and junior lien requests exceeding the State Director's approval authority limit must be submitted to the National Office for prior approval authorization.

E. Appraisal Procedures

The State Director may request an appraisal at any time deemed appropriate. As stated in Paragraph 8.4, most subordinations and junior liens will not require an appraisal. If an appraisal is deemed necessary, an Agency official authorized to make appraisals for the type of project involved will prepare an appraisal report. Alternatively, the new creditor may perform the appraisal as part of the due diligence process. If an appraisal that is less than one year old is available, it may be used in lieu of a new appraisal.

8.6 POST-APPROVAL OF JUNIOR LIENS

Sometimes a borrower will obtain additional credit (e.g., a personal loan) using the project as security for that credit, despite the Agency's requirements that prohibit such actions. In effect, that loan functions as a junior lien on the property. When a junior lien is placed on any

property without the prior consent of the Agency, the Loan Servicer will normally service the account for liquidation with the guidance of OGC.

SECTION 2: PARTIAL DISPOSITION OF SECURITY PROPERTY
[7 CFR 3560.407]

8.7 OVERVIEW

Borrowers may also request Agency approval of the sale of a portion of an interest in the security property under certain circumstances. The borrower may use the proceeds from such sale in accordance with Exhibit 8-3. Alternatively, a borrower could grant a conveyance or right of way easement, among other actions. This section addresses each of these options, and the Agency's procedures for reviewing and approving requests.

Exhibit 8-3

Allowable Uses for Proceeds from Disposition of Security Property

- To pay customary incidental closing costs such as title and recording fees appropriate to the transaction, including additional real estate tax the borrower is required to pay for the year for which alternate arrangements to pay cannot be made;
- To pay debts owed to any prior lienholders;
- To make extra payments on the loan;
- To pay costs necessary to determine the reasonableness of an offer or asking price, such as fees for appraisal of minerals, land, or timber where the necessary appraisal cannot be obtained without costs;
- To pay a real estate broker's commission if the borrower can reasonably expect to obtain proceeds at least equal to the commission in excess of what could otherwise be obtained without the broker's assistance;
- To repair, develop, or enlarge the borrower's facility for purposes for which a loan of the same type involved could be made, if the development or enlargement is necessary to improve the borrower's debt-paying ability, place the operation on a more sound basis, or otherwise further loan objectives;
- To purchase or acquire property to be used for purposes for which a loan of the same type involved is authorized, if the debt will be as well secured after the transaction as before (The Agency will obtain a lien on the acquired property, and obtain title evidence); and
- To increase reserves based on an Agency-approved capital plan.

8.8 ALLOWABLE ACTIONS INVOLVING THE PARTIAL DISPOSITION OF SECURITY PROPERTY

The State Director may grant consent to requests for the following actions involving the partial disposition of security property for a project:

- Use of proceeds from the sale of a portion of or an interest in the security;
- Exchange of all or a part of the undeveloped security for other real estate; or

- Granting or conveyance or rights-of-way subject to applicable conditions and requirements.

8.9 ALLOWABLE USES FOR PROCEEDS FROM PARTIAL DISPOSITION OF SECURITY PROPERTY

The Agency may consent to the partial disposition of security property if borrowers plan to use the proceeds for one or more of the uses listed in Exhibit 8-3.

It should be noted that while borrowers may use proceeds from disposition of security property for any of the purposes listed in Exhibit 8-3, there is a priority order for using such proceeds. The order in which the allowable uses are listed in Exhibit 8-3 roughly corresponds to the Agency's preferred priority order (although not all uses will apply to all projects).

If property to be sold or exchanged is to be used for the same or similar purposes for which the loan or grant was made, the purchaser is required to execute *Form RD 400-4*. The agreement will remain in effect for as long as the property continues to be used for the same or similar purpose for which the loan or grant was made.

8.10 REQUIRED CONDITIONS FOR AGENCY CONSENT

The State Director may grant consent to partial sales of security property, including the sale of individual units or developed portions of a multi-family housing project, so long as the conditions listed in Exhibit 8-4 are met.

8.11 PROCESSING BORROWER REQUESTS

The Agency grants consent to disposition of part of, or an interest in, security property by approving a completed *Form RD 3560-1,* or other forms approved by OGC or prescribed in State Supplements.

Exhibit 8-4

Required Conditions for Agency Consent to Partial Disposition of Security Property

- The transaction will not impair orderly payment of the Agency debt;
- The transaction will not interfere with the successful operation of the project or prevent the borrower from carrying out the purpose for which the loan was made;
- The borrower certifies compliance with fair housing laws;
- The appropriate level of environmental review under the National Environmental Policy Act (NEPA) is completed and mitigation measures to protect any important resources are established;
- The consideration is at least equal to the market value of the security property disposed of or the rights being granted, except that right-of-way easements may be granted or conveyed without consideration being offered or with only the minimal consideration being offered if the value of the security property will not be reduced, its suitability for the intended purpose will not be impaired, and the easement is granted for the borrower to develop additional lots or units that will be integrated into the project or with a public body for enhancement of streets or utilities benefiting the project;
  - To establish market value, an authorized Agency official will either make a new appraisal if the current appraisal is more than one year old, or supplement the present appraisal report by inserting information as to the market value of the security disposed; or
  - An authorized agency official may also accept a value determination for such easements that have been provided by other competent sources at no cost to the Government that is mutually acceptable to the borrower and the Agency.
- The remaining property is adequate security for the unpaid balance of the loan; and
- The proceeds from the disposition of the security are to be used for one or more approved purposes (e.g., to pay closing costs, make extra payments, pay brokers' commission).

A. Borrower Submission

When a borrower requests consent to lease a portion of the security property or the Loan Servicer discovers that the borrower is leasing the security without consent, the Loan Servicer will require the borrower to complete *Form RD 3560-1*. The form will show the terms of the proposed lease and will specify the use of proceeds, including any proceeds to be released to the borrower.

B. Agency Review

The Loan Servicer will forward to the State Director:

- A properly completed and executed *Form RD 3560-1;*
- The proposed deed, easement, or other form of title conveyance;

- A memorandum from the Loan Servicer justifying the approval or disapproval of the proposed transaction; and

- Any other information pertinent to the transaction.

The State Director will review the materials, obtain the guidance of OGC (if needed), prior to indicating approval or disapproval on *Form RD 3560-1*, and provide additional servicing instructions to the Loan Servicer.

C. Agency Decision and Notice to Borrower

Before the Agency consents to any transaction that affects its security or lien position, Loan Servicers must obtain the written consent of any other lienholders. Such consent should include an agreement on the disposition of any funds resulting from the transaction and must be consistent with loan program requirements.

Loan Servicers should advise the borrower if the mortgage or deed of trust requires Agency consent to the sale or other transfer of real estate security. In such cases, the Loan Servicer should explain the applicable requirements to the borrower.

8.12 AGENCY RELEASE OF SECURITY

The Agency will release security for Agency loans in accordance with applicable program regulations and as follows:

- The Agency will not release its lien until it receives from the borrower the appropriate sales proceeds for application on the Government's claim. Loan Servicers will hold borrowers strictly accountable to the Agency for all proceeds derived from the sale of mortgaged property that the Agency is entitled to receive under its lien.

- The State Director or his or her designee may release real estate security by using *Form RD 3560-1* or other form approved by OGC. Satisfaction or termination of real estate security instruments when the Agency debt has been paid in full or satisfied by debt settlement action will be accomplished with *Form RD 3560-58, Satisfaction.*

- Any consent that results in an Agency loan account being paid in full is subject to all applicable prepayment provisions.

SECTION 3: LEASING OF SECURITY PROPERTY *[7 CFR 3560.408]*

8.13 OVERVIEW

Borrowers must obtain Agency approval to lease security property serving as security for Agency loans and grants. The Agency may approve leases to tenants for specific program purposes or otherwise at its discretion.

8.14 LEASES TO PUBLIC HOUSING AUTHORITIES

Loan Servicers may only authorize multi-family housing borrowers to renew and continue leasing all or part of their housing facilities to a housing authority, although borrowers may not enter into any new leases. Such leases must be on a form provided by the housing authority, and Loan Servicers must determine that the lease terms will enable the borrower to continue the objectives of the loan and make payments on schedule.

8.15 LEASE OF A PORTION OF THE SECURITY PROPERTY

Loan Servicers may approve the leasing of related facilities such as kitchens, recreation facilities, and community buildings when the borrower will continue to operate the facilities for the purposes for which the loan or grant was made. Loan Servicers should not approve such leases, however, unless they can verify that all of the following conditions are met:

- The lease is in the best interest of the borrower, the tenants, and the Government;
- The amount of the consideration is adequate to pay all prorated operating and maintenance expenses, a prorated share of the annual reserve deposit, and the prorated part of the loan amortization at the note rate of interest;
- The lease provides at its termination for the restoration of the leased space to its original condition or to a condition acceptable to the owner and the Government;
- Consent to the lease does not exceed three years at a time, unless a longer lease is clearly more advantageous to the borrower, the tenants, and the Government;
- The borrower has obtained written consent from any other lienholders whose mortgages require consent to any lease; and
- The borrower will obtain leases on the most advantageous terms to the project. The borrower will secure and credit to the project all discounts, rebates, or commissions obtainable with respect to project leases.

8.16 MINERAL LEASES

The Agency handles mineral leases according to the requirements set forth in 7 CFR 3560.408(d).

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SECTION 4: OTHER LIENS AGAINST A PROPERTY OR OTHER ASSETS *[7 CFR 3560.409 (d)]*

8.17 OVERVIEW

If none of the options presented in Sections 1, 2, or 3 of this chapter are applicable to a particular borrower or property, the Agency may consent to other liens against the property or other assets. The State Director may approve other liens against a property or other assets or instruments of similar effect under which a borrower may acquire—through other credit—items that will not become part of real estate security.

If additional liens are taken against other real property, the Loan Servicer must ensure that appropriate NEPA environmental review and due diligence requirements are satisfied.

8.18 REQUIRED CONDITIONS

The Agency's rule states that borrowers must not enter into any agreements placing a lien on the property or the equipment on it (e.g., items such as laundry equipment, air conditioning units, and basic household furnishings that will not become part of real estate security) without prior Agency approval and unless the following three conditions are met:

- The transaction will not affect the Agency's security position;
- The items covered by the transaction are needed for the successful operation of the property; and
- The financing arrangements are otherwise sound.

The rule also specifies that borrowers must complete and file with the Agency a financing statement and a security agreement.

8.19 AGENCY PROCEDURES

Requests for approval of other such liens will be made by the borrower on *Form RD 3560-1*. The Loan Servicer will forward to the State Director a properly completed and executed *Form RD 3560-1*, the proposed arrangement, the case file, and specific recommendations regarding the request.

The State Director will indicate approval or disapproval on *Form RD 3560-1*. The State Director will request that OGC prepare or approve the arrangement and issue special instructions when necessary.

CHAPTER 9: UNAUTHORIZED ASSISTANCE

9.1 INTRODUCTION

During the term of an Agency loan, there may be cases when the borrower or tenants receive assistance to which they are not entitled. Such unauthorized assistance may be due to intentional fraud, inadvertent submittal of inaccurate information by borrowers or tenants, Agency error in calculation or assignment of benefits, or other causes. In cases where unauthorized assistance is identified, the Agency seeks to collect the entire amount of assistance determined to be unauthorized.

This chapter covers Agency procedures for identifying and collecting unauthorized assistance received by tenants, members, or borrowers.

SECTION 1: TYPES OF UNAUTHORIZED ASSISTANCE

9.2 OVERVIEW

The Agency has established procedures for servicing its multi-family housing loans and grants when it determines that the borrower, grantee, or tenants were not eligible for all or part of the financial assistance received, or the project was not made subject to restrictive-use provisions required by law and/or regulation. Unauthorized assistance includes the following categories:

- The recipient was not eligible for the assistance;
- The property, as approved, does not qualify for the program (e.g., a property clearly above modest in size, design, or cost, or that was not located in an area designated as rural when the initial loan was made);
- The loan or grant was made for unauthorized purposes (e.g., purchase of an excessive amount of land);
- The recipient was granted unauthorized subsidy in the form of interest credits, rental assistance, or a subsidy benefit received through use of an incorrect interest rate; and
- The recipient was not subjected to obligations required by the assistance, such as restrictive-use provisions, at the time the assistance was provided.

9.3 ADDRESSING UNAUTHORIZED ASSISTANCE

Provisions in 7 CFR part 3560, subpart O establish the Agency's authority to seek recapture of the full amount of unauthorized assistance regardless of whether receipt of the assistance is due to errors by the Agency, the borrower, or the tenant. In determining whether to recapture unauthorized assistance, the Agency will consider the cost-effectiveness of such action given the amount of unauthorized assistance, the availability of records to support the Agency's determination, and any applicable statute of limitations.

However, there are certain circumstances where repayment of the unauthorized assistance will not be the agreed-to corrective action. The Agency may forgo collection of unauthorized assistance if the following conditions are met:

- A demand for recovery of the unauthorized assistance was made;
- The unauthorized assistance did not result from inaccurate or false information knowingly or fraudulently provided by a borrower or tenant;
- The Agency determines that the borrower or tenant is unable to comply with the unauthorized assistance repayment demand, but is otherwise willing and able to meet Agency requirements; and
- The Agency determines that it is in the best interest of the Federal Government to forgo collection of the unauthorized assistance.

At the other extreme, the Agency can also choose to initiate liquidation or enforcement proceedings against a recipient of unauthorized assistance on a case-by-case basis.

SECTION 2: IDENTIFYING UNAUTHORIZED ASSISTANCE
[7 CFR 3560.703]

9.4 OVERVIEW

Unauthorized assistance may be identified through audits conducted by the Office of the Inspector General (OIG), through reviews conducted by Loan Servicers, or through other means such as information provided by a private citizen that documents the receipt of unauthorized assistance by a recipient of Agency assistance. In addition, a borrower or management agent also may identify unauthorized assistance resulting from tenant error or fraud.

If the Agency has reason to believe that unauthorized assistance was received but is unable to determine whether or not the assistance was in fact unauthorized, the case will be referred to Office of General Counsel (OGC) or the National Office, as appropriate, for review and advice. OIG investigation should be requested in every case where the Agency knows or believes that the assistance was based on false information. If OIG conducts an investigation, the Agency's notification and collection procedures will be deferred until the investigation is completed.

9.5 REQUIREMENTS FOR IDENTIFYING UNAUTHORIZED ASSISTANCE

Identification of unauthorized assistance may be accomplished by the Agency or by borrowers in cases involving tenant fraud. The Agency may use all available means to identify unauthorized assistance, including audit reports, monitoring activities, and information provided by reliable sources. Borrowers have the primary responsibility for identifying and pursuing cases of unauthorized assistance received by tenants.

The Agency will take necessary actions to identify unauthorized assistance, provide notice of the unauthorized assistance to the borrower, and recapture that assistance. At its discretion, the Agency may choose to continue with the borrower following the receipt of unauthorized assistance if certain criteria are met. Section 7 of this chapter presents the requirements and procedures for continuation of accounts following the receipt of unauthorized assistance.

9.6 METHODS OF IDENTIFYING UNAUTHORIZED ASSISTANCE

The Agency uses a number of methods to identify unauthorized assistance, including:

- Audits conducted by OIG;
- Reviews by Agency personnel; or
- Other means (e.g., information provided by a private citizen that documents the unauthorized assistance).

In addition, the Agency has the authority to pay a contractor (from authorized contracting funds) to conduct an audit to identify unauthorized assistance. In such cases, the State Office

and Contracting Staff would work together to identify audit needs and a contractor to perform the audit.

OIG audits can be random or targeted at projects or borrowers suspected of receiving unauthorized assistance. These audits may be either requested by Loan Servicers or conducted at OIG's initiative. In every case where the Agency knows or believes that the unauthorized assistance was based on false information, OIG investigation will be requested by the Servicing Office as provided for in RD Instruction 2012-B.

9.7 DOCUMENTATION OF UNAUTHORIZED ASSISTANCE

Loan Servicers must document the reasons for unauthorized assistance in the case file, specifically stating whether the cause was error or submission of false or inaccurate information. The case file will specifically state whether the unauthorized assistance was a result of:

- Submission of inaccurate information by the recipient;
- Submission of false information by the recipient;
- Submission of inaccurate or false information by another party on the recipient's behalf, such as a loan packager, developer, or real estate broker, or professional consultants (e.g., engineers, architects, management agents, and attorneys), when the recipient did not know the other party had submitted inaccurate or false information;
- Error by Agency personnel, either in making computations or failure to follow published regulations or guidance; or
- Error in preparing a debt instrument that caused a loan to be closed at an interest rate lower than the correct rate in effect when the loan was approved or which was caused by omission from the instrument of language required by applicable regulation (e.g., restrictive-use provisions).

9.8 NOTICE TO RECIPIENT

A. Agency Notice to Borrower

The Agency will provide notice to borrowers upon determining that unauthorized assistance was received. The notice will:

- Specify in detail the reason(s) that the assistance was determined to be unauthorized;
- State the amount of unauthorized assistance to be repaid;
- Establish a meeting for the borrower to discuss the basis for the claim and give the borrower an opportunity to provide facts, figures, written records, or other information that might alter the determination that the assistance was unauthorized; and

- Outline borrower's appeal rights.

Upon request, the Agency may grant additional time for the borrower to assemble the necessary documentation.

B. Borrower Notice to Tenant

The borrower will provide notice to tenants upon determining that a household received unauthorized assistance. The notice will:

- Specify in detail the reason(s) that the assistance was determined to be unauthorized;
- State the amount of unauthorized assistance to be repaid; and
- Establish a meeting for the tenant to discuss the basis for the claim and give the tenant an opportunity to provide facts, figures, written records, or other information that might alter the determination that the assistance was unauthorized.

Upon request, the borrower may grant additional time for the tenant to assemble the necessary documentation.

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SECTION 3: CORRECTING UNAUTHORIZED ASSISTANCE

9.9 OVERVIEW

After confirming and documenting receipt of unauthorized assistance, the next step is to end the flow of unauthorized assistance to the borrower or tenant receiving it. This section outlines the procedures employed to correct unauthorized assistance, including procedures for both audit and nonaudit cases.

9.10 ACCOUNT ADJUSTMENTS – AUDIT CASES

When a final determination has been made through an OIG audit that unauthorized assistance has been granted, the Field Office will be notified of necessary account adjustments by OIG and the State Office.

Types of Unauthorized Assistance

- Unauthorized loan
- Unauthorized subsidy benefits received through use of incorrect interest rate
- Unauthorized interest credit or rental assistance
- Unauthorized grant assistance

Only cases of unauthorized assistance identified by OIG audits are reported to the Field Office. In such cases, the Automated Multi-Family Housing Accounting System (AMAS) will be updated with the correct information, if the unauthorized assistance affects establishment of the loan interest rate or closing information.

The chosen method of corrective action depends on the type of unauthorized assistance. The following text describes the actions that Loan Servicers must take to correct each type of unauthorized assistance.

A. Unauthorized Loan

For an active borrower with an unauthorized loan, if the problem causing the assistance to be unauthorized can be corrected, appropriate corrective action will be required. For example:

- Where a loan was in excess of the authorized amount, the Agency will require the recipient to refund the difference;
- Where the loan included funds for purchase of excess land, the Agency will require the recipient to sell the excess land and apply the proceeds to the account as an extra payment; and
- Where a restrictive-use provision was omitted from a loan document, the Agency will insert the provision.

B. Unauthorized Subsidy Benefits Received Through Use of Incorrect Interest Rate

When the recipient was eligible for the loan but should have been charged a higher interest rate than that shown in the debt instrument, resulting in the receipt of

unauthorized subsidy benefits, the Agency must correct the interest rate to that which was in effect when the loan was approved.

- Loan Servicers must ensure that all payments made are reversed and reapplied at the correct interest rate and future installments will be scheduled at the correct interest rate;

- The Agency will service any delinquency thus created in accordance with applicable Agency procedures;

- After reapplication of payments, the Agency will service the loan as an authorized loan; and

- Continuation of existing terms is authorized when the recipient is a public body with loans secured by bonds on which the interest rate cannot legally be changed or payments reversed or reapplied.

C. Unauthorized Interest Credit or Rental Assistance

In cases involving rental assistance or interest credit, the subsidy benefits should be terminated as provided in *Form RD 3560-9*. The Agency will service unauthorized rental assistance as a delinquent account, see Chapter 10.

D. Unauthorized Grant Assistance

When the recipient will repay unauthorized grant assistance over a period of time, the Agency will charge interest at the rate specified in the grant agreement for default from the date received until paid.

- The Agency will schedule repayment over a period consistent with the recipient's repayment ability but not to exceed 10 years;

- The Loan Servicer must maintain collection records, as the St. Louis Office cannot set up an account for repayment of a grant. The Loan Servicer will attempt to collect the monies due, and all collections data will be entered into AMAS as a "Miscellaneous Collection;"

- The Loan Servicer will report quarterly to the State Office on cases identified in OIG audits;

- If the Agency determines that the recipient cannot repay unauthorized grant assistance, the Agency may leave the assistance outstanding under the terms of the grant agreement; and

- In the case of committed funds not yet disbursed, the Agency will make no further disbursements without prior consent of the Administrator.

E. Cases Where Recipient Has Both Authorized and Unauthorized Loans Outstanding

When a recipient has both authorized and unauthorized loans outstanding, the Agency will schedule installments to be paid concurrently on all loans. The Agency will service each loan according to the loan servicing regulations in effect for an authorized loan of its type.

F. Liquidation Pending

When the Agency initiates liquidation, Loan Servicers enter data into AMAS and the account will be flagged accordingly. The account is overseen by the Loan Servicer.

G. Liquidation Not Initiated

Cases in which liquidation have not been initiated because the outstanding amount is less than $1,000 or it would not be in the Agency's best interest to do so will be adjusted, and the adjustments will be entered into AMAS. In this instance only, State Office staff may make adjustments without the recipient's signature.

As requested, the State Office will report to OIG on the status of cases of unauthorized assistance identified in OIG audit reports and tracked by Loan Servicers. The amounts to be reported will be determined by the Field Office after servicing actions have been completed.

9.11 ACCOUNT ADJUSTMENTS – NONAUDIT CASES

Servicing procedures are essentially the same for audit and nonaudit cases. However, when the Agency identifies receipt of unauthorized assistance by a means other than an OIG audit report, the St. Louis Office will be notified only if adjustments to an active account or reinstatement of an inactive account are needed or grant funds are repaid.

Once the appropriate adjustments are made, the Agency will treat the loan(s) as an authorized loan(s). Any payment reversed will be reapplied as of the original date of credit.

The Agency will handle nonaudit account adjustments as follows:

- When a change in interest rate retroactive to the date of loan closing is necessary, the borrower will initial changes to *Form RD 3560-52, Promissory Note*. Loan Servicers will update AMAS with the correct information. AMAS will automatically will reverse and reapply payments accordingly.

- When an inactive borrower agrees to repay unauthorized assistance, the Loan Servicer will notify the St. Louis Office by memo, attaching a copy of *Form RD 3560-52*. The St. Louis Office will establish or reinstate the account according to the terms of *Form RD 3560-52*.

- If a loan is paid in full, the Agency will handle the remittance like any other final payment.

SECTION 4: RECAPTURE OF UNAUTHORIZED ASSISTANCE TO BORROWERS

9.12 OVERVIEW

To ensure that borrowers do not benefit from unauthorized assistance at the expense of others who truly need and qualify for such assistance, the Agency seeks to recover all unauthorized assistance from borrowers. The Agency has established a set of detailed procedures that Loan Servicers must follow in each case of unauthorized assistance.

9.13 REQUIREMENTS FOR COLLECTING UNAUTHORIZED ASSISTANCE *[7 CFR 3560.705]*

The Agency has the authority to recapture unauthorized assistance from borrowers, subject to the following terms and conditions:

- The amount due will be the amount stated in the notice letter;
- If a borrower agrees to repay the money in a lump sum, the Loan Servicer may allow a reasonable period for the borrower to arrange for repayment; and
- When the borrower cannot repay the unauthorized assistance in a lump sum but will repay over a period of time, the Loan Servicer may charge interest at a reasonable rate established by the Agency.

In determining whether to recapture unauthorized assistance, the Agency will consider:

- The cost effectiveness of recapture efforts relative to the amount of unauthorized assistance to be repaid;
- The availability of records to support the Agency's unauthorized assistance determination;
- Any applicable Federal, state, or local statute of limitations;
- Whether the unauthorized assistance resulted from the provision of inaccurate or false information knowingly or fraudulently provided by the borrower or tenant; and
- The ability of the borrower or tenant to repay.

9.14 AGENCY RECAPTURE OF UNAUTHORIZED ASSISTANCE

A. Overview

To collect unauthorized assistance, Loan Servicers must follow the following steps described in subparagraph 9.14 A.1 through A.5:

1. Coordination With OGC

In each case of unauthorized assistance, Loan Servicers need to work with OGC to determine the appropriate statute of limitations before making a decision to collect.

2. Notification to Recipient

Steps for Recapturing Unauthorized Assistance from Borrowers

- Coordination with OGC
- Notification to recipient
- Recipient response and Agency follow-up
- Collection
- Restriction on Loan Servicer's actions

The Agency will seek to collect unauthorized assistance from borrowers, up to the applicable statute of limitations for any particular amount of unauthorized acceptance. Normally, however, the Agency will not go back more than one year in the pursuit of unauthorized assistance unless the amount is sufficiently large to justify such action. The Loan Servicer will initiate collection efforts in the notice described in the Section 3 of this chapter. The Loan Servicer mails the notice to the recipient by certified mail, with a copy to the State Director and, for a case identified in an OIG audit report, a copy to the OIG office that conducted the audit and the Planning and Analysis staff of the National Office. The Loan Servicer will send the notice to all recipients who received unauthorized assistance, regardless of the amount. Generally, unauthorized assistance is not aggressively pursued beyond this notice if the amount is less than $1,000.

3. Recipient Response and Agency Follow-Up

When the recipient does not agree with the Agency's determination, or if the recipient fails to respond to the initial letter within 30 days, the Loan Servicer will notify the recipient of the following in a second certified letter:

- The amount of assistance finally determined by the Agency to be unauthorized;
- A statement of further actions to be taken by the Agency; and
- The recipient's appeal rights.

As with the first notice, the Loan Servicer sends copies of the letter to the State Director and, for a case identified in an OIG audit report, the OIG office that conducted the audit and the Planning and Analysis staff of the National Office.

4. Collection

If the recipient does not prevail in an appeal, or when an appeal is not made during the time allowed, the Loan Servicer will proceed with either liquidation or legal action to enforce collection. If during the course of the appeal the appellant decides to agree with the Agency's findings or is willing to repay the unauthorized assistance, the Loan

Servicer will either continue to service the account or accept full payment, subject to all applicable prepayment requirements, as appropriate.

The Agency will allow a "reasonable period" for repayment of unauthorized assistance in a lump sum, although this will usually not exceed 90 days. If lump sum payment is not feasible, the Loan Servicer may propose a repayment schedule on an exception basis.

5. Restriction on Loan Servicer's Actions

When the Loan Servicer is the same person who approved the unauthorized assistance, the State Director must review the case before further actions are taken by the Loan Servicer.

B. Procedures for Collection of Unauthorized Assistance

Following the final Agency determination of unauthorized assistance, Loan Servicers must take the following steps:

- Notify the St. Louis Office of necessary account adjustments; and

- Restructure accounts so that all money owed is collected and no borrowers are receiving assistance to which they are not entitled. This is normally accomplished on a case-by-case basis, with appropriate involvement of the management agent and tenant in cases where the tenant receives unauthorized assistance. Otherwise, it is accomplished on a case-by-case basis for repayment by the borrower in 3 months or less. Upon demand, borrowers must repay any unauthorized rental assistance and/or return on investment; sometimes this may be achieved through a workout agreement with the Agency. If 3 months is not a feasible timeframe for complete repayment, the State Director can make an exception where justified.

The specific procedures to be followed in each case will depend on the reason for the unauthorized assistance (i.e., borrower error or Agency error). The procedures associated with each cause of unauthorized assistance are discussed below.

1. Borrower Error

- If the borrower assigned rental assistance incorrectly even though the tenant correctly reported income and household size, the borrower will first notify the Loan Servicer. If the Loan Servicer verifies that the error was made based on information that was available at the time the unit was assigned, the borrower or management agent will give the tenant a 30-day written notice that the unit was assigned in error and that the rental assistance benefit will be canceled effective on the next monthly rental payment due after the end of the 30-day notice period. The written notice will provide that: the rental assistance will be assigned to the next eligible household based on *Form RD 3560-29,* from which the original priority was established when the unit was erroneously assigned. The rental assistance will not be retroactive unless

the reassignment was based on an appeal by the tenant. Retroactive rental assistance may not exceed the project's remaining rental assistance obligation balance; and

- Restitution for unauthorized rental assistance that is the borrower's fault will be handled as a refund.

Exhibit 9-1 lists the specific actions that Loan Servicers must take to attempt to recapture unauthorized assistance to borrowers.

Exhibit 9-1

Loan Servicer Actions to Recapture Unauthorized Assistance to Borrowers

Specific Agency actions to be taken in order to recapture unauthorized assistance in cases of borrower error include the following:

- Notify the borrower of the Agency's finding in *Handbook Letter 301 (3560), Servicing Letter #1*. Include in the letter a specific dollar amount and timeframe for response (usually 15 days);
- Allow the borrower time to review the finding;
- If the borrower concurs with the finding and agrees to repay the unauthorized amount, require repayment within 90 days. Note that repayment can only come from project funds if the project benefited from the unauthorized assistance;
- If the borrower does not respond to the first letter within 15 days, send *Handbook Letter 302 (3560), Servicing Letter #2*. Schedule a meeting and state that a response is required within 15 days;
- If there is no response by 5 days after the deadline established in the second non-compliance letter, send a third and final letter *Handbook Letter 303 (3560), Servicing Letter #3*. This letter should include a final demand and a description of the collection and enforcement action(s) the Agency plans to take if there is no response;
- After the third letter is sent, the amount due becomes an audit receivable in 15 days. Make necessary changes to AMAS, and make arrangements to collect the unauthorized amount (no "netting" is authorized on this amount);
- Borrowers have until 5 days before the deadline for collection to appeal the Agency's decision;
- If there is still no acceptable response from the borrower, file a problem case report with the State Director. This report will recommend specific actions that should be taken to enforce compliance (e.g., acceleration, suing for performance, replacement of management agent); and
- Unauthorized assistance received due to borrower fraud will not be repaid from project funds.

2. Agency Error

There are several types of Agency error that may result in unauthorized assistance. The most common include:

- Use of incorrect interest rate;
- Assignment of unauthorized rental assistance;
- Improper issuance of interest credit;
- Non-application of recoverable cost changes;
- Approving a loan for ineligible purposes; and
- Other errors (e.g., failure to apply use restrictions).

Exhibit 9-2 describes the actions that Loan Servicers must take to attempt to recapture unauthorized assistance in the event of Agency error.

Exhibit 9-2

Actions to Recapture Unauthorized Assistance due to Agency Error

Specific Agency actions to be taken in order to correct cases of Agency error include the following:

- Identify the mistake and the amount of assistance involved;
- Provide notice to the borrower of the Agency's intent to correct its mistake and collect the unauthorized amount. This notice will include a description of where corrections to documents are required, if applicable;
- Contact OGC for advice if needed;
- Request repayment based on OGC advice regarding the feasibility of collection and any applicable collection threshold. The State Director retains the authority to decide not to pursue any unauthorized amounts below the collection threshold. If the unauthorized amount is above the collection threshold, no OGC review is required;
- Take all appropriate actions to correct the original error that led to the unauthorized assistance, and negotiate terms of repayment (if applicable) with the borrower; and
- If there is no response from the borrower, follow the procedures outlined in Exhibit 9-1.

9.15 REPAYMENT METHODS

Repayment of unauthorized assistance may be accomplished by voluntary repayment from the borrower, full prepayment, or offsets. The best approach will depend largely on case-specific circumstances.

9.16 FULL PREPAYMENT

If full prepayment is determined to be the optimal servicing solution, the Agency will accept the prepayment in accordance with applicable requirements under 7 CFR part 3560, subpart N. Prepayment would be the best solution if the action would not result in tenants being displaced such that they could not find comparable housing elsewhere in the community at rental rates of 30 percent of income or less, and if there would be no adverse impact to low- or moderate-income housing stocks for majority or minority segments of the community. Appropriate restrictive-use provisions, if applicable, must remain in the deeds of release following prepayment.

SECTION 5: RECAPTURE OF UNAUTHORIZED ASSISTANCE TO TENANTS

9.17 OVERVIEW

Section 4 of this chapter addressed the requirements and procedures for recapturing unauthorized assistance from borrowers. The Agency also established requirements that borrowers identify and collect unauthorized assistance from tenants. This section addresses those requirements and procedures.

9.18 REQUIREMENTS FOR COLLECTION OF UNAUTHORIZED ASSISTANCE TO TENANTS *[7 CFR 3560.708]*

Any assistance resulting from misrepresentation of tenant income or status that varies from the allowable amounts set forth under the occupancy requirements is unauthorized and must be repaid. Borrowers who discover that unauthorized assistance has been granted to a tenant have primary responsibility for attempting to recapture it, although the Agency may provide assistance, when needed, at its discretion.

When a tenant moves out of a property, the borrower is no longer responsible for collecting the unauthorized assistance. At that point, the Agency has primary responsibility to collect at its discretion and it accordance with the Debt Collection and Improvement Act.

9.19 PROCEDURES FOR COLLECTION OF UNAUTHORIZED ASSISTANCE TO TENANTS

If it appears that the tenant has knowingly misrepresented household status to the borrower, the Loan Servicer will look into the case to determine the facts. If the Loan Servicer determines that income or number of occupants was misrepresented, they will direct the borrower to demand and to attempt to recoup improperly received rental assistance from the tenant.

The borrower will provide the tenant with a notice of intent to recapture unauthorized assistance. The notice informs the tenant of the amount improperly advanced and the lump sum or monthly amount that will be added to the tenant's rent to recapture the unauthorized rental subsidy. The borrower will inform the Agency of the unauthorized benefits and of the agreement made by the tenant to repay.

Money collected will be remitted and processed through AMAS. The rental assistance will be credited to the rental assistance account. If the tenant fails to make restitution, the Loan Servicer will refer the case to the State Director, who will request the advice of OGC on further action.

Tenants whose rental assistance benefit will be canceled due to mistaken assignment of the benefit by the borrower/management agent must receive 30 days written notice. In such cases, Loan Servicers must insure that borrowers grant tenants the chance to cancel their lease or appeal the decision.

Exhibit 9-3 outlines the steps that must be taken by Loan Servicers and borrowers to recapture unauthorized assistance from tenants.

Exhibit 9-3

Actions to Recapture Unauthorized Assistance from Tenants

The following steps should be taken by the borrower to correct cases of unauthorized assistance due to tenant error:

- If the Agency determines that a tenant misrepresented income or the number of occupants in the unit and has received unauthorized assistance, the Agency will direct the borrower to recapture the improperly received rental assistance;
- The borrower may review the Agency's finding. The borrower may either confirm that the Agency's finding is correct, provide evidence that the problem has been corrected, or note that the tenant disputes the finding;
- If the borrower agrees with the Agency's finding and discovers the source of the unauthorized assistance, the borrower will provide a notice of lease violation to the tenant and provide an opportunity for repayment;
- The borrower and tenant will negotiate the repayment terms. If the tenant refuses or is unable to repay, the borrower will initiate eviction proceedings. The Agency will provide support as needed through this process;
- The borrower will notify the Agency of the actions taken in response to the problems cited (e.g., repayment, agreed-upon date for repayment, eviction) as well as a plan for additional actions (with time frame). These should be added to the case file;
- If either the borrower or the tenant dispute the Agency's finding, they may provide evidence for consideration by the Agency. OGC assistance may be required to review and interpret these submissions; and
- If tenant has moved out of the unit, the borrower must turn over relevant tenant records upon request (e.g., tenant move-out form).

SECTION 6: OFFSETS

9.20 GENERAL OFFSET REQUIREMENTS

Offsets are a process by which delinquent debts are collected from borrowers, grantees, or tenants through means other than a direct payment. Offsets are normally implemented only when the Agency considers the delinquent debits to be otherwise uncollectable. Loan Servicers rarely make the "uncollectable" determination; this task normally falls to regional attorneys or investigators.

Offsets must not interfere with or defeat the purpose of Agency programs, and will be used only where feasible and in the best interest of the Government. Exhibit 9-4 lists the general procedures that Loan Servicers must follow when implementing offsets.

9.21 ADMINISTRATIVE OFFSETS

Administrative offset is a process whereby other Federal agencies owing money to a borrower, grantee, or tenant pay the Agency rather than the party to which the money is owed. The following steps must be taken by Loan Servicers when implementing administrative offsets:

- Give the borrower notice through a formal letter, afford the borrower all applicable rights, and accelerate the account before asking another agency to offset any amount of debt; and

- Cancel promptly (i.e., within 30 to 90 days) administrative offset requests to other agencies if for any reason the Agency is no longer entitled to such offset.

Exhibit 9-4
General Procedures for Implementing Offsets

- **Only pursue offset when appropriate.** Avoid using offset to collect a debt more than 6 years after the right to collect the debt first accrued, unless the delay resulted from facts that were not known and could not reasonably have been known. Do not pursue offset against a claim that has been accrued for more than 10 years under any circumstances;
- **Notify borrowers of intent to use offsets.** Notify borrowers of the Agency's intent to use offset procedures. If the borrower requests a meeting to discuss the matter, schedule the meeting and advise the borrower of the date, time, and place;
- **Inform borrowers of their rights.** Inform borrowers that they have 15 days after receipt of notification to inspect/copy records, and 30 days to either make a written submission, request a meeting, or appeal. Inform borrowers of when and where records may be inspected and/or copied within 10 days of the request to do so;
- **Respect borrowers' rights.** Ensure that borrowers' rights are respected (e.g., the right to inspect and copy records, the right to avoid offset by paying debts in full within 30 days, the right to present reasons why offset should not be used, the right to request meetings with the decision-making official, and the right to appeal the decision);
- **Communicate effectively with borrowers.** Make decisions promptly, within 15 days, after a meeting with a borrower and communicate them in writing to the borrower. If a request from a borrower not to use offset is denied, the letter communicating that decision should advise the borrower of their rights to appeal to the National Appeals Division;
- **Follow appropriate hearing procedures.** Inform borrowers that they may request a hearing if they dispute any Agency finding. Hearings can include consideration of any issues concerning the debt that the borrower wishes to raise. Respond promptly to all written or oral requests or presentations made by borrowers;
- **Make appropriate refunds.** Make refunds within 45 days if it is determined that an amount should not have been offset or if the borrower wins an appeal;
- **Credit collections to borrower's account.** Process amounts collected through offset as regular payments that are credited to the borrower's account; and
- **Report to State Administrative Officer.** Consolidate and forward all information on borrowers referred for and/or collected through offsets to the State Administrative Officer within 5 days after the end of each quarter. The State Administrative Officer then consolidates the local reports and forwards that information to the St. Louis Office within 10 days after the end of the quarter.

9.22 SALARY OFFSETS

When the Agency uses salary offsets, payment for the debt is deducted from the employee's pay and sent directly to the creditor agency. Exhibit 9-5 presents the procedures that Loan Servicers must follow when implementing salary offsets.

Exhibit 9-5

Procedures for Implementing Administrative Offsets

- **Determine feasibility of salary offset**. Decide on a case-by-case basis whether salary offset is feasible.
- **Develop a payment schedule**. Schedule installment payments to liquidate the debt in approximately three years, if possible. Certifying Officials are responsible for determining the size and frequency of the deductions, which must be reasonable given the size of debt and ability to pay. Installment deductions will generally be made over a period no longer than the anticipated period of employment.
- **Set offsets at a reasonable amount**. Ensure that no more than 15 percent of an employee's disposable pay will be offset per pay period unless such an arrangement is agreed to by the employee.
- **Provide key information to borrower's employer**. Certify the following to the borrower's employing agency when requesting initiation of salary offset: that debt in a certain amount exists, that proper offset procedures have been followed, and that actions required by the Debt Collection Act have been taken.
- **Notify borrower of planned offsets**. Make notification of salary offset to the borrower at least 30 days before it is to begin. Ensure that the evidence used to make the decision to notify the borrower is sufficient for the Agency to proceed at a hearing.
- **Follow appropriate hearing procedures**. Arrange for a Hearing Officer and notify the employee of the time and place of the hearing whenever accepting a petition for a hearing regarding salary offset. The Hearing Officer will issue a written decision no later than 60 days after the filing of the petition requesting the hearing unless the employee requests and the Certifying Official grants a delay in the proceedings. Both the employee and the Agency will receive a copy of the Hearing Officer's decision.
- **Report to Field Offices**. Notify Field Offices of payments received from salary offset by providing a transaction record from the St. Louis Office.
- **Initiate cancellation procedures at the appropriate time**. Complete *Form AD-343, Payroll Action Request*, and send it to the National Office if a borrower's name has been submitted to another agency for offset and the borrower's account is brought current or otherwise satisfied. The National Office will notify the paying agency that the borrower is no longer delinquent or indebted, and advise them to cancel the offset.

9.23 IRS OFFSETS

Internal Revenue Service (IRS) offsets are a process by which the IRS can reduce a taxpayer's refund by the amount of any legally enforceable debt owed to a Federal agency. The following procedures should be followed by Loan Servicers when considering implementing IRS offsets:

- Screen the accounts of all borrowers potentially eligible for IRS offset. The St. Louis Office should take the lead, but Field Offices will further screen the accounts based on ineligibility criteria; and

- Credit the borrower's account for the amount required after IRS effects an offset and notify the appropriate Field Office. The Finance Office will take the lead; it may deduct an amount equal to the IRS's processing costs from the amount offset.

SECTION 7: CONTINUATION OF LOAN ACCOUNTS

9.24 OVERVIEW

The Agency realizes that it would be counterproductive to liquidate the account of each borrower that receives unauthorized assistance. Thus, a much more common scenario is to continue the loan account with a stipulation that some or all of the unauthorized assistance will be collected, either immediately or over time. This way, the Agency can continue to meet the needs of low-income tenants while still responsibly protecting the taxpayers' interest in the RHS portfolio.

9.25 REQUIREMENTS FOR CONTINUATION OF LOAN ACCOUNTS *[7 CFR 3560.707]*

If a recipient of unauthorized assistance is willing to pay the amount in question but cannot repay within a reasonable period of time, the Agency may continue to service the account if the recipient has the legal and financial capabilities to continue.

When the borrower is responsible for the circumstances causing the assistance to be unauthorized, the borrower must take appropriate action to correct the problem. When unauthorized assistance is due to Agency actions, the Agency will take appropriate action to correct the problem. When circumstances resulting in a determination of unauthorized assistance cannot be corrected, the Agency may, at its discretion, decide that continuation on existing terms is appropriate.

9.26 AGENCY DECISION TO CONTINUE ACCOUNT

If a recipient is willing to pay the amount in question but cannot repay within a reasonable period of time, the Agency has the option of continuing to service the account. The Agency will take appropriate servicing actions to continue the account if all of the following conditions are met:

- The recipient did not provide false information;
- Requiring prompt repayment of the unauthorized assistance would be highly inequitable; and
- Failure to collect the unauthorized assistance in full will not adversely affect the Agency's financial interest.

9.27 SERVICING OPTIONS IN LIEU OF LIQUIDATION OR LEGAL ACTION TO COLLECT

When the conditions for continuation of the account are met, the Loan Servicer will service an unauthorized loan or grant, provided the recipient has the legal and financial capabilities to continue. Agency actions will depend on whether the case involves an active or inactive borrower or grantee and the type of unauthorized assistance received.

A. Agency Actions

Generally, borrower accounts need to be restructured so that the Agency collects all money due it and so that no borrower is receiving assistance to which they are not entitled. The Loan Servicer accomplishes this result through the account adjustments described below. In most cases requiring such corrective actions, the Loan Servicer reports to the State Director, who often consults with OGC on further actions.

B. Notice of Determination When Agreement is Not Reached

If the recipient does not agree with the Agency determination of unauthorized assistance or does not respond to the initial letter within 30 days, the Loan Servicer must send a second certified letter (to the same recipients) specifying the final amount determined by the Agency to be unauthorized, further actions to be taken by the Agency, and the recipient's appeal rights.

C. Reporting to OIG

At prescribed intervals, the St. Louis Office will report to OIG on the status of cases involving unauthorized assistance which were identified by OIG in audit reports. The St. Louis Office will determine the amounts to be reported to OIG after account servicing actions have been completed. For reporting purposes, the procedures outlined below apply.

1. Unauthorized Loan

When a borrower repays an unauthorized loan account in full, Loan Servicers should include that payment in the next scheduled report only. When the Agency approves continuation with the loan on existing terms, Loan Servicers will report the case as resolved on the next scheduled report. No further reporting is required.

2. Unauthorized Subsidy

For unauthorized subsidy cases, after the borrower has repaid the unauthorized amount or payments have been reversed and reapplied at the correct interest rate, Loan Servicers should include the unauthorized subsidy as resolved in the next scheduled report. No further reporting is required.

3. Liquidation Pending

When the Agency establishes an account with liquidation action pending, Loan Servicers will include the status in each scheduled report until the liquidation is completed or the account is otherwise paid in full.

4. Liquidation Not Initiated

When liquidation is not initiated, Loan Servicers should report so in the next scheduled report, along with collections (if any). No further reporting is required.

5. Unauthorized Grant

When unauthorized grant assistance is scheduled to be repaid, the collections and status reported by the State Office to the St. Louis Office by memorandum are included in the OIG report until the account is paid in full.

6. Inactive Borrower

When an inactive borrower has agreed to repay unauthorized assistance, Loan Servicers will report the account initially, and include collections and status in each scheduled report until the account is paid in full.

D. Quarterly Reporting to the State Office

The Loan Servicer will report to the State Office by the first day of March, June, September, and December of each year the repayment of unauthorized rental assistance by account name, case number, account code, audit report number, finding number, date of claim, amount of claim, amount collected during period, and balance owed at the end of the reporting period. The State Office will forward a consolidated report to the St. Louis Office no later than the fifteenth day of March, June, September, and December of each year for inclusion in the OIG report.

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SECTION 8: ENFORCEMENT

9.28 OVERVIEW

If all of the Agency actions described in this chapter fail to result in an acceptable resolution to the unauthorized assistance, enforcement actions may be considered. Most enforcement actions will require close coordination with OGC, which will develop the Agency's enforcement approach based on information supplied by Loan Servicers. It is the Agency's goal to resolve most unauthorized assistance cases before they reach this stage.

9.29 AGENCY ACTIONS FOR ENFORCEMENT AGAINST RECIPIENTS OF UNAUTHORIZED ASSISTANCE

If a recipient is unwilling or unable to arrange for repayment, or continuation is not feasible, the Agency may take one of the following actions, as appropriate.

A. Liquidation

In the case of an active borrower with a secured loan, the Loan Servicer will attempt to have the recipient liquidate voluntarily subject to compliance with prepayment requirements. If the recipient agrees, Loan Servicers will document the agreement with an entry in the running record of the case file.

Where real property is involved, the Loan Servicer will prepare a letter to be signed by the recipient agreeing to voluntary liquidation. If the recipient does not agree to voluntary liquidation, or agrees but is unable to accomplish it within a reasonable period of time (usually not more than 90 days), the Agency will initiate forced liquidation action, unless the amount of unauthorized assistance outstanding totals less than $1,000 or it can be clearly documented that it would not be in the best financial interest of the Government to force liquidation. If a borrower meets either of the two criteria to forego forced liquidation, the Agency will make all necessary account adjustments without the recipient's signature and notify the recipient by letter of the actions taken.

B. Legal Action to Enforce Collection

In the case of a grantee, inactive borrower, or active borrower with an unsecured loan (e.g., collection-only or unsatisfied balance after liquidation), the Loan Servicer will document the facts in the case file and submit it to the State Director, who will request the advice of OGC on pursuing legal action to effect collection. The State Director will tell OGC what assets, if any, are available from which to collect. The State Director will forward the case file, recommendation of the State Director, and OGC comments to the National Office for review and authorization to implement recommended servicing actions.

C. Double Damages

1. Action to Recover Assets or Income

The Agency may request to the Attorney General to bring an action in a U.S. district court to recover any assets or income used by any person in violation of the provisions of a loan made by the Agency under this section or in violation of any applicable statute or regulation.

For the purposes of this section, use of assets or income in violation of the applicable loan, statute, or regulation includes any use for which the documentation in the books and accounts does not establish that the use was made for a reasonable operating expense or necessary repair of the project or for which the documentation has not been maintained in accordance with the requirements of the Agency and in reasonable condition for proper audit.

For the purposes of this section, the term “person” means:

- Any individual or entity that borrows funds in accordance with programs authorized by this section;
- Any individual or entity holding 25 percent or more interest in any entity that the Agency funds in accordance with programs authorized by this section; and
- Any officer, director, or partner of an entity that borrows funds in accordance with programs authorized by this section.

2. Amount Recoverable

In any judgment favorable to the United States entered under this subsection, the Attorney General may recover double the value of the assets and income of the project that the court determines to have been used in violation of the provisions of a loan made by the Agency under this section or any applicable statute or regulation, plus all costs related to the actions, including reasonable attorney and auditing fees.

Notwithstanding any other provisions of law, the Agency may use amounts recovered under this section for activities authorized under this section, and such funds must remain available for such use until expended.

3. Time Limitation

Notwithstanding any other provisions of law, an action under this section may be commenced at any time during the six-year period beginning on the date that the Agency discovered or should have discovered the violation of the provisions of this section or any related statutes or regulations.

4. Continued Availability of Other Remedies

The remedy provided in this section is in addition to—not in substitution of—any other remedies available to the Agency or the United States Government.

D. Equity Skimming

1. Criminal penalty

Whoever, as an owner, agent, employee, or manager, or is otherwise in custody, control, or possession of property that is security for a loan made under this title, willfully uses, or authorizes the use, of any part of the rents, assets, proceeds, income, or other funds derived from such property, for any purpose other than to meet actual, reasonable, and necessary expenses of the property, or for any other purpose not authorized by this title or the regulations adopted pursuant to this title, must be fined under title 18, United States Code (USC), or imprisoned not more than five years, or both.

2. Civil sanctions

An entity or individual who as an owner, operator, employee, or manager, or who acts as an agency for a property that is security for a loan made under this title where any part of the rents, assets, proceeds, income, or other funds derived from such property are used for any purpose other than to meet actual, reasonable, and necessary expenses of the property, or for any other purpose not authorized by this title of the regulations adopted pursuant to this title, must be subject to a fine of not more than $25,000 per violation. The sanctions provided in this paragraph may be imposed in addition to any other civil sanctions or civil monetary penalties authorized by law.

E. Civil Monetary Penalties

1. Overview

The Agency may, after notice and opportunity for a hearing, impose a civil monetary penalty in accordance with this section against any individual or entity, including its owners, officers, general partners, limited partners, or employees, who knowingly and materially violate, or participate in the violation of, the provisions of this title, the regulation issued by the Agency pursuant to this title, or agreements made in accordance to this title by:

- Submitting information to the Agency that is false;
- Providing the Agency with false certifications;
- Failing to submit information requested by the Agency in a timely manner;
- Failing to maintain the property subject to loans made under this title in good repair and condition, as determined by the Agency;

- Failing to provide management for a project that received a loan made under this title that is acceptable to the Agency; and

- Failing to comply with the provisions of applicable civil rights statutes and regulations.

2. Amount

The amount of a civil penalty imposed under this section must not exceed the greater of twice the damages the Agency or the project that is secured for a loan under this section suffered or would have suffered as a result of the violation, or $50,000 per violation.

In determining the amount of a civil monetary penalty under this section, the Agency must take into consideration:

- The gravity of the offense;

- Any history of prior offenses by the violator (including offenses occurring prior to the enactment of this section);

- Any injury to tenants;

- Any injury to the public;

- Any benefits received by the violator as a result of the violation;

- Deterrence of future violations; and

- Such other factors as the Agency may establish by regulation.

3. Payment of Penalties

No payment of a penalty assessed under this section may be made from funds provided under this title or from funds of a project that serve as security for a loan made under this title.

4. Remedies for Noncompliance

If a person or entity fails to comply with a final determination by the Agency imposing a civil monetary penalty, the Agency may request the Attorney General of the United States to bring an action in an appropriate district court to obtain a monetary judgment against such an individual or entity and such other relief as may be available. The monetary judgment may, at the court's discretion, include attorney's fees and other expenses incurred by the United States in connection with the action.

In an action under this paragraph, the validity and appropriateness of a determination by the Agency imposing the penalty must not be subject to review.

5. Conditions for Renewal Extension

The Agency may require that expiring loan or assistance agreements entered into under this title must not be renewed or extended unless the owner executes an agreement to comply with additional conditions prescribed by the Agency, or executes a new loan or assistance agreement in the form prescribed by the Agency.

F. Money Laundering

The Agency will act in accordance with USC Title 18, part I, chapter 95, section 1956(c)(7)(D).

G. Obstruction of Federal Audits

The Agency will act in accordance with USC Title 18, part I, chapter 73, section 1516(a).

CHAPTER 10: COMPLIANCE VIOLATIONS, DEFAULTS, AND WORK-OUT AGREEMENTS *[7 CFR 3560.453]*

10.1 INTRODUCTION

When routine monitoring of projects reveals noncompliance with program requirements, the Field Office must take immediate steps to notify the borrower and state of the need for timely corrective actions. To protect the security value of a property, it is in the Agency's best interest to work with the borrower to resolve any compliance violations. Resolving situations of noncompliance is the main subject of this chapter.

Loan Servicers should be firm in dealing with the borrower or the borrower's representative in matters of compliance violations. Because the management agent is not the party ultimately responsible for the loan, it is imperative that the borrower be directly apprised of and fully understands the consequences of default. Therefore, whenever any written servicing notice is sent to a management agent who is not the borrower, the borrower must also receive a copy of the notice. Loan Servicers need to employ courtesy, cooperation, and sound judgment when interacting with borrowers and management agents in any servicing situation.

A noncompliance situation is often resolved or deterred through a work-out agreement. This is a plan for resolving or deterring noncompliance that is developed and presented by a borrower to the Agency for approval. The Agency may or may not approve the proposed work-out agreement. This chapter discusses the Agency requirements for work-out agreements.

10.2 ADDRESSING COMPLIANCE VIOLATIONS AND DEFAULTS

Borrowers are in default of their loan or grant agreements whenever they are not in compliance with the terms of the loan or grant agreement. Such defaults may be of a monetary nature, such as when borrowers do not make their loan payments, or of a nonmonetary nature, such as when borrowers have not maintained projects properly. Default may be triggered by events that are beyond the borrower's control, such as changing markets that lead to prolonged vacancies. Nevertheless, being in default is a serious situation for a borrower and requires that every effort be made to resolve it.

Defaults may lead to foreclosure and loan liquidation. One significant step that can be taken toward resolving the default is for the Agency and the borrower to agree to a work-out agreement. A work-out agreement may also be used in certain cases to avert a default situation. The Agency will not pursue enforcement against a borrower in default (monetary or nonmonetary) if an approved work-out agreement is in place and on schedule. Thus, it is in the borrower's best interest to work with the Agency to resolve compliance issues through a work-out agreement.

A work-out agreement is a proposal that is submitted by the borrower to the Agency for approval of changes in project operations, for additional time to restore compliance, or for servicing actions to assist in correcting identified deficiencies. There are several servicing options available under a work-out agreement, and the borrower and Loan Servicer should consider all of them and evaluate which are the most appropriate for a specific problem project.

This chapter explains how borrowers may enter into default of their loan or grant agreement and the different types of defaults that may occur. It describes the process by which the Loan Servicer notifies the borrower of compliance violations and the options available to remedy the noncompliance. The chapter then discusses work-out agreements and includes a separate section on Special Note Rents (SNRs), which enable borrowers to reduce rents to attract tenants. By reading this chapter, the Loan Servicer will understand how to systematically work with the borrower to resolve noncompliance, when it is appropriate and feasible for a borrower to enter into a work-out agreement, what are the required terms of the agreement, and how to monitor borrower compliance with the work-out agreement.

SECTION 1: TYPES OF DEFAULTS *[7 CFR 3560.452]*

10.3 OVERVIEW

Borrowers in violation of the terms of the loan or grant documents for the project or applicable Federal regulations, including a work-out agreement, who fail to fully correct a deficiency by a date specified by the Agency in a written notice are in default of their loan or grant documents.

Defaults can be of a monetary or nonmonetary nature. The Agency will initiate appropriate enforcement actions against any borrower in default.

10.4 MONETARY DEFAULT

A project that is in monetary default is defined as one that is delinquent for more than 60 days. Projects with monetary violations include those for which the loans have been accelerated and of which the borrowers are in bankruptcy. A project is delinquent when a loan payment is more than 10 days past due. Project payments are due on the date specified on *Form RD 3560-52, Promissory Note*.

Monetary default may warrant the development of a work-out agreement or initiation of enforcement actions by the Agency that include termination of a management agreement, receivership, suing for performance, collection of unauthorized assistance, or denial of a rent increase.

10.5 NONMONETARY DEFAULT

Nonmonetary defaults include, but are not limited to, failing to maintain project reserves, failing to adequately maintain the physical condition of the property, failing to comply with environmental mitigation measures, occupying units with ineligible tenants without prior Agency approval, charging incorrect rents, failing to meet fair housing requirements, and failing to properly report to the Agency. A borrower will be considered in nonmonetary default if the identified deficiencies are not cured within 60 days of notification.

Attempts to resolve nonmonetary defaults should be handled whenever possible at the Field Office level with appropriate guidance and assistance from the State Office. Environmental concerns, such as failure to comply with mitigation measures, should be reviewed with the State Environmental Coordinator for further guidance. The State Director should counsel with the Office of General Counsel (OGC) for advice, if needed, in servicing those cases where nonmonetary defaults cannot be resolved at the Field Office level. These actions may include liquidation of the account, see Chapter 12.

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SECTION 2: CONDITIONS OF CONCERN, COMPLIANCE VIOLATIONS, AND DEFAULTS

10.6 AGENCY CLASSIFICATION SYSTEM

The Agency has developed a classification system that describes the servicing status of each operational multi-family housing project. This classification system provides a picture of the status of the housing portfolio and flags those projects that need special servicing and/or monitoring. Exhibit 10-1 shows how projects are classified.

The Agency's classification system is to be used to focus servicing efforts. Projects classified as a D or a C should receive first priority when allocating resources to address portfolio concerns. Internal supervisory reviews should primarily examine how Loan Servicers are working to address projects with servicing concerns.

The classification system will be maintained on the Multi-Family Integrated System (MFIS). Servicing officials are responsible for making sure that MFIS is current and accurately reflects a project's servicing status. The supervisory visit and engagement review are key events for updating a project's servicing status. Chapter 9 of HB-2-3560 describes the Agency review process in more detail.

Exhibit 10-1

Classification System of Operational Projects

Class D includes:

- Projects in nonmonetary default having an unresolved violation for more than 60 days from the date of *Handbook Letter 301 (3560), Servicing Letter #1*; and
- Projects in monetary default that are delinquent for more than 60 days

Class C includes:

- Projects with an unresolved finding or violation; and
- Projects with an unresolved violation for less than 60 days from the date of *Handbook Letter 301 (3560)*.

Class B includes:

- Projects with findings or violations with an approved work-out plan that is on schedule.

Class A includes:

- Projects with no unresolved finding or violation.

10.7 FINDINGS

A finding is determined when the Agency "finds" that a borrower is not operating in accordance with the loan or grant agreement, with Agency regulations, or with applicable local, state, or Federal laws. When the Agency discovers a deficiency in a project that requires correction but is not the equivalent of a violation or an unacceptable summary level finding during an inspection or review report, the Agency must notify the borrower of this finding. Depending on the severity of the finding, the servicing official may advise the borrower of the finding either orally, or in writing through a monitoring letter. Should the finding not be corrected after at least one written notice has been sent to the borrower with a specified date by which the finding must be corrected, the Loan Servicer must determine whether the issue should be elevated to a violation status. When the Servicing Office concludes that the finding should be viewed as a violation that could lead to a default, the Loan Servicer must begin the process of issuing the servicing letters described in Paragraph 10.10.

10.8 VIOLATIONS

A violation is a finding that the Servicing Office escalates because of its severity or because of the type of servicing effort that will be needed to obtain compliance. When the Agency designates a finding as a violation, it indicates a willingness to pursue the finding to the point of acceleration to have it corrected. Compliance violations include, but are not limited to, any unacceptable summary level finding on the physical inspection report, project management and occupancy review, or engagement review that could be updated at any time. Examples include failing to make required contributions to project reserves, failing to adequately maintain the exterior physical condition of the property under Agency standards, failing to comply with environmental mitigation measures, occupying units with ineligible tenants without prior Agency approval, charging incorrect rents, and failing to properly report to the Agency.

10.9 KEY STEPS IN ADDRESSING COMPLIANCE VIOLATIONS AND DEFAULTS

The Agency must respond quickly and systematically whenever a project is identified as being in noncompliance with program requirements. In responding to a noncompliance situation, the Loan Servicer will take some or all of the following steps and update the servicing status on MFIS:

- Notify the borrower of the violation and request corrective action;
- Meet with the borrower to discuss the problem and possible servicing actions to remedy the problem;
- Review any proposed work-out agreement developed by the borrower and suggest acceptable servicing actions if appropriate;
- Issue a problem case report; and
- Initiate enforcement actions to motivate the borrower to restore compliance.

These steps are discussed in detail in the following sections.

10.10 NOTIFICATION TO BORROWER OF SERVICING PROBLEMS

The Agency must notify the borrower using formal servicing letters that state the need for corrective action to be taken. It is not the Agency's responsibility to come up with solutions to the problems. Rather, it is the borrower who must identify what corrective actions will take place immediately or over time through a work-out agreement.

The Field Office will use a series of servicing letters to communicate with the borrower until the problem is resolved. Copies of the letters must be sent to the management agent of the property that is the subject of the letters if the owner is not the management agent. Exhibit 10-2 shows the sequencing of these servicing letters.

Handbook Letter 301 (3560) serves to trigger the start of a 60-day period for nonmonetary violations and a 45-day period for monetary violations, at the end of which the borrowers are in default of their loan agreement if the situation has not been resolved. Resolution may take the form of action proposed by the borrower and approved by the Agency, or it may take the form of enforcement actions instituted by the Agency when the borrower fails to respond or responds inadequately.

A. Preliminary Notification

When a borrower becomes delinquent on a payment, an automatically generated Delinquency Billing Statement is mailed to the borrower. The borrower will be in default if the loan payment is not made in full within 60 days of this notice. If the borrower does not submit the loan payment before the payment is 30 days past due, the borrower receives *Handbook Letter 301 (3560)*. If the borrower submits the full payment, including any applicable late fees (see Chapter 4, paragraph 4.4 on late fees) the Loan Servicer does not take any further servicing action.

During an on-site monitoring visit the monitors should meet with the borrower to review the initial results of the visit, including a discussion of compliance violations. See Chapter 9, paragraph 9.6 B of HB-2-3560 for more information about on-site monitoring visits.

Example: Borrower B's project has several crumbling steps in the stairwell. Since this represents an unacceptable condition of exterior maintenance, which is a compliance violation, the Loan Servicer notifies the borrower during the on-site visit on this violation.

Exhibit 10-2 Sequence of Servicing Letters		
Letter	**Nonmonetary**	**Monetary**
Preliminary Notification	The Loan Servicer informs the borrower of violations during a wrap-up meeting of a monitoring visit.	A Delinquency Billing Statement is automatically sent to borrower when the borrower becomes delinquent (10 days past due).
Letter #1	Sent upon evidence of violation and no later than 30 days after the monitoring visit. Date of letter signifies beginning of 60 day period to default.	Sent no later than when payment is 35 days past due.
Letter #2	Sent sometime after 15 days if borrower fails to respond or responds inadequately to Letter #1. Notifies borrower of date by which they will be considered delinquent if violation not corrected (60 days after date of Letter #1).	Sent after payment is 45 days past due. Notifies borrowers of date by which they will be classified a D project (60 days after payment due date).
Letter #3	Sent at least 60 days after date of first letter and at least 15 days after Letter #2 notifying borrowers that they are in default and warning of enforcement action if problem is not corrected within 15 days.	Sent 60 days after payment due date notifying borrower that the Agency will take legal action to cure the default and warning of enforcement action if payment is not made within 15 days.

B. Borrowers with Multiple Servicing Issues

If a borrower is in violation in several different areas, the *Handbook Letter 301 (3560)* should identify all the violations. If sent, *Handbook Letter 302 (3560)* would reference "ongoing compliance violations" to cover multiple servicing issues. The series of letters continues until each violation has been resolved.

A servicing letter may cite conditions of concern (see Paragraph 10.7) along with compliance violations. However, only the cited compliance violations could lead to a default status if left unresolved. If the borrower resolves all violations within 60 days, they will not default even if the conditions of concern have not been resolved.

If at any time the Agency discovers that a borrower who has received a servicing letter has another problem that warrants a servicing letter, the letter will be sent, triggering a second series of letters. These letters can run separately from and independent of the first series of letters or they may be combined at some point. However, it is important that the Loan Servicer track the separate violations cited by the date of each *Handbook Letter 301 (3560)* so that *Handbook Letter 303 (3560* correctly identifies the violation that has resulted in the default by a certain date.

10.11 EVALUATING THE PROJECT

When the Loan Servicer has sent two servicing letters to notify a borrower of problems with a project, the Loan Servicer must evaluate the project to establish whether it is in the Agency's best interests to attempt to work with the borrower to preserve the subject project. The Loan Servicer will use the procedures outlined in Chapter 6. Such an evaluation should come before any meeting with the borrower so that the Loan Servicer is familiar with the project and its status.

10.12 MEETING WITH THE BORROWER

When the borrower proposes a work-out agreement in response to *Handbook Letter 301 (3560),* or when *Handbook Letter 302 (3560)* must be sent, the Loan Servicer must request a meeting with the borrower. The purpose of the meeting is to identify and agree upon the servicing problem, establish the underlying causes of the problem, and begin to develop the parameters of a work-out agreement. The Loan Servicer will discuss possible Agency servicing actions.

It is the responsibility of the borrower—not the Agency—to propose and develop an acceptable work-out agreement. However, borrowers may delegate authority to their management agent to develop a work-out agreement. A borrower may do this by signing a statement in the management plan or certifying in a letter to the Agency that the management agent has the authority to act on their behalf.

Once the work-out agreement is proposed, the Loan Servicer may propose servicing actions that are appropriate and acceptable to the Agency. Section 4 of this chapter describes the special servicing actions available to Loan Servicers.

10.13 SELECTING SERVICING OPTIONS

The Agency may agree to various servicing options to resolve the compliance problems depending upon the circumstances of the noncompliance. The deciding factor will often be the quality of management.

A. Poor Management and Noncompliance with Program Requirements

Where management is poor and/or there is noncompliance with program requirements, the Agency may agree to:

- **Borrower training**. Training of resident managers may be charged as a project expense if directly related to improving project operations;
- **New management**. Hiring or changing resident managers or management agents;
- **Improving maintenance**. Change to normal, preventive, and long-term maintenance and repair programs to make the project more marketable;
- **Improving budget and record keeping, and using monthly reports**. Major expenditures should be reviewed for appropriateness; and

- **Improving outreach and marketing**. Project marketing plans, including the Affirmative Fair Housing Marketing Plan, should be reviewed and updated as appropriate.

B. Acceptable Management, but Marketability and Cash Flow Problems

Where management is acceptable, marketability and cash flow problems may be resolved through one or more of the following actions.

- Upgrading project desirability by:
  - ◊ Performing necessary and preventive maintenance;
  - ◊ Improving curb appeal at the project;
  - ◊ Improving security for tenants, such as installing deadbolts and more lighting; and
  - ◊ Improving communication between management, residents, and the community.
- Reducing expenditures by reviewing the appropriateness of operating and expense levels in relation to services rendered. It is not intended that management fees be adjusted as a condition for consideration of servicing options. Operation and expense levels may be reduced by:
  - ◊ Containing operation and maintenance costs that will not disrupt project operations;
  - ◊ Renegotiating contracts with suppliers of material and services; and
  - ◊ Temporarily deferring noncritical maintenance, provided tenant safety and project marketability are preserved.
- Temporarily reducing or deferring reserve contribution levels.
- Increasing revenues by:
  - ◊ Injecting non-project revenues;
  - ◊ Requesting rental assistance; or
  - ◊ Permitting temporary incentives to improve occupancy.
- Permitting a release of the rental assistance payments that would ordinarily go for debt service to be used for project operation and maintenance.

C. Acceptable Management, but Lack of Project Demand

Where management is acceptable, but there is a lack of project demand or a problem of obtaining and/or retaining eligible tenants, the problems may be resolved by:

- Granting occupancy waivers;
- Changing the project designation; and
- Implementing a SNR, see Section 6 of this chapter.

10.14 THE PROBLEM CASE REPORT

The Loan Servicer must develop a problem case report using *Form RD 3560-56 Report on Real Estate Problem Case* for the State Director if the Loan Servicer has sent a borrower three letters requesting corrective action to a compliance violation and the borrower has failed to provide an adequate response.

The problem case report describes the situation for the State Director and recommends enforcement action. The State Director will review the problem case report and respond to the Field Office within 30 days of receipt of the problem case report indicating the action to be taken. The State Director's response will be either:

- An agreement with the Loan Servicer's proposal for enforcement; or
- A directive for alternative servicing.

10.15 ENFORCEMENT ACTIONS

If a borrower fails to provide an acceptable work-out agreement or fails to comply with the work-out agreement, the Agency will initiate enforcement actions when liquidation is not in the Government's or the tenants' best interests. This might occur in the case of defaults that do not affect the health and safety of tenants and where the cost of liquidation is significant relative to the violation, or where the costs of liquidation and providing adequate tenant protections is high. Available enforcement actions that the Agency can take include:

- **Termination of the management agreement**. The Agency may terminate the management agreement and require the borrower to hire new management;
- **Receivership**. The Agency may appoint a third party to manage the project. When this becomes necessary, the State Director must contact OGC for assistance and provide them with alternative management agents;
- **Suing for performance under the loan document**. In such cases, the Office of General Counsel will provide assistance; and
- **Collection of unauthorized assistance**. The procedures outlined in Chapter 9 will be followed.

A. Liquidation

When it is in the Government's or the tenants' best interest to liquidate, or if enforcement actions have been unsuccessful, the Agency will initiate liquidation through either:

- Voluntary liquidation; or
- Foreclosure.

The Agency may proceed directly to liquidation if doing so will not adversely affect tenants. Normally this is reserved for cases where the borrower has abandoned the project or a partnership has been dissolved, leaving no legal entity in place to oversee the property. Properties where serious health and safety concerns exist are the most likely to go straight to enforcement or liquidation. Chapter 12 provides details on liquidation.

B. Debt Settlement

If the property is worth less than the outstanding Agency debt, it may be in the government's best interest to settle the debt using its debt settlement procedures. Compromise offers to settle outstanding debts may be part of a work-out agreement accompanying a transfer. Chapter 12 provides further details on debt settlement.

SECTION 3: DEVELOPING A WORK-OUT AGREEMENT
[7 CFR 3560.453]

10.16 OVERVIEW OF WORK-OUT AGREEMENTS

A work-out agreement is a proposal submitted by a borrower to the Agency for approval of changes in project operations, additional time to restore compliance, or other special servicing actions to assist in correcting identified deficiencies. A borrower may submit a work-out agreement at any time in response to Agency notification of compliance problems or prior to that if the borrower feels that noncompliance is imminent.

The work-out agreement may be a very simple one page plan for resolving a single problem, or it may be a more complex document of several pages that describes several plans of action to resolve a more complicated problem. If a borrower does not develop a work-out plan, the Loan Servicer must develop a problem case report, in accordance with Paragraph 10.14.

Acceptable and successful work-out agreements depend upon some flexibility on the part of the Loan Servicer and the borrower, thoughtful and project-specific servicing, and thorough and consistent monitoring that serves to track the progress of the agreement.

10.17 CONDITIONS WARRANTING A WORK-OUT AGREEMENT

Serious compliance deficiencies that cannot be resolved promptly may warrant the development of a work-out agreement. Such conditions may reflect a financial, physical, fair housing, or occupancy deficiency.

A. Financial Deficiencies

Financial deficiencies that may require a work-out agreement include:

- Inadequate cash flow to meet project needs. Cash flow should be adequate to pay Agency debt, meet reserve requirements, pay taxes, pay insurance, pay other project expenses, and pay any authorized return on owner investment when earned;
- Projects that are 60 days past due;
- Seriously underfunded reserve accounts that cannot be brought up to required levels within a normal budget cycle or where unauthorized withdrawals have been made; and
- Borrowers who have not adhered to program requirements such as paying taxes, maintaining insurance, or submitting required financial information.

B. Physical Deficiencies

Physical deficiencies that may require a work-out agreement include failure to maintain decent, safe, and sanitary housing opportunities for residents and maintenance that has been deferred for so long that it has become a financial burden to the project.

C. Fair Housing Deficiencies

Fair housing or Section 504 violations and problems with tenant certification and project occupancy requirements may warrant the development of a work-out agreement.

D. Occupancy Deficiencies

Serious vacancies that threaten property viability where management can furnish evidence that they have made efforts to increase occupancy may warrant a work-out agreement.

10.18 ELIGIBILITY FOR WORK-OUT AGREEMENTS

The Agency will consider work-out agreements only for properties:

- That are deemed to be program property; or
- Whose owners demonstrate a commitment to correcting property deficiencies.

A. Program Property

The Loan Servicer must establish whether the project is suitable for the program using the guidance provided in Chapter 6. If the project is deemed to be non-program property, a work-out agreement must not be considered.

B. Owner Evaluation

An owner who has not maintained compliance with prior work-out agreements and has historically ignored Agency requests for corrective actions must not be considered eligible for a work-out agreement.

10.19 CONTENT OF A WORK-OUT AGREEMENT

All work-out agreements must be in writing and executed by the borrower, or the borrower's designated representative, the management agent who manages the project (if different from the borrower), and the Agency before they take effect. The work-out agreement must correct all deficiencies that have been identified in a project.

Exhibit 10-3 lists the information that must be included in a work-out agreement.

10.20 CONDITIONS PLACED ON THE BORROWER

Borrowers must forgo and cannot recoup the annual return to owner for the budget year in which a work-out agreement is in effect.

Exhibit 10-3

Recommended Format for Servicing Work-out Plan (SWP)

Background information. Provide history and describe past goals and accomplishments.

Description of the problem(s) to be solved. Identify project weaknesses and needs making sure to cover:

- Compliance deficiencies (e.g., delinquent amounts, underfunded reserves, nonpayment of taxes, deferred maintenance, unacceptable tenant file records, noncompliance with accessibility and fair housing issues, etc.); and
- Serious financial concerns (e.g., high vacancies, inadequate cash flow, high Operations & Maintenance (O&M) expenses.).

Underlying causes of problem. Attempt to identify the cause of the problem. Attempt to recognize when problems identified are symptoms or the results of the same underlying causes.

Overview of plan to correct problem. Provide a summary of the plan and identification of key assumptions used in projections.

How the plan will work. Provide details on how the plan will work with attached supporting documentation (i.e., budget), when appropriate. A timetable for completing the work-out plan and key components of the plan (i.e., plan calling for capital improvements should identify the improvement proposed, cost with supporting estimates, source of funds, and completion dates).

Anticipated results. Clearly identify the goals to be reached. Have periodic, measurable interim goals to determine that full implementation is on track.

Written work-out plans. All work-out plans must be in writing and must be executed by the borrower or the borrower's designated representative, and Rural Development. A copy of the executed work-out plan will be placed in the case file; copies will be given to the borrower, management agent, and the State Director.

Time frames for implementing and completing the plan. Prior to approval, all plans must be evaluated on whether the plan realistically achieves the objectives of the loan. All plans must be reevaluated at the end of the two-year period. If the plan includes a time frame for completion of more than two years, the plan must be revised and reexecuted at the end of each year to determine if satisfactory progress has been made.

Monitoring working plans. The following statements must be a part of the plan immediately above the signatory line:

> "The management agent is responsible for making quarterly progress reports with regard to plan compliance to Rural Development and the borrower. The first report will be due no later than 100 days from the date of Rural Development approval and every 100 days thereafter."

Check appropriate box:

- ☐ Initial SWP
- ☐ Renewal of SWP
- ☐ Renegotiated SWP. There have been _____ previous SWPs on this account.

10.21 PRIORITIES IN MEETING EXPENDITURES

In developing work-out budgets for projects experiencing cash-flow difficulties, the following priorities will be used:

- First priority is to meet obligations to the prior lienholder, if any;
- Second priority is for critical project operating and maintenance expenses, including taxes and insurance;
- Third priority is for Agency debt payments;

- Fourth priority is for reserves; and
- Fifth priority is for other project needs.

10.22 LENGTH OF TERM AND AUTHORITIES

A. Term of Work-Out Agreement

The maximum term of a work-out agreement is two years. All agreements must be reevaluated annually as well as at the end of the two-year period. The evaluation is based on whether the plan realistically achieves financial viability and otherwise meets the objectives for which the loan was made. If an approved work-out agreement calls for actions that extend beyond a two-year period, borrowers must submit an updated and if necessary, revised work-out agreement to the Agency for approval. The updated work-out agreement must be submitted to the Agency 30 days prior to the expiration of the work-out agreement in effect. The Agency may reexecute the agreement if satisfactory progress has been made.

Reserve Account Deficiencies

When seriously underfunded reserve levels are involved in an extended work-out time period, the Loan Servicer should reassess the reserve level for the project and establish a new reserve level, if appropriate. A capital needs assessment can be useful to make this determination. If re-funding the reserve to its new level will require more than two years, the borrower and Loan Servicer may want to consider additional work-out terms so that the project is not in continual need of requiring a work-out agreement.

Normally, work-out agreements should not exceed two years, especially if a plan calls for less than full payment on an Agency loan, or less than full contribution to the reserve account. Plans not meeting these criteria are normally not considered as viable and feasible.

B. Authority to Approve Work-Out Agreements

1. Field Offices

Delegated Field Office staff can approve work-out agreements that correct deficiencies within 12 months, except when the agreement includes a special servicing action per Section 4.

2. State Offices

Delegated State Office Staff approves any work-out agreements that:

- Are for longer than 12 months;
- Require reduced or zero loan payments;
- Require contributions to reserves of less than that which is required plus 10 percent of the delinquent amount; or
- Include loan adjustments or writedowns.

10.23 AGENCY REVIEW AND APPROVAL *[7 CFR 3560.453(b)]*

Work-out agreements are a tool that the Agency can use to work with the borrower to effectively resolve defaults if the borrower is acting in good faith to actively propose realistic corrective actions. Approval of a work-out agreement is not guaranteed to a borrower. Failure to approve a work-out agreement is not an adverse action by the Agency because the Agency is not required to grant approval of modifications to the terms of the loan for borrowers in default; thus, the Agency is not taking away any borrower rights by not approving the work-out agreement. Therefore, failure to approve a work-out agreement is not appealable by a borrower, although the Agency's decision may be reviewed.

A. Evaluation of Work-Out Agreement

The Agency is under no obligation to offer or agree to any special servicing actions contained within a proposed work-out agreement. In evaluating the borrower's proposal, the Agency will accept work-out agreements that meet the following criteria:

- The proposed actions effectively correct the deficiency;
- The proposed time frame for correction is reasonable and realistic for correcting the deficiency;
- There is evidence of adequate borrower commitment of resources, considering the cause of the problem, (e.g., a lesser commitment may be appropriate if the problem was caused by circumstances beyond the borrower's control);
- The proposed special servicing actions for the Agency (e.g., reamortization, writedown) is in the interest of the Government and the tenants, and the costs of

- continuation are not more than the costs of liquidation and providing tenant protection; and

- The proposed actions are consistent with the borrower's management plan. If the proposed actions are not consistent, the management plan must be updated.

B. Procedures Following Approval of Agreement

The approved work-out agreement will be signed and dated by the Approval Official, the borrower, and the management agent, if different from the borrower, and will be attached as an addendum to the management plan for the project.

10.24 CANCELING A WORK-OUT AGREEMENT

A work-out agreement may be canceled by whoever approved it 10 days after discovering a borrower's noncompliance with its terms. If the official who originally approved the work-out agreement is not available, then the official who has assumed that individual's responsibilities will be responsible for canceling the agreement and notifying the borrower.

SECTION 4: SPECIAL SERVICING ACTIONS

10.25 SPECIAL SERVICING ACTIONS THAT MAY BE A PART OF A WORK-OUT AGREEMENT

A number of special servicing actions may be proposed and approved as part of a work-out agreement. As shown in Exhibit 10-4, these servicing actions may be divided into two broad categories: changes in project operations and changes to the loan account. This section describes other servicing actions, most of which are less extreme.

A. Servicing Actions to Change Project Operations

The borrower may propose one or more servicing actions that will produce a change in project operations. Some of these actions are discussed in detail in other sections.

Exhibit 10-4

Special Servicing Actions That May Be Part of an Approved Work-out Agreement

Changes in Project Operations	Changes to the Loan Account
• Rent changes and/or preparation of a new budget • Occupancy waivers • Temporary incentives to improve occupancy • Special note rents (SNRs) • Changing management agent or management plan • Changing project designation • Transfer of ownership • Substitution of partners	• Loan reamortizations • Loan adjustments (writedowns) • Loan consolidation • Deferral of payments • Prepayment/compromise offer • Providing rental assistance (if available) • Recasting the entire loan (i.e., “starting fresh”)

1. Rent Changes or Preparation of a New Budget

To achieve financial stability, the borrower may propose a new budget that shows a change in rents or operation costs. In evaluating the request, it may be appropriate for the Agency to analyze the current market in which the project is located to see whether the project rents compare favorably with rents for similar properties in the market. Rent incentives will be allowed as described in paragraph 10.25 A.3 of this section, but the change and accompanying budget will be conditionally approved by the Agency subject to meeting the requirements in Agency regulations, see Chapter 7 of HB-2-3560. If the

Agency receives comments from tenants that warrant a different decision from the one made when the work-out agreement was conditionally approved, the Agency must inform the borrower of these discoveries and make any needed adjustments to the conditionally approved budget.

In reviewing these changes, the Loan Servicer must evaluate both short- and long-term budget projections so as to establish whether the project is likely to achieve its financial goals during the work-out period, and whether the project is likely to achieve and maintain financial viability in the long term. The Loan Servicer must evaluate whether projections show repayment ability after the work-out agreement objectives are met based on realistic vacancy, rent rate, and/or reamortization assumption.

Any projected capital improvements shown in the budget must be accompanied by statements that describe the work to be done, the estimated costs with supporting material, the projected time frame for completing the work, and the source of funds to be used for the improvements.

2. Occupancy Waivers

When a project is experiencing high vacancies and eligible tenants are not available, the borrower may request to temporarily solve the problem by renting to ineligible tenants. Ineligible tenants might be individuals whose incomes or family sizes are above the maximum limits or who do not meet an occupancy requirement, such as an age limit.

A request to rent to ineligible tenants may be approved by the Loan Servicer based on the following determinations:

- There are no eligible persons on the waiting list;
- The borrower has made a diligent but unsuccessful effort to rent any vacant units to an eligible tenant; and
- The borrower will continue to seek eligible tenants and will submit the following to the Field Office;
  - ◊ *Form RD 3560-29; and*
  - ◊ A report of efforts made to locate eligible tenants.

The borrower must agree to the following conditions:

- The units may be rented to ineligible tenants for no more than one year, following which the lease must convert to a monthly lease. A statement to this effect must be included in the lease;
- Tenants who are ineligible because their household income exceeds the maximum for the project will be charged the Agency-approved SNR, if applicable; and

- Without Agency approval, management may assign a larger or smaller unit than the household needs if the household is otherwise eligible. Tenants must agree to transfer to a correctly sized unit when one becomes available and must pay all costs associated with moving. A statement to this effect must be included in the lease.

3. Temporary Incentives to Improve Occupancy

The borrower may request temporary incentives to improve project occupancy. These incentives may not exceed the life of the work-out agreement. The Agency may grant such incentives when project management has been acceptable and under the following conditions:

- The project is encountering unacceptable vacancy levels.
- The incentives are short-term, modest, and consistent with program objectives.
- Recipients are given a clear understanding of the extents and limits of the incentives.
- The use of incentives is fully accounted for on project budgets and annual reports.
- Occupancy incentives will be paid from the following sources:
  - ◊ Non-project sources;
  - ◊ Forgone return to owner; and
  - ◊ Project funds when it can be shown to be cost-effective, which means that the revenues derived will outweigh the costs of providing the incentives.

Temporary Incentives to Improve Occupancy

1. Security deposit reductions or waivers and extended security deposit payment period.
2. Reduced rents in the form of rebates, coupons, or a temporary agreement.
3. Free rent.
4. Reduced or free utilities.
5. Referral fee payments.
6. Rent-up gift to tenant, such as a savings bond or gift certificate.

4. Special Note Rents

The borrower may request a SNR to reduce the note rate rent to attract tenants who can afford to pay more than 30 percent of their incomes in rent and utilities but who will not pay the existing note rate rent. This servicing action is discussed in detail in Section 6 of this chapter.

5. Changing the Management Agent or Management Plan

Where poor management is evidenced by a record of failing to comply with Agency requirements, the borrower may elect to change management. Where the Agency has notified the borrower of the need to change management, financial incentives under work-out agreement provisions may not be approved until the borrower changes

management, or agrees to change management within a reasonable time frame.

6. Changing the Project Designation

When a market has changed such that the type of tenant who would qualify for the project is no longer available and vacancies are resulting, the borrower may request a change in project designation. The State Director will consider such a change when the following information has been provided:

- The complete borrower case files will be submitted together with the Loan Servicer's specific recommendations and analysis of the present and long-term situation;

- Market feasibility documentation, which may include inquiry lists from the project or waiting lists at other nearby and similar properties, which shows that other tenants are available to occupy the project. Market feasibility documentation must also clearly indicate that the present long-term marketability of the project is significantly changed from the original market, and must include the appropriate demographic information that reflects the population trends in the area. The market feasibility documentation must also show if the demand is for the bedroom-sized units in the project or if different sized units would be more desirable;

- A summary of all servicing actions taken by the Agency to aid the borrower in maintaining the present designation;

- A summary of all actions taken by the borrower to effectively market the units to potential eligible tenants;

- A summary of the impact the change will have on any existing tenants, rent subsidy needs, and the community as a whole; and

- A summary of any needed or required physical modifications and analysis of cost feasibility to complete the modifications, including modification to unit sizes in terms of number of bedrooms.

7. Transfer of Ownership

In some cases, the only means of addressing project concerns is through replacement of the borrower. Some reasons that may require a transfer of ownership include:

- Illness or death of a borrower;

- Financial difficulties that cause a borrower to terminate his or her business operation; and

- Fraudulent activity, as determined by the Office of the Inspector General (OIG).

Where work-out agreements call for a change in the borrower, the Agency may temporarily approve financial concessions contingent upon the borrower agreeing to seek a transfer of ownership. The borrower must agree to provide evidence that ownership

replacement is being actively pursued. Should ownership replacement not be achieved within an agreed-upon time frame, liquidation of the account may be appropriate.

When a transfer occurs as a result of noncompliance, the transferee (new borrower) must provide a plan for bringing the project into compliance as part of the application package. For example, the loan payments and reserve account may be behind schedule. The transferee provides a plan that identifies the source of funds to meet these conditions.

Chapter 7 provides the details on approving and processing transfers of ownership.

8. Substitution of Partners

The borrower may request a substitution of general partners as a way to inject new resources into the borrower entity. Chapter 5 provides the details on approving and processing substitution of partners.

B. Changes to the Loan Account

Proposed servicing actions may require changes to the loan account such as those that are described in Chapter 11.

1. Deferral of Payments

Deferring any debt payment to the Agency is an extreme measure that should be used as a last resort. Deferring a portion of the Agency debt and using this deferred amount to build up reserve funds may only be approved when the funds are being used to pay identified critical project needs. For example, when a roof must be replaced within the next two years, the work-out agreement may call for deferring payments in an amount equal to the cost of replacing the roof and this amount will be deposited into the reserve account. The critical need must be identified and closely monitored to ensure compliance.

Deferral of payment by the Agency should usually be accompanied by a borrower contribution of financial resources to the project.

Deferring debt payments should not exceed two years. National Office approval must be obtained when longer periods of time are justified.

2. Change of Payments

Scheduling loan payment in accordance with the borrower's repayment ability. The provisions must be documented. The issuance of *Form RD 3560-29A, Multiple Family Housing Statement of Payment Due*, will normally be suppressed during the period in which a work-out agreement calling for less than the normal full scheduled installment is effective. To suppress issuance of *Form RD 3560-29A*, process by using the appropriate screen on the Automated Multi-Family Housing Accounting System (AMAS); see the AMAS manual for specific instructions on how this is done. Upon expiration of the work-out agreement, a review will be conducted to determine any further servicing actions that may be appropriate (e.g., reamortizing, rescheduling, executing a new

servicing plan and/or supplementary payment agreement that may call for higher than normal payments, preparing a problem case report, etc.). As long as a borrower is meeting the provisions of an approved work-out agreement calling for less than full installments, late fees will be waived.

3. Prepayment

A borrower may offer to pay their loan in full, ahead of the scheduled loan repayment date and exit the program. In such an event, the project will no longer be a part of the Multi-Family Housing program, will no longer be subsidized by the Agency, and will no longer be subject to Agency regulations and procedures. Chapter 15 provides the details on approving and processing prepayment requests.

4. Voluntary Conveyance

Voluntary conveyance is a method of liquidation by which title to security is transferred to the Federal Government. The State Director is authorized to approve voluntary conveyance of property if the total indebtedness, including prior and junior liens, does not exceed their approval authority. Chapter 12 provides the details on approving and processing an offer of voluntary conveyance.

5. Provision of Rental Assistance

Where there is servicing rental assistance available, the State Director may agree to provide rental assistance to a project as part of a work-out agreement in order to enable tenants who could otherwise not afford the rents to move into a project and improve vacancy.

SECTION 5: MONITORING THE WORK-OUT AGREEMENT AND SUBSEQUENT SERVICING

10.26 MONITORING WORK-OUT AGREEMENTS

Once a work-out agreement has been developed and approved, the Loan Servicer must monitor the borrower's progress and provide guidance as needed. This is an important and necessary component of ensuring the success of the work-out agreement. The monitoring serves to make sure not only that the terms of the agreement are being upheld, but that they are having the desired effect of moving the project back into compliance. If not, the Loan Servicer must work with the borrower to amend the agreement to incorporate servicing techniques that will achieve the desired goals or cancel the work-out agreement and move to implement enforcement measures.

The Loan Servicer will conduct the monitoring in the following ways:

- Reviewing the financial reports submitted by the borrower. These include *Form RD 3560-7*, which must be submitted on a quarterly basis and bank statements, if appropriate;

- Holding quarterly meetings at the project site with the borrower to track the progress of the work-out agreement; and

- Conducting supervisory visits to monitor progress with an agreement. Such visits are mandatory to determine if the work is being done when the work-out agreement includes correcting deferred maintenance or when reserve funds are being used for repairs. These supervisory visits should be held in conjunction with the quarterly meetings with the borrower.

10.27 SUBSEQUENT SERVICING AND IMPACT ON FUTURE LOANS

Any member of a borrower entity with a controlling interest in a property in which there are serious noncompliance issues and no work-out agreement is in place, or where the entity is in noncompliance with its work-out agreement, will not be eligible for further Agency loans. In a case such as this, the borrowers must make arrangements to restore compliance with Agency requirements and restore their financial viability.

In cases where the borrower and the Agency work together to make an acceptable work-out agreement, the borrower may be eligible to receive additional assistance after they have been in compliance with the work-out agreement for six consecutive months. In cases where work-out arrangements cannot be made, the primary basis for denying such assistance would be based on the borrowers' inability to meet eligibility requirements, shown by their track record of failing to meet existing requirements and responsibilities for other projects.

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SECTION 6: SPECIAL NOTE RENTS (SNR)

10.28 OVERVIEW OF SPECIAL NOTE RENTS *[7 CFR 3560.210]*

When a project is experiencing severe vacancies due to market conditions, the State Director may allow a borrower to charge a SNR rent to attract and keep tenants who have the financial ability to pay more than basic rent but who will not pay the current note rate rent. An SNR addresses the situation where some existing and prospective tenants are not willing to pay 30 percent of adjusted income or note rate rent because the rental rates would exceed those of other rental properties in the community. This action may only be taken after supervisory efforts by the Agency and management efforts by the borrower have not produced an acceptable level of occupancy.

10.29 SNR ELIGIBILITY REQUIREMENTS

A. Required Project Conditions

The borrower must document that the following conditions exist in the project for the Loan Servicer to consider allowing an SNR to be implemented:

- The project has been operational for at least 24 months (the borrower may request a waiver to this provision);
- No more than 10 percent of budgeted expenses are reflected as unrestricted cash on hand, and reserve account balances do not exceed the required accumulation-to-date minus authorized withdrawals;
- Over the most recent six-month period vacancy rates have averaged at least 15 percent or the project shows revenue losses of at least 15 percent;
- The loss of rents available is not a result of management's failure to effectively market the units; and
- Comparable rents in the area are lower than the previously approved note rate rents.

B. Borrower Requirements

To be eligible for the SNR, the borrower must:

- Be in compliance with Agency regulations and encourage occupancy through good maintenance and positive relations with tenants;
- Sign a statement agreeing to forgo return to owner for the duration of the SNR;
- Submit a budget with only the minimal sufficient operation and maintenance expenses;

- Have engaged in aggressive marketing efforts, including:

  ◊ Significant outreach efforts in the community, including, but not limited to, contacts listed in the AFHMP; or

  ◊ Obtaining approval from the Agency for a servicing work-out plan, exclusive of SNR features, at least three months earlier.

10.30 SUBMITTING AND PROCESSING SNR REQUESTS

In making the request for an SNR, the borrower submits the same information as they would when requesting a rent change. See Chapter 7of HB-2-3560 and *7 CFR 3560.203*.

The Loan Servicer reviews the documentation from the borrower and forwards the information with a recommendation to the State Director, who makes the final decision. If the decision is to approve the SNR, the following steps will be taken:

- Adjust the note rate column in the proposed changes to rent section of *Form RD 3560-7* to reflect rents needed for payment to the Agency amortized at an interest rate that is less than the full note rate on the borrower's *Form RD 3560-52*. The interest rate chosen may never be less than two percent.

- Set the interest rate of the SNR budget at a level that will make project SNR rates comparable with community rental rates.

- When an SNR is implemented in a Plan II Section 8/515 project, use lines 23 through 29 of *Form RD 3560-29* to report any additional payments to the reserve account required when HUD contract rents exceed SNR rates.

When the Approval Official determines a request for an SNR is not justified on the basis of the information submitted, the Approval Official will notify the borrower in writing of the reason(s) why the SNR is not approved. The borrowers will be advised of their appeal rights in accordance with 7 CFR Part 11.

10.31 CHANGES TO AND TERMINATION OF SNRS

Borrowers must request changes to SNRs at the time of budget review. If the local market conditions have not changed since the SNR was implemented, then no change is made to the SNR. If the conditions have changed, then the SNR is changed accordingly.

The borrower must notify tenants of the project in which the SNR is proposed to be changed just as would be done for tenants where a regular rent change request is made.

An increase in an SNR will be handled in accordance with regular program requirements for a rent change. See Chapter 7 of HB-2-3560.

An SNR is terminated when the note rate rent is regained.

10.32 RESTRICTION ON NEW UNITS

While an SNR is pending or in effect, the Field Office must not review or approve any other projects—of any type—in the same market area. State Directors may seek National Office approval for a waiver from this provision when an SNR has been in effect for 24 months.

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SECTION 7: ENFORCEMENT

10.33 MULTI-FAMILY HOUSING ENFORCEMENT TEAM

The Agency has established a Multi-Family Housing Enforcement Team to improve the Agency's efforts to detect and eradicate fraud, waste, and abuse in the Multi-Family Housing program. The mission of the Enforcement Team is to protect the interests of residents; ensure quality housing; restore public trust in Government investments; and eliminate program fraud, waste, and abuse. Within the scope of its mission, the Enforcement Team provides the following services:

- Performs problem property reviews including data reviews, site visits, interviews, reports on findings, recommendations for remedial actions, and follow-up actions to ensure problem resolution;
- Coordinates multi–state reviews of problem borrowers and management agents;
- Recommends enforcement actions to ensure borrower/agent compliance with regulatory and statutory program requirements;
- Analyzes problem property data collected by Field Office Staff and provides feedback concerning administrative actions for Field Office Staff to pursue in relation to problem properties;
- Coordinates enforcement efforts with the OIG, OGC, Department of Justice, Department of Housing and Urban Development, Federal Bureau of Investigation, and the Internal Revenue Service, as appropriate;
- Provides technical assistance and advice to Field Office Staff;
- Develops training materials and conduct training related to problem property analysis and enforcement techniques;
- Develops a standardized process to deal with problem properties and ensure comparable actions are applied in similar cases; and
- Guides field staff with appropriate actions to ensure resolutions of recommendations from OIG audits.

10.34 REQUESTING ENFORCEMENT TEAM SERVICES

Activities of the Enforcement Team may be initiated by the Deputy Administrator for Multi-Family Housing or by a request from a State Office.

CHAPTER 11: LOAN RESTRUCTURING

11.1 INTRODUCTION

During the term of an Agency loan, borrowers may request Agency consent to restructure the loan for their project that will simplify the operation of the project or help address financial distress due to factors beyond the borrower's control. One example is when a borrower requests that loans be restructured to reduce administrative burden, improve cost-effectiveness and efficiency, or more effectively use the physical facilities common to projects. Another example is a project experiencing negative cash flow due to increases in local taxes and utilities that are rising faster than area rents. The methods used by the Agency to help accomplish the objectives stated above include loan agreement or loan resolution consolidation, loan consolidation, reamortization, and loan adjustments (writedowns). In addition to 7 CFR 3560 and the instructions provided below, the requirements of Attachment A to Chapter 7, "Transfer of Project Ownership" should also be used.

This chapter describes the requirements for loan restructuring techniques and Agency procedures for reviewing, approving and implementing such requests.

This chapter describes the requirements for each of these loan restructuring techniques, and Agency procedures for reviewing, approving, and implementing such requests.

SECTION 1: ALLOWABLE TYPES OF RESTRUCTURING

11.2 OVERVIEW

As mentioned above, the loan restructuring activities that the Agency may approve include the following:

- **Loan agreement or loan resolution consolidation,** which is an administrative action whereby the loan agreements, or loan resolutions, for multiple projects held by the same borrower are consolidated and assigned a single new project number. The borrower still has separate loan notes and the Agency still tracks each loan individually, but all projects are administered by the Agency as if they were a single project;

- **Loan consolidation,** which is the consolidation of multiple loans for a single property into a single loan, with one note and one payment;

- **Reamortization,** which is a rescheduling of a borrower's debt; and

- **Loan adjustments (writedowns),** which are reductions of the amount of the borrower's debt, allowing an otherwise sound project experiencing financial difficulties beyond its control to continue operating as a program property.

11.3 LOAN AGREEMENT OR LOAN RESOLUTION CONSOLIDATION REQUIREMENTS *[7 CFR 3560.410]*

The Agency may approve the consolidation of loan agreements or resolutions regardless of the total amount of debt being consolidated as long as the loan agreements being consolidated represent loans made for the same purpose, to the same borrower, with the same plan of operation (e.g., nonprofit, limited profit, full profit). The terms and the due date of the loans involved must not be altered, and other security instruments must remain unchanged and must not be released.

Under no circumstances will loan agreements or loan resolutions be consolidated if the Agency's security position will be adversely affected. Any applicable restrictive-use provisions of the existing notes will continue to apply following consolidation.

11.4 LOAN CONSOLIDATION REQUIREMENTS *[7 CFR 3560.410]*

The Agency may approve loan consolidations under two circumstances:

- The loans are being transferred on new terms; or
- An initial and subsequent loan under one project number were closed on the same date at the same rates and terms.

The Agency may approve loan consolidations if, in addition to the above requirements, the following conditions are met:

- *Form RD 3560-52, Promissory Note* and the loan agreements or resolutions will be consolidated;
- Consolidation occurs on the Amortization Effective Date (AED) or as soon as possible after the AED is established;
- All project accounts being consolidated will be current after the consolidation process, unless otherwise authorized by the Administrator; and
- The Agency's security position will not be adversely affected.

11.5 REAMORTIZATION REQUIREMENTS *[7 CFR 3560.455 (b)]*

The Agency may approve the reamortization of any Agency multi-family housing loan account, although it will not reamortize accounts solely to remove a delinquency.

The Agency may reamortize accounts when doing so is in the best interest of the Government and when needed to improve the financial viability of the property and project operations. The Agency will not approve a loan reamortization if the reamortization will adversely affect the Government lien priority.

11.6 LOAN ADJUSTMENT (WRITEDOWN) REQUIREMENTS *[7 CFR 3560.455(c)]*

Borrower requests for loan writedowns must be part of an approved workout agreement with the Agency and be in the best interest of the Government. Writedowns are permitted with existing borrowers or transferees where:

- The causes are beyond the borrower's control—such as market weaknesses, unforeseen site problems, or natural disasters; and

- Sound management is evident or unsound management practices can be resolved by the removal of the responsible individuals in accordance with an approved work-out agreement with the Agency.

SECTION 2: LOAN AGREEMENT OR LOAN RESOLUTION/LOAN CONSOLIDATION

11.7 OVERVIEW

Loan agreement or loan resolution consolidation offers several advantages. For instance, following loan agreement or loan resolution consolidation, all reporting, accounting, and project management requirements for the various projects being consolidated are fulfilled as a single project. In other words, borrowers need to maintain only one set of books and one operating budget, and can track all rents as a single project. In addition, because rental assistance agreements are not consolidated, borrowers can apply rental assistance across projects following consolidation. That is, waiting lists for the projects being consolidated will be combined and rental assistance can be assigned to eligible tenants in the newly formed "project" per assignment priorities.

Loan consolidation also offers several advantages. For instance, when consolidating a loan under new rates and terms in conjunction with a transfer, borrowers can combine notes and cost items. In addition, different portions of the property that may have been financed with separate loans can still be set up as distinct projects, but the borrower need track only one loan and one note.

State Directors or their designees may approve project or loan consolidations with the advice of the Office of General Counsel (OGC) and when all required conditions outlined in this chapter are met.

11.8 BORROWER SUBMISSIONS

A. Loan Agreement or Loan Resolution Consolidation

A borrower requests a loan agreement or loan resolution consolidation by submitting the following forms to the appropriate Field Office:

- *Form RD 3560-33A, Consolidated Loan Agreement;*

- *Form RD 3560-34A, Consolidated RRH Loan Agreement;*

- *Form RD 3560-35A, Consolidated Loan Resolution;*
- *Form RD 3560-7* as well as a project budget;
- Updated loan agreements/resolutions; and
- Management plans.

B. Loan Consolidation

For loan consolidations, borrowers must execute a new *Form RD 3560-9* for the new consolidated *Form RD 3560-52*, and submit it to the Field Office. The interest credit plan originally established for the project applies to the consolidated note. If the interest credit plan is changed by submitting a new *Form RD 3560-9*, Loan Servicers will enter the new plan for the project through the field office terminal.

11.9 AGENCY PROCESSING OF BORROWER SUBMISSIONS

A. Loan Agreement or Loan Resolution Consolidation

1. Complete Form RD 3560-17A, Multi-Family Housing Consolidation of Projects/Loan Agreements/Resolutions

The Servicing Office completes *Form RD 3560-17A* to show all notes for the projects being consolidated.

2. Send Form to the State Office and St. Louis Office

The Field Office sends *Form RD 3560-17A* and a letter recommending the consolidation to the State Office for approval. The State Office then forwards the materials to the St. Louis Office for processing.

3. Obtain OGC Guidance

OGC guidance is required to accomplish loan agreement or loan resolution consolidations. Under no circumstances will the Agency consolidate projects if the security position of the Agency will be adversely affected. If required by OGC, all of the loan agreements or loan resolutions being consolidated may be secured by one deed of trust or mortgage describing all of the loans for the projects.

4. Maintain Loan Terms and Due Date

The Agency alters neither the terms nor the due date of the loan(s) involved. Other security instruments also remain unchanged, and are not released following the consolidation.

B. Loan Consolidation

Loan Servicers should note that there are some potential obstacles to consolidating certain loans. For instance, the St. Louis Office is unable to consolidate loans unless the loans are on the same plan of operation. In addition, direct loans cannot be consolidated with interest credit loans, and loans with HUD Section 8 subsidy cannot be consolidated with insured loans. In all other cases, however, the procedures outlined in this chapter will apply to loan consolidations.

1. Prepare Form RD 3560-52

Loan Servicers prepare *Form RD 3560-52* for the notes or assumption agreements being consolidated. If the Field Office does not have possession of the original note or assumption agreement, the Loan Servicer calls the St. Louis Office to request the return of the original form so it is in the Field Office before the *Form RD 3560-52* is processed, or as soon as possible thereafter. *Form RD 3560-52* should be prepared on a monthly payment basis, as appropriate.

2. Prepare a Consolidated Loan Agreement or Resolution

Loan Servicers prepare a consolidated loan agreement or resolution using *Forms RD 3560-33A*, *3560-34A*, or *3560-35A*, as appropriate, to reflect current reporting requirements and the authorized initial investment attributable to the owner after the consolidation has occurred.

3. Obtain OGC Guidance

Consolidation of notes may only occur with OGC guidance. Under no circumstances will the Agency approve consolidation of *Form RD 3560-52* if the security position of the Agency will be adversely affected.

4. Complete Form RD 3560-17, Multi-Family Housing Note Consolidation, and Send a Copy to the Finance Office

Loan Servicers complete *Form RD 3560-17* to show all of the notes that are consolidated on *Form RD 3560-52*. Loan Servicers send a copy of *Form RD 3560-17* to the State Office for approval. The State Office forwards *Form RD 3560-17* to the St. Louis Office for processing.

5. Stamp Notes or Assumption Agreements "Consolidated"

The original and Field Office copies of all notes or assumption agreements that are consolidated will be stamped "consolidated" by Loan Servicers. The original instruments being consolidated will be stapled to the "consolidated" note and filed in the safe in the Field Office. When the consolidated note has been paid in full or otherwise satisfied, Loan Servicers will handle it and all other instruments according to RD Instruction 1951-A.

6. File New Security Instruments

Loan Servicers file new security instruments that describe the consolidated note to perfect the Agency lien position. If the new lien position taken is junior only to the previous lien position, the previous security instruments may be released with the guidance and assistance of OGC.

SECTION 3: LOAN REAMORTIZATION

11.10 OVERVIEW

Reamortization is the process of revising an existing loan payment plan or schedule established for repayment of a loan. The new schedule is usually developed to enable the borrower to continue the objectives of the loan.

State Directors or their designees may approve the reamortization of Agency loans within their approval authority for the type of loan involved. Reamortization will not subject the borrower to any additional restrictive-use provisions beyond those associated with the original loan. For example, if there were 10 years of restrictive use remaining on a loan prior to a reamortization, there would still be 10 years remaining following the action. If the original loan contained no restrictive-use provisions, the reamortization would not add new use restrictions.

11.11 ACCEPTABLE USES OF REAMORTIZATIONS

A. Allowable Conditions for Reamortizations

The Agency may consider approving a reamortization if any of the following four conditions are met:

1. Preventive Measure for a Borrower Likely to Experience Delinquency

The State Director determines that the borrower and tenants cannot reasonably be expected to continue to meet their obligations unless the account is reamortized to reduce substantially the installments and rental rates.

2. Corrective Measure to Help Delinquent Borrower Attain Successful Operation

The borrower has a substantial delinquency that cannot be cured within one year. In addition, the borrower must have acted in good faith and maintained compliance with all applicable Agency policies and procedures.

3. Incentive to a Borrower Requesting Prepayment

The borrower has received an equity loan as an incentive to avert prepayment, or a subsequent loan has been made to a nonprofit corporation or public agency to purchase a project to avert prepayment.

4. Measure to Improve Project Operations

The borrower is not delinquent or likely to become delinquent, but proposes the reamortization to improve project operations. The State Director's approval is required for such reamortization requests.

B. Requirements for Obtaining a Reamortization

In addition, borrowers must demonstrate that the following criteria are satisfied before the Agency will approve a reamortization:

- The reamortization must be in the best interest of the Government;
- The reamortization will enable the borrower to operate successfully and carry out the purpose of the loan;
- The Agency's lien position remains unchanged; and
- The action is not proposed solely to remove a delinquency.

11.12 BORROWER SUBMISSIONS

To request a reamortization, the borrower must complete and submit *Form RD 3560-15, Reamortization Request* to the Field Office. Loan Servicers review the form and determine whether the required conditions for a reamortization exist.

11.13 AGENCY REVIEW AND APPROVAL

A. Field Office Actions

When the Field Office receives a request to reamortize, Loan Servicers will take several actions, as follows:

- Determine whether the conditions for a reamortization exist;
- Document the request in the official case file and on *Form RD 3560-15*; and
- Submit the request, the case file, and other pertinent information to the State Office for review.

B. Evaluating Borrower Requests

To receive Agency approval, Loan Servicers must review the borrower's submission and Agency records to ensure that the reamortization meets all of the following requirements, and adequately document in the case file and on *Form RD 3560-15* that the requirements are met. The analyses described below are used to evaluate all reamortization requests. Additional evaluation is required for requests involving projects with delinquencies or compliance violations (see Paragraph 11.14).

1. Budget is Adequate

The borrower's budget or plan of operations must provide reasonable assurance of the following:

- The newly scheduled payments will be made according to the terms of the proposed reamortization;

- The charges for the use of the facility or service are within the payment ability of those it is intended to serve and are comparable to similar units in the area; and

- Applicable rent increase procedures will be followed if any rent increase is required.

2. Management is Adequate

The borrower must demonstrate the following:

- The Board of Directors and memberships will obtain membership and community support, and will provide competent management for the continued operation of the borrower entity and the facility financed with the loan; and

- The borrower can provide acceptable management for the project and has corrected any management deficiencies identified by the Agency. Acceptable corrective actions may include revision of the management plan or employment of professional management services.

3. Security is Adequate

The borrower must demonstrate that the security will be adequate to protect the Agency's interests over the term of the reamortization.

C. Approval Recommendation and State Office Review

If the Loan Servicer determines that a borrower's request meets the requirements described in subparagraph B of this section, they must forward the case file with a recommendation for approval to the State Office for review. If the State Office concurs with the recommendation to reamortize, it will submit the request and any other pertinent information to OGC for legal advice and closing instructions, as needed.

When the indebtedness to be reamortized exceeds the State Director's approval authority but the State Director determines that the required conditions for approval can be met, the request for reamortization, the official case file, and all other pertinent information, along with complete comments and recommendations by both the State Office and Loan Servicers, is sent to the National Office.

D. National Office Exception

If the State Director concludes that the conditions for a reamortization cannot be met but a reamortization would be in the best interest of the Government, the file, along with recommendations from the Field Office, will be sent to the National Office for an exception. The State Director will submit all subsequent reamortization requests for the same project to the National Office for prior authorization.

E. OGC Guidance

When OGC determines that the reamortization request is legally sufficient, the servicing official will execute the reamortization request.

F. Agency Denial of Request

If the Agency denies a request for a reamortization, it must send a formal letter to the applicant indicating the reasons for the Agency's decision and informing the applicant of appeal rights. A copy of this letter should be placed in the case file.

11.14 ADDITIONAL EVALUATION FOR REQUESTS INVOLVING DELINQUENCIES OR COMPLIANCE VIOLATIONS

Reamortization requests to address a delinquency or compliance violations will be approved only as part of a work-out agreement acceptable to the Agency. Reamortization may be used to address reserve accounts that are not at the authorized levels, as long as the deficiency is not due to improper or unauthorized use of reserve funds.

To obtain a reamortization to address a delinquency or compliance violations, the borrower must correct or be able to effectively address the cause of the deficiency, demonstrate that the objectives of the loan can be met following the reamortization, and meet the requirements described below. To show that the objectives of the loan can be met, borrowers must demonstrate the following:

A. Project Feasibility

Borrowers must demonstrate that they are operating on a financially sound basis and have adequate operating income to:

- Repay the loan at the reamortized rate;
- Fund reserve accounts adequately;
- Fund tax and insurance accounts adequately;
- Pay operation and maintenance expenses as they become due; and
- Maintain an acceptable level of occupancy.

B. Property is Adequately Maintained

Borrowers must ensure that they provide modest, decent, safe, and sanitary housing by properly maintaining the property.

C. Housing Remains Affordable

Borrowers must provide affordable housing opportunities/services to eligible residents.

D. Compliance with Agency Regulations is Maintained

Borrowers must be in compliance with all applicable Agency regulations, including:

- Providing financial information to the Agency in a timely manner; and
- Maintaining required records needed to ensure the eligibility of residents (e.g., tenant certifications).

If the borrower cannot demonstrate the ability to meet the above-listed objectives, the Loan Servicer must reject the borrower's request for reamortization of the Agency loan and provide the borrower all applicable appeal rights.

11.15 PROCESSING REAMORTIZATIONS

In general, to reamortize an account, Loan Servicers must ensure that they obtain, complete, and sign all relevant forms, and obtain OGC review of documents for legal sufficiency, if needed. To actually process a reamortization, Loan Servicers must take the following steps, as applicable.

A. Complete Reamortization Agreement

Loan Servicers will complete *Form RD 3560-16* according to the FMI. The effective date and the due date for all payments will be the first of the month, except for labor housing loans, whose due date will be established in accordance with the FMI. *Note*: Appraisals will not be required in the case of reamortizations as long as there is adequate documentation that the Agency's security interest is protected.

B. Obtain *Form RD 3560-52* and Assumption Agreement

If the note or assumption agreement being reamortized is not held in the Field Office, the Loan Servicer will obtain the *Form RD 3560-52* and any assumption agreement from the St. Louis Office before processing the reamortization.

On the back of the original note or assumption agreement, below all signatures and endorsements, the Loan Servicer will insert the following: "A reamortization agreement dated _____, 20__, in the principal sum of $_____, has been given to modify the payment schedule of the note."

C. Establish End of the Reamortization Period

The reamortization period will end on the final due date of the note being reamortized, unless the term is extended with the advice and guidance of OGC and the

Agency's lien position is not altered. Any extension of the final due date should not exceed the lesser of the remaining useful life of the security property or the maximum term granted by the respective loan program authorizations.

The Agency may amortize the loan over a period not to exceed the remaining economic life of the project or 50 years, whichever is less. The Agency may extend the term of the loan to a period not to exceed 30 years or the remaining economic life of the project, whichever is less.

D. Establish Interest Rate

The interest rate for the account will remain unchanged except when the final due date has been extended. The interest rate charged by the Agency will be either the existing note rate, or the current rate at the time the reamortization request *Form RD 3560-15* is approved or closed, whichever is less.

E. Address Delinquent Reserve Accounts

The Agency may use reamortizations to address reserve accounts that are not at authorized levels, as long as the shortfall is not due to the borrower's improper or unauthorized use of reserve funds. Loan Servicers should take the following steps to address delinquent reserve accounts:

1. Modify the Loan Agreement or Resolution

The Loan Servicer should modify the loan agreement or resolution, or execute a new agreement or resolution, that bases the new fully funded amount (i.e., 10 percent of the indebtedness) and annual reserve requirement (i.e., one-tenth of the fully funded amount) on the amount of the reamortization, rather than on the original amount of indebtedness.

2. Establish Reserve Requirements

The Loan Servicer may establish reserve requirements at a higher level than the amount required for the reamortization to allow for capital expenditures that have been identified and quantified, as long as the budget will support a higher level.

3. Begin the Reserve Account with a New Base

Since the fully funded amount and annual requirement are reestablished based on the amount of the reamortization, the reserve account will begin with a new base. That is, any underfunded reserves existing prior to the reamortization will no longer be considered underfunded. In essence, the reamortization allows the borrower to begin with a "clean slate."

4. Allow the Borrower to Receive a Return on Investment

When a newly established fully funded amount and annual requirement are based on the reamortization amount, the Loan Servicer may allow the borrower to receive a return on investment if all other applicable conditions for receiving a return have been met.

F. Obtain OGC Guidance As Needed

Loan Servicers may obtain OGC guidance in the review of documents for legal sufficiency. OGC also may offer further guidance to properly perfect the reamortization.

G. Execute New Interest Credit Agreement

If the borrower is to receive interest credit benefits following the reamortization of the account, Loan Servicers will cancel the current interest credit agreement and prepare a new *Form RD 3560-9*.

H. Close the Reamortization

The Agency always closes reamortizations on the first day of the month. Unpaid interest to the date of closing may be capitalized.

I. Meet Other Procedural Requirements

In addition, Loan Servicers need to ensure that the following procedural requirements are met:

- All reamortized loans must be closed on Predetermined Amortization Schedule System (PASS). All initial and subsequent loans must convert to PASS in connection with the reamortization;

- When recoverable cost items are involved, they are first capitalized by adding them to the principal loan balance outstanding on the oldest loan and then the entire indebtedness (principal plus outstanding interest, overage, and late fees) is reamortized; and

- Audit receivables and late fees may be reamortized.

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SECTION 4: LOAN WRITEDOWNS

11.16 OVERVIEW

In cases of severe financial distress, the Agency may agree to a writedown of the debt, whereby the Agency agrees to reduce the outstanding loan amount. Writedowns should occur only when the value of the property is less than the outstanding Agency debt.

Generally, writedowns will occur simultaneously with a transfer and assumption for less than the total amount of outstanding debt. However, the Agency may write down debts and continue the account with the same borrower if doing so is in the best interest of the Agency, the property, and tenants.

In all cases, writedowns must be part of an approved work-out plan with the Agency, in the Government's best interest, and designed to correct circumstances beyond the borrower's control. Writedowns require approval by the State Director. The Agency should consider the project's suitability in accordance with Chapter 6 before approving a writedown.

Borrower equity in the project following the writedown will be no less than five percent of the amended loan balance for limited for-profit owners. The borrower may realize the eight percent return on investment on a maximum of five percent equity, if applicable. A reduced return may be authorized on amounts of equity contributed greater than five percent. Nonprofit and public agency borrowers may enter into workouts that propose loan-to-value ratios of 100 percent.

11.17 ALLOWABLE USES

Writedowns may only be approved when the conditions leading to a default were beyond the borrower's control and management is generally sound. Writedowns are used to address severe financial difficulties with a project and the Agency will consider all available servicing options before approving a writedown. Some examples of circumstances where a writedown might be an acceptable servicing solution include:

- Sustained market weaknesses in the property's community or region;
- Unforeseen site problems; or
- A natural disaster results in significant damage to the property.

11.18 BORROWER SUBMISSIONS

Borrowers requesting writedowns must submit the following documents to the Field Office:

- *Form RD 3560-15*; and

- A work-out plan, which includes:
  - ◊ A revised budget; and
  - ◊ A narrative description of project difficulties and proposed corrective actions.

11.19 AGENCY REVIEW AND APPROVAL

A. Appraisal

For a borrower to receive Agency approval for a writedown, the borrower is responsible for obtaining an "as-is" market value, subject to restricted rents. The Agency generally will not approve a writedown to an amount that is lower than the "as-is" unsubsidized value of the property. The Agency may require the general partner or primary person controlling the borrower to exit or waive equity, or both, to qualify for the writedown.

B. OGC Advice

OGC advice is required for all writedowns. The OGC review will primarily focus on the legal sufficiency of the transferee's organizational documents in cases where the writedown is occurring concurrently with a transfer.

C. Approval

As part of the writedown approval process, the State Office will review the following items:

- Field Office recommendation;
- Eligibility review; and
- An appraisal of the property.

The State Director is the approval official. The State Director may determine whether a writedown that does <u>not</u> include a change in the management structure of the project is acceptable.

11.20 PROCESSING WRITEDOWNS

To process a writedown, borrowers must execute documents per guidance from OGC.

CHAPTER 12: ACCOUNT LIQUIDATION *[7 CFR 3560.456]*

12.1 INTRODUCTION

This chapter covers Agency procedures regarding account acceleration, foreclosure, and liquidation for projects in default.

Loan Servicers should offer all appropriate special servicing tools to help borrowers with financial problems bring the account current. However, if it is clear that a borrower cannot continue with the loan, the Loan Servicer should analyze the feasibility of liquidation options and recommend the option that is in the Government's best interest, defined as the option that will result in the greatest net recovery.

Section 1 of this chapter describes how the Agency determines whether or not to liquidate, and if so, which of the available options would be least costly for the Government. This section provides a brief catalogue of liquidation options, a discussion of net recovery value and basic security loss, and an outline of how decisions to liquidate are ultimately made.

Section 2 of the chapter contains information on liquidation procedures for voluntary liquidation and foreclosure. A discussion about the acquisition of chattel property is also included. Section 3 discusses debt settlement.

SECTION 1: MAKING THE DECISION TO LIQUIDATE

12.2 AN OVERVIEW OF LIQUIDATION OPTIONS

When the Agency determines that liquidation is appropriate, it may accelerate the loan. The borrower must pay the full account balance and meet the other terms of the loan within the prescribed time frame, or the Agency may initiate foreclosure proceedings. Once the loan has been accelerated, the Agency will not accept partial payment unless required to do so by State law.

A. Voluntary Liquidation

1. Voluntary Sale

Sale of the security property is generally the most desirable option for both the Agency and a borrower who is unable to continue the loan. For the Agency, a sale to another party avoids the costs of foreclosure, as well as the costs related to owning and disposing of a property. For the borrower, it offers the best opportunity for being released from the debt without a major credit history blemish. A borrower may sell the property to a third party even after the account is accelerated.

If the borrower sells or transfers title of a security property on which the loan has been accelerated, the Agency requires payment in full to release any Agency liens or to

stop foreclosure action. However, to facilitate a sale after acceleration, the Agency may agree to release Agency liens in return for payment of the estimated net recovery value.

2. Deed in Lieu of Foreclosure

After the account has been accelerated, the borrower can offer to convey the security property to the Agency. The Agency will accept the deed in lieu of foreclosure only if the Agency will realize a greater net recovery value than would be obtained if foreclosure proceedings continued.

3. Assignment to Junior Lien Holder

The Agency may assign the note and mortgage to a junior lien holder, if such a lien holder makes an offer for the property in the amount of at least the net recovery value, and all appeal rights have expired.

B. Foreclosure

1. Agency Foreclosure

When all reasonable efforts have failed to encourage the borrower to voluntarily liquidate the loan through sale of the property, deed in lieu of foreclosure, or by entering into an accelerated repayment agreement, the Agency may initiate foreclosure proceedings.

2. Foreclosure by a Another Lien Holder

If there is a prior lien holder, the Agency must determine if the prior lien holder should have the opportunity to foreclose. Foreclosure by a prior lien holder may be a less costly alternative to Agency foreclosure. If the Agency intends to foreclose in cases in which there is a prior lien, the Agency must decide either to settle the lien or foreclose subject to the lien.

C. Acquisition of Chattel Property

The Agency will make determinations regarding disposition of chattel property that are in the best interest of the government. The Agency will make every effort to avoid acquiring chattel property by having the borrower or Field Office Staff liquidate the property.

12.3 NET RECOVERY VALUE

Estimated net recovery value represents the amount that the Agency could expect to recover from a property if it was liquidated after considering all costs associated with liquidating, holding, and selling the property. **Attachment 12-A** contains a net recovery value worksheet to aid in this calculation. Actual net recovery value is the amount the Agency does in fact recover from the sale of a property, after accounting for all costs.

The following sections provide guidance in estimating net recovery value.

A. Establishing Market Value

The market value of the property is the fundamental basis for establishing the estimated net recovery value. All calculations undertaken on the net recovery value worksheet provide additions or deductions from market value.

Depending upon the likely method of liquidation and at what point in the process the calculation is being made, market value may be based on an estimated value, on an appraisal or on the actual sale price. Early in the process of determining which liquidation method should be followed, the Loan Servicer may need to make a rough estimate of the market value based on any available information.

B. Environmental Considerations

The Loan Servicer's estimate of market value must take into consideration potential environmental hazards that may pose a liability issue for the Agency, and the presence of environmental resources for which the Agency will have an affirmative responsibility to take protective measures once it owns the property. Exhibit 12-1 provides a partial list of environmental factors for consideration.

To minimize Agency liability, the Agency must ensure, prior to acquiring property through foreclosure, that the property has been examined for potential contamination from hazardous substances, hazardous wastes, and petroleum products, including underground storage tanks. This should be accomplished by requesting that Field Office Staff complete the *ASTM Standard E-1528 Transaction Screen Questionnaire, (TSQ)*. If the completed form raises any concerns it should be submitted to the State Environmental Coordinator for further evaluation and guidance.

The Agency also should examine the property prior to acquisition and consider any costs associated with environmental resources the Agency might be required to protect.

For additional information, see RD Instruction 1940-G.

Exhibit 12-1

Environmental Considerations

Environmental Factors

- Traffic or noise;
- Hazardous materials or waste;
- Radon, asbestos, or urea formaldehyde; and
- Lead-based paint or other lead contaminants.

Environmental Resources

- Aquifer recharge areas;
- Coastal barrier resources;
- Coastal zone management areas;
- Endangered/threatened species or critical habitat;
- Floodplains, wetlands, or flood hazard areas;
- Historical or archaeological sites;
- Important farmland, prime forestland, or prime rangeland;
- National landmarks;
- Wild and scenic rivers; and
- Wilderness areas.

C. Ordering an Appraisal

Guidance about ordering appraisals is presented in Chapter 4 of HB-1-3560. The point at which a formal appraisal is actually conducted will vary.

1. Valueless Lien

If the Loan Servicer's estimate suggests that the lien may be valueless, an appraisal should be obtained immediately. If the appraisal indicates that the lien is in fact valueless, it should be released without incurring servicing costs.

2. Deed in Lieu of Foreclosure

If, after acceleration, the borrower offers a deed in lieu of foreclosure, an appraisal should be obtained immediately so the Loan Servicer can determine whether it is in the government's interest to accept the deed.

3. Foreclosure

If the property will be going to foreclosure, no appraisal should be obtained until shortly before the sale is scheduled to take place. In areas where the foreclosure process can be lengthy, the value of the property could change before the sale if the appraisal is conducted too far in advance.

D. Holding Period

Nearly all costs and income used in the net recovery value calculation are affected by the holding period. For estimated net recovery value, the length of the holding period is estimated differently, depending on the likely method of disposition. The holding period should be estimated as the time between the date the net recovery worksheet is being filled out and the anticipated date for:

- Filing of the deed and the expiration of redemption rights (foreclosure);
- Filing the warranty deed (deed in lieu of foreclosure);
- Filing the release (release of valueless lien); or
- Payoff and release (debt settlement offer subsequent to acceleration).

The time for marketing and disposition, if the property is acquired, should also be considered when estimating the holding period.

E. Deductions from Market Value

Numerous costs associated with liquidation must be considered when determining the net recovery value, including the following costs.

- **Prior liens to be paid by the Agency**. In a case where a prior lien is involved, the amount required to repay the prior lien holder must be included in the calculation;
- **Junior liens to be paid by the Agency**. If the Agency pursues foreclosure, junior liens are not paid. However, in the case of a deed in lieu of foreclosure, it may be to the Agency's advantage to pay off a junior lien holder. The agency should conduct a title search to identify the position and the amount of each lien against the property;
- **Selling expenses to be paid by the Agency**. All transaction costs involved in selling the property, including advertising, commissions for selling agents, required seller certifications, surveys, points, and closing costs paid by the Agency, whether on behalf of the borrower in a voluntary liquidation, or as an Agency expense for a real estate owned (REO) sale;
- **Holding costs**. During the time that the Agency owns the property, the monthly interest accrued is multiplied by the number of months in the holding period;
- **Depreciation during the holding period**. The property may depreciate in value while it is being held by the Agency;
- **Administrative costs**. The administrative burden associated with holding a property includes the cost of liquidation, such as attorney fees, filing, recordation, advertising, and document service fees, that are customarily incurred in a foreclosure action; and

- **Management costs**. During the period the Agency holds the property it will accrue costs related to cleaning, securing, and maintaining the property such as utilities and real estate taxes.

F. Additions to Market Value

Although most of the adjustments to market value involve deductions to reduce the recovery amount, there are a few factors that can increase the market value.

- **Appreciation during the holding period**. In markets that are strong, the property may appreciate while it is being held by the Agency; and

- **Income during the holding period**. In general, the Agency does not lease properties. However, REO properties may be leased in limited circumstances, such as a property located in an area where keeping the property occupied could greatly reduce vandalism, or if there are tenants living in the property whom the Agency does not wish to displace.

12.4 BASIC SECURITY LOSS

The basic security loss is the difference between the property's market value and the outstanding Agency debt on the property, including principal, and other recoverable costs.

It is important for the Loan Servicer to consider the basic security loss in determining how to work with the borrower. For example, the debt settlement arrangements the Agency agrees to might be more lenient in the case of a borrower with a property that lost value through no fault of the borrower. This information can be used for portfolio analysis to help the Agency originate loans more effectively in the future.

12.5 ACCOUNT LIQUIDATION

A. Making the Decision to Liquidate

In all liquidation cases, the State Director will be responsible for the final decision to liquidate the borrower's account based on advice and counsel from the Office of General Counsel (OGC) and the following information supplied by the Loan Servicer:

- An opinion by the Loan Servicer about whether the borrower is forcing an acceleration to circumvent the prepayment process;

- The specific recommendations of the Loan Servicer on the method of carrying out the liquidation;

- The case file and any other pertinent information developed in support of the accusations;

- A summary of Agency efforts to work out an acceptable solution short of liquidation;

- A current appraisal of the security property will be completed by an Agency official authorized to make that particular type of appraisal and an estimate of the net amount that may be realized from the sale of the assets;

- The most recent balance sheet or financial statement from the borrower;

- A current statement of account from the St. Louis Office; and

- A problem case report.

- The Agency will handle liquidation, whether by voluntary liquidation or foreclosure, in accordance with the requirements at 7 CFR 3560.456(c) and (d).

In all liquidation cases, the State Director is responsible for the final decision to liquidate the account based on an opinion from OGC and relevant information supplied by the Field Office (e.g., case files, summary of efforts to work out an acceptable solution, appraisals of the property, borrower's financial statements and balance sheets, specific recommendations). If the Agency determines that the borrower has taken action to bring about the acceleration in an effort to avoid the prepayment process, the Agency will consider alternatives to acceleration, such as suing for specific performance under the loan and management documents.

B. Possible Outcomes of Agency's Decision to Liquidate

If the Agency decides to liquidate, there are several possible outcomes, which are as follows:

- The borrower may cure the default by developing and submit to the Agency for approval a workout agreement that proposes actions to be taken over a period of time to prevent or correct a default;

- The borrower can voluntarily convey the property to the Agency;

- Transfer (sale or transfer and assumption of mortgage);

- Foreclosure;

- Payoff with use restriction; or

- Debt settlement (cash only) for minimum bid or greater.

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SECTION 2: LIQUIDATION PROCEDURES

12.6 OVERVIEW

After the Loan Servicer exercises special servicing options and the borrower is still unable to continue with the loan, the Loan Servicer must determine the feasibility of liquidating the borrower's account. Any recommendation should result in the greatest net recovery to the Government.

The borrower may liquidate voluntarily, either through sale of the property or deed in lieu of foreclosure. If it determined that the borrower's account must be liquidated, the Agency may recommend foreclosure and accelerate the loan.

12.7 VOLUNTARY CONVEYANCE

After acceleration, borrowers may voluntarily liquidate through deed in lieu of foreclosure or an offer by a junior lien holder. In the case of voluntary liquidation, the borrower is responsible for all expenses associated with liquidation and acquisition. The Agency will only consider acceptance of an offer of voluntary conveyance if it is likely to receive a recovery on its investment. The Agency will not accept a voluntary conveyance offer if it is not in the Government's best interest to do so. The Agency should refuse the voluntary conveyance if the Agency lien has neither present nor prospective value or recovery of the value would be unlikely or uneconomical.

Voluntary sale of the security property may be the least onerous option for the borrower and the least costly option for the Government. If there is an interested buyer, procedures for property transfer that should be followed are described in Chapter 7 of this handbook.

A. Payment of Liens

If the Agency accepts a deed in lieu of foreclosure, it will pay prior liens if the Government's investment and payment of the lien may be recovered. The Agency will accept conveyance subject to prior liens if the lien holder does not object. In this case, the Agency will make installment payments on the lien.

Junior liens must be paid by the borrower. If the borrower does not agree to pay these obligations, the Government will do so if it is in its best interest in the long run. The State Director determines whether the Agency will settle junior liens.

B. Required Components of an Offer of Voluntary Conveyance

An offer of voluntary conveyance will consist of the following documentation:

- *Form RD 3560-22, Offer to Convey Security*;
- Warranty Deed, which will be recorded only when the voluntary conveyance is accepted;

- A current financial statement, balance sheet, and information on present income and potential earning ability;

- For organization borrowers, a resolution by the Board of Directors that authorizes conveyance of the property; and

- Assignment of Housing Assistance Payments (HAP).

C. Appraisals

Prior to the Agency's acceptance of an offer of a deed in lieu of foreclosure, the current market value of the property must be obtained through an appraisal by a qualified appraiser.

D. Decisions

The Loan Servicer will submit the case file of the borrower to the State Office. The State Office will review the file and make a decision, after having obtained advice from the OGC. When the market value of the property is less than the Agency debt, the Agency must consider the borrower's current situation and future prospects for paying this debt.

Items to be included in the borrower's case file are shown in Exhibit 12-2.

Exhibit 12-2

Liquidation Option - Borrower's Case File

- Report on Multi-family Housing Problem Case;
- Liquidation and management plan;
- *Form RD 3560-22*;
- Resolution authorizing conveyance, if applicable;
- Current title search;
- Environmental review;
- *Form RD 3560-7;*
- *Form RD 3560-10;*
- Current appraisal prepared by a qualified appraiser;
- Due diligence report;
- Balance of Rural Development account and other liens, if any;
- Assignment of HAP contracts, if applicable;
- Current statement of account from the St. Louis Office;
- Development plan with breakdown of costs, if applicable; and
- *Form RD 402-2, Statement of Deposits and Withdrawals,* if applicable.

E. Closing of Conveyance

Closing of conveyance will be complete when the recorded deed has been returned to the Agency with no outstanding encumbrances other than Agency liens and/or previously approved prior liens. Costs incurred prior to the completion of the transaction will be charged to the borrower as recoverable costs.

Upon closing of the transaction, if applicable, the Loan Servicer will release liens and inform the borrower of the release from liability. Borrowers must be notified whether or not they have been released from liability.

The State Director will cancel any interest credit and suspend any rental assistance. Tenants must be informed of the possible consequences of liquidation. If the property will no longer participate in the Section 515, 514/516, or 521 programs, the tenants must be given a minimum of 180 days' written notice.

12.8 FORECLOSURE

State laws pertaining to acceleration and foreclosure will affect the procedures the Agency is required to follow. OGC should be consulted to ensure that appropriate procedures are followed.

A. Making the Acceleration Decision

The Agency must decide whether to accelerate the account and begin the foreclosure process. The decision to accelerate involves numerous considerations, many of which will vary case by case. The following issues should always be considered.

1. OGC Concurrence

Advice and counsel should be obtained from OGC before beginning the foreclosure process if:

- The foreclosure is based on a nonmonetary default; or
- The property also serves as security for a loan under another USDA program, such as the FSA, since this may trigger liquidation of the other loan.

2. Tribal Land

If the security property is on tribal-allotted or trust land, the acceleration may be approved only after the Agency has offered, in writing, to transfer the account to an eligible tribal member, the tribe, and the Indian Housing Authority serving the tribe or tribes.

3. Role of Other Lien Holders

Depending upon the status of other liens on the security property, the Agency may invite other lien holders to join in the foreclosure action, or join in a foreclosure action initiated by another lien holder.

B. Acceleration

1. Acceleration Notice

If the Agency determines that the appropriate approach to liquidation is foreclosure, the process begins with an acceleration notice (*Guide Letter 1955-A-1, Notice of Acceleration to MFH Borrowers Liable for the Debt (Excludes Borrowers Who Were Discharged in Bankruptcy*) or *Guide Letter 1955-A-2, Notice of Acceleration to MFH Borrowers Discharged in Bankruptcy Who Have Not Reaffirmed the Debt*). The acceleration notice demands full payment of the account, including unpaid principal and interest, advances, and subsidy subject to recapture. It notifies the borrower of: (1) the reason for the acceleration, (2) the amount due, (3) the method of payment, (4) the opportunity for an informal review with the decision maker to seek mediation or alternative dispute resolution or to request an administrative appeal hearing, (5) and prepayment restrictions. The notice gives the borrower 30 days to pay in full or request a hearing.

The acceleration notice must also include language regarding prepayment restrictions. If a borrower prepays an Agency loan made before December 21, 1979, the tenants must be given 180 days' notice that the project can be removed from the program. For information on these loans, see Chapter 15.

The notice must be sent to the borrower and any cosigners simultaneously by both regular mail and certified mail, return receipt requested. If the property address is different from the address of the borrower, the notice should be sent to the property address as well.

2. Payment Subsidy

If a borrower is receiving payment subsidy, the payment subsidy agreement will not be canceled when the debt is accelerated, but it will not be renewed unless the account is reinstated.

3. Offers to Pay

The decision to accelerate the account must not be made until the Loan Servicer has made all reasonable efforts to help the borrower become successful. Therefore, once the account has been accelerated, borrower efforts to cure the default will not be accepted unless required by state law. If state law requires that foreclosure actions be halted if an account is brought current, partial payment of the accelerated amount must be accepted. Otherwise, any payment for less than the full amount required to close the account should be returned to the borrower.

The borrower's account may be paid off by cash, transfer and assumption, sale of the property, or voluntary conveyance. The Agency may grant the borrower additional time to voluntarily liquidate. If an offer is deemed unacceptable, the Agency's denial is not appealable.

C. Review of the Acceleration Decision

Several remedies are available to borrowers who believe their accounts should not have been accelerated. These include an informal review, mediation or dispute resolution, and a formal appeal with the National Appeals Division (NAD) of the Department of Agriculture. Foreclosure actions will be held in abeyance while an appeal is pending.

D. Transfers and Subsequent Loans During Foreclosure

Properties can be transferred during the foreclosure process. However, the foreclosure process should not be stopped until the applicant is determined eligible and the transfer is determined to be feasible and in the best interest of the government. For a discussion of how the value of a property is determined, see Chapter 7, Section 7.26.

E. Foreclosure Notice

A foreclosure notice that includes the following must be published:

- Projected sale date and location;
- Fair market value of the property;

When a property is liquidated through foreclosure action or other debt settlement actions, the property may be released without restrictive-use provisions. The appraiser will be given instructions to value the property as conventional nonsubsidized property without restrictive-use provisions. The encumbering restrictive-use provisions in the loan documents will be nullified by the foreclosure sale or debt settlement unless ownership is continued by the current borrower, and that borrower is currently subject to restrictive-use as part of the original loan obligation or a subsequent servicing action.

- The amount to be bid by the Agency;
- The amount of Agency debt against the property; and
- Use restriction provisions.

For judicial foreclosure states, notices are to comply with State laws.

Servicing Officials should take an aggressive approach to advertising foreclosure sales and marketing inventory properties. A list of potential buyers who would be interested in purchasing projects at foreclosure sale or inventory properties should be developed. Notices of scheduled foreclosure sales can then be sent to those interested

parties in addition to advertising in newspapers, notifying local real estate agents, and posting advertisements on the Agency's Multi-Family Housing REO website at https://mfhreo.sc.egov.usda.gov.

F. Determining the Government's Bid at Foreclosure Sale

The Government's bid should equal the amount of the Agency's net recovery value or the market value of the security, whichever is less.

The State Director will designate an individual to bid at foreclosure, unless prohibited by State law. If the Agency is the senior lien holder, it can only submit one bid. If the Agency is not the senior lien holder, the designated bidder may make incremental bids in competition with other bidders.

If a project that is subject to restrictive-use provisions is sold outside the program at the foreclosure sale, the Agency has no means to continue to enforce the restrictive-use provisions after the purchase.

G. After Foreclosure

1. Agency Reporting

After the property has been acquired, the Field Office must furnish the State Director with a report on the sale. Two forms must be filed: *Form RD 3560-19, Status of REO Property*, and, if applicable, *Form RD 3560-55*.

2. The Property

Upon acquisition, any existing leases must be transferred, and management agreements must either be extended or canceled.

3. The Borrower

If the property is acquired by the Agency, the Agency must credit the borrower's account with the Government's maximum bid. If the property is not acquired by the Agency, the borrower's account must be handled in accordance with State law.

The Agency must make attempts to collect any unsatisfied balances. When deficiency judgments are sought, the State Director must prepare *Form RD 1962-20, Notice of Judgment*, which establishes how the account is to be handled by the Field Office.

12.9 ACQUISITION OF CHATTEL PROPERTY

The Agency will make every effort to avoid acquiring chattel property by having the borrower or Field Office Staff liquidate the property according to RD Instruction 1962-A, and applying the proceeds to the borrower's accounts. Authorized methods of acquisition of chattel property include:

- **Sales**, including execution sales, Agency foreclosure sales, sale by trustee in bankruptcy, public sale by prior lien holder, and public sale conducted under voluntary liquidation.

- **Voluntary conveyance**, which is acceptable only when the borrower can convey ownership free of other liens and the borrower can be released from liability under the conditions set forth in 7 CFR 3560.457. Payment of other lien holders' debts by the Agency in order to accept voluntary conveyance of chattels is not authorized. If the Agency declines an offer of voluntary conveyance of chattels, the Loan Servicer will provide a copy of the rejection to the borrower.

- **Attending sales**, which the Loan Servicer will attend unless it is deemed to be physically unsafe to do so or if attending the sale would cause unfavorable publicity. The Loan Servicer will attend a sale held by a prior lien holder if the market value of the chattel is significantly greater than the amount of the prior lien.

- **Appraising chattel property**, which is the Loan Servicer's responsibility prior to the sale. An outside contractor in accordance with RD Instruction 2024-A may conduct an appraisal.

- **Abandonment of security interest**, should the chattel property have no market value and obtaining title would not be in the best interest of the Government. Such a situation might occur if costs of moving or rehabilitation are excessive.

- **Bidding at sale**, which the Loan Servicer might do if there are no other bids or if the property may be sold at an amount which is less than the Government's authorized bid. The Loan Servicer may not bid if the chattel property under prior lien is significantly less than the amount owed to the prior lien holder or if the Agency debt has been satisfied. Loan Servicers may not bid at a sale held by a junior lien holder or at a private sale.

Unless costs are incurred after the government acquires title to the chattel property, the borrower will pay all costs related to acquisition of the property. The Loan Servicer will use *Form RD 3560-19, Status of REO Property,* to report acquisition of chattel property.

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SECTION 3: DEBT SETTLEMENT

Debt settlement is a process in which the Agency attempts to maximize repayment of outstanding debts that are not satisfied through voluntary or involuntary liquidation. There are four types of debt settlement: compromise, adjustment, charge-off, and cancellation. The Agency complies with the Debt Collection and Improvement Act of 1996 in pursuing outstanding debt. However, a majority of MFH loans are to non-recourse borrowers for which no additional recovery is possible after liquidation. Therefore, the Agency primarily uses debt settlement in conjunction with voluntary liquidation.

The State Director may approve or reject proposed debt settlements when the outstanding balance of the indebtedness amount in the offer is less than $1 million. The National Office must approve or reject any settlements totaling $1 million or more.

12.10 BORROWER ELIGIBILITY

A borrower may request debt settlement in conjunction with or after voluntary liquidation of security. The Agency may agree to settle a borrower's debt if:

- All liable parties apply for debt settlement;
- The loan security is sold for cash or transferred to a third party;
- The borrower pays a compromise or adjustment offer of the current market value of the security, less prior liens, plus any additional amount the Agency determines the borrower can pay; and
- The initial payment, with a compromise or adjustment offer must be equal to or greater than the value of the security, less prior liens.

The Agency will not debt settle a borrower's debt if:

- The borrower possesses another Agency loan for which he or she cannot or will not settle the debt;
- The Department of Justice has jurisdiction over the borrower's loans or has a case pending against the borrower because of a suspected criminal violation in connection with the debt or security for the debt; or
- The Agency requests the Department of Justice to institute a civil action against the borrower to protect its interests.

12.11 APPLICATION REQUIREMENTS

The Agency considers a borrower's financial status when evaluating the borrower's request for debt settlement. A borrower must submit complete and accurate information from which the Agency can make a full determination of the borrower's financial condition. This information must include the following items from all liable parties:

- A completed *Form RD 3560-57, Application for Settlement of Indebtedness*;
- A current financial statement and cash flow projections;
- Verification of income;
- Verification of assets for the past 12 months;
- Verification of debts greater than $1,000;
- Tax returns for the past three years; and
- Any other items requested by the Agency.

12.12 COMPROMISE AND ADJUSTMENT

A borrower is not required to dispose of security prior to application for debt settlement. However, if a borrower has disposed of security prior to applying for debt settlement, proceeds from the disposed security must first be applied to the borrower's account. If the Agency approves a compromise or adjustment offer, the Agency will cancel any debt remaining after the compromise or adjustment offer is paid and applied to the debt.

A. Secured Debts

Secured debts may be compromised or adjusted as follows:

- The debt is fully matured under the terms of the note or other instrument, or has been accelerated by the Agency prior to the settlement application;
- A compromise offer must at least equal the net recovery value of the security as determined by the Agency, less prior liens, plus any additional amount the Agency determines the borrower is able to pay based on a current financial statement; and
- An adjustment offer must meet the requirements of a compromise offer, except the payments may be made over the shortest period the Agency determines is feasible, not to exceed five years

B. Unsecured Debts

Unsecured debts are most frequently account balances remaining after the borrower has voluntarily liquidated security property. The borrower's compromise or adjustment offer must represent the maximum amount the Agency determines the borrower can pay based on a current financial statement and any other available information. An adjustment agreement may not exceed five years.

C. Handling Payments

All compromise or adjustment payments will be recorded. The St. Louis Office will hold payments in the Deposits Fund Account until notification is received from the State Office of the approval or rejection of the offer. For approved offers, payments will be applied in accordance with established policies, beginning with the oldest loan in the settlement. When the Agency accepts an adjustment offer, the St. Louis Office does not adjust the accounts involved until the borrower makes all the payments to the Agency.

D. Delinquent Adjustment Agreement

Adjustment payments that are more than 30 days past due are referred to the State Director. The State Director may:

- Void the agreement;
- Process a new debt settlement agreement; or
- Grant a time extension.

The borrower may appeal the cancellation of the adjustment agreement.

12.13 CHARGE-OFF

Charge-off is an administrative tool the Agency uses to write off nonperforming debt from the Agency's portfolio. However, borrowers remain liable for charged-off debt, and the Government may continue to pursue collection. The Agency may charge off nonjudgment debt when:

- The principal balance is $2,000 or less, and efforts to collect the debt have been unsuccessful or would not be economical;
- OGC advises in writing that the Agency's claim is legally without merit;
- Efforts to induce voluntary repayment are unsuccessful and OGC advises in writing that evidence to prove the Agency's claim in court cannot be produced;
- The borrower is unable to pay any part of the debt and has no apparent future debt repayment ability; or
- There is no security for the debt.

12.14 CANCELLATION

When the Agency administratively extinguishes a debt owed to it, a cancellation occurs. Under these circumstances, the Agency releases the borrower from liability for the debt.

A. Cancellation with Application

When the borrower applies for debt settlement, the Agency may approve the request if the borrower's application shows that the borrower cannot make any compromise or adjustment offer. The Loan Servicer must obtain documentation from the borrower that, due to unusual or extenuating circumstances, a compromise or adjustment offer is not feasible.

B. Cancellation without Application

The Loan Servicer may make a recommendation to cancel debt, without an application from the borrower in the following circumstances:

- All liable entities no longer exist;
- The 6-year statute of limitations of offset expires;
- The borrower has been discharged of the debt in bankruptcy;
- The debt, including a deficiency judgment, is otherwise legally without merit; or
- The account has been returned to the Agency after cross-servicing by the Department of Treasury.

C. Processing and Approving Cancellations

The Loan Servicer must execute the completed *Form RD 3560-57* and process the cancellation in accordance with the FMI.

The Loan Servicer must notify the borrower in writing of the debt settlement approval and the approximate amount that the Agency will report to the IRS. When the Agency cancels debt without application from the borrower, the Agency must send a letter regarding the debt cancellation to the borrower's last known address.

The Agency must cancel any requests for offsets against the borrower after debt settlement approval.

12.15 REFERRAL TO THE DEPARTMENT OF TREASURY

Because most borrowers are nonrecourse borrowers, the Agency does not often refer accounts to the Department of Treasury for cross-servicing or offset as there are no liable parties for the debt. However, there may be times when it is appropriate to refer an account to the Department of Treasury for debt collection. The Agency should refer an account to the Department of Treasury when:

- The debt is <u>180 days</u> past due;
- The security has been liquidated; and

- The balance is due and payable.

The Agency should not refer an account to the Department of Treasury when:

- There are no liable entities to pursue;
- An internal offset is sufficient to collect the debt within three years after the debt becomes past due;
- The borrower is in compliance with an adjustment agreement;
- The debt is in litigation or bankruptcy action is pending; or
- The borrower is deceased.

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ATTACHMENT 12-A

NET RECOVERY VALUE WORKSHEET

I. BACKGROUND		
(1) Case Number:	(2) Borrower Name/ID:	
(3) Proposed Liquidation Option:		(4) Calculation Date:
(5) Estimated Holding Period: [1]		
II. CALCULATION OF NET RECOVERY VALUE		
(6) Market Value (use current appraisal)		
(7) Deductions from Market Value		
A. Liquidation costs		$_____
B. Acquisition cost		$_____
C. Settlement cost of prior liens		$_____
D. Estimated cost to operate during appraisal period[2]		$_____
E. Cost to correct health and safety violations		$_____
F. Cost to address environmental hazards (if different from E)		$_____
G. Selling costs		$_____
(8) Additions to Present Market Value		
A. Appreciation during holding period		$_____
B. Income during holding period		$_____
C. Total Additions (sum of items 8A and 8B)		$_____
(9) NET RECOVERY VALUE (6 minus Item 7G plus Item 8C)		

[1] The estimated inventory holding period prior to resale should be based upon previous experience in selling non-program property in the state and the availability of current funding for non-program inventory properties. If a state has not had experience in marketing non-program properties, the Multi-Family Housing Portfolio Management (MFHPM) Division in the National Office should be contacted.

[2] The cost to operate the project during the inventory holding period prior to resale should be based upon typical operating costs, excluding debt payments to the government, for similar projects in the servicing jurisdiction.

CHAPTER 13: OTHER SPECIAL CASES
[7 CFR 3560.458 THROUGH 3560.459]

13.1 INTRODUCTION

There are a number of special circumstances that necessitate additional servicing procedures beyond those presented in previous chapters. Most of these cases involve characteristics unique to either a particular property or to a particular borrower. Property and borrower issues include a number of relatively uncommon, but nevertheless important, situations that Loan Servicers need to know how to address. Property issues include abandonment, valueless liens, and other security issues. Borrower issues include death, divorce, bankruptcy/insolvency, and membership liability agreements.

This chapter presents the requirements for these other special servicing cases and Agency procedures for addressing them.

SECTION 1: PROPERTY ISSUES

13.2 OVERVIEW OF PROPERTY ISSUES

The Agency's servicing goal is to protect the physical and financial asset that each project represents, and ensure that each project is operated in a way that meets program objectives. Sometimes, a property becomes troubled due to mismanagement, deferred maintenance, or market changes. As a result, the property may lose a significant share of its value. Whether a borrower chooses to abandon the property or to continue with its management, the Agency needs to address the situation created by the property's problems with appropriate servicing measures that protect the interest of the tenants and the Government. This section describes those measures.

In general, Loan Servicers should obtain the advice of the Office of General Counsel (OGC) as needed for handling the special circumstances addressed in this section. These circumstances include:

- Abandonment;
- Valueless liens;
- Other security issues; and
- Taking additional security to protect Agency interests.

Prior to any decision involving real property under the above-listed special circumstances, Loan Servicers will complete an environmental review under The National Environmental Policy Act (NEPA), and a due diligence report. Refer to RD Instruction 1940-G and Chapter 3, Section 3 of HB-1-3560 for further information.

13.3 ABANDONMENT

When the Agency believes that a borrower has abandoned a project, it will make an immediate check to determine if the borrower has moved and, if so, whether a forwarding address can be determined so that further servicing actions can be taken. The Agency will take the steps necessary to protect the Government's security interest in the property. In general, the steps taken following abandonment are similar to those taken following foreclosure, once abandonment has been confirmed.

A. Indicators of Abandonment

The Agency considers a property to be abandoned when any or all of the following conditions exist:

- The borrower cannot be located after the Loan Servicer has made diligent efforts to contact the borrower. This condition also applies to instances where the general partner(s) of a limited partnership cannot be located and the limited partners are unknown or cannot be located.

- The project remains unoccupied for an extended period of time, and the borrower makes no effort to maintain the security property, secure eligible occupants, and/or comply with the objectives of the loan within a reasonable period of time as specified by the Loan Servicer in a certified letter sent to the borrower requesting compliance.

B. Contacting Prior Lien Holders

If the property is not being maintained and the Loan Servicer determines that the borrower has abandoned the project, the Loan Servicer will attempt to contact any prior lien holders with a request that they take control of the property and make any emergency repairs necessary.

If no prior lien holder is involved or the prior lien holder cannot immediately be contacted or refuses to make the emergency repairs, the Loan Servicer will immediately notify the State Director and request permission to:

- Take possession of the property pending liquidation;

- Make health and safety repairs to prevent further deterioration of the security; and

- Enter into a management or caretaker's agreement on behalf of the owner.

C. Making Emergency Health and Safety Repairs

When making necessary health and safety repairs where an emergency exists, Loan Servicers should recognize that the repairs need to be completed as quickly and effectively as possible. Accordingly, a commonsense approach that balances the health and safety of tenants with the price, speed, and quality of the repairs should be employed. Bids for specific services may be obtained from several local contractors only if the bid

process does not adversely affect the health and safety of the tenants. Loan Servicers must document the circumstances leading to the emergency situation, as well as the reasonable steps taken to address health and safety concerns in the case file, to later back up any costs incurred.

All costs incurred at the project during the interim period between abandonment and eventual disposition by the Agency—including repair costs—are the responsibility of the borrower. The Agency treats the costs of managing abandoned property as a recoverable cost item.

D. Appointing a Caretaker or Management Agent

A caretaker or management agent will normally be appointed when the borrower has abandoned the security property or has failed to maintain its operation and the State Director determines, with the advice of OGC, that the Agency should take possession of the property to best protect the interest of the government. Selection of a caretaker or management agent is subject to the following requirements:

- **Qualifications.** Persons or firms chosen as caretakers or management agents should have experience in operating and managing similar properties or have business experience that qualifies them to provide the needed services. They must be located near the property to provide day-to-day supervision, or be able to appoint a qualified local person to meet this requirement. Caretakers will normally be selected for unoccupied projects or those not suitable for occupancy. Management agents will only be selected for projects that are occupied or suitable for occupancy. The selection process—which must comply with all applicable Federal Acquisition Regulation (FAR) requirements—must be adequately documented by Loan Servicers in the case file.

- **Allowable fees.** The amount of the management agent or caretaker fee must be set in accordance with Agency requirements for management fees. The requirements regarding management fees are established at 7 CFR 3560.102(i) and described in Chapter 3 of HB-2-3560. These fees will be paid as a project expense if project funds (e.g., reserve accounts) are available. If project funds are not available, fees will be paid with Government vouchers, considered a recoverable cost, and charged to the borrower's account. The fees will be paid on a monthly basis.

- **Rental rates.** Rental rates at abandoned properties will normally remain the same for eligible occupants as when the project was under the control of the borrower, although revisions may be allowed under certain circumstances with the approval of the State Director. Such conditions include:

  ◊ The lease agreement between the borrower and tenant permits changing the rates;

  ◊ A change of rates is needed to provide income sufficient to pay operational and maintenance expenses, including the caretaker's fee, and to repay the loan on schedule; or

◊ Any increase will not result in rental rates above the payment ability of eligible occupants, unless the State Director has given the authority to rent units to ineligible occupants.

- **OGC advice.** The State Director should consult OGC for advice, including the possibility of having a receiver appointed, when the following conditions exist:

  ◊ The project is occupied but rent is not paid or collected;

  ◊ The eligibility of the occupants cannot be determined; and

  ◊ The borrower has failed to comply with the objectives of the loan within a reasonable time frame as specified by the Loan Servicer in a certified letter to the borrower requesting compliance.

E. Addressing the Agency's Relationship with the Borrower

To resolve the abandonment situation, the Agency must determine the cause of the abandonment. If a property is abandoned in accordance with Section 13.3 A of this chapter, Loan Servicers need to document that the Agency will proceed with one of three servicing options: foreclosure, acceptance of a deed in lieu of foreclosure, or debt settlement. The Agency normally will proceed with foreclosure unless one of the other two options is offered by the borrower. If the Agency determines after investigating the causes for the abandonment that the borrower entity is no longer viable, it will normally proceed to foreclosure or accept a deed in lieu of foreclosure, if debt settlement cannot be achieved. The Agency will consider negotiated debt settlement only in cases where a default is evident and doing so is in the best interest of the Government. Properties in which debts are settled may be declared non-program properties.

Upon foreclosure, the Agency has the authority to seize any project accounts on which the Agency has countersigned (e.g., reserve accounts).

13.4 VALUELESS LIENS

A valueless lien exists at a property where the recoverable value of the lien is less than the estimated cost of recovery. When the Agency determines that it has a valueless lien, it will prepare a written determination to that effect and release its lien.

A. Declaring a Valueless Lien

To declare a valueless lien, the Loan Servicer must provide the following submissions to the State Office:

- Identification of property (legal description);
- Description of the Agency's lien position;
- Documentation of reasons that lien is determined to be without value; and

- Explanation of the reasons for releasing the lien and a description of the type of release sought (i.e., partial or full).

B. Documenting Valueless Liens

To document the reasons the lien on a project is determined to be valueless and to devise a strategy for releasing the lien, Loan Servicers should take the following steps:

- Within the context of a problem case report, write up an assessment of the value of the project and forward it to the State Director for review and guidance on how to release the lien; and

- Follow State Office instructions, as applicable.

13.5 OTHER SECURITY

The Agency also services other security instruments, such as collateral assignments, assignments of rents, Housing Assistance Payments (HAP) contracts, and notices of lien holder interest in a manner indicated by the agreements and according to acceptable practices in the respective states. When other security is taken, the Approval Official should develop a plan for servicing it at the outset.

- The State Director should develop any special servicing actions with the advice of OGC to protect the Agency's interest.

- Loan Servicers should file evidence of the other security in the loan docket in the Field Office.

- The Loan Servicer should make a notation on the management system card showing that the security has been retained.

13.6 OBTAINING ADDITIONAL SECURITY TO PROTECT AGENCY INTERESTS

The Agency generally does not need additional security to protect its interest. However, the Agency may negotiate with the borrower to obtain additional security in the form of real estate or other security when a decline in the value of the original security or other changes adversely affect the security available to the Agency in the event of a default. Examples of cases where the Agency may seek additional security include when the account is delinquent, the property has not been properly managed or maintained, or there is serious doubt that the borrower can carry out loan objectives.

While the Agency has the authority to seek additional security in the circumstances listed above, it is generally a negotiated, nonforcible action. However, there may be instances where the Agency can use its leverage to obtain additional security (e.g., a case where loan funds are used to purchase land on which the borrower plans to build a parking lot). In such cases, the Agency might demand an interest in the parking lot as additional security for the entire project. Additional security is taken by executing a deed of trust with the borrower.

A. State Director Authorization

In cases where taking additional security is warranted, the Loan Servicer must forward the borrower's case file to the State Director for authorization, along with a memorandum providing the following information:

- The facts that justify the taking of additional security;
- A conservative estimate of the market value of any real estate to be mortgaged (*Note:* It is not necessary to obtain an appraisal of the property to be mortgaged unless required by the State Director.);
- A brief description of any existing liens on the additional security, including the repayment terms and the unpaid balance;
- The name of the title holder and how the title to the property is held (*Note:* Title evidence is not required.);
- A plan for servicing the additional security to be taken; and
- A description of other servicing alternatives available to ensure that the objectives of the loan will be met and to protect the Government from loss.

The highest quality security available should be taken whenever additional security is considered. This means that if several security options are available, the option that has the least amount of risk associated with it (and would thus be easiest to liquidate if necessary) should be chosen. Security property with known environmental hazards or other risks generally should not be taken as additional security. Such risks will generally be identified when the Loan Servicer conducts due diligence, including an environmental review. When the Agency chooses not to acquire additional security property, whether in whole or in part due to the presence of or potential for release of hazardous substances or petroleum products, the Loan Servicer will notify the appropriate regulatory authority of the Agency's findings and actions.

B. OGC Advice

Loan Servicers should obtain OGC advice and assistance whenever additional security is taken. Specifically, OGC can provide a title opinion, which will advise Loan Servicers as to what lien position is available to the Agency.

13.7 SECURITY ISSUES INVOLVING PROJECTS WITH PARTICIPATION LOANS

The Agency's rule states that when other participation is involved, the Agency will service the account in accordance with appropriate Agency servicing regulations and the agreements made with the other participants at the time of loan origination.

SECTION 2: BORROWER ISSUES

13.8 OVERVIEW OF BORROWER ISSUES

Borrowers may occasionally experience special circumstances that affect their ability to operate the property and, thus, the Agency's approach to servicing their accounts. Bankruptcy, death, and divorce are events that require special attention to ensure that the interests of the tenants and the Government are protected. Similarly, special agreements that borrowers may have with members of the organization may affect the Agency's servicing approaches and decisions. This section addresses such special cases.

13.9 REQUIREMENTS FOR ADDRESSING BORROWER ISSUES

The Agency will address borrower accounts affected by special circumstances, such as death, bankruptcy, insolvency, and divorce, on a case-specific basis. The Agency will make servicing decisions in such cases that are in the best interest of the tenants and the Government. The Agency will bring legal action questioning the legal capacity of the borrower to administer the project if found necessary to protect the Government's interest. The borrower or the borrower's representative will provide to the Agency information concerning the:

- Evidence of legal action, due to a will or court actions that establish who is to become the owner, on the part of the heirs or trustee following the borrower's death;
- Financial status of the borrower;
- Status of the security property; and
- Impact of the identified actions on the project's operation.

In general, Loan Servicers should obtain the advice of OGC as necessary to handle circumstances involving death, bankruptcy, insolvency, and divorce.

A. Bankruptcy

The handling of bankruptcy cases varies from state to state. Therefore, the State Director may issue State Supplements providing more specific guidance to expedite the handling of those cases. In general, however, Loan Servicers should obtain and follow the advice of OGC as necessary whenever general partners file for bankruptcy.

B. Divorce

When individual borrowers with loans are involved in a divorce action, the Loan Servicer will review the case after the final divorce decree has been granted to determine if any action is needed for the future servicing of the account. The Loan Servicer will submit the case file to the State Director for advice if the Loan Servicer is uncertain of the servicing actions needed to protect the Agency's interest, or if continuation of the loan with the remaining borrower is not authorized. The Agency will not make subsequent loans to pay equity as a result of a divorce action.

C. Membership Liability Agreements

As a loan approval requirement, some borrowers may have special agreements with members of the organization for the purchase of shares of stock or for the payment of a pro rata share of the loan in the event of a default. Alternatively, they may have instruments commonly referred to as individual liability agreements, which are usually assigned to and held by the Agency as additional security for the loan. In other cases, the borrower's note may be endorsed by individuals. The Agency will service these security and liability instruments in a manner indicated by the agreements to adequately protect the Agency's interest. The State Director will develop servicing actions with the advice of OGC.

CHAPTER 14: MANAGEMENT AND DISPOSAL OF REAL ESTATE OWNED PROPERTY

14.1 INTRODUCTION

When the Agency takes ownership of a project, adding the property to its inventory through liquidation proceedings, the project becomes real estate owned (REO). When the title transfers to the Agency, the property becomes an Agency asset. The Agency's objectives in managing and selling its inventory of REO properties include:

- Preserving affordable, decent, safe, and sanitary housing for tenants or potential tenants;
- Maintaining the value of the housing project;
- Protecting the Agency's financial interests;
- Ensuring that the properties comply with state and local code requirements and applicable environmental regulations; and

14.2 OVERVIEW OF THE CHAPTER

This chapter is divided into five sections.

- Section 1 describes the management of custodial and REO property. It describes acceptable management methods; discusses issues related to taking possession of custodial and REO properties, such as disposing of nonsecurity property and paying taxes and insurance premiums; and explains requirements related to maintenance, environmental concerns, and other management issues.
- Section 2 covers the disposition of REO property. It describes the methods for pricing and selling the properties and outlines procedures for accepting bids from potential purchasers. It also describes the standards the property must meet before being sold.
- Section 3 describes the environmental requirements that must be fulfilled before selling an REO property. These include requirements related to flood and mudslide hazard areas, wetlands, coastal barrier resources systems, historic places, protective covenants and easements, underground storage tanks, and hazardous substances.
- Section 4 outlines the procedures for processing and closing the sale of an REO property. These procedures are similar to the procedures for closing other Agency loans. This section also highlights some of the special considerations for REO properties.
- Section 5 provides instructions on processing credit sales for non-program terms.

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SECTION 1: MANAGEMENT OF CUSTODIAL AND REO PROPERTY

14.3 OVERVIEW

The Agency assumes management responsibility for two types of properties: custodial and REO. Custodial property is borrower-owned property that has been abandoned. REO is Agency-owned property to which the Agency has acquired title, either as a result of foreclosure or conveyance by deed in lieu of foreclosure. This section outlines the requirements for management of each type of property.

Loan Servicers are responsible for ensuring that custodial and REO properties are appropriately managed and maintained. The goal of property management is to protect the tenants and the interests of the Government. Consequently, Agency efforts to secure and manage these properties are to begin immediately once the following occurs:

- The property title is conveyed to the Agency; or
- The Agency determines property is abandoned.

14.4 MANAGEMENT METHODS AND CONTRACTS

The Agency has the authority to contract with qualified management entities to perform the management activities discussed in this section. The extent of management is dependent on factors such as:

- The nature of the project;
- The project's location;
- The condition of the project;
- Necessary maintenance; and
- Availability of acceptable management entities.

In some cases, the existing management agent can be maintained; in others, the Agency must hire a new management agent to provide all property management services on behalf of the Agency.

A. Selecting a Management Contractor

Management contractors are selected in accordance with Agency procurement procedures outlined in RD Instruction 2024-A. Alternative methods for selecting a management contractor may be established by the Agency if it is in the best interest of the Government. Alternative selection methods require advice from the Office of General Counsel (OGC). Prior to obtaining a management agent for custodial property, the Agency should determine if court approval is required.

B. Management Contract Requirements

At a minimum, management contracts must:

- Allow for properties to be added or removed from the contractor's assignment, whenever necessary, such as when a property is taken into custody, acquired, or sold during the period of a contract;
- Prohibit the contractor or associates of the contractor from performing repairs if the executed agreement calls for the contractor to provide detailed repair specifications;
- Require the management agent to hold security deposits in trust and handle them in accordance with the tenant's lease or occupancy agreement; and
- Require compliance with environmental laws.

The management agent must develop an Affirmative Fair Housing Marketing Plan (AFHMP), in accordance with RD Instruction 1901-E. The AFHMP must be submitted to the loan office. The AFHMP must receive written approval from the Civil Rights Coordinator in the Rural Development State Office. *Form RD 1955-62, Request for Contract Services for Custodial/Inventory Property or Program Services* is a sample statement of work for a project management contract.

C. Management Costs

The costs of management services related to REO property will be paid out of income generated by the housing project being managed. If income from the housing project is inadequate to pay for management services, Agency resources may be used to pay for management services.

D. Project Funds

When a property becomes REO, the Agency transmits operating and maintenance, reserve accounts, and escrow funds to the St. Louis Office. The former borrower's account is credited for these amounts. If there is a surplus of funds, the St. Louis Office will forward a refund check payable to the former borrower.

14.5 TAKING POSSESSION

A. Taking Custodial Possession

The Agency is authorized to take custody of security property when a borrower becomes incapacitated, dies, or has abandoned a security property. When the Field Office has attempted for more than 30 days and is unable to contact a borrower, the Loan Servicer must inspect the property to determine its status and attempt to locate and contact the borrower. The Field Office should seek the advice of OGC in making its determination and recommendation.

1. Determining Whether a Property Has Been Abandoned

The determination that a property has been abandoned requires significant investigation and documentation. In addition to the actions described in this paragraph, Field Office Staff must follow any procedures required by state or local law in order to confirm the determination of abandonment and to take custodial possession. The Agency cannot act to obtain possession of a property as long as a lien holder has legal possession of the property, or the borrower or the lien holder has a right to lease proceeds. Field Office Staff cannot classify a property as "abandoned" prior to documenting attempts to:

- Determine that there is no clear evidence of management presence at the project. For example, a site visit indicates that tenants are unable to contact borrower or property manager regarding repairs or rent collection, the project has fallen into disrepair due to a total lack of maintenance activities, or the Loan Servicer cannot locate the borrower or property manager;

- Locate the borrower through sources including, but not limited to, tenants, the postal service, utility companies, business associates, relatives, insurance agents, and tax authorities; and

- Determine whether there are other liens on the property**.** If liens exist, whether the lien holder(s) are willing to work with the Agency to secure the property.

2. Recommendation for Taking Custody

The Field Office will report its findings to the State Director. The report will recommend that a property be taken into custodial possession if it appears that the property has been completely abandoned and the Agency needs to assume responsibility for it to protect the security. Alternatively, if the Field Office reports that the property is occupied, the report will give details as to whether the occupants are under a lease or are unauthorized. The Field Office will provide any other relevant details and recommend future action. When appropriate, the State Director will authorize the Field Office to take custodial possession. When the Field Office believes that a property is abandoned, it must prepare a report that provides evidence of a property's abandonment. The report is placed in the borrower's case file, and a copy of the report is forwarded to the State Office.

3. Liquidation

The need to take custodial possession of a property may occur before or after a loan has been accelerated. If liquidation is not already in progress, taking custodial possession should initiate the process. Field Office Staff are responsible for conducting liquidation activities.

B. Acquiring an REO Property

When a Field Office acquires a property, Field Office Staff must notify the State Director. An additional REO case file should be created from the original case. The

REO case file should include the property title, recent inspection reports, appraisals, environmental reviews, and any other documentation related to the physical condition or value of the property. No information related to the borrower is needed in the REO file.

14.6 INSPECTING AND SECURING CUSTODIAL AND REO PROPERTY

Once REO property is acquired, Field Office Staff must inspect the property to determine what steps need to be taken to further ensure its security and maintain its value. The inspection will allow Field Office Staff to designate the property as program or non-program and evaluate the need for repairs.

A. Inspecting and Classifying the Property

Field Office Staff must perform an on-site field inspection of REO property to:

- Determine repair needs;
- Gather information to assist in completing the environmental review;
- Assist in updating the due diligence report and appraisal, as necessary; and
- Take necessary actions to secure and maintain the housing project.

Based on the results of the inspection, Field Office Staff designate REO property as program or non-program property after considering factors such as size; design; possible health and/or safety hazards; and obsolescence due to functional, economic, or locational conditions. REO property may be sold as non-program property it any of the following conditions exist:

- The housing project does not meet Agency requirements and the cost of bringing the housing into compliance is determined, by the Agency, to be economically unfeasible based on the amount of funds available to the Agency and the housing needs in the market area where the housing is located;
- Attempting to sell the property on program terms is not in the best interest of the Federal Government; or
- Hazardous substances or petroleum products have been released on the property and the cost of cleanup is estimated to exceed the dollar value the Agency will recover through sale of the property.

REO property in an area no longer designated rural is treated as if it were still in a rural area.

B. Securing Custodial and REO Property

When the Field Office assumes management responsibility and takes possession of REO or custodial property, immediate steps must be taken to inspect and secure the property whether by Field Office Staff or management contractor.

1. Physical Security of Vacant Properties

If the property is vacant, it should be locked or otherwise secured and a no trespassing notice should be posted. For REO only, after an inspection determines utility systems are in safe operable condition, utility companies should be contacted to maintain or reinstate utility service. An inventory should be made of any nonsecurity personal property left on the premises and efforts made to identify any owners or lien holders.

2. REO Properties Occupied by Tenants

REO property may be occupied by tenants with leases executed by the former borrower. The Agency may require tenants to sign a new lease, but if it is in the best interest of the Government, the Agency may honor existing leases. The Agency may evict unauthorized tenants.

When units in an REO property are under an existing lease and the Agency decides to continue the lease, the tenant must be notified, in writing, that the Agency has acquired the former owner's rights under the lease and that all payments should be remitted to the Agency's management agent. If a lease is to be terminated, the tenant must be notified, in writing, that their lease is being terminated in 30 days, and they must vacate. The OGC should be contacted for advice and assistance prior to evicting a tenant in order to obtain possession of an REO property.

Rent payments due and payable before the date the Agency acquired the property are applied to the borrower's account. Any surplus funds will remain with the project.

14.7 DISPOSITION OF NONSECURITY PROPERTY

The Agency has no legal claim to any nonsecurity, owner, or tenant property left on the premises. State or local law may affect procedures for disposing of personal property left on the premises of an REO or custodial property. Field Office Staff must comply with any state or local requirements, as well as the procedures discussed in this paragraph. If the owners or lien holders of any personal property that remains custodial or REO property can be identified and located, Field Office Staff must offer them a reasonable opportunity to remove the property. Any conversations with the owner of the property should be documented and placed in the case file.

A. Custodial Property

The Agency may remove any nonsecurity personal property from custodial properties as long as such property can be safely stored. Personal property cannot be removed and stored if:

- The storage facility presents a hazard to the security of the property, such as a leaking roof or unsecured area, which allows access to the property by unauthorized persons; and

- The personal property itself presents a hazard, such as flammables or explosives. Hazardous materials must be managed in compliance with Paragraph 14.10.

B. REO Property

1. Notice to Owners or Lien Holders of Personal Property

If the property is not retrieved after the initial notification, a certified letter should be sent, return receipt requested, notifying the owner or lien holder of the date on which the Agency will dispose of the property, and that the property may be retrieved before the disposition upon payment of any expenses incurred by the Agency related to the personal property, such as advertisement or storage.

2. Disposal of Unclaimed Property

The Field Office will dispose of unclaimed property in accordance with its value and conforming with local practices. For example, if there are items of significant value, an advertisement may be placed in the local newspaper. Unclaimed tenant property will be disposed of in accordance with the terms of the lease.

3. Income from Disposition

Proceeds from the sale of items under lien should be paid to any owner or lien holder after deducting Agency selling expenses. If there is no known owner or lien holder, proceeds are applied to the REO account.

14.8 TAXES AND INSURANCE

A. Taxes

REO property is subject to taxation by state and local political jurisdictions in the same manner and to the same extent as other properties, unless state law specifically exempts property owned by the Federal Government. If a jurisdiction changes the law to begin taxing Government-owned property, only taxes accrued after the effective date of the change will be paid. Field Office Staff must notify the taxing authority, in writing, when title to real estate is acquired and provide the Field Office address to which tax bills should be sent during Agency ownership.

If the value of the property is significantly less than the value at which it is being taxed, as soon as it is acquired the Agency may request a new assessment by the local taxing authority. Management contracts between the Agency and property managers may include provisions allowing the management agent to request a new tax assessment.

If property is acquired subject to a prior lien, before the Agency pays taxes, Field Office Staff must contact the prior lien holder to determine if that lien holder will pay the taxes.

Taxes on program property are paid when due. Taxes on non-program property may be deferred until the property is sold if the taxes that accrue before disposition exceed the value of the property. If the taxing authority schedules a tax sale before the Agency can sell the property, Field Office Staff will determine what is in best interest of the Government. To make this determination the Field Office Staff will calculate the net recovery value that would result from paying the taxes and continuing sales efforts. This calculation will be compared with the net recovery value if the Agency allowed the property to be sold for delinquent taxes. (See Chapter 12 for a more detailed discussion of net recovery value.)

B. Insurance

1. Custodial Property

Insurance on custodial property will be maintained per program instructions.

2. REO Property

Insurance will not be canceled when property is acquired. However, the Agency will pay additional premiums to continue coverage only when it is in the best interest of the Federal Government. If it is necessary to file a claim, Field Office Staff should submit the claim and direct that insurance proceeds be forwarded to the St. Louis Office.

14.9 PHYSICAL MAINTENANCE AND REPAIR

Custodial property will be maintained and repaired only as needed to protect the security of the property and to prevent deterioration. In the case of historic buildings, such repair and maintenance will be done in a manner that preserves the design integrity. Consult with the SEC and/or SHPO to resolve any issues in this regard**.** In the event of damage or theft, the procedures described under subparagraph A of this section should be followed.

All contracts for management or lease of REO property will contain provisions that protect environmental resources determined to be present in keeping with Section 3, Environmental Requirements

REO property designated to be sold as program property must be repaired, as necessary to meet the Agency's requirements for decent, safe, and sanitary housing.

REO property designated to be sold as non-program property will be managed in a manner that:

- Removes health and safety hazards;
- Prevents deterioration; and

- Complies with state and local requirements for the sale of the property.

Additional repairs or renovations will only be made if they will enhance the sale value of the property and are determined, by the Agency, to be in the best interest of the Government.

A. Vandalism and Theft

Field Office Staff will report any willful damage or theft to the local law enforcement authorities and in whatever manner necessary, to attempt to resolve the incident, including signing complaints and testifying at hearings or trials.

Field Office Staff should send a written report of the incident to the State Director and a copy to the Regional Office of the Inspector General (OIG). The State Director, in consultation with the OGC as necessary, will advise and assist the Field Office Staff.

Damage to REO program property as a result of vandalism and theft may be repaired as necessary to continue marketing. Repairs may include cost-effective improvements to minimize the likelihood of future damage, such as increased lighting, security fencing, and removal of shrubs that limit visibility. Non-program property should be broom swept, but generally will not be repaired unless necessary to prevent deterioration. Custodial property should be repaired only to protect the security and prevent deterioration.

B. Off-Site Repairs or Improvements

The Agency may require off-site repairs or improvements to protect property from damage, to protect the Government's interest or enhance the marketability of property. Off-site improvements must be approved by the State Office. To obtain approval, Field Office Staff must prepare a justification that demonstrates failure to make the improvements would likely result in a loss in property net recovery value greater than the expenditure, and that there are no other feasible means with state or local entities to accomplish the same result.

To obtain off-site improvements, the Agency may enter into a contract with a private company or enter into a cooperative agreement with a state or local government, or other entity to obtain repairs or improvements. Under a cooperative agreement, the entity will provide money, property, services, or other items of value to the entity to accomplish a public purpose. While cooperative agreements are not a contract action, the authority, responsibility, and administration of a cooperative agreement must be consistent with contract action. OGC should be consulted when a cooperative agreement is considered.

14.10 SPECIAL USES OF REO

A. Transitional Housing for the Homeless

By a Memorandum of Understanding (MOU) between the Agency and the Department of Health and Human Services, REO property that is not under lease or sales

agreement may be leased to public bodies and nonprofit organizations to provide transitional housing for the homeless.

B. Mineral Leases

When it is in the best interest of the Government, the Agency may lease mineral rights associated with REO property. OGC should be contacted for assistance in preparing the lease agreement. The appropriate level of environmental review must be completed prior to any agreement to lease mineral rights. Since such actions may be controversial and may have the potential for significant impact on the environment, prior consultation with the State Environmental Coordinator is required.

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SECTION 2: DISPOSITION OF REO PROPERTY *[7 CFR 3560.503]*

14.11 OVERVIEW

The Agency will make every effort to sell REO properties quickly and at the best possible price. Whenever possible, preference will be given to selling REO program property to a program borrower. Preference will be given to offers from bidders who are determined eligible by the Agency to purchase REO property designated to be sold as program property.

A. Sale Methods and Pricing

Most REO properties are sold through public drawing. However, the Agency may sell properties through auction, sealed bid, negotiation, or agreements with other Federal Agencies, such as the Department of Housing and Urban Development (HUD).

REO properties are initially priced for sale at their present market value, as determined by appraisal. Administrative price reductions may be taken over time to facilitate sale of the property (see Paragraph 14.14 for a discussion of price reduction). A schedule is published that restricts sales of program property to program-eligible buyers for a period of time before any offering to the general public, and whenever there is a reduction in price.

An Affirmative Fair Housing Marketing Plan, as described in Paragraph 14.15, must be prepared for REO multi-family housing properties of four or more units.

B. Financing

When funds are available, the Agency may offer financing to buyers of REO property. When program credit is offered, the loan is processed following the procedures described in HB-1-3560.

Non-program credit terms are offered when the buyer is not eligible for a Section 514 or 515 loan, or the property does not qualify as a program property. Section 5 provides instructions for credit sales on non-program terms. Buyers who receive financing on non-program terms must be advised that they are not eligible for interest credit or rental assistance.

C. Warranty

The Agency does not provide a warranty of either the title or the physical condition of any REO property.

14.12 PRICING AND SALES SCHEDULES

REO housing is priced and initially offered for sale at its present market value, based on a current appraisal. Administrative price reductions may reduce the offering price to facilitate the sale. Mineral, water, and similar rights are generally sold with the property and are not sold

separately except when the Government's security interest will not be jeopardized. Lease or royalty interests that do not pass by deed are assigned to the buyer.

A. Appraisals

To determine the property's present market value, the Field Office must arrange for an appraisal in accordance with the procedures described in Chapter 4, Notice of Funding Availability (NOFA) and Initial Application Process. If repair or improvement is planned, the appraisal must provide both as-is and as-improved values. Each as-improved appraisal must include a list of the planned repairs. Any special flood or mudslide hazard areas or wetlands and related use restrictions must be reflected in the appraisal. All REO property considered for disposal or lease must be evaluated for possible contamination from hazardous substances or petroleum products through the process of due diligence and completion of the Transaction Screen Questionnaire (*TSQ)* as described in Paragraph 14.26. This will normally be completed at the same time as, or prior to, the appraisal.

A property must be reappraised whenever its condition has deteriorated, it has been significantly damaged or vandalized, additional repairs and improvements have been made, cleanup of hazardous material or lead-based paint, or there has been a change in market conditions. Refer to Section 3 for detailed environmental requirements.

B. Sales Schedules and Administrative Price Reductions

The sale of REO program property is restricted to program-eligible buyers when a property is offered for sale and any time an administrative price reduction is taken. Exhibit 14-1 provides the sales schedule for program property. The sales price is fixed when a sales contract is executed and does not decrease further based upon scheduled price reductions.

Exhibit 14-1 Sales Schedule for Multi-family Housing REO Property Program Property	
Days from Initial Offer	**Action**
Day 1	Initial offer (appraised as-is value with subsidy).
Day 45	If no acceptable offer, reduce price by 10 percent and offer again.
Day 91	If no acceptable offer, reduce price by another 10 percent or use other methods (additional 10 percent price reductions allowable after 45 days)
Day 180	If no acceptable offer, submit REO case file with documentation of marketing efforts to State Office for further advice on sales incentives or to authorize sealed bid/auction. Loan Servicer may reevaluate whether the project should be classified as a program property.

Exhibit 14-2 provides the sales schedule for non-program properties. If a program property has not sold following active marketing efforts and two price reductions, Field Office Staff will reevaluate the property to determination if it should continue to be marketed as a program property. The reevaluation process may include an updated appraisal.

Exhibit 14-2 Sales Schedule for Non-Program REO Property	
Days from Initial Offer	**Action**
Day 1	Initial offer (appraised as-is value without subsidy).
Day 45	If no offer, reduce price by 10 percent and offer again. Additional 10 percent price reductions are allowable after 45 days.
Day 91	If no acceptable offer, reduce the price by another 10 percent or use other sale methods.
Day 180	Submit REO case file with documentation of marketing efforts to State Office for further advice on sales initiatives to authorize sealed bid/auction.

14.13 MARKETING AND ADVERTISEMENT

A good marketing plan is the key to reaching the maximum number of potential buyers and to ensuring that eligible program applicants have an opportunity to purchase REO properties. The Agency may advertise directly or contract for advertising services. Broker contracts may include advertising services. All advertisements must state occupancy or environmental restrictions.

A. Fair Housing and Affirmative Fair Housing Marketing Plan

All advertising must meet equal housing opportunity requirements and contain the equal housing opportunity statement and logo.

B. Truth in Lending Requirements

If the availability of Agency financing will be advertised, marketing efforts must conform to the requirements of the Truth in Lending Act. Exhibit 14-3 highlights these requirements, see RD Instruction 1940-I for additional information.

Exhibit 14-3

Truth in Lending Highlights

- Advertisements that state specific credit terms must state only terms that will actually be offered.
- Any finance charge listed must be stated as an annual percentage rate.
- Key terms related to financing used in the advertisement must be defined

C. Advertising and Marketing Methods

Advertising efforts should be designed to reach a broad audience. Each Field Office should identify appropriate marketing efforts and tailor them for each market area. At a minimum, advertisements must be placed in newspapers of general circulation and posted on the Field Office bulletin board. Other marketing efforts that may be appropriate include:

- Posting an advertisement on the Agency's multi-family housing REO Web site at https://mfhreo.sc.egov.usda.gov. This site allows staff to upload, modify, and delete properties. The general public will view multi-family housing REO properties for sale at: http://www.resales.usda.gov;

- Posting advertisements in public locations accessible to prospective purchasers, including community bulletin boards and major employment sites;

- Broadcasting announcements on radio or television; or

- Informing potential program applicants or investors of the availability of REO properties.

Advertisements must include the following:

- Appropriate language, stressing the need for potential buyers to complete and submit an application and other required documentation;

- Any restrictive-use requirements that will be attached to the project and added to the property's title;
- Sale price; and
- Date, time, and location of drawing. The date and time must allow adequate time for advertising and review of application packages.

D. Review of Marketing for Unsold Properties

At least quarterly, the State Director must review the status of unsold REO property to ensure that acquired properties are being placed on the market promptly, properties on the market are selling within a reasonable time frame, and that properties under contract are closed in a timely manner. Of particular concern are:

- Properties acquired more than 90 days ago that have not yet been made available for sale;
- Program properties that have been available for sale for 6 months or more and are not under contract;
- Non-program properties that have been available for sale for 4 months or more and are not under contract; and
- Properties that have been under contract for more than 60 days and have not closed.

14.14 SPECIAL MARKETING TECHNIQUES

A. Buyer Incentives

The State Director may authorize buyer incentives when Field Office Staff provide evidence that a specific market area is depressed and the incentives are required to stimulate buyer interest. To request approval for buyer incentives, the Field Office must describe past efforts to sell the property and explain why the proposed incentives are expected to produce improved results. Incentives, such as the payment of closing costs, may be appropriate for any property. Amortization schedules longer than the standard term may be offered for non-program properties.

B. Broker Incentives

When an additional broker incentive is needed, such as when a very low-value property offers an inadequate commission; the State Director may authorize a minimum commission or fixed-amount sale bonus. To request the incentive, the Field Office must describe the past efforts to sell the property and justify the amount and the purpose of the incentive. Upon the approval of the State Director, a written offer of the incentive that

specifies the requirements and circumstances in which the incentive will be given must be provided to the broker.

C. Acquisition of Land, Easements, or Rights-of-Way to Effect Sale

When it will help the sale of REO property and it is in the best interest of the Government, the State Director may authorize the acquisition of adjacent land, easements, or rights-of-way in order to cure title defects or encroachments. Additional land may not be acquired at a cost in excess of its appraised market value.

14.15 REO PROPERTY NOT MEETING PHYSICAL STANDARDS

When REO property does not meet the Agency's dwelling standards, and making repairs that will allow the property to meet these standards is not economically feasible for the Government, the property is listed, advertised, and sold with specific occupancy restrictions.

Housing that does not meet the Agency's dwelling standards may still be considered decent, safe, and sanitary if it:

- Is structurally sound and habitable;
- Has a potable water supply;
- Has functionally adequate, safe, and operable heating, plumbing, electrical, and sewage disposal systems;
- Meets the Agency's thermal performance standards; and
- Is safe—that is, a hazard does not exist that would endanger the health or safety of occupants.

The deed by which such a property is conveyed will contain a covenant restricting the new owner from allowing occupancy of affected residential units until it those units meet the Agency's dwelling standards, as discussed in Chapter 3 of HB-1-3560. Property that is not decent, safe, and sanitary must still meet the Agency's environmental requirements, including the management of hazardous substance requirements discussed in Paragraph 14.10.

In the event that the Agency has acquired property that is unsafe and cannot feasibly be made safe, for reasons that are environmental in nature or relate to contamination from hazardous substances or petroleum products, Field Office Staff will provide appropriate information to the State Director, including the observations and recommendations of the State Environmental Coordinator. The State Director will submit the case file, along with complete documentation of the problem and a recommended course of action, to the Deputy Administrator, Multi-Family Housing, with a copy to the Director, Program Support Staff, for their joint review and guidance.

A. Notice of Occupancy Restriction

The notice of sale and sale contract must describe the specific conditions that prohibit occupancy and the items necessary for the property to meet decent, safe, and sanitary standards, using language similar to the following:

> "Pursuant to Section 510(e) of the Housing Act of 1949, as amended, 42 U.S.C. 1480, RHS has determined dwelling unit or units on this property inadequate for residential occupancy. The quitclaim deed by which this property will be conveyed will contain a covenant excluding the inadequate residential unit(s) from residential use until the dwelling unit(s) is repaired or renovated as follows:" (insert the items necessary for the property to meet decent, safe, and sanitary standards, clearly indicating the inadequate unit(s) and necessary repairs for each unit).

For purposes of advertising, the list of specifications may be replaced with a statement to contact the Agency, or the real estate broker under an exclusive listing contract or "any real estate broker" for open listing agreements, whichever is relevant, for a list of specific items necessary for the property to meet decent, safe, and sanitary standards.

B. Quitclaim Deed Restrictive Covenant

The quitclaim deed must contain a covenant restricting residential occupancy if units within the project fail to meet the Agency's dwelling standards. The covenant must describe the conditions that prohibit occupancy of specific units and specify the improvements that are necessary for the property to fully comply with Agency standards for housing that is decent, safe, and sanitary. The covenant may use language in a State Supplement, similar to the following:

> "Pursuant to Section 510(e) of the Housing Act of 1949, as amended, 42 U.S.C. 1480, the purchaser ('Grantee' herein) of the above described property ('subject property' herein) covenants and agrees with the United States acting by and through the U.S. Department of Agriculture ('Grantor' herein) that the inadequate dwelling unit(s) located on the subject property as of the date of this quitclaim deed will not be occupied or used for residential purposes until the item(s) listed at the end of this paragraph have been accomplished. This covenant shall be binding on Grantee and Grantee's heirs, assigns, and successors and will be construed as both a covenant running with the subject property and as equitable servitude. This covenant will be enforceable by the United States in any court of competent jurisdiction. When the existing dwelling unit(s) on the subject property complies with the aforementioned standards of the U.S. Department of Agriculture in accordance with its regulations, the subject property may be

released from the effect of this covenant and the covenant will thereafter be of no further force or effect. The property must be repaired as follows:_____." (insert the items referenced in the notice of sale and sale contract, necessary for the property to meet decent, safe, and sanitary standards)

C. Release of Restrictive Covenant

When the owner requests a release of the restrictive covenant, the Agency inspects the property. The Agency will release the covenant if the conditions that prohibited occupancy have been corrected; the specific items necessary for the property to meet decent, safe, and sanitary standards have been provided; or the structure necessitating the restrictive covenant has been removed from the site. Restrictive covenants, established as environmental mitigation measures, will not be released without the concurrence of the State Director.

14.16 DISPOSITION BY PUBLIC DRAWING

Public drawing is the preferred and most common method of sale for REO properties. Exhibit 14-4 outlines the public drawing process. Use of any other sale method requires approval from the State Office.

Exhibit 14-4 The Disposition by Public Drawing Process	
Step 1	The property is offered for sale at market value. Loan Servicer completes *Form RD 1955-40, Notice of Real Property for Sale*.
Step 2	The Loan Servicer advertises the property. Contacting known interested parties is part of advertising efforts. Program properties are offered exclusively to program applicants for the first 45 days, after which the property is available to anyone. The Agency may accept offers from program applicants prior to the advertised drawing date. Non-program purchase offers cannot be accepted prior to the drawing date.
Step 3	Offers are accepted and stamped with the date and time of receipt.
Step 4	Agency reviews offers. If only one offer is received and the offer meets Agency requirements, that single offer may be accepted. If more than one offer is received, the Agency will accept the offer that is in the best interest of the Government. If acceptable offers are comparable, these will be sealed, placed in a receptacle, and drawn sequentially.
Step 5	If no acceptable offer is received, reduce price by 10 percent or use other incentives. Repeat steps 1 through 4.
Step 6	If no acceptable offer is received, submit REO case file with documentation of marketing efforts to the State Office for further advice on sales incentives or to authorize sealed bid/auction. Loan Servicer may reevaluate whether the project should be classified as a program property.

A. Listing the Property

REO property is offered for sale using *Form RD 1955-40*. The date indicated on *Form RD 1955-40* is the effective date of the offer to sell. An offer to purchase may be submitted at any time after the effective date listed in the notice.

When an offer is accepted, the notice of sale is revised to indicate that only back-up offers will be taken. The notice is not withdrawn until the sale is closed, except when the offer is from a nonprofit organization or a public body for transitional housing for the homeless.

REO Property Subject to Redemption Rights

REO property subject to redemption rights may still be sold if Field Office Staff determine that there is no probability of its redemption and state law permits its sale. In states where such sales are permitted, a State Supplement will be issued with the specific state law requirements. The buyer must sign a statement acknowledging sale conditions under state law. The original signed statement will be filed in the REO case file and transferred to the borrower's case file if it is Agency financed.

B. Submission Requirements

An offer to buy must be submitted on *Form RD 1955-45, Standard Sales Contract, Sale of Real Property of the United States*. Offers received in any other form must be returned to the offeror. Any offer to buy that is contingent upon Agency credit must be accompanied by a completed *Form SF 424, Application for Federal Assistance*. Applications are considered completed and acceptable only if they include the required attachments. To establish borrower eligibility, the following attachments must be included when the application is submitted:

- Financial statements for the past two years;
- Credit report for each general partner (if limited partnership) or each officer (if corporation);
- Proposed limited partnership agreement and certificates of limited partners, if applicable;
- Tax-exempt ruling from the IRS designating the borrower organization as a 501(c)(3) or 501(c)(4) if applicant is nonprofit (if designation is pending, a copy of the designation request);
- Mission statement;
- Evidence of organization under state and local law or copies of pending applications; and
- List of board members

Those requesting Agency credit must meet the applicant eligibility requirements as outlined in Paragraph 4.16 of HB-1-3560.

C. Receiving and Considering Offers

Each offer must be date stamped when it is received. Offers received on the same day will be selected for consideration by lot. Names will be placed in a receptacle, drawn, and numbered sequentially. Offers drawn after the first are held as backup and the offeror so notified.

The Agency selects the first minimum acceptable offer received and executes *Form RD 1955-45*. The form is then sent to the bidder along with a letter to indicate acceptance of the offer. A letter is also sent to notify all unsuccessful bidders of the status of their offers.

D. Cancellation of Sales Contracts

If an offer contingent upon obtaining Agency financing on program terms is selected and the credit request is subsequently rejected, the next offer is considered. Property is not held off the market pending the outcome of an appeal. If there are no backup offers, the notice of sale is revised to indicate the new status of the property.

When a sales contract is canceled due to offeror default, any earnest money collected is forwarded to the Field Office where it will in turn be forwarded to the St. Louis Office for application to the General Fund.

14.17 DISPOSITION BY SEALED BID OR AUCTION

Any use of the sealed bid or auction methods must be authorized by the State Director. Program properties may be sold using these methods only after regular sales efforts have been unsuccessful for six months. Either method may be used as the initial sale effort for non-program properties when regular sale efforts are not likely to result in prompt sale (such as when structures have been substantially destroyed by fire).

A. Establishing the Minimum Acceptable Offer

Field Office Staff must develop and document the recommendation for the minimum acceptable bid or sales price using the net recovery value worksheet provided in Chapter 12, **Attachment 12-A**.

B. Publicizing the Sale

The Agency solicits sealed bids or publicizes an auction by public notice. The notice must include the date, time, and place of the bid opening or auction and describe how bids are to be made, the required percentage of bid deposit, the maximum credit terms, the cash preference percentage described in subparagraph C.3 of this section, and other pertinent information, such as a notice of special flood or mudslide hazard area or wetland and any related use restrictions.

C. Sealed Bid Procedures

1. Submission Requirements

Sealed bids must be made on *Form RD 1955-46, Invitation, Bid, and Acceptance, Sale of Real Property of the United States*, and be accompanied by a deposit provided in the form specified in the bidding instructions. No deposit is required from bidders who are eligible program purchasers. A minimum deposit of 10 percent is required for non-program loans.

Bidders must submit their bids in a sealed envelope marked: "SEALED BID OFFER _____* " (*insert Property Identification Number).

Bids may be submitted for individual properties or a group of properties.

2. Receiving and Opening Bids

All bids will be date and time stamped when they are received. Sealed bids will be held in a secured file before bid opening. If the bidder wants to withdraw their bid, this must be done prior to the drawing date. The bid opening will be held publicly at the place and time specified in the notice with at least two Agency employees present. Each bid received will be recorded showing the name and address of the bidder, the amount of the bid, the amount and form of deposit, and any conditions of the bid. The record of bids will be signed by the staff person conducting the bid opening and retained in the REO file.

3. Reviewing and Accepting Bids

Only responsive bids will be considered. To be considered responsive, bids must be signed and dated by the offeror, include any required deposit, and be for an amount at least equal to the established minimum bid. Minor deviations or defects in the bid submission may be waived by the Approval Official so long as the bid meets these minimum requirements.

Generally, the highest bid will be selected. However, cash bids will be given preference over bids that are contingent upon the offeror obtaining financing if the cash offer is at least equal to a specified percentage of the highest offer. Exhibit B of RD Instruction 440.1 specifies the applicable percentage.

In the case of two identical bids for a program property, program-eligible purchasers will be selected before bidders who are not program-eligible.

4. No Acceptable Bid

If no acceptable bids are received, the Agency may negotiate a sale at the best price possible in accordance with Paragraph 14.18. All bidders must be informed, in writing, of any anticipated negotiations. Deposits must be returned to all bidders by certified mail, return receipt requested.

5. Notification to Bidders

Field Office Staff also must notify unsuccessful bidders in writing that their bids were not accepted and who the successful bidder was. Deposits must be returned to all unsuccessful bidders by certified mail, return receipt requested.

When a bid is accepted, Field Office Staff must execute *Form RD 1955-46* and send a written acceptance of the bid.

6. Failure to Close

If a successful bidder fails to perform under the terms of the offer, for any reason other than denial of credit by the Agency, the bid deposit will be forfeited and forwarded to the St. Louis Office for application to the General Fund.

Upon determination that the successful bidder will not close, the State Director may authorize direct negotiations with the next highest bidder, authorize another sealed bid sale, or authorize negotiations with other interested parties, as described in Paragraph 14.18.

D. Auction Procedures

The State Director will determine whether an Agency employee will conduct the auction or whether the complexity of the sale requires the services of a professional auctioneer. *Form RD 1955-46* is used for auction sales.

1. Selecting a Professional Auctioneer

Auctioneers are selected through a competitive process using the procedures described in RD Instruction 2024-A. The commission will be set as part of the auctioneer solicitation. If an auctioneer submits a bid with a commission rate that is significantly lower than other bids, detailed documentation will be provided attesting that they have successfully sold properties at the lower rate with no compromise in service.

2. Bid Deposits

Successful bidders will be required to make a bid deposit of 10 percent of the purchase offer. This fee will be waived for program-eligible bidders, pending final determination of eligibility. Deposits should be in the form of cashier's check, certified check, postal or bank money order, or bank draft payable to the Agency. Cash and/or personal check may be accepted only if deemed necessary for a successful auction to occur by the person conducting the auction.

Where program financing is authorized, all notices and publicity should provide for a method of prior approval of credit and the credit limit for potential program-eligible purchasers. This may include submission of letters of credit or financial statements prior to the auction. The auctioneer should not accept bids that request program financing in excess of the market value.

3. Accepting Bids

When the highest bid is lower than the minimum amount acceptable to the Agency, negotiations should be conducted with the highest bidder or, in turn, the next highest bidder(s) or other persons known to be interested in obtaining an executed bid at the predetermined minimum.

4. Purchaser's Default

Upon purchaser's default, the Field Office Staff will remit the bid deposit to the St. Louis Office as a miscellaneous collection. The property may than be disposed of through a negotiated sale.

14.18 NEGOTIATED SALE

If no acceptable bid is received either from a sealed bid sale or at a public auction, the State Director may negotiate a sale at the best price possible without further public notice by negotiating with interested parties, including previous bidders.

A sale made through negotiation will be documented and accepted by the Approval Official on *Form RD 1955-46* and must be accompanied by a bid deposit of 10 percent of the negotiated sales price, except that the deposit will be waived for program-eligible buyers.

14.19 DISPOSAL OF PROPERTY FOR SPECIAL PURPOSES

REO properties may benefit people in need of housing who can be reached in cooperation with other programs or Federal agencies. Cooperative agreements with other Federal or state-assisted housing programs will be announced and updated with administrative notices.

14.20 DISPOSAL AS CHATTEL OR SALVAGE

If the Agency is unable to sell non-program property by regular sale, sealed bid, or public auction, the structure may be sold as chattel or salvage to be removed from the site. *Form RD 1955-47* is used to transfer title of real property converted to chattel to the purchaser.

If no offer is received to remove the structure, the State Director may contract or arrange to have it demolished, in exchange for the salvaged materials or otherwise as determined appropriate. For example, the local fire-fighting unit may be permitted to use a structure slated for demolition as a burn for fire fighting practice. Once the structure is disposed of, the lot is offered for sale as non-program REO property.

If REO property is a vacant lot, the lot is offered for sale as non-program property.

SECTION 3: ENVIRONMENTAL REQUIREMENTS

14.21 OVERVIEW

The Agency must complete the appropriate level of environmental review under the National Environmental Policy Act for disposal of REO property in accordance with RD Instruction 1940-G prior to determining the disposition of the property. The proposed disposal of REO property will normally qualify as a categorical exclusion. However, an environmental assessment and an environmental impact statement (EIS), when deemed necessary, is required for any proposed disposal of REO property that meets one of the following criteria:

- The Agency has evidence that the transaction would result in a change in use of the REO property (for example, residential to commercial);
- The transaction is controversial for environmental reasons;
- The original environmental assessment for the project contains mitigation measures requiring an on-going managerial action (such as preservation of an historic building or setbacks from wetlands);
- The transaction affects environmental resources identified in 1940-G, or
- The property is contaminated with hazardous substances or petroleum products.

This section summarizes the basic environmental information that pertains to disposal of REO properties. For more detailed information and assistance, refer to RD Instruction 1940-G and the State Natural Resource Management Guide.

14.22 PROPERTY LOCATED WITHIN A SPECIAL FLOOD OR MUDSLIDE HAZARD AREA OR CONTAINS WETLANDS

Prospective buyers will be provided written notice that the REO property is in a special flood or mudslide hazard area.

Form RD 1955-46 , "Invitation, Bid, and Acceptance, Sale of Real Property of the United States" must include notice of special flood or mudslide hazard areas, wetlands and other environmental use restrictions. Prospective purchasers, auctioneers, and brokers must be provided a copy of this information.

The conveyance instrument for disposal of REO property containing wetlands or located in a special flood or mudslide hazard area must specify those uses of the property that are restricted under any Federal, state or local floodplain and wetland regulations, as well as other relevant restrictions. Use restrictions will relate to the use of the property by the purchaser and any successors as determined by the Agency. See 14.28.

14.23 COASTAL BARRIER RESOURCES SYSTEMS

REO property located within a Coastal Barrier Resource System (CBRS) will not be sold until the Agency completes consultation with the USFWS Regional Director, and agreement is reached that the proposed sale does not violate the provisions of the CBRS.

No continued Federal financing is permitted for REO property located within a CBRS.

14.24 NATIONAL REGISTER OF HISTORIC PLACES

When REO property has been determined to be listed on (or eligible to be listed on) the National Historic Register, the Loan Approval Official must consult with the SHPO. This consultation will establish any necessary restrictions on future use of the property to maintain compatibility with preservation objectives per 14.28.

A property that is listed or eligible for listing on the National Register of Historic Places may be leased or operated by management contract, the lease or management contract will contain provisions that the use will preserve property's condition and historic character.

14.25 UNDERGROUND STORAGE TANKS (UST)

USTs found on the property will be investigated to determine the contents of the tank and whether the tank has leaked or is leaking. Investigations will include the extent of contamination and methods of remediation. Such investigations will be undertaken by persons authorized by state law and provided to the appropriate state regulatory agency for consultation on appropriate steps to take. The report will be made a part of public information provided to prospective buyers and lenders. Notice of cleanup will be made a part of covenants to the deed to assure notice to future buyers as further discussed at 14.28. When a UST is leaking, the tank will be removed and the areas of contamination cleaned up in accordance with state regulations. If the UST is replaced, the work will be in accordance with state and local requirements

14.26 MANAGEMENT OF HAZARDOUS SUBSTANCES AND PETROLEUM PRODUCTS

All property considered for disposal or lease must be evaluated for possible hazardous substance contamination as part of the Agency's environmental due diligence. The minimum level of documentation of due diligence is the Transaction Screen Questionnaire (TSQ), which will be prepared by the Agency or an environmental professional under contract to the Agency. If the TSQ indicates the possibility of contamination a Phase I Environmental Site Assessment (ESA) will be prepared to determine the types of contamination present. If determined necessary by the ESA, a Phase II ESA will be prepared to determine the extent and potential costs for remediation. An environmental professional will prepare the ESA. The SEC should be consulted during this process for guidance and assistance in review and acceptability of the reports.

Environmental due diligence is normally conducted prior to the Agency taking action to foreclose and the reports previously prepared should be reviewed and supplemented as necessary prior to sale or lease.

14.27 LEAD-BASED PAINT

All projects constructed prior to 1978 will be assessed for the presence of lead-based paint in accordance with the Rural Development adopted portions of the HUD "Lead Safe Housing Rule." To assist staff in determining the requirements for compliance the "Lead-Based Paint Compliance Key" is available at the RHS Intranet site. This automated tool should be run and a copy saved for records and any requirements for investigation and remediation included in the scope of work for repair prior to sale. The costs of the lead-based paint work should also be included in the appraisal of property value.

Prospective purchasers must be notified of the results of the inspection inspection and any remediation efforts. **Attachment 14-A** is a sample disclosure format to provide purchasers with information about known lead-based paint hazards in the property.

14.28 PROTECTIVE COVENANTS RESTRICTIONS AND EASEMENTS

The Agency has a responsibility to take actions to protect environmental resources on REO property. Protective actions or mitigation measures on future use of the property may take the form of covenants, restrictions or conservation easements and will be filed with the deed. Such protection may be used to limit use of and to protect:

- Floodplains;
- Wetlands;
- Coastal barrier systems;
- Historic and cultural resources;
- Endangered or threatened species;
- Critical habitat;
- Wilderness areas;
- Wild or scenic rivers;
- Natural landmarks listed in the National Register of Natural Landmarks; Sole source aquifer recharge areas designated by EPA;
- Designated national trails;
- Important farmland; or
- Other resources identified in 1940-G or protected under state law.

The appropriate state and Federal agencies should be consulted for determinations of effect. The advise of the State Environmental Coordinator should be sought if it appears that

disposal of the REO property may affect any of these resources and the environmental review raised as indicated in 1940-G.

Examples of use restrictions include prohibition of draining, filling or building in a floodplain or wetland area, maintaining the property in keeping with results of consultation with the SHPO or notifications on hazardous material remediation on the site.

In any case in which a property has been contaminated with hazardous materials or petroleum products, notice shall be provided to prospective buyers and a covenant attached to the deed providing notice to future buyers. The notice shall include all findings and actions to cleanup taken by the Agency. Any information from Agency site reconnaissance, investigations and clearances provided by independent environmental professionals will be made a part of presale notices and covenants or restrictions in the deed. In addition, the Agency is obligated to cleanup any materials found on site in the future provided that the materials were in place prior to the date of conveyance. Covenants and restrictions to address the specific conditions will be developed with the assistance of OGC, the SEC and National Office environmental staff.

SECTION 4: PROCESSING AND CLOSING

14.29 OVERVIEW

If the Agency is closing the sale with program financing, the sale is closed in accordance with program closing instructions provided in Chapter 8 of HB-1-3560. If other financing is being used, the financing agent's closing procedures should be followed. Cash sales are closed by the Agency collecting the sale price and delivering the quitclaim deed to the buyer.

Title clearance and property insurance requirements for a program-financed sale are the same as for a program loan.

14.30 SPECIAL NOTICES AT SALE

In accordance with the Residential Lead-Based Paint Hazard Reduction Act of 1992, sellers of housing built before 1978 receiving Federal assistance must provide the purchasers of such housing with specific information about the housing's lead history and general information on lead exposure prevention. As seller the Agency must:

- Provide the buyer with the lead hazard information pamphlet, *Protect Your Family from Lead in Your Home*, available from the National Lead Information Clearinghouse at 1-800-424-LEAD, or a similar EPA-approved pamphlet developed by the State;

- Permit the buyer a 10-day opportunity to conduct a risk assessment or inspection for the presence of lead-based paint hazard; and

- Include in the sales contract: (1) disclosure of any lead-based paint hazard or a statement that the Agency has no knowledge of such hazard; (2) a list of any information about the hazard available to the seller and passed on to the buyer; and (3) a Lead Warning Statement and acknowledgment, signed by the buyer. A sample disclosure format, including the required Lead Warning Statement, is provided in **Attachment 14-A**.

- Notice shall be provided to prospective buyers of all hazardous material activities and findings. This shall include access to records of Agency site reconnaissance and investigations by environmental professionals. If hazardous materials have been found in performance of due diligence, notification of remediation results will be provided. Covenants or restrictions to the deed will be developed with the assistance of OGC to address the specific conditions. The National Office environmental staff and the SEC should be consulted in the preparation of all environmental covenants or restrictions.

14.31 INSPECTION

An inspection of the property by the buyer should be scheduled immediately before closing to ensure satisfactory condition of the property and the resolution of any problems or discrepancies.

14.32 PRORATING REAL ESTATE TAXES AND/OR ASSESSMENTS

When REO property is subject to taxation and/or assessment, they are prorated between the Agency and the buyer, as of the date the title is conveyed. The Agency is responsible for all taxes and assessments accrued as of the settlement date, and the buyer is responsible for all taxes and assessment that accrue after the closing date. The Agency's pro rata share is deducted from the proceeds of the sale at closing, if sufficient funds are available, or is paid under RD Instruction 2024-A.

14.33 COMMISSIONS

Commissions are paid at closing if there is sufficient cash from sale proceeds to cover the commission. If not, the Agency will pay the commission and charge it to the REO account as a recoverable cost.

14.34 TRANSFERRING TITLE

The Agency conveys the property to the buyer by *Form RD 1955-49, Quitclaim Deed*, or other form of non-warranty deed approved by OGC. The State Director signs the conveyance instrument, a copy of which is retained in the REO case file. The buyer is responsible for recording the instrument.

14.35 REPORTING SALE

When the transaction is closed and the conveying instrument has been delivered, the disposition is recorded in the REO system. Real property that has been disposed of by means other than sale, including total loss or destruction, will also be reported in the REO system. Sale proceeds are forwarded to the St. Louis Office to be credited to the General Fund.

SECTION 5: PROCESSING CREDIT SALES ON NON-PROGRAM TERMS

14.36 OVERVIEW

The sale of non-program properties is conducted in a manner similar to other sales; however, there are some differences in the terms of the sale, the processing of the offers, loan closing, and the treatment of the property after the sale is complete. This section highlights these differences. See HB-1-3560 for processing credit sales for program properties.

14.37 TERMS OF A NON-PROGRAM CREDIT SALE

The following provisions apply to credit sales on non-program terms.

- **Interest rate.** The Section 515 interest rate plus 0.5 percent will be charged on all types of housing credit sales. Refer to Exhibit B of RD Instruction 440.1 (available in any Field Office) for interest rates. Loans made on non-program terms will be equal to the lesser of the prevailing interest rate at the time of loan approval or loan closing; and

- **Term of note.** The note amount will be amortized over a period not to exceed 10 years. If the State Director determines more favorable terms are necessary to facilitate the sale, the note amount may be amortized using a 30-year factor with payment in full (balloon payment) due not later than 10 years from the date of closing. In no case will the term be longer than the period for which the property will serve as adequate security.

Agency loans to finance the purchase of non-program REO property are subject to the availability of funds.

Each tenant in an REO property designated to be sold as a non-program property will be notified by the Agency, in writing, of the housing project's non-program designation and will be given an opportunity to obtain a Letter of Priority Entitlement (LOPE).

14.38 ACCEPTING OFFERS

The sale of a non-program property is similar to other sales. Field Office Staff publicize the sale, accept bids, and choose a bid from the first acceptable bids received.

- **Documenting offers and acceptance.** Field Office Staff must use *Forms RD 1955-45* and *1955-46*, as appropriate, to document the offer and acceptance. Field Office Staff must accept the contract prior to processing a request for credit on non-program terms.

- **Cash sales.** If the offeror can purchase the property without Agency assistance, Field Office Staff will simply collect the purchase price (less any deposits) and deliver the deed to the purchaser.

- **Purchase with non-program credit.** Purchasers requesting credit on non-program terms will be required to submit documentation to establish financial stability, repayment ability, and creditworthiness:

  ◊ The borrower may submit the standard forms used to process program applications or comparable documentation. Field Office Staff may request additional information as needed to support loan approval.

  ◊ Field Office Staff will order individual credit reports for each individual applicant and each principal within an applicant entity. Commercial credit reports will be ordered for profit corporations and partnerships, and organizations with a substantial interest in the applicant entity.

14.39 APPROVAL

Field Office Staff must use *Form RD 3560-51* to approve a credit sale even though no obligation of funds is involved. For guidance on how to complete the form, see the special instructions on the FMI pertaining to non-program credit sales.

The Loan Servicer must review *Form RD 1910-11* with the applicant, and the form must be signed by the applicant.

14.40 CLOSING SALE

The Loan Servicer will provide the closing agent with necessary information for closing the sale. Title clearance, loan closing, and property insurance requirements for a credit sale are similar to those for program loans. As for program sales, OGC assistance will be requested to provide closing instructions.

The following are the highlights of the closing process for non-program sales:

- **Closing costs.** The purchaser will pay their own closing costs. Earnest money, if any, will be used to pay purchaser's closing costs with any balance of closing costs being paid by the purchaser. Any closing costs which are legally or customarily paid by the seller will be paid by the Agency from the down payment;

- **Down payment.** A down payment of not less than 10 percent of the purchase price is required at closing and will be remitted by the Field Office Staff;

- **Modification of security instruments.** Field Office Staff must modify security instruments as necessary:

  ◊ On the *Form RD 3560-52, Promissory Note* and/or security instrument (mortgage or deed of trust) any covenants relating to graduation to other credit, restrictive-use provisions, personal occupancy, inability to secure other financing, and restrictions on leasing may be deleted; and

◊ Deletions are made by drawing a line through the specific inapplicable language. The borrower and an Agency representative must initial the changes.

- **Purchase of more than one property.** When more than one property is bought by the same buyer and the transactions are closed at the same time, a separate *Form RD 3560-52* will be prepared for each property, but one mortgage will cover all the properties; and

- **Reporting sale.** When the transaction is closed and the conveying instrument has been delivered, Field Office Staff will report the sale like all other sales. They will process *Form RD 3560-19, Status of REO Property,* in accordance with the respective FMI.

14.41 SERVICING THE NON-PROGRAM LOAN

Credit sales on non-program terms will be classified as non-program loans and serviced accordingly. The project is not subject to any rent, occupancy, or other program requirements.

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ATTACHMENT 14-A

LEAD-BASED PAINT DISCLOSURE FORM

SAMPLE Disclosure Form for Target Housing Sales

Disclosure of Information on Lead-Based Paint and/or Lead-Based Paint Hazards

This form is also available at HUD's Lead Safe Housing website.

LEAD WARNING STATEMENT

Every purchaser of any interest in residential real property on which a residential dwelling was built prior to 1978 is notified that such property may present exposure to lead from lead-based paint that may place young children at risk of developing lead poisoning. Lead poisoning in young children may produce permanent neurological damage, including learning disabilities, reduced intelligence quotient, behavioral problems, and impaired memory. Lead poisoning also poses a particular risk to pregnant women. The seller of any interest in residential real property is required to provide the buyer with any information on lead-based paint hazards from risk assessments or inspections in the seller's possession and notify the buyer of any known lead-based paint hazards. A risk assessment or inspection for possible lead-based paint hazards is recommended prior to purchase.

SELLER'S DISCLOSURE (INITIAL)

_____(a) Presence of lead-based paint and/or lead-based paint hazards (check one below):

☐ Known lead-based paint and/or lead-based paint hazards are present in the housing (explain).
_____
_____
_____

☐ Seller has no knowledge of lead-based paint and/or lead-based paint hazards in the housing

_____(b) Records and reports available to the seller (check one below):

☐ Seller has provided the purchaser with all available records and reports pertaining to lead-based paint and/or lead-based paint hazards in the housing (list documents below).
_____
_____
_____

☐ Seller has no reports or records pertaining to lead-based paint and/or lead-based paint hazards in the housing.

☐ Purchaser's Acknowledgment (initial)

_____ (c) Purchaser has received copies of all information listed above.

_____ (d) Purchaser has received the pamphlet *Protect Your Family From Lead in Your Home*.

_____ (e) Purchaser has (check one below):

☐ Received a 10-day opportunity (or mutually agreed upon period) to conduct a risk assessment or inspection for the presence of lead-based paint and/or lead-based paint hazards; or

☐ Waived the opportunity to conduct a risk assessment or inspection for the presence of lead-based paint and/or lead-based paint hazards.

AGENT'S ACKNOWLEDGMENT (INITIAL)

____ (f) Agent has informed the seller of the seller's obligations under 42 U.S.C. 4852d and is aware of his/her responsibility to ensure compliance.

CERTIFICATION OF ACCURACY

The following parties have reviewed the information above and certify, to the best of their knowledge, that the information provided by the signatory is true and accurate.

_____	_____	_____	_____
Seller	Date	Seller	Date
_____	_____	_____	_____
Purchaser	Date	Purchaser	Date
_____	_____	_____	_____
Agent	Date	Agent	Date

CHAPTER 15: PROJECT PRESERVATION

15.1 INTRODUCTION

Some borrowers may want to prepay their Agency loans and convert their properties to conventional use. To protect the supply of affordable housing and to ensure that tenants of multi-family housing properties do not suffer from rent overburden or lose their units, the Agency requires that borrowers obtain approval before prepaying their loans *[7 CFR part 3560, subpart N]*. The approval process allows the Agency to offer the borrower incentives to forgo prepayment and maintain the affordability of the housing. This chapter explains prepayment requirements and describes the prepayment request and approval process.

15.2 OVERVIEW OF THE CHAPTER

The key decision points in the prepayment process are shown in Exhibit 15-1 of this section. For an overview of the process, see **Attachment 15-A**.

This chapter addresses the process in five parts:

- Section 1 outlines the key eligibility requirements for participating in the process and obtaining approval to prepay.
- Section 2 describes requirements and procedures for processing and evaluating prepayment requests for loans closed before 1979 or loans with no restrictive agreements.
- Section 3 describes requirements and procedures for processing and evaluating prepayment requests for loans closed between 1979 and 1989 that have restrictive agreements. This section also describes the process of offering the property for sale to nonprofit organizations and public agencies.
- Section 4 discusses properties subject to special circumstances, including foreclosure, bankruptcy, acceleration, and the advance payment of accounts.

Office of Rental Housing Preservation (ORHP)

ORHP was established to ensure a standard approach to the prepayment decision-making process. ORHP will approve all incentive offers made by the Field Offices and authorize the closing of these offers.

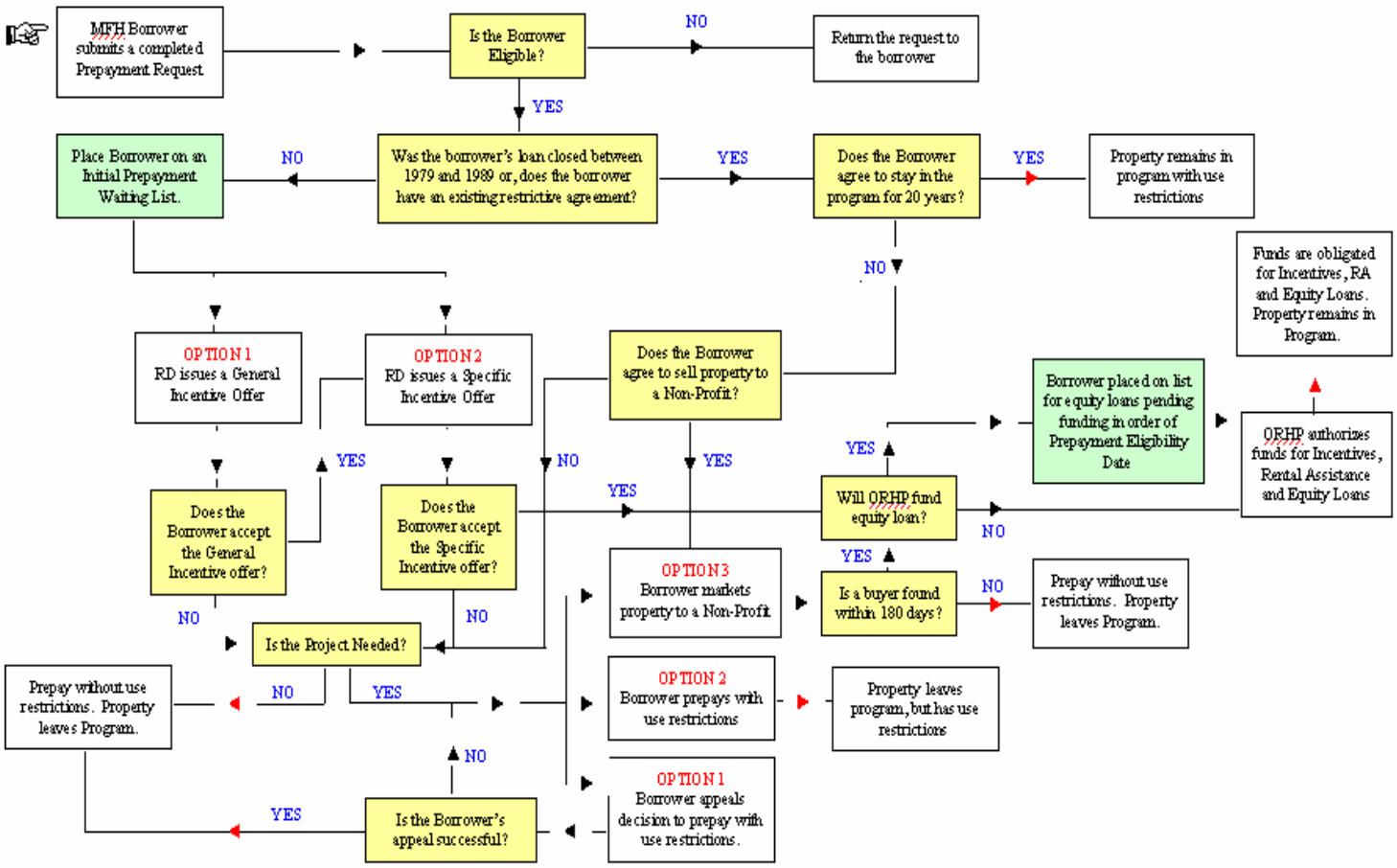
Through Prepayment Tracking and Concurrence (Pre-Trac), ORHP should be kept informed of the prepayment request's progress through the process. Field Offices should inform ORHP when:

- A prepayment request is received;
- A request is to be removed from the list;
- An incentive offer is developed and ready for ORHP approval before being offered;
- A borrower accepts incentives;
- A borrower rejects an incentive offer;
- The State Office is ready to process a transfer to a nonprofit or public body; or
- The State Office requests prepayment with or without restrictive-use provisions (RUPs).

Loan Servicers should use Pre-Trac, which is an Internet-ready database application that allows Loan Servicers to process multi-family housing prepayment requests.

Exhibit 15-1

Flow Chart of Prepayment Requests & Incentives



SECTION 1: PRESERVATION AND ELIGIBILITY FOR PREPAYMENT

15.3 OVERVIEW

This section covers key eligibility requirements that apply to prepayment process, including:

- Determining eligibility to submit a prepayment request;
- Meeting with the borrower;
- Notifying tenants;
- Receiving a prepayment request and conducting a completeness review; and
- Determining prepayment feasibility.

15.4 BORROWERS ELIGIBLE TO REQUEST PREPAYMENT *[7 CFR 3560.652]*

Before submitting a prepayment request, borrowers should confirm that they are eligible to prepay and that they are required to submit a prepayment request. All loans approved prior to December 15, 1989 are subject to prepayment regulations and must file a prepayment application to request payoff the loan(s). Loans made on or after December 15, 1989, to build or acquire new multi-family housing units are prohibited from prepayment.

15.5 MEETING WITH THE BORROWER

Whenever Loan Servicers receive an inquiry concerning prepayment, they should invite the borrower to a meeting. If the borrower begins the prepayment request process with an understanding of the steps involved and the incentives available, the process is more likely to proceed with fewer miscommunications and delays.

At the meeting, the Loan Servicer should:

- Provide the borrower with the items necessary to constitute a prepayment request in accordance with 7 CFR 3560.653 and review the list of items to be submitted. Answer any questions regarding the submissions. Make clear that a complete request includes evidence that the borrower is able to prepay the loan;
- Explain the prepayment process, including the procedures for requesting prepayment, the offer of incentives, and the sale to nonprofit organizations or public agencies;
- Recommend that the borrower hold a meeting with tenants to inform them of the prepayment request and explain the implications of the prepayment process for tenants. The borrower may invite other affordable housing agencies to this meeting to discuss options with the tenants. The Loan Servicer may attend this meeting as well;

- Describe the incentives that are available and explain that the offer will depend on the value of the borrower's project and its potential for conventional use (**Attachment 15-B** provides a description of incentives and the incentive development process that can be given to the borrower); and

- Explain the restrictive-use provisions that will apply if the borrower accepts the Agency's offer of incentives (see **Attachment 15-E**).

15.6 TENANT NOTIFICATION REQUIREMENTS *[7 CFR 3560.654]*

Throughout the prepayment process, the Agency and the borrower both have a responsibility to inform tenants of the status of the prepayment request.

> Tenants are often alarmed by the prospect of prepayment and uninformed about its implications for their housing situation. The Agency recommends that owners hold a meeting early in the request process. Items to cover at such a meeting include:
>
> - The meaning of the first tenant notification letter;
> - The steps in the prepayment process;
> - Potential outcomes for the property;
> - Alternative housing options for the tenants; and
> - Tenants' eligibility for LOPE letters.

- **Initial notice.** Within 30 days of the receipt of a complete request, the Loan Servicer must send a notification to each tenant in the project. A sample letter is attached as **Attachment 15-C**.

  ◊ The Agency may deliver the notices to the borrowers by mail or directly.

  ◊ The Agency should also send copies of the notification to the borrower and the management agent because the borrower must post copies of the notifications in public areas in the project. These notices must remain posted until the next notice providing an update on the status of the prepayment request is sent.

  ◊ The borrower must provide copies of the notifications to any tenants who occupy units after these notices were sent.

- **Subsequent notices.** To keep the tenants informed of the progress of the prepayment request, additional notifications are sent after key decisions in the process are made. These notices should be sent, posted, and provided to new tenants, as described for the initial notice. A list of appropriate times to send these notices is provided in Exhibit 15-2.

- **Other interested parties.** Whenever Loan Servicers provide notices to tenants regarding the prepayment process, they must also notify other interested parties such as nonprofit organizations and public agencies.

Exhibit 15-2
List of Notices to be Provided to Tenants
During the Prepayment Process

The following notifications must be sent to tenants at the times indicated below. These notices must be sent to individual tenant households and posted in the project.

1. **Within 30 days of receipt of the prepayment request:**

   Tenant Notification #1: This notice must be sent within 30 days of receipt of a complete prepayment request. This letter informs tenants that the borrower has submitted a request to prepay. This letter may be coordinated with a meeting including the borrower, the tenants, and the Agency. *[7 CFR 3560.654(a)]*

2. **After a decision has been made to accept prepayment or offer incentives:**

   Tenant Notification #2A: If the borrower's prepayment request is withdrawn, the Loan Servicer will send a letter to the tenants informing them that prepayment will not take place. If there is an appeal, this letter should be delayed until the outcome of the appeal is known. *[7 CFR 3560.654(d)]*

   Tenant Notification #2B: If the borrower is permitted to prepay with or without use restrictions, the Loan Servicer will send a letter to the tenants informing them of the prepayment and providing them information on their rights (such as reimbursement of relocation costs). This letter must be sent 60 days prior to prepayment. *[7 CFR 3560.654(c)]*

3. **After the offer of incentives has been accepted or rejected:**

   Tenant Notification #3A: If the borrower accepts the incentives and related use restrictions, the Loan Servicer will send tenants a letter informing them of the outcome and describing the use restrictions. *[7 CFR 3560.654(e)]*

   Tenant Notification #3B: If the borrower rejects the incentives, the Agency will decide if prepayment will be accepted with or without use restrictions. The Loan Servicer will send letters to the tenants informing them that the borrower is prepaying with or without and explaining their rights under the use restrictions. This letter must be sent 60 days prior to prepayment. *[7 CFR 3560.654(c)]*

   Tenant Notification #3C: If the borrower chooses to offer the property for sale to a nonprofit organization or a public agency, the Loan Servicer will send a letter to the tenants informing them that the borrower is offering the property for sale and explaining the sale process. *[7 CFR 3560.654(f)]*

4. **After the offer for sale is complete:**

   Tenant Notification #4A: If the borrower does not receive a good faith offer within 180 days and is proceeding to prepay the loan, the Loan Servicer will notify tenants of the prepayment. This letter must be sent 60 days prior to prepayment (i.e., 60 days prior to the end of the 180-day marketing period). If a good faith offer is received within the final 60 days of the marketing period, a new letter must be sent to the tenants as described in Tenant Notification #4B. *[7 CFR 3560.654(h)]*

   Tenant Notification #4B: If a tenant applicant signs a lease in a housing project for which a prepayment request has been submitted, the borrower must provide the tenant with copies of all notifications provided to tenants by the Agency or the borrower prior to the tenant's occupancy in the housing project. *[7 CFR 3560.654(g)]*

15.7 REQUIREMENTS FOR PREPAYMENT REQUESTS *[7 CFR 3560.653]*

To be considered for prepayment, the borrower must submit a complete request at least 180 days before the expected date of prepayment. This time frame allows the Agency time to review the request, complete the applicable analyses, and offer incentives, if appropriate, prior to

the prepayment date. If all required procedures can be completed in fewer than 180 days, the prepayment may occur at an earlier date.

A copy of all items to be submitted by the borrower can be found in Pre-Trac on the Prepayment Application Checklist Screen**.**

Good Practice—Notification to Borrowers

Some borrowers may pay their loans on an accelerated schedule. As these borrowers approach 180 days from their last payment, the Agency should notify them of their status and of their obligation to submit a prepayment request. See paragraph 15.33 for more information on the advance payment of accounts.

15.8 RECEIPT OF PREPAYMENT REQUESTS

When a request for prepayment is received, the Loan Servicer must take the following steps to establish the date of receipt and begin a project file.

- Immediately upon receipt of a written prepayment request, date stamp the request and enter the date of receipt in Pre-Trac on the Timeline Screen at Activity A00. If the completeness review shows the request to be complete (as described in Paragraph 15.9) the date stamped on the request will be used as the date of receipt. (This date will be used by the ORHP to establish the borrower's position on the waiting list for incentives, if necessary.)
- Begin a project file. The Agency should have a separate file on each prepayment request that includes:
  - ◊ Application (with coversheet that summarizes all key project information);
  - ◊ Tenant notifications;
  - ◊ Project appraisal;
  - ◊ Documentation of all analysis performed;
  - ◊ Communications with the borrower; and
  - ◊ The mortgage document.
- Enter prepayment-related project data into Multi-Family Information System (MFIS) (MFIS) and Pre-Trac.

15.9 COMPLETENESS REVIEW

Within <u>10 days</u> of receiving the prepayment request, the Loan Servicer must review it for completeness. This entails a brief look at the submission to ensure that all the items listed in the Pre-Trac Prepayment Application Checklist Screen are included.

- **Complete requests.** If the Loan Servicer determines that the request is complete, the Loan Servicer must:

◊ Send a letter to the borrower providing the date of receipt of the request, and informing the borrower that the Agency is reviewing the request and may ask for additional information;

◊ Send a letter to tenants informing them that the borrower has submitted a request to prepay. This letter must be sent within 30 days of receiving the request (as described in Paragraph 15.6). Also notify other interested parties at this time; and

◊ Complete a review of the request for the feasibility of prepayment. This review must be completed within 60 days of the receipt of the complete request and is described in Paragraph 15.10.

- **Incomplete requests.** If the Loan Servicer finds that all items are not included, the incomplete request must be returned to the borrower with a letter listing the missing items. The borrower may submit a new request to begin the prepayment request process again. The date of receipt cannot be established until a complete request is received.

15.10 DETERMINATION OF PREPAYMENT FEASIBILITY

To receive an offer of incentives, the borrower must demonstrate the ability to prepay the Agency loan. Within 60 days of the receipt of a complete application, the Loan Servicer must review the prepayment request to determine the feasibility of prepayment and enter the date of complete application into Pre-Trac on the Timeline Screen at Activity A06.

To determine the feasibility of prepayment, the Loan Servicer must review the borrower's ability to prepay. To be considered "feasible", the borrower must have the ability to prepay the loan, as discussed below. It is not in the Agency's interests to offer incentives to a borrower who does not have the financial capacity to prepay the loan since there is little risk that the borrower will actually prepay and remove the project from the program.

The borrower may be planning to finance the prepayment in one of three ways:

- From the borrower's own resources;
- With financing from a lender or other third-party; or
- By selling the project.

Regardless of the source of funds, the borrower must be able to show that the proposed source of financing is available. The Loan Servicer must review the borrower's prepayment request to ensure that the borrower has submitted sufficient evidence that the funding is available, as described below.

A. Borrower's Funds

If using their own funds, the borrower must provide:

- A balance sheet and income statement showing that sufficient cash is available to pay the loan principal or that assets of sufficient value are available and can be readily converted to cash; and

- Certification that the income or assets are not pledged elsewhere (e.g., to other prepayment requests or other loans).

B. Third-Party Lender

If obtaining a loan, the borrower must provide an original copy of the precommitment letter from the lender, stating:

- The rates and terms of loan;

- The amount financed; and

- A description of the security of the loan.

C. Sale

If the borrower is planning to sell the project, the borrower must submit a purchase agreement and documentation of the purchaser's ability to pay. The purchaser's ability to pay can be documented in the same manner as the borrower's, as described in Paragraph 15.10(A).

15.11 ELIGIBILITY DETERMINATION

If the Loan Servicer determines that the borrower is eligible with a complete prepayment request and prepayment is feasible, the Loan Servicer continues to process the request. If the borrower is not eligible for prepayment, the Loan Servicer notifies the borrower in writing stating the reasons that the borrower is not eligible for prepayment.

For loans that were closed prior to 1979, or if the loan does not have any existing restrictive agreements, the Loan Servicer follows the process described in Section 2 of this chapter. If the borrower's loan closed between 1979 and 1989 and has a restrictive agreement, the Loan Servicer follows the process described in Section 3 of this chapter.

SECTION 2: LOANS CLOSED BEFORE 1979 OR LOANS WITH NO RESTRICTIVE AGREEMENTS

15.12 PREPAYMENT WAITING LIST

For borrowers who meet the eligibility requirements of Section 1 of this chapter and who have loans that closed prior to 1979 or have no restrictive agreements, the Loan Servicer will place the borrower on an initial prepayment waiting list using Pre-Trac.

15.13 MAKING THE INCENTIVE OFFER—OVERVIEW

To encourage borrowers to forgo prepayment, the Agency offers incentives to all borrowers applicable under this section. Paragraphs 15.14 through 15.21 of this section describe the process for offering incentives and responding to the borrower's acceptance or rejection of Agency incentives.

15.14 GENERAL INCENTIVE OFFER

At the discretion of the Agency, the Loan Servicer may make a general incentive offer to the borrower before developing the specific incentive package. The Loan Servicer should make a general offer only if the borrower indicates that any specific incentive offer will be rejected. From the date of the general offer, the borrower has 30 calendar days to accept or reject the offer.

- If the borrower rejects the general offer in writing, the Agency will not develop a specific incentive offer. The Agency will determine the impact of prepayment as described in Paragraph 15.22.

- If the borrower accepts the general offer, the Agency will develop a specific incentive offer in accordance with this section.

- If the borrower rejects the general offer in writing after 30 calendar days, the Agency will not complete the specific incentive offer and will consider all incentives rejected.

15.15 SPECIFIC INCENTIVE REQUIREMENTS *[7 CFR 3560.656]*

Specific incentive offers are subject to the following requirements.

- **Value of incentive offer.** The incentive offer must be based on the Agency's assessment of:

  ◊ The amount necessary to provide a fair return on the investment of the borrower;

  ◊ An amount that will not cause project rents to increase above the Conventional Rents for Comparable Units (CRCU) standard in accordance with Chapter 4 of HB-2-23560; and

  ◊ The least costly alternative for the Federal Government that is consistent with extending the low-income use of the property.

- **Eligible recipients.** The Agency will offer incentives only to borrowers who have met the requirements outlined in Section 1 of this chapter.

- **Time frame for offer response.** The Agency must develop the offer within 60 days of completing the review for feasibility and impact. The borrower must respond to an incentive offer within 30 calendar days. If no answer to the offer is received within 30 calendar days, the Agency must consider the incentive offer rejected.

- **Reserve requirements.** At the time the incentive is developed, the maximum reserve amount must be adjusted to include the costs of any deferred maintenance items or expected long-term repair or replacement costs of the project based on the project's capital plan. The Agency may require an additional deposit to the reserve account from the incentive package and/or reduce the incentive in order to allow rents to be increased to fund the reserve at a level necessary to meet capital needs.

- **Capital Improvements.** Any necessary capital improvements must be addressed (monies set aside) prior to receiving any incentives.

- **Consolidation and reamortization of loans.** If a project has more than one Agency loan, existing project loans must be consolidated and reamortized unless consolidation is not necessary to maintain feasibility of the project for the current tenants or the level of monthly rental subsidies must be reduced.

- **Appraisal requirements.** An appraisal is required to provide the Agency the information needed to establish the appropriate value of the incentive offer. It is the Agency's responsibility to assure that an appraisal is obtained.

15.16 TYPES OF INCENTIVES *[7 CFR 3560.656(c)]*

The Agency may offer the borrower one or more of the items discussed below as incentives to forgo prepayment. The following considerations apply to the development of the incentive package:

- Incentive offers must not be made without sufficient rental assistance to protect current tenants against rent overburden;

- If the incentive package involves a rent increase, the Agency must approve the rent increase in accordance with budget approval procedures outlined in Chapter 4 of HB-2-3560. In no case may the rent increase cause rents to increase above the CRCU standard as discussed in Chapter 4 of HB-2-3560 *[7 CFR 3560.656(b)(3)]*; and

- An Agency equity loan must be the last incentive option considered in developing an offer.

A. Rental Assistance

The Agency may offer rental assistance if the project tenants will experience rent overburden as a result of the incentive offer.

B. Increase in Annual Return

The Agency may offer an increase in the amount of the borrower's annual return on investment by one or both of the following methods:

- The Agency may recognize the borrower's current equity in the project at the original rate of return; and/or

- The Agency may increase the borrower's rate of return on the original equity.

The actual withdrawal of the return remains subject to conditions specified in 7 CFR 3560.301, and Chapter 4 of HB-2-3560.

C. Excess HUD Section 8 Rents

For projects with project-based HUD Section 8 assistance, the Agency may permit the borrower to receive rents paid to the project in excess of the amounts needed to meet annual project operating and maintenance expenses, debt service, and reserve requirements. This payment is received in a lump sum.

In these cases, the reserve account will be adjusted to provide adequate funding for long-term capital repairs and maintenance based on the project's capital plan.

D. Project Conversion or Modification of Interest Rate

The Agency may agree to convert full-profit loans to limited profit Plan II loans or increase the interest subsidy for loans with HUD Section 8 assistance to lower the interest rate on the loan and make basic rents more financially feasible.

E. Agency Equity Loans

The Agency may make an equity loan to the borrower. The Agency may offer an equity loan only after it determines that all other incentive options will not result in an adequate incentive offer. The equity loan may not exceed the difference between the current unpaid loan balance and 90 percent of the project's value appraised as unsubsidized conventional housing.

The following requirements apply to equity loans:

- Labor housing projects are not eligible for equity loans;

- The loan must not adversely affect the borrower's repayment ability;

- Equity loans may be processed and closed with the current borrower or any eligible transferee; and

- If the equity loan is made in conjunction with excess HUD Section 8 funds, the equity will be paid using excess reserves before an equity loan is made.

F. Third-Party Equity Loans

A third-party equity loan is not considered an incentive, but it is an option the Agency may give the borrower at the same time it makes an incentive offer.

- All incentive requirements described in Paragraph 15.15 apply to third-party equity loans;

- An offer to allow the borrower to receive a third-party equity loan must be included in the incentive calculation worksheet located in Pre-Trac or by completing an Excel spreadsheet version for consideration in the Agency's incentive offer;

- In exchange for taking a third-party equity loan, the borrower must agree to the applicable 20-year use restrictions and all relevant requirements under this chapter;

- The third-party lender must take a subordinate lien position to the Agency;

- The third-party lender must agree in writing that foreclosure action under its lien will not be initiated before holding a discussion with the Loan Servicer and after giving a reasonable period of notice to the Agency; and

- A third-party equity loan may not be associated with a transfer of ownership.

15.17 DEVELOPMENT OF THE INCENTIVE OFFER

Loan Servicers will develop the incentive offer based on calculations outlined in Pre-Trac or using the electronic version in the form of an Excel spreadsheet. Loan Servicers should complete the worksheet, according to the directions in Pre-Trac (also provided in **Attachment 15-D** for the electronic version) and submit it to ORHP prior to making the offer to the borrower.

To help ensure the consistency of incentive offers, ORHP will review each completed worksheet and approve the proposed incentives before the offer is made to the borrower.

15.18 AGENCY OFFER OF INCENTIVES

Once ORHP approves the incentive package, the Loan Servicer must send a letter (located in Pre-Trac) to the borrower outlining the choice of incentives and informing the borrower that they must respond to the offer within 30 days.

15.19 BORROWER ACCEPTANCE OF INCENTIVES AND SUBSEQUENT ACTIONS *[7 CFR 3560.657]*

If a borrower accepts the Agency's offer of incentives, both the borrower and the Loan Servicer have a number of responsibilities.

A. Borrower Acceptance

If the borrower accepts the Agency's offer of incentives, the borrower must complete the following actions:

- The borrower must agree to restrictive-use provisions that prohibit prepayment for 20 years and adopt appropriate amendments to the project's loan documents and rental assistance agreements;

- If the incentive offer accepted includes an Agency equity loan, the borrower must complete an application for the equity loan and the borrower must remain eligible for it. For additional information on how to process the equity loan, see Chapter 10of HB-1-3560; and

- If the incentive offer accepted includes rent increases, the borrower must follow program requirements for rent increases. See Chapter 4 of HB-2-3560.

B. Closing the Incentive Offer

To close the incentive offer, the Loan Servicer must take the following steps:

- Prior to closing, notify ORHP via Pre-Trac that the borrower has accepted the incentive offer and to request the allocation of equity loan funds or Rental Assistance (RA) (as appropriate);

- ORHP will authorize all incentives and notify the State Office of the authorization;

- Insert appropriate restrictive-use provisions in the loan documents and rental assistance agreements (e.g., the deed, security instruments, loan agreement/resolution, assumption agreement, and/or reamortization agreement) with consultation from the Office of General Counsel (OGC):

  ◊ **For equity loans.** Execute a new loan agreement/resolution, *Form RD 3560-52, Promissory Note,* and mortgage and convert to Plan II if needed. Follow other loan closing procedures as described in Chapter 8 of HB-1-3560; and

  ◊ **For RA or increase in owner return.** Execute a new *Form RD 3560-9, Interest Credit and Rental Assistance Agreement*, with the borrower and change the loan agreement/loan resolution as necessary.

- Notify tenants and other interested parties that prepayment will not take place.

C. Transfers

If a transfer is to take place simultaneously with the Agency incentive offer, a complete transfer application package must be submitted as described in Chapter 7 of this handbook.

- If a proposed transferee is determined not to be eligible for the transfer and assumption, the borrower will be given an additional 45 days to reconsider whether to accept the original incentive offer or find another transferee; and

- In some cases, the Agency may make an offer of incentives contingent on the successful transfer of the project to an acceptable purchaser. The Agency may offer a smaller incentive if the transfer does not take place.

15.20 INSUFFICIENT FUNDING FOR INCENTIVES

In some cases, the borrower may be offered incentives that cannot be provided immediately. For example, the Agency may lack funding for equity loans or sufficient RA. If a borrower accepts an incentive offer but the Agency is unable to fund the incentive within 15 months, the borrower will be removed from the incentive waiting list. The borrower then has three options:

- The borrower may offer to sell the project to a nonprofit or public agency as described in Section 3 of this chapter;

- The borrower may stay on the list of borrowers awaiting incentives until the borrower's incentive offer is funded. If this option is chosen, the Agency will not renegotiate the incentive offer; and

- The borrower may withdraw the prepayment request and be removed from the list of borrowers awaiting incentives. If the borrower chooses this option, the borrower may submit a new request for prepayment and repeat the prepayment process.

15.21 BORROWER REJECTION OF INCENTIVE OFFER AND SUBSEQUENT ACTIONS *[7 CFR 3560.658]*

If the borrower rejects the incentive offer, the Loan Servicer must make a determination of the project's impact and whether it is needed, in accordance with Paragraph 15.22.

If the Agency determines that the project is not needed and that there is no adverse impact on minorities, the borrower may prepay without restrictions. After prepayment, the property leaves the program. Processing the prepayment is described in paragraph 15.22.

If the project is needed, or there is an adverse impact, the Loan Servicer must send the borrower a letter informing the borrower of four options:

- The borrower may prepay the Agency loan subject to use restrictions. The letter should describe the applicable use restrictions. Guidance on how to determine the appropriate use restriction is described in Paragraph 15.22.A.

- If the borrower does not want to accept the use restrictions, the borrower may offer the property for sale to nonprofit organizations and public agencies. This process is described in Section 3 of this chapter.

- The borrower may forgo prepayment and stay in the program.

- The borrower may appeal the decision to prepay with use restrictions. The borrower and Agency follow the appeal procedures described in Chapter 1.

The letter should also request the borrower to send a written response indicating the borrower's intentions within 30 days.

If the borrower chooses to prepay the loan subject to restrictive-use provisions, the Loan Servicer must determine the appropriate use restrictions to apply. The analysis for making this determination follows:

- **For prepayments that will have an adverse impact on minorities.** If the borrower chooses to prepay subject to use restrictions, the Agency must make a determination regarding the impact of the prepayment on minorities. Loan Servicing Staff should rely on Civil Rights Staff to make this determination. Relevant factors include:

  ◊ The percentage of minorities residing in the project and the percentage of minorities residing in projects in the market area where displaced tenants are most likely to move;

  ◊ The impact of prepayment on minority residents in the project and in the market area. Determine whether displaced minority tenants will be forced to move to other low-income housing in areas not convenient to their places of employment, to areas with a concentrated minority population, and/or to areas with a concentration of substandard housing;

  ◊ The vacancy trends and number of potential minority tenants on the waiting list at the project being prepaid and at other projects in the market that might attract minority tenants; and

  ◊ The impact prepayment will have on the opportunity for minorities residing in substandard housing in the market area to have comparable decent, safe, and affordable housing, as is offered by the project being prepaid.

If Civil Rights Staff determine that the prepayment will have a negative impact on minorities, the borrower must adopt use restrictions that protect the affordability of the project over the long term.

- **For prepayments that will have an adverse impact on the adequacy of supply of affordable housing.** In projects where the prepayment does not have an adverse impact on minorities, the borrower is required to adopt use restrictions that protect the access of current tenants to adequate affordable housing. These provisions prohibit the borrower from raising rents for tenants who live in the property at the time of prepayment unless the rent increase is necessary to meet the operating costs of the project. (Their rents cannot be raised as a result of actions associated with prepayment.)

15.22 DETERMINATION OF PREPAYMENT IMPACT

One of the Agency's key goals in the prepayment process is to ensure that affordable housing opportunities exist for program eligible tenants. Therefore, one of the most important issues to address is the impact of the prepayment on project tenants. In cases where prepayment will have little or no impact on project rents or availability of units, the Agency has less interest in keeping the property in the program than in cases where prepayment will likely result in the displacement of project tenants.

To make this determination, the Loan Servicer will review the following information provided in the market study:

- Existence of comparable conventional units, their rents, and vacancy rates;
- Any plans to build a similar project in the market area; and
- Other subsidized units and the availability of rental assistance.

The goal of this analysis is to determine if tenants will lose their units or suffer from rent overburden. The steps involved in the analysis of impact depend on whether the project has rental assistance.

A. Prepayment Impact on Projects without Rental Assistance

For these projects, the Loan Servicer must review the prepayment request, including market information, and address the following items:

- **Change in rents or loss of units.** The Loan Servicer must look at the impact of the prepayment on tenants' ability to stay in the project. This analysis depends on the proposed use of the project after prepayment and rents for comparable conventional units in the market area. (For example, if the proposed use of the project is conventional rental units, the Loan Servicer should compare rents in the project to conventional rents in the market area.) Likely rents should be compared to tenants' income to ensure that a change in rents will not result in rent overburden.

  - ◊ If the prepayment is not likely to result in an increase in rents above current rents or 30 percent of tenants' adjusted incomes, the prepayment is considered to have no adverse impact on project tenants; and

◊ If the prepayment is likely to result in an increase in rents that will create rent overburden, the Loan Servicer must consider the availability of alternative comparable housing as described below.

- **Availability of alternative housing.** If the proposed use of the project after prepayment is likely to cause an increase in rents or a loss of units, the Loan Servicer must assess the availability of comparable housing in the community. The Loan Servicer must determine if there is sufficient housing that is comparable in size and rent to house project tenants in the local community without causing them rent overburden.

  ◊ If there is sufficient comparable housing in the local community to replace the units that will be lost after prepayment, then the prepayment is considered to have no adverse impact on project tenants; and

  ◊ If sufficient comparable housing is not available in the local community, the prepayment is considered to have an adverse impact on project tenants.

B. Prepayment Impact on Projects with Rental Assistance

If project tenants have rental assistance, the Loan Servicer must conduct the same analysis as described in Paragraph 15.22(A). However, in assessing the availability of comparable affordable units, the Loan Servicer must identify comparable units with rental assistance or other rental subsidy such as HUD Section 8 (as long as the tenants will have priority for these units).

- If sufficient comparable units with rental assistance are available in the local community to house all tenants with rental assistance (for example, if another Section 515 project in the local community has vacancies to house the tenants from this prepaid property), the prepayment is considered to have no adverse impact.

- If insufficient units with rental assistance are available, the prepayment is considered to have an adverse impact on project tenants.

Exhibit 15-3 of this section provides an overview of the full analysis of impact.

Exhibit 15-3

Analysis of Impact on Tenants

Step 1: Answer the following questions about rents and loss of units.

A. Will prepayment result in an increase in tenant payments and if so, will this new payment be higher than 30 percent of the current tenants' incomes?

OR

B. Will prepayment result in a loss of units?

If the answer to both A and B is no, there is no adverse impact on tenants.
If the answer to either A or B is yes, proceed to step 2.

Step 2: Answer the following questions about the availability of alternative housing:

A. Are there sufficient comparable vacant units in the market area (as indicated by the market study) for displaced tenants to find alternative housing?

AND

B. Are the tenant payments in these units equal to or less than the greater of their current rent of 30 percent of their income?

If the answer to both C and D is yes, there is no adverse impact on tenants.
If the answer to either C or D is no, there is an adverse impact on tenants.

C. Processing the Prepayment

Prior to prepayment, the Loan Servicer must take the following steps:

- Establish the target date for the prepayment to occur;
- Prepare the prepayment figures based on the borrower's outstanding balance on the Agency loan; and
- Notify tenants and other interested parties of the prepayment and its implications. Tenants must be notified at least 60 days in advance of the prepayment date.

To finalize the prepayment, the Loan Servicer must:

- Document the borrower's satisfaction of the mortgage; and
- Place a deed restriction on the property to establish the use restrictions.

D. Monitoring Compliance with the Use Restrictions

If a borrower prepays a loan and the project remains subject to continued restrictive-use provisions, the following requirements apply after prepayment:

- The owner of the prepaid project (formerly the borrower) is responsible for ensuring that the restrictive-use provisions agreed to as a condition of prepayment are observed and must retain appropriate documentation to demonstrate compliance with the use restrictions;

- The owners must provide the Agency with a signed and dated certification within 30 days of the beginning of each calendar year for the full period of the restrictive-use provisions establishing that these provisions are being met;

- The Loan Servicer must visit the site on an annual basis to perform an annual physical inspection;

- The Loan Servicer must also investigate any complaints from tenants or other parties regarding the violation of the use restrictions; and

- The Loan Servicer must keep owner certifications and records of visits in the project file.

SECTION 3: LOANS CLOSED BETWEEN 1979 AND 1989 WITH A RESTRICTIVE AGREEMENT

15.23 APPLICABILITY

For borrowers whose loans have restrictive agreements and which closed between 1979 and 1989, Loan Servicers should follow the procedures in this section. For loans closed between 1979 and 1989 with no restrictive agreements, follow the procedures in Section 2 of this chapter.

15.24 REQUEST BORROWER TO REMAIN IN PROGRAM

The Agency will make an effort to enter into a restrictive-use agreement with borrowers who received Section 514 or 515 loans on which restrictive-use provisions are still in place, who received “restricted” loans, or who make a prepayment request and prepayment is feasible. If a borrower accepts the Agency’s request to enter into a 20-year restrictive-use agreement, without prepayment, no further action is necessary.

After receiving a complete application to prepay and determining the borrower's ability to prepay, the Agency must make a reasonable effort to enter into a new restrictive-use agreement with the borrower before accepting prepayment of a restricted loan.

If a borrower declines the Agency’s offer, the Loan Servicer should document this in writing, noting the date on which this information was obtained. The document should be included in the case file. The Loan Servicer should then proceed to review the prepayment process to determine the impact of prepayment.

15.25 SALE TO A NONPROFIT OR PUBLIC BODY *[7 CFR 3560.659]*

A borrower who rejects the Agency’s offer to enter into a restrictive-use agreement may offer the project for sale to nonprofit or public agencies. A borrower who is being processed

under Section 2 of this chapter, where the Agency's incentive offer is rejected may offer the project for sale to nonprofit or public agencies. A borrower who accepts the incentives but does not receive them within 15 months of accepting them, may offer the project for sale to nonprofit and public agencies. This process can take up to 30 months to complete. At the end of this process, if the property has not been purchased, the borrower is permitted to prepay without restrictive-use provisions.

The sale process has several steps:

- The property must be marketed for 180 days as described in Paragraph 15.27;
- If no offer is made within 180 days, the borrower may prepay the loan without use restrictions (see Paragraph 15.31);
- Offers received within the 180 days must be treated as described in Paragraph 15.28;
- If an offer is accepted, the purchaser must finalize the sale within 24 months. If the sale is not finalized, the borrower may prepay the loan without use restrictions (see Paragraph 15.31); and
- After a sale is completed, the Loan Servicer must oversee the transfer of the property and continue to monitor the project as a program property (see Paragraph 15.30).

15.26 ESTABLISHING THE PROJECT VALUE

To establish the value of the property (as an unsubsidized conventional property) and determine an acceptable offer, two independent "as-is" market value appraisals will be completed in accordance with Chapter 7 of HB-1-3560. The borrower must pay the expense of the borrower's appraisal. The appraiser selected may not have an identity-of-interest with the borrower.

If the two appraisers fail to agree on the fair market value, the Agency and the borrower will jointly select an appraiser whose appraisal will be binding. The Agency and the borrower will jointly fund the cost of the appraisal.

15.27 MARKETING REQUIREMENTS

The Loan Servicer must ensure that the borrower takes appropriate actions to inform appropriate entities of the sale. The borrower must provide the Loan Servicer with appropriate documentation (e.g., copies of advertisements) to demonstrate that the following actions occurred:

- The borrower must contact interested nonprofit organizations and public agencies from the list maintained by ORHP. The borrower should also contact other interested organizations.
- The borrower must provide these entities with sufficient information regarding the project and its operations for interested purchasers to make an informed decision.

This information must include the minimum acceptable bid prices based on the appraised market value (as discussed in Paragraph 15.26). It should also state the preference for local entities, as described in Paragraph 15.28.

- If an interested purchaser requests additional information concerning the project, the borrower must promptly provide the requested materials.

- The borrower must advertise and offer to sell the project for a minimum of 180 days. The borrower may choose to suspend advertising and other sales efforts while eligibility of an interested purchaser is determined. If the purchaser is determined to be ineligible, the borrower must resume advertising for the balance of the required 180 days.

15.28 SELECTING AN OFFER

The borrower must accept any bona fide offer at or above the minimum acceptable bid price.

- **Requirements for nonprofit organizations and public agencies to purchase.** To buy and operate a multi-family housing project, a nonprofit organization or public agency must meet the requirements listed in Exhibit 15-4.

Exhibit 15-4

Requirements for Nonprofit Organizations and Public Agencies to Purchase

- The purchaser must agree to maintain the housing for very low- and low-income families or persons for the remaining useful life of the project and related facilities. However, currently eligible moderate-income tenants will not be required to move;
- The purchaser must agree that no subsequent transfer of the housing and related facilities will be permitted for the remaining useful life of the housing and related facilities unless the Agency determines that the transfer will further the provision of housing and related facilities for low-income families and persons, or there is no longer a need for such housing and related facilities;
- The purchaser must show financial feasibility of the project including anticipated funding;
- The purchaser must certify on *Form RD 3560-30* that there are no identity-of-interest relationships;
- The purchaser must complete an Agency-approved application and obtain Agency approval in accordance with 7 CFR part 3560 subpart I; and
- To be eligible to purchase properties, nonprofit organizations must meet the criteria outlined in 7 CFR part 3650, subpart B. These requirements are discussed in Chapter 4 of HB-1-3560.

- **Preference for local nonprofit and public agencies.** Local nonprofit organizations and public agencies have priority over regional and national nonprofit and public agencies. The borrower may not accept an offer from a regional or national nonprofit organization or public agency during the first 60 days that the property is advertised.

  ◊ If no offer from a local nonprofit or public agency is received in the first 60 days, the borrower may accept an offer from a regional or national nonprofit organization or public agency.

  ◊ If more than one qualified nonprofit organization or public agency submits an offer to purchase the project, the Agency will give priority to qualified local nonprofit organizations and public agencies over regional and national nonprofit organizations and public agencies.

  ◊ If additional criteria are needed to make a selection, the borrower must consider the organization's past success in developing and maintaining subsidized housing and the length of experience in developing and maintaining subsidized housing. Past success is given priority over length of experience when comparing equal offers.

- **Approving an offer.** The Loan Servicer must approve the borrower's acceptance or rejection of any offer for purchase. If the borrower receives an offer, they must notify the Loan Servicer of the offer and whether or not they want to accept the offer. The Loan Servicer must review the borrower's decision.

  ◊ If the borrower wants to reject the offer, the Loan Servicer must concur with the borrower's reasons for rejection. If the Loan Servicer does not concur, the borrower must accept the offer.

  ◊ If the offer is to be accepted, the proposed purchaser must submit appropriate documentation to the Agency to demonstrate eligibility for the transfer. The Loan Servicer must approve the transfer and then take appropriate steps to close the transfer (see Chapter 7 for the procedures for transfer).

15.29 LOANS MADE BY THE AGENCY OR OTHER SOURCES TO NONPROFIT ORGANIZATIONS AND PUBLIC AGENCIES

The Agency may make loans to nonprofit organizations or public agencies to facilitate the purchase of the project. Alternatively, the Agency may approve a loan from another entity. These loans must be approved as described in HB-1-3560. They may be made for either of the purposes described below.

- A loan may be made to enable the nonprofit organization or public agency to purchase a project at the appraised value; and

- With proper justification, a loan may be made to help meet the project's first-year operating expense if current operating funds are not sufficient. This loan may not exceed two percent of the project's appraised value.

The Agency may also make an advance of up to $20,000 to a nonprofit organization or public agency to cover the costs to develop a loan application package or close a loan to purchase a property.

15.30 POSTSALE REQUIREMENTS

Once the property has been sold to a nonprofit or public agency, the new owner of the property is subject to all applicable program requirements and use restrictions that applied to the property prior to the sale.

- The Loan Servicer must ensure that the transfer of the property takes place according to Agency rules and that the new owner is made subject to all applicable use restrictions (see Chapter 7);

- The Loan Servicer must notify tenants and other interested parties that the sale will take place; and

- The Loan Servicer will monitor this property as it monitors all other program properties (see Chapter 9 of HB-2-3560).

15.31 REQUIREMENTS FOR BORROWERS IF AN ACCEPTABLE PURCHASER IS NOT FOUND

If no purchaser is found for the property within the 180-day marketing period or if an offer is made but the purchaser fails to come up with the funds to complete the purchase within 24 months, the borrower is considered to have fulfilled the requirements for offering the property for sale. At this time, the borrower is permitted to prepay the Agency loan without use restrictions.

The Loan Servicer must:

- Send a letter to the borrower notifying him or her that prepayment is permitted; and

- Close out the application in Pre-Trac.

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SECTION 4: SPECIAL CIRCUMSTANCES

15.32 PROPERTIES UNDER BANKRUPTCY OR FORECLOSURE

Bankruptcy proceedings will have no effect on contractual requirements for restrictive use.

If a project that is subject to restrictive-use provisions is sold outside the program at a foreclosure sale, the Agency has no means to continue to enforce restrictive-use provisions after the purchase.

15.33 ADVANCE PAYMENT OF ACCOUNTS

When an Agency loan, which is not subject to prepayment prohibitions, reaches or falls below six remaining payments due to a borrower's voluntary advance payments or extra payments required by the Agency, the borrower will be notified that the final payment on the account cannot be accepted unless a prepayment request is made. The borrower will be required to submit all applicable information to a prepayment request.

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ATTACHMENT 15-A

OVERVIEW OF PREPAYMENT PROCESS

Outlined below is a summary of the conditions to be met for making key decisions related to the prepayment process.

What are the criteria for accepting a prepayment request?

- The borrowers' loans were closed before 1989;
- All items on the application checklist have been submitted; and
- The borrowers submit proof of their ability to prepay their loans.

You may issue a general or specific incentive offer to a borrower if the following conditions are met:

- The application has been accepted (see criteria listed above);
- The existing loan is a Rural Rental Housing (RRH) loan or an Off-Farm Labor Housing loan;
- The loan closed prior to 1979; and
- There are no restrictive-use provisions associated with the loan.

Note: If the borrower is inclined not to accept a specific incentive offer, you may proffer a general offer and proceed from there when the borrower declines the offer. If, however, the borrower accepts the general offer, you must then proceed with a specific incentive offer.

A borrower may prepay WITHOUT use restrictions when the following conditions are met:

- If the borrower rejects the general and/or specific incentive offers and the property is not needed;
- If the borrower appeals the decision to prepay with use restrictions, when the property is needed, and wins the appeal;
- If the borrower markets the property to a nonprofit organization and a buyer is not found within 180 days; and
- If the borrower markets the property and a buyer is found, but the deal fails to close.

A borrower may prepay WITH use restrictions when the following conditions are met:

- If the borrower rejects the general or specific incentive offer and the property is needed.

A borrower can market the property to a nonprofit organization under the following circumstances:

- If the borrower's loan closed between 1979 and 1989 and the borrower does not wish to continue in the program, but agrees to sell the property to a nonprofit organization;

- If the borrower's loan closed between 1979 and 1989 and the borrower does not wish to continue in the program or sell to a nonprofit organization. However, a subsequent needs assessment reveals that minority tenants will be materially affected. In this case, the borrower is obligated to sell to a nonprofit organization;

- If a pre-1979 borrower declines both the general and specific incentive offers. A needs assessment reveals that the property is needed. The borrowers can then agree to sell to a nonprofit organization if he or she does not wish to prepay with use restrictions; and

- If a pre-1979 borrower declines both the general and specific incentive offers, but a needs assessment reveals that the property is needed. The borrowers can then appeal the decision. However, if they lose the appeal, they can then agree to sell to a nonprofit organization if they do not wish to prepay with use restrictions.

A request is returned to the borrower under the following circumstances:

- If the borrower's loan closed after 1989;

- If the borrower's prepayment request is withdrawn or rejected; and

- If the project is needed, the borrower is obligated to prepay with use restrictions. The borrower can then appeal. It the borrower loses the appeal, he or she may decide to withdraw the application rather than have to sell to a nonprofit organization.

ATTACHMENT 15-B

EXPLANATION OF INCENTIVE OFFERS

(1) The Agency may increase the borrower's annual return on equity by one of the following two methods. The actual withdrawal of the return remains subject to the procedures and conditions for withdrawal specified in 7 CFR part 3560 subpart G of this part.

(2) The Agency may recognize the borrower's current equity in the housing project. The equity will be determined using an Agency accepted appraisal based on the housing project's MARKET value.

(3) When a current appraisal indicates an equity loan can not be made, the Agency may recognize the borrower's current equity in the housing project at the higher of the original rate of return or the current 15-year Treasury bond rate plus 2 percent rounded to the nearest one-quarter percent. The equity will be determined using the most recent Agency accepted appraisal of the housing project prior to receiving the prepayment request.

(4) The Agency may agree to convert projects without interest credit or with Plan I interest credit to Plan II interest credit or increase the interest credit subsidy for loans with HUD Section 8 assistance to lower the interest rate on the loan and make basic rents more financially feasible.

(5) The Agency may offer additional rental assistance, or an increase in assistance provided under existing contracts under §§ 521(a)(2), 521(a)(5) of the Housing Act of 1949 [42 U.S.C. 1490a (a)(2)] or section 8 of the United States Housing Act of 1937 [42 U.S.C. § 1437f].

(6) The Agency may make an equity loan to the borrower. The equity loan must not adversely affect the borrower's ability to repay other Agency loans held by the borrower and must be made in conformance with the following requirements:

(7) The equity loan must not exceed the difference between the current unpaid loan balance and 90 percent of the housing project's value as determined by an "as-is" market value appraisal conducted in accordance with 7 CFR part 3560 subpart P of this part.

1. Borrowers with farm labor housing loans are not eligible to receive equity loans as incentives.

2. If an incentive offer for an equity loan is accepted, the equity loan may be processed and closed with the borrower or any eligible transferee.

3. Excess reserve funds will be used to reduce the amount of an equity loan offered to a borrower.

4. Equity loans may not be offered unless the Agency determines that other incentives are not adequate to provide a fair return on the investment of the

borrower to prevent prepayment of the loan or to prevent displacement of project tenants.

(8) The Agency will offer rental assistance to protect tenants from rent overburden caused by any rent increase as a result of a borrower's acceptance of an incentive offer or tenants who are currently overburdened.

All incentives will be processed using the Incentive Calculation Worksheet. The Worksheet has two versions:

- A Stand Alone Excel Spreadsheet located on the Agency's Intranet; or
- The Pre-Trac version.

ATTACHMENT 15-C

SAMPLE LETTERS TO TENANTS

Initial Tenant Notification of Owner's Intent to Prepay

TO: The Tenants of Riddlebrook Apts

SUBJECT: Notice of Prepayment Request

Your apartment was developed with a loan from the U.S. Department of Agriculture (USDA) Rural Development, an Agency of the U.S. Government. The owners of your apartment recently asked USDA for permission to pay off their USDA loan ahead of schedule.

Based on USDA's communications with the owner so far, it is not clear whether:

* The owner plans to continue to operate the apartments as affordable rental housing, or to sell or operate the apartment as conventional, market rate apartments.

* The owner wants to prepay their USDA loan, and then either sell or operate the apartment as conventional, market rate apartments.

* The owner wants to sell the property to a new owner who is willing to continue to operate the apartments as affordable rental housing.

* The owner does not really plan to prepay their USDA loan. The owner has applied in order to qualify for financial incentives from USDA. In return for the incentives, the owner must continue to operate the apartments as affordable rental housing.

In any case, if USDA agrees to the owner's request and if the owner actually does pay off the USDA loan, rents at the apartments could go up and USDA would not be able to provide rent subsidy for tenants. Also USDA would no longer be involved in supervising the apartment's management, leases and rents.

USDA WOULD LIKE TO KNOW YOUR OPINION ABOUT THIS PAYOFF REQUEST. We would like to know what you think the effect of paying off the loan would be on you, other tenants in the apartments, other people in the community, and any minorities living in the apartments and in the community. You have 30 days from the date of this letter to give us your opinion in writing. If you wish to write us, please send your comments to the local USDA Office at the address shown above.

It may be helpful to know that USDA follows a very careful process before deciding whether or not to allow apartment owners to pay off their USDA loans. First, USDA may offer various financial incentives to the owners to encourage them not to prepay their loan and to continue to operate the apartments for affordable rental housing. Often such incentives are sufficient to

prevent prepayment, and the apartment will continue to be operated without change for the tenants.

However, if the owner is not interested in the financial incentives that USDA can offer, USDA will evaluate how prepayment would affect the tenants of the apartments.

* If USDA decides that housing opportunities for minorities would be materially affected by a prepayment, USDA will require that the owner try to sell the apartments to a nonprofit organization or public agency which would continue to operate the apartments for affordable rental housing.

* If USDA decides that there is an inadequate supply of affordable rental housing nearby, USDA may require that the owner continues to provide low rents to you and the other current renters, even if rents go up for future tenants.

* If USDA decides to allow the owner to prepay, you and the other tenants may be given immediate priority for other USDA financed apartments. Even if USDA's loan is paid off, the owner will not be able to evict any tenant without cause.

We will keep you notified of the status of this request until a final resolution is reached. You will be allowed to review the information used by USDA to make its decisions regarding prepayment.

If the owner disagrees with the decision that USDA makes on the prepayment request, the owner may be given an opportunity to appeal USDA's decision. If the owner appeals, tenants will be given the opportunity to submit evidence at the appeal hearing.

Please contact our office if you have any questions or concerns.

Sincerely,

Notification of Sale to a Nonprofit Organization or Public Body

[Insert Tenant Address]

TO: Tenants of [Project Name]

Rural Development has reviewed relevant information concerning a request from your landlord (Insert Owner's Name) to pay off the Rural Development loan on (Enter Name of Project). Rural Development has decided that we cannot accept the payoff because we determined that tenants would be adversely affected by a prepayment. Therefore, Rural Development has offered the owner an incentive to stay in program and not prepay the loan.

Rural Development is considering providing a loan to **[Insert name of new nonprofit or public body]**, a nonprofit organization/public housing authority, to finance the owner's equity in the property and to purchase the property in exchange for an extension of the low- and moderate-income use of the housing. **[Insert name of new entity]** would be required to continue to use the property for the purpose of housing very low- and low-income people eligible for occupancy as provided in Rural Development regulations during the remaining useful life of the project. You may remain in the project throughout the remaining useful life of the project, and as long as you remain eligible or wish to occupy your apartment/unit. Rents, other charges, and conditions of occupancy will be set to meet these conditions. **[Insert name of new entity]** would only be released from these obligations when the government determines that (1) there is no longer a need for such housing; (2) that such other financial assistance provided to the residents of such housing will no longer be provided due to no fault, action, or lack of action on the part of **[insert name of new entity]**. The restrictions are intended to protect only very low- and low-income individuals and families for the remaining useful life of the project. These restrictions will not be superceded by new restrictions imposed by any subsequent transfers of the property. Eligible moderate-income tenants living at the project at the time of prepayment will not be required to move as a result of the restrictions.

Information regarding the approval of the prepayment can be reviewed at the Rural Development Area Office located at **[Insert address]**. Please call ahead to arrange an appointment if you wish to review this information.

If you have any questions, please contact me prior to **[enter date].**

Sincerely,

Rural Development Specialist

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ATTACHMENT 15-D

INCENTIVE CALCULATION WORKSHEET AND DIRECTIONS

State Office:	Contact Person:
Project Name:	Project Location:
Borrower Name:	Borrower I.D.:
Date Submitted to ORHP:	Project Number:

Number of Units:		Current Basic Rents:		Comparable Rents:		Other Data:	
	: 0 Bedroom		: 0 Bedroom		: 0 Bedroom		: Original Debt
	: 1 Bedroom		: 1 Bedroom		: 1 Bedroom		: Current Debt
	: 2 Bedroom		: 2 Bedroom		: 2 Bedroom		: Initial Bor. contribution
	: 3 Bedroom		: 3 Bedroom		: 3 Bedroom		: Original ROI rate
	: Other Br.		: Other Br.		: Other Br.		: 30 yr. Tres. Bond rate
0	Total	#DIV/0!	Average	#DIV/0!	Average		: Authorized reserve balance
	: Appraised value prior to prepayment						: Current reserve balance
	: Appraised value as unsubsidized conventional housing						: Required capital needs
	: Interest rate of third party equity loan						: Add'l monthly reserve deposit per unit
	: Term of third party equity loan						: Current Debt Service
	: Term of reamortized RHS debt					#DIV/0!	Reamortized Debt Service
	: Term of Agency equity loan						Will you ream the debt? Enter yes or no.
1%	Interest rate for Agency equity loan/reamortization						

MAXIMUM RHS EQUITY LOAN	
$ -	Appraised value (unsub. conv. housing)
-	Maximum equity (90%)
$ -	(Current debt)
$ -	90% RHS equity
$ -	Total excess reserve
$ -	90% eq. loan, less excess res. for eq., w/o regard to comp. rent
#DIV/0!	Max. eq. loan w/i comp. rents, less ex. res. for eq.
#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + EX. RESERVES)
#DIV/0!	New basic rent after RHS equity loan
#DIV/0!	Amount above or (below) comparable rent

MAXIMUM RHS EQUITY LOAN AND INCREASED ROI	
#DIV/0!	Max. eq'ty loan after using ex. res. for eq'ty
#DIV/0!	New debt service (DS) for equity loan
#DIV/0!	Debt service for existing RHS loan
#DIV/0!	New total debt service
#DIV/0!	Difference between new and current DS
#DIV/0!	Monthly/per unit increase to DS
#DIV/0!	New equity position
#DIV/0!	New ROI
$ -	Original ROI
#DIV/0!	Difference betw'n new and current ROI
#DIV/0!	Monthly/per unit increase to ROI
#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + INCR. ROI + EX. RES.)
#DIV/0!	Average current rent
#DIV/0!	Average rent with new ROI and DS
#DIV/0!	Plus any additional reserve requirement
#DIV/0!	Average comparable rent
#DIV/0!	Amount above or (below) comparable rent

INCREASED ROI WHEN AN EQUITY LOAN COULD BE OFFERED, BUT IS NOT	
$ -	RHS Debt Service
$ -	Decrease in current monthly debt service, if any
#DIV/0!	Monthly per-unit decrease to debt service, if any
$ -	Appraised value (unsub. conv. housing)
$ -	(Current debt)
$ -	Max. new equity position with ROI only
$ -	TOTAL INCENTIVE: NEW ROI
$ -	Original ROI
$ -	ROI increase with new equity position
#DIV/0!	Monthly/per unit increase to ROI
#DIV/0!	Average current rent
#DIV/0!	Average rent with new ROI and DS
#DIV/0!	Plus any additional reserve requirement
#DIV/0!	Average comparable rent
#DIV/0!	Amount above or (below) comparable rent

MAXIMUM THIRD-PARTY EQUITY LOAN	
#DIV/0!	Max. equity loan after using excess reserves for equity
#DIV/0!	New debt service for third party equity loan
#DIV/0!	Debt Service for existing RHS loan
#DIV/0!	New total debt service
#DIV/0!	Difference between new and current debt service
#DIV/0!	Monthly/per unit increase to debt service
#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + EX. RESERVES)
#DIV/0!	Average current rent
#DIV/0!	Average rent with new debt service
#DIV/0!	Plus any additional reserve requirement
#DIV/0!	Average comparable rent
#DIV/0!	Amount above or (below) comparable rent

INCREASED ROI WHEN AN EQUITY LOAN CANNOT BE OFFERED	
$ -	Appraised value prior to prepayment
$ -	(Current balance)
$ -	Current equity position
$ -	ROI w/o equity loan at 8%
$ -	ROI w/o equity loan at Treasury rate +2
$ -	Original ROI
$ -	TOTAL INCENTIVE: NEW ROI
$ -	Difference betw'n new and current ROI
#DIV/0!	Monthly/per unit increase to ROI
#DIV/0!	Average current rent
#DIV/0!	Average rent with new ROI
#DIV/0!	Plus any additional reserve requirement
#DIV/0!	Average comparable rent
#DIV/0!	Amount above or (below) comparable rent

RHS EQUITY LOANS IN CONJUNCTION WITH TRANSFERS AND SALES	
#DIV/0!	Max. eq. loan in transfer to ltd. Profit with tax credits (<=95%), less ex. res.
#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + EX. RESERVES)
#DIV/0!	New basic rent after equity loan
#DIV/0!	Amount (below) comparable rent
#DIV/0!	Max. eq. loan in transfer to ltd. Profit, no tax credits (<=97%), less ex. res.
#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + EX. RESERVES)
#DIV/0!	New basic rent after equity loan
#DIV/0!	Amount (below) comparable rent
#DIV/0!	Max. eq. loan in transfer or sale to nonprofit (<=100%), less ex. res.
#DIV/0!	TOTAL INCENTIVE (EQ. LOAN + EX. RESERVES)
#DIV/0!	New basic rent after equity loan
#DIV/0!	Amount above or (below) comparable rent

COMMENTS:

INSTRUCTIONS FOR RHS INCENTIVE CALCULATION WORKSHEET

1. **GO TO PROJECT LIST SCREEN**

2. **CLICK ON QUERY**

3. **TYPE IN "OR"**

4. **CLICK ON QUERY AGAIN - this will give you a listing of every application in the State of Oregon.**

5. **ONCE YOU HAVE THE PROJECT NAME AND BORROWER NAME FROM THE PROJECT LISTING - CLICK ON SCREENS; THEN CLICK ON "BORROWER"**

6. **WHEN YOU GET TO THE BORROWER SCREEN, CLICK ON QUERY, TYPE IN OR IN THE STATE FIELD, CLICK ON QUERY AGAIN.**

7. **THE FIRST BORROWER WILL APPEAR FOR THE STATE OF OREGON**

8. **CLICK ON THE "DOWN" BUTTON UNTIL YOU SEE THE BORROWER YOU ARE LOOKING FOR.**

9. **PRINT THAT PAGE; THEN CLICK ON THE GREEN RECTANGULAR BUTTON THAT SAYS "PROJECT" AND PRINT THAT SCREEN**

10. **THEN CLICK ON THE "NEXT" BUTTON (NOTE: You'll see a dialogue box that asks if you want to continue working with this borrower/application) CLICK YES**

11. **THIS WILL TAKE YOU BACK TO THE PROJECT LIST; CLICK ON TIMELINE FOR THAT APPLICATION**

12. **CLICK ON THE GREEN BUTTON THAT SAYS "TIMELINE TREE"**

13. **CLICK ON "TIMELINE TREE"**

14. **CLICK ON "TIMELINE RPT"**

15. **THE TIMELINE REPORT WILL APPEAR IN A SEPARATE ACROBAT WINDOW; CLICK ON THE "PRINTER" ICON**

16. **ONCE THE REPORT HAS PRINTED, CLOSE THE ACROBAT WINDOW.**

17. **CLICK ON "TIMELINE" AND ONCE BACK TO THE TIMELINE SCREEN CLICK ON THE GREEN "NEXT" BUTTON (this will take you to the Application Checklist Screen)**

18. PRINT PAGE 1 OF THE CHECKLIST SCREEN

19. CLICK ON THE GREEN RECTANGULAR "PROJECT NEEDED" BUTTON

20. PRINT PAGE 2 OF THE CHECKLIST SCREEN

21. CLICK ON THE GREEN "NEXT" BUTTON (this will take you to the Prepayment Information Screen)

22. PRINT PAGE 1 OF THE PREPAYMENT INFORMATION SCREEN

23. CLICK ON THE GREEN RECTANGULAR "PREPAY, PAGE 2" BUTTON

24. PRINT PAGE 2 OF THE PREPAYMENT INFORMATION SCREEN

25. CLICK ON THE GREEN "NEXT" BUTTON (this will take you to the Incentive Calculation Worksheet)

26. PRINT ALL 11 PAGES OF THE INCENTIVE CALCULATION WORKSHEET

THAT'S IT.

PLEASE PRINT THE SCREEN EVEN IF IT IS BLANK.

NOTE: CHECK THE TIMELINE SCREEN TO SEE IF ANY OF THE PROJECTS HAVE REHAB/REPAIR/DEFERRED MAINTENANCE; IF SO, PRINT THOSE 2 SCREENS AS WELL.

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ATTACHMENT 15-E

RESTRICTIVE-USE PROVISIONS AND AGREEMENTS

(a) The undersigned, and any successors in interest, agree to use the subject property (described herein) in compliance with 42 USC 1484 or 1485, whichever is applicable, and applicable regulations and the subsequent amendments, for the purpose of housing:

(1) very low, or low income households when required by 7 CFR 3560.658 (a)(3) or (b)(1), or

(2) very low, low, or moderate income households when required by 7 CFR 3560.655, 3560.658 (a)(1) and (2) and (b)(2), or 7 CFR 3560.401.

(b) The period of the restriction will be inserted in accordance with the following:

(1) 10 years if required by 7 CFR 3560.658 (a) (1);

(2) 15 years if required by 7 CFR 3560.655;

(3) 20 years if required by 7 CFR 3560.655 or 3560.656;

(4) 30 years if required by 7 CFR 3560.406(g);

(5) Remaining period of existing Restrictive Use Provision's if required by 7 CFR 3560.655 or 3560.658 (a)(2);

(6) The remaining useful life of the housing and related facilities if required by 7 CFR 3560.658 (a)(3) and (b)(1);

(7) The last existing tenant (that occupied the property on the date of prepayment) voluntarily vacates if required by this subpart.

(c) When required by 7 CFR 3560.658 (a)(1) and (2), the borrower will also agree that at the expiration of this restriction, the undersigned agrees to offer the property for sale to a qualified nonprofit organization or public body, in accordance with previously cited statutes and regulations.

(d) The Agency and eligible tenants or applicants may enforce these restrictions.

(e) The borrower must also agree to the following requirements to implement these restrictions:

(1) rents, other charges, and conditions of occupancy will be set to meet these conditions;

(2) an Agency approved notice of this restriction will be posted for tenants of the project;

(3) to adhere to applicable local, state, and Federal laws; and

(4) to obtain Agency concurrence for any rental procedures that deviate from those approved at the time of prepayment, prior to implementation.

(f) The borrower will be released from these obligations before that date only when the Agency determines that there is no longer a need for the housing or that such other financial assistance provided the residents of the housing will no longer be provided due to no fault, action or lack of action on the part of the borrower.

Appendix 1

7 CFR PART 3560--DIRECT MULTI-FAMILY HOUSING LOANS AND GRANTS

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7 CFR Part 3560

7 CFR PART 3560 – DIRECT MULTI-FAMILY HOUSING LOANS AND GRANTS

Subpart A--General Provisions and Definitions

§3560.1 Applicability and purpose.

(a) This part sets forth requirements, policies, and procedures for multi-family housing (MFH) direct loan and grant programs to serve eligible very-low, low- and moderate-income households. The programs covered by this part are authorized by title V of the Housing Act of 1949 and are:

(1) Section 515 Rural Rental Housing, which includes congregate housing, group homes, and Rural Cooperative Housing. Section 515 loans may be made to finance multi-family units in rural areas as defined in §3560.11.

(2) Sections 514 and 516 Farm Labor Housing loans and grants. Housing under these programs may be built in any area with a need and demand for housing for farm workers.

(3) Section 521 Rental Assistance. A project-based tenant rent subsidy which may be provided to Rural Rental Housing and Farm Labor Housing facilities.

(b) The programs covered by this part provide economically designed and constructed rural rental, cooperative, and farm labor housing and related facilities operated and managed in an affordable, decent, safe, and sanitary manner.

(c) Internal Agency procedures containing details for Agency processing under these regulations can be found in the program handbooks, available in any Rural Development office, or from the Rural Development Web site.

§3560.2 Civil rights.

(a) As per the Fair Housing Act, as amended and section 504 of the Rehabilitation Act of 1973, all actions taken by recipients of loans and grants will be conducted without regard to race, color, religion, sex, familial status, national origin, age, or disability. These actions include any actions in the sale, rental, or advertising of the dwellings, in the provision of brokerage services, or in residential real estate transactions involving Rural Housing Service (RHS) assistance. It is unlawful for a borrower or grantee or an agent of a borrower or grantee:

(1) To refuse to make reasonable accommodations in rules, policies, practices, or services that would provide a person with a disability an opportunity to use or continue to use a dwelling unit and all public and common use areas; or

(2) To refuse to provide a reasonable accommodation at the borrower's expense that would not cause an undue financial or administrative burden, or to refuse to allow an individual with a disability to make reasonable modifications to the unit at their own expense with the understanding that the owner may require the tenant to return the unit to its original condition when the unit is vacated by the tenant making the modifications (see §3560.104(c)).

(b) Borrowers and grantees must take reasonable steps to ensure that Limited English Proficiency (LEP) persons receive the language assistance necessary to afford them meaningful access to USDA programs and activities, free of charge. Failure to ensure that LEP persons can effectively participate in or benefit from federally-assisted programs and activities may violate the prohibition under Title VI of the Civil Rights Act of 1964, 42 U.S.C. 2000d and Title VI regulations against national origin discrimination. USDA has issued guidance to clarify the responsibilities of recipients and subrecipients who receive financial assistance from USDA and to assist them in fulfilling their responsibilities to LEP persons under Title VI of the Civil Rights Act, as amended, and implementing regulations.

(c) Any tenant/member or prospective tenant seeking occupancy in or use of facilities financed by the Agency who believes he or she is being discriminated against because of race, color, religion, sex, familial status, national origin, or disability may file a complaint in person with, or by mail to the U. S. Department of Agriculture's Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, Washington, DC 20410. Complaints received by Agency employees must be directed to the National Office Civil Rights staff through the State Civil Rights Manager/Coordinator.

(d) Borrowers or grantees that fail to comply with the requirements of federal civil rights requirements are subject to sanctions authorized by law. The following are the major civil rights laws affecting multifamily housing loan and grant programs:

(1) Equal Credit Opportunity Act (ECOA).
(2) Title VI of the Civil Rights Act of 1964.
(3) Title VIII of the Civil Rights Act of 1968.
(4) Section 504 of the Rehabilitation Act of 1973.
(5) Age Discrimination Act of 1975.
(6) Title IX of the Education Amendments of 1972.

§3560.3 Environmental requirements.

RHS will consider environmental impacts of proposed housing as equal with economic, social, and other factors. By working with applicants, Federal agencies, Indian tribes, state and local governments, interested citizens, and organizations, RHS will formulate actions that advance program goals in a manner that protects, enhances, and restores environmental quality. Loan and grant processing and servicing actions taken by RHS under this part are subject to an environmental review conducted in accordance with 7 CFR part 1940, subpart G or any successor regulation.

§3560.4 Compliance with other Federal requirements.

RHS is responsible for ensuring that the application is in compliance with all applicable Federal requirements, including the following specific requirements:

(a) Intergovernmental review. 7 CFR part 3015, subpart V, or any successor regulation, including the Agency supplemental administrative instruction, RD Instruction 1940-J, available in any Rural Development office.

(b) National flood insurance. The National Flood Insurance Act of 1968, as amended by the Flood Disaster Protection Act of 1973; the National Flood Insurance Reform Act of 1994; and 7 CFR part 1806, subpart B, or any successor regulation.

(c) Clean Air Act and Water Pollution Control Act Requirements. For any contract, all applicable standards, orders or requirements issued under section 306 of the Clean Air Act; section 508 of the Clean Water Act, Executive Order 11738, and 40 CFR part 32.

(d) Historic preservation requirements. The provisions of 7 CFR part 1901, subpart F or any successor regulation.

(e) Lead-based paint requirements. The applicable provisions of 24 CFR part 35, subparts A through D, J, and R, as published by the U.S. Department of Housing and Urban Development.

§3560.5 State, local or tribal laws.

Borrowers must comply with all applicable state and local laws, and laws of Federally-recognized Indian tribes to the extent they are not inconsistent with this part.

§3560.6 Borrower responsibility and requirements.

(a) Borrower responsibilities and requirements specified in this part may be carried out by an individual or entity designated by the borrower to act on behalf of the borrower such as a resident manager or management agent. Ultimate accountability to the Agency, however, is with the borrower whether or not the borrower designated another person or entity to act on the borrower's behalf.

(b) Borrowers who have not executed a loan agreement, and who were not required to execute a loan agreement by the regulations in effect at the time of their loan closing are exempt from the requirements of subparts D through G of this part, as long as the borrower is not in default of any applicable requirement, security instrument, payment, or any other agreement with the Agency. Such borrowers must provide evidence of tenant income eligibility in accordance with §3560.152(a), except in Farm Labor Housing where the tenant is not paying shelter cost.

§3560.7 Delegation of responsibility.

The RHS Administrator may delegate, on an individual or other basis, any decision-making responsibility for Agency programs, unless otherwise noted.

§3560.8 Administrator's exception authority.

The RHS Administrator may make an exception to any provision of this part or address any omissions provided that the exception is consistent with the applicable statute, does not adversely affect the interest of the Federal Government, and does not adversely affect the accomplishment of the purposes of the MFH programs or application of the requirement would result in undue hardship on the tenants. Exception requests presented to the RHS Administrator must have the concurrence of a Rural Development State Director or a Deputy Administrator for MFH.

§3560.9 Reviews and appeals.

Rural Housing Service decisions may be appealed pursuant to 7 CFR part 11.

§3560.10 Conflict of interest.

To reduce the potential for employee conflict of interest, all RHS activities will be conducted in accordance with 7 CFR part 1900, subpart D.

§3560.11 Definitions.

Unless otherwise noted, terms listed in this part shall be defined as follows:
Administrator. The head of the Rural Housing Service who reports directly to the Under Secretary for Rural Development in the U.S. Department of Agriculture.

Agency. The Rural Housing Service within the Rural Development mission area of the U.S. Department of Agriculture.

Amortization. Payment of debt in regular, periodic installments of principal and interest, as opposed to interest only payments.

Applicant. An individual, partnership or limited partnership, consumer cooperative, trust, state or local public agency, corporation, limited liability company, nonprofit organization, Indian tribe, association, or other entity that will be the owner of the project for which an application for funding from the Agency is submitted.

Appraisal. As used by the Agency, a written report developed by a qualified appraiser as established in subpart P that concludes an opinion of value(s) for a specific real property.

Assistance. Financial assistance in the form of a loan, grant, interest credit, or rental assistance.

Association of farmers. Two or more farmers acting as a single legal entity. Association members may include the individual members of farming partnerships or corporations.

Borrower. An individual, partnership or limited partnership, consumer cooperative, trust, state or local public agency, corporation, limited liability company, nonprofit organization, Indian tribe,
association, or other entity that has received a loan from the Agency.

Capital Needs Assessment. A Capital Needs Assessment is designed to capture and report on the immediate and the long-range capital needs of an individual property. It includes attention to site features, mechanical and electrical systems, building exterior and common area systems, and dwelling unit interiors.

Caretaker. An individual employed by a borrower or a management agent to handle routine interior and exterior maintenance and upkeep of a MFHMFH project.

Congregate housing. A housing program authorized by section 515 of the Housing Act of 1949 which provides housing for elderly persons, individuals with disabilities, and families who require some supervision and central services but are otherwise able to care for themselves. Such housing does not include any licensed healthcare facility.

Consumer cooperative. A corporation organized under the cooperative laws of a state or Federally recognized Indian tribe that will own and operate the housing on a cooperative basis solely for the benefit of its members.

Conventional rents for comparable units (CRCU). Market rents for comparable rental units in conventional housing located in the same geographic area as a particular Section 514, 515, or 516 project.

Current appraisal. An appraisal with a report date that is no more than 1 year old.

Daily Interest Accrual System (DIAS). A system where interest is charged daily on outstanding principal. Level loan payments are made by the borrower. The amount of interest due on any date is equal to the unpaid daily interest that has accrued.

Default. Failure by a borrower to meet significant monetary or non-monetary obligations or terms of a loan, grant, or other agreement with the Agency which remain unpaid or unperformed for more than 30 days after the date such obligation is due or required to be paid or performed, or within time periods specified in notices of compliance violations.

Disability. The term disability is considered equivalent to the term handicap. Eligibility requirements for fully accessible units are contained in §§3560.154(g)(1)(i) and 3560.155(b). A person is considered to have a disability if either of the following two situations occur:

(1) As defined in section 501(b) of the Housing Act of 1949. The person is the head of household (or his or her spouse) and is determined to have an impairment which:

(i) Is expected to be of long-continued and indefinite duration;

(ii) Substantially impedes his or her ability to live independently; and

(iii) Is of such a nature that such ability could be improved by more suitable housing conditions, or if such person has a developmental disability as defined in section 102(7) of the Developmental Disability and Bill of Rights Act (42 U.S.C. 6001(7)).

(2) As defined in the Fair Housing Act; the Americans with Disabilities Act; and section 504 of the Rehabilitation Act of 1973. The person has a physical or mental impairment which substantially limits one or more of such person's major life activities; a record of such impairment; or being regarded as having such an impairment. The term does not include current, illegal use of or addiction to a controlled substance. As used in this definition, 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; genito-urinary; hemic and lymphatic; skin; and endocrine;

(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, autism, epilepsy, muscular dystrophy, multiple sclerosis, cancer, heart disease, diabetes, Human Immunodeficiency Virus infection, mental retardation, emotional illness, drug addiction (other than addiction caused by current, illegal use of a controlled substance), and alcoholism;

(iii) Major life activities means functions such as caring for one's self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, and working;

(iv) 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;

(v) Is regarded as having an impairment means:

(A) Has a physical or mental impairment that does not substantially limit one or more major life activities but that is treated by the borrower or management agent as constituting such a limitation;

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

(C) Has none of the impairments described in this definition but is treated by another person as having such an impairment.

Disabled domestic farm laborer. An individual with a disability as separately defined in this paragraph and who was a domestic farm laborer at the time of becoming disabled.

Domestic farm laborer. A person who, consistent with the requirements in §3560.576(b)(2), receives a substantial portion of his or her income from farm labor employment (not self-employed) in the United States, Puerto Rico, or the Virgin Islands and either is a citizen of the United States or resides in the United States, Puerto Rico or the Virgin Islands after being legally admitted for permanent residence. This definition may include the immediate family members residing with such a person.

Due diligence on hazardous substances. Due diligence is the process of inquiring into the environmental conditions of real estate, in the context of a real estate transaction to determine the presence of contamination from hazardous substances, and to determine the impact such contamination may have on the market value of the property.

Elderly household or individual with a handicapped household. A household in which the tenant or co-tenant of the household is 62 years old or older or is an individual with a disability. An elderly household may include persons younger than 62 years old and the household of an individual with a handicap may include persons without disabilities.

Elderly person. A person who is at least 62 years old. The term also means a person with a disability as separately defined in this paragraph, regardless of age.

Engagement. An Agency defined financial review of a housing project's financial status that a borrower will contract with a certified public accountant or other qualified individual to perform. An engagement will result in annual financial reports for use by the Agency as described in §3560.308.

Familial status. One or more individuals (who have not attained the age of 18 years) being domiciled with a parent or another person having legal custody of such individual or individuals; or the designee of such parent or other person having such custody, with the written permission of such parent or other person. The protections afforded against discrimination on the basis of familial status shall apply to any person who is pregnant or is in the process of securing legal custody of any individual who has not attained the age of 18 years.

Family farm corporation or partnership. A private corporation or partnership involved in agricultural production in which at least 90 percent of the stock or interest is owned and controlled by persons related by blood, which shall include parents, siblings, and children, or law. If more than three separate households are supported by the farming operation, the family farm corporation or partnership must be:

(1) Legally organized and authorized to own and operate a farm business within the state;

(2) Legally able to carry out the purposes of the loan; and

(3) Prohibited from the sale or transfer of 90 percent of the stock or interest to other than family members by either the articles of incorporation, bylaws or by agreement between the stockholders or partners and the corporation or partnership.

Farm. A tract or tracts of land, improvements, and other appurtenances that are used or will be used in the production of crops, livestock, or aquaculture products for sale in sufficient quantities so that the property is recognized as a farm rather than a rural residence. The term “farm” also includes the term “ranch.” It may also include land and improvements and facilities used in a non-eligible enterprise or the residence that, although physically separate from the farm acreage, is ordinarily treated as part of the farm in the local community.

Farmer. A person who is actually involved in day to day on-site operations of a farm and who devotes a substantial amount of time to personal participation in the conduct of the operation of a “farm.”

Farm labor. Services in connection with cultivating the soil, raising or harvesting any agriculture or aquaculture commodity; or in catching, netting, handling, planting, drying, packing, grading, storing, or preserving in the unprocessed stage, without respect to the source of employment (but not self-employed), any agriculture or aquaculture commodity; or delivering to storage, market, or a carrier for transportation to market or to processing any agricultural or aquacultural commodity in its unprocessed stage.

Farm labor contractor. A person--other than an agricultural employer, a member of an agricultural association, or an employee of an agricultural employer or agricultural association--who recruits, solicits, hires, employs, furnishes, or transports any year-round or seasonal migrant farm laborer for money or other valuable consideration.

Farm labor housing. On-farm or off-farm housing for farm laborers authorized by section 514 and section 516 of the Housing Act of 1949.

Farm owner. A natural person, persons, or legal entity who are the owners of a “farm” as this term is further defined in this section.

Foreclosure. A proceeding in or out of court to extinguish all rights, title, and interest of the owners of property in order to sell the property to satisfy a lien against it.

General overhead. Includes general operation items necessary for the contractor to be in business. They may include, but are not limited to the following: tools and minor equipment; worker's compensation and employer's liability; unemployment tax; Social Security and Medicare; manager's, clerical, and estimator's salaries; pension and bonus plans; main office insurance, rental, utilities, miscellaneous expenses; general liability insurance; legal, accounting, and data processing; automotive and light truck expense; vehicle expenses; depreciation of overhead capital expenditures; and office equipment maintenance.

General requirements. Includes items that are required in the construction contract for the contractor to provide for the specific project. They do not include items that pertain to a specific trade nor overhead expenses of the contractor's general operation. Items may include, but are not limited to, the following: Field supervision; field engineering such as field office, sheds, toilets, phone; performance and payment or latent defects bonds; cost certification; building permits; site security; temporary utilities; property insurance; and cleaning or rubbish removal.

Grantee. An entity that has received a grant from the Agency.

Group home. Housing that is occupied by elderly persons or individuals with disabilities who share living space within a rental unit and in which a resident assistant may be required.

Household. The tenant or co-tenant and the persons or dependents living with a tenant or co-tenant, but not including a resident assistant.

Household furnishings. Basic durable items such as stoves, refrigerators, drapes, drapery rods, tables, chairs, dressers and beds.

Housing project. A property with two or more affordable, decent, safe and sanitary rental units and related facilities operated under one management plan and financed with funds appropriated under the authority of sections 515, 514, or 516 of the Housing Act of 1949.

Identity-of-Interest (IOI). A relationship between applicants, borrowers, grantees, management agents, or suppliers of materials or services described under, but not limited to, any of the following conditions:

(1) There is a financial interest between the applicant, borrower, grantee and a management agent or the supplying entity;

(2) One or more of the officers, directors, stockholders or partners of the applicant, borrower, or management agent is also an officer, director, stockholder, or partner of the supplying entity;

(3) An officer, director, stockholder, or partner of the applicant, borrower, or management agent has a 10 percent or more financial interest in the supplying entity;

(4) The supplying entity has or will advance funds to an applicant, borrower, or management agent;

(5) The supplying entity provides or pays on behalf of the applicant, borrower, or management agent the cost of any materials or services in connection with obligations under the management plan or management agreement;

(6) The supplying entity takes stock or a financial interest in the applicant, borrower, or management agent as part of the consideration to be paid them; or

(7) There exists or come into being any side deals, agreements, contracts or understandings entered into thereby altering, amending, or canceling any of the management plan, management agreement documents, organization documents, or other legal documents pertaining to the property, except as approved by the Agency.

Indian tribe. The term "Indian tribe" means any Indian tribe, band, group, and nation, including Alaskan Indians, Aleuts, and Eskimos, and any Alaskan-Native Village, which is considered an eligible recipient under the Indian Self-Determination and Education Assistance Act (Public Law 93-638) or under the State and Local Fiscal Assistance Act of 1972 (Public Law 92-512).

Interest credit. A form of assistance available to eligible borrowers that reduces the effective interest rate of the loan.

Lease. A contract setting forth the rights and obligations of a tenant or cooperative member and a property owner, including charges and terms under which a tenant or cooperative member will occupy or use the housing or related facilities.

Legal or qualified alien. Legal or qualified 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.

Letter of Priority Entitlement (LOPE). A letter issued by the Agency providing a tenant with priority entitlement to rental units in other Agency-financed housing projects for 120 days from the date of the LOPE.

Life cycle cost. The life cycle cost has 2 purposes: (1) To determine the expected usable life (utility) of a building component or furnishing and (2) to determine which building components or furnishings are the most cost efficient over the life of the building. Cost efficient is not to be construed to mean the least initial cost.

Life cycle cost analysis. Life cycle cost analysis is the comparison of different materials to examine anticipated useful life and the cost of using a specific material or building component. The analysis has multiple uses, such as: (1) To conduct a cost efficiency comparison between products, (2) for developing component replacement time tables, and (3) for estimating future component replacement costs. Life cycle cost analysis can be accomplished through various methods, such as; insurance actuary tables or Agency documentation of a component's life expectancy. Life cycle cost analysis is conducted by a design professional. For Agency financed projects, a life cycle cost analysis is to be conducted for specific components: (1) drives and parking, (2) roofing system and roofing material, (3) exterior finishes, and (4) energy source items.

Limited Liability Company (LLC). An unincorporated organization of one or more persons or entities established in accordance with applicable state laws and whose members may actively participate in the organization without being personally liable for the debts, obligations or liabilities of the organization.

Limited partnership. An ownership arrangement consisting of general and limited partners; general partners manage the business, while limited partners are passive and liable only for their own capital contributions.

Loan agreement. A written agreement between the Agency and the borrower that sets forth the borrower's responsibilities with respect to Agency financing.

Low-income household. A household that has an adjusted income that is greater than the Department of Housing and Urban Development's (HUD) established very-low income limit, but that does not exceed the HUD established low-income limit (generally 80 percent of median income adjusted for household size for the county where the property is or will be located).

Low-Income Housing Tax Credit (LIHTC). A federal tax credit allowed for investment in qualified low-income housing administered by the Internal Revenue Service (IRS) under section 42 of the Internal Revenue Code.

Management agent. A firm or individual employed or designated by a borrower to act on the borrower's behalf in accordance with a written management agreement.

Management agreement. A written agreement between a borrower and a management agent setting forth the management agent's responsibilities and fees for management services.

Management fee. The compensation provided to a management agent for services provided in accordance with a management agreement.

Management plan. A detailed description of the policies and procedures to be followed by the borrower in managing a MFH project.

Manufactured housing. Housing, constructed of one or more factory-built sections, which includes the plumbing, heating, and electrical systems contained therein, which is built to comply with the Federal Manufactured Home Construction and Safety Standards (FMHCSS), and which is designed to be used with a permanent foundation.

Market area. The geographic or locational delineation of the market for a specific project, including outlaying areas that will be impacted by the project, i.e., the area in which alternative, similar properties effectively compete with the subject property.

Market rent. The most probable rent that a property should bring in a competitive and open market reflecting all conditions and restrictions of the specified lease agreement, including term, rental adjustment and revaluation, permitted uses, use restrictions, and expense obligations; the lessee and lessor each acting prudently and knowledgeably, and assuming consummation of a lease contract as a specified date and the passing of the leasehold from lessor to lessee.

Maximum debt limit. The maximum amount that the Agency will lend or grant for a MFHMFH project based on the appraised value or total development cost excluding costs ineligible for payment from loan or grant funds, whichever is less, reduced by all funding available to the borrower from sources other than the Agency, multiplied by 95, 97, or 102 percent depending upon the applicant entity and their use of the low-income housing tax credit, in accordance with §3560.63(b).

Member or co-member. A stockholder or other person who has executed documents or stock pertaining to a cooperative housing type of living arrangement and has made a commitment to upholding the cooperative concept.

Migrants or migrant agricultural laborer. A person (and the family of such person) who receives a substantial portion of his or her income from farm labor employment and who establishes a residence in a location on a seasonal or temporary basis, in an attempt to receive farm labor employment at one or more locations away from their home base state, excluding day-haul agricultural workers whose travels are limited to work areas within one day of their residence.

Minor. An individual under 18 years of age who is a dependent of a tenant or an individual age 18 or older who is a full-time student and a dependent of a tenant.

Moderate-income household. A household that has an adjusted income that is greater than the HUD-established low-income limit, but does not exceed the low-income limit by more than $5,500.

Mortgage or Deed of Trust. A form or security instrument or consensual lien on real property.

Net recovery value. The value realized from the Government's acquisition of security property in a default situation after subtracting all costs, actual or anticipated, from acquiring, holding, and disposing of the security property.

New construction. A MFHMFH project being constructed to be occupied for the first time.

Nonprofit organization. A private organization that:

(1) Is organized under state or local laws;

(2) Has no part of its net earnings inuring to the benefit of any member, founder, contributor, or individual; and

(3) Is approved by the Secretary of Agriculture and considered to be financially responsible.

Nonprofit organization for section 515 program (Prepayment or Purchase). To be eligible to purchase properties under the conditions of subpart N of this part, nonprofit organizations may not have among their officers or directorate any persons or parties with an identity-of-interest (or any persons or parties related to any person with identity-of-interest) in loans financed under section 515 that have been prepaid or have requested prepayment.

Nonprofit organization of farm workers. A nonprofit organization, as defined in this section, whose membership is composed of at least 51 percent farm workers.

Notice of Funding Availability (NOFA). A “Notice of Funding Availability” issued by the Agency to inform interested parties of the availability of assistance and other matters pertinent to the program.

Occupancy agreement. A contract establishing the rights and obligations of the cooperative member and the cooperative, including the amount of the monthly occupancy charge and the other terms under which the member will occupy the housing.

Occupancy charge. The amount of money charged a cooperative member to cover their proportional share of the cooperative's operating costs and cash requirements.

Off-farm labor housing. Housing for farm laborers in any location approved by the Agency but not on the farm where the laborer works.

Office of the General Counsel (OGC). The USDA Office of the General Counsel, including the Regional Attorney, Associate Regional Attorney, or Assistant Regional Attorney.

Office of the Inspector General (OIG). The USDA Office of the Inspector General.

On-farm labor housing. Housing for farm laborers located on the farm where they work that is away from service buildings or in the nearby community.

Overage. That portion of a tenant's net tenant contribution that exceeds basic rent up to note rent. Full overage is an amount equal to the difference between the note rent for a unit and the basic rent.

Plan I. A type of interest subsidy available to borrowers prior to October 27, 1980. Budgets and rental rates developed for Plan I loans are based on a 3 percent loan amortization.

Plan II. A type of interest subsidy available to borrowers operating on a limited profit basis. Budgets and rental rates developed for Plan II loans are based on both the loan being amortized at the interest rate shown on the promissory note and at a 1 percent subsidized rate.

Predetermined Amortization Schedule System (PASS). A system where loan payments are applied based on an amortization schedule.

Prepayment. Payment in full of the outstanding balance on an Agency loan prior to the note's originally scheduled maturity date.

Program requirements. All provisions related to MFHMFH contained in the loan document, grant agreement, statute, regulation, handbook, or administrative notice.

Promissory note. A legal document containing conditions (interest rate and timing) for repayment of indebtedness.

Real estate owned (REO) property. The real estate owned by the Agency acquired through voluntary conveyance, foreclosure or other action.

Rehabilitation. Rehabilitation is when the remodeling of a property is of a complex nature involving structural repairs or when two or more of the life cycle cost components are included in the remodeling of a property.

Related facilities. Facilities in a MFHMFH project that are related to the housing and are in addition to rental units, (e.g., community rooms or buildings, cafeterias, dining halls, infirmaries, child care facilities, assembly halls, and essential service facilities such as central heating, sewerage, lighting systems, clothes washing facilities, trash disposal and safe domestic water supply).

Rent. The amount established as a charge for occupancy in a rental unit of Agency-financed MFH. Rents must be established at the same rate for all similar units in the housing project. The following terms are used to describe rents for various program purposes.

(1) Note rent is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment set at the interest rate shown in the promissory note.

(2) Basic rent is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment contained in the promissory note reduced by the interest credit agreement.

(3) HUD contract rent is the rental charge established for housing receiving project-based Section 8 rental subsidies in accordance with 24 CFR part 880 or part 884, as applicable.

(4) Low-income housing tax credit (LIHTC) rent is the rental charge established in accordance with LIHTC requirements.

Rental assistance (RA). The portion of the approved shelter cost paid by the Agency to compensate a borrower for the difference between the approved shelter cost and the tenant contribution when such contribution is less than the basic rent.

Rental assistance units. Dwelling units in a MFH project qualified for rental assistance. There are three types of rental assistance units.

(1) New construction units are units provided in conjunction with initial loans for construction or substantial rehabilitation of the MFHMFH projects.

(2) Replacement units are Agency-funded rental assistance units which replace units with expiring rental assistance agreements or which replace Section 8 units which have expired under the Section 8 contract.

(3) Servicing units are units provided to an operational MFHMFH project as a part of the Agency's general loan servicing or preservation activities.

Repair and replacement. Repair and replacement is the restoration of minor building materials, elements, components, equipment and fixtures. Examples include: Painting, carpeting, appliances, cabinets, and other fixtures.

Resident assistant. A person residing in a rental unit who is essential to the well-being and care of an elderly person or an individual with a disability, but who:

(1) Is not obligated for the tenant's financial support;

(2) Would not be living in the unit except to provide the needed services;

(3) May be a family member, but is not a dependent of the tenant for tax purposes;

(4) Is not subject to the eligibility requirements of a tenant; and

(5) Is not considered a household member in the determination of household income.

Resident or site manager. The individual employed by the borrower and who is responsible for the day-to-day operations of the housing.

Retired domestic farm laborer. An individual who is at least 55 years of age and who has spent the last 5 years prior to retirement as a domestic farm laborer or spent the majority of the last 10 years prior to retirement as a domestic farm laborer.

Return on Investment (ROI). The annual amount of profit an owner operating on a limited or full profit basis may withdraw from a project, as established in the loan agreement. The amount is calculated as a percentage of the owner's investment in the project.

Rural area. Any open country, or any place, town, village, or city which is not (except in the cases of Pajaro, in the State of California, and Guadalupe, in the State of Arizona) part of or associated with an urban area and which (1) has a population not in excess of 2,500 inhabitants, or (2) has a population in excess of 2,500 but not in excess of 10,000 if it is rural in character, or (3) has a population in excess of 10,000 but not in excess of 20,000 and (A) is not contained within a standard metropolitan statistical area, and (B) has a serious lack of mortgage credit for lower and moderate-income families, as determined by the Secretary and the Secretary of

Housing and Urban Development. For purposes of this title, any area classified as 'rural' or a 'rural area' prior to October 1, 1990, and determined not to be 'rural' or a 'rural area' as a result of data received from or after the 1990 or 2000 decennial census shall continue to be so classified until the receipt of data from the decennial census in the year 2010, if such area has a population in excess of 10,000 but not in excess of 25,000, is rural in character, and has a serious lack of mortgage credit for lower and moderate-income families. Notwithstanding any other provision of this section, the city of Plainview, Texas, shall be considered a rural area for purposes of this title, and the city of Altus, Oklahoma, shall be considered a rural area for purposes of this title until the receipt of data from the decennial census in the year 2000.

Rural Cooperative Housing (RCH). A housing program authorized under section 515 of the Housing Act of 1949, in which a consumer cooperative, organized and operating on a nonprofit basis, may own and operate a MFHMFH development.

Rural Housing Service (RHS). The Agency within the Rural Development mission area of the U.S. Department of Agriculture or its successor agency which administers programs authorized by sections 514, 515, 516, and 521 of the Housing Act of 1949, as amended.

Rural Rental Housing (RRH). A housing program authorized by section 515 of the Housing Act of 1949 to provide rental housing in rural areas for persons of very-low, low- and moderate income.

Seasonal housing. Housing operated on a seasonal basis, typically for migrants or migrant agricultural laborers as opposed to year round.

Security deposit. A one-time fee charged a tenant prior to occupancy of a unit to cover possible loss or damage to the housing unit caused by the tenant.

Self-employed. A person who meets the IRS definition of self-employed at 26 CFR 1.401-10.

Service agreement. A written agreement between a borrower and a service provider establishing the specific service to be provided to a MFH project, the cost of the service, and the length of time the service will be provided.

Service plan. A written plan describing how services will be provided to a MFH project and which, at a minimum, must specify the services to be provided, the frequency of the services, who will provide the services, how tenants will be advised of the availability of services, and the staff needed to provide the services.

Service provider. A person who signs a written agreement with a borrower to provide services to a MFH project.

Shelter costs. Basic or note rent plus the utility allowance, when used, or the occupancy charge plus the utility allowance. If the utility costs are included in the rent, the rent will equal shelter costs.

Sources and Uses Comprehensive Evaluation (SAUCE). A computer software program used by the Agency to analyze the total funds provided to a MFH project to ensure that the Agency is not providing excess assistance.

Special note rent (SNR). A rental rate charged at a Plan II project experiencing vacancies that is less than note rent but higher than basic rent.

State consolidated plan. A planning document for an individual state that includes a housing and homeless needs assessment; a housing market analysis; a strategic plan for addressing the state's housing challenges; an Action Plan that is an annual description of the state's Federal and other resources that are expected to be available to address its priority housing needs and how the Federal funds will leverage other resources; certifications relating to fair housing, its antidisplacement and relocation plan, a drug-free workplace, and other statutory and program requirements; and a monitoring plan to ensure that the state is using its Federal funds appropriately and effectively.

Tenant or co-tenant. An individual who signs a lease and occupies or will occupy a rental unit in a MFH project. The term tenant or co-tenant also refers to a member of cooperative housing occupying or planning to occupy a dwelling unit in cooperative housing.

Tenant contribution. The portion of the approved shelter cost paid by the tenant household. The proportion of tenant income and adjusted income paid will vary according to the type of subsidy provided to the tenant household.

Total development cost (TDC). The cost of constructing, purchasing, improving, altering, or repairing MFH and related facilities, buying household furnishings (for sections 514/516 only), and purchasing or improving the necessary land, including architectural, engineering, or legal fees, and charges and other technical and professional fees and charges, but excluding fees, charges, or commissions such as payments to brokers, negotiators, or other persons for the referral of prospective applicants or solicitations of loans. Although a developer's fee is part of the project's development cost, such fees are not eligible for payment from Agency loan or grant funds and are not included in determining the Agency authorized development cost.

Utility allowance. An amount determined by a borrower as the amount to be considered a tenant's portion of utility cost in the calculation of a tenant's total shelter cost when utility costs are not included in the rent.

Very low-income household. A household that has an adjusted income that does not exceed the HUD established very low-income limit (generally 50 percent of median income adjusted for household size in the county where the property is or will be located).Workout agreement. An agreement between a borrower and the Agency listing actions to be taken over a period of time to prevent or correct a compliance violation or to cure a monetary or non-monetary default.

§§3560.12-3560.49 [Reserved]

§3560.50 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart B--Direct Loan and Grant Origination

§3560.51 General.

This subpart contains the Agency's loan origination requirements for multi-family housing (MFH) direct loans for Rural Rental Housing, Rural Cooperative Housing, and Farm Labor Housing. Additional requirements for farm labor housing loans and grants are contained in subpart L of this part for Off-Farm Labor Housing and subpart M of this part for On-Farm Labor Housing.

§3560.52 Program objectives.

The Agency uses appropriated funds to finance the construction, rehabilitation of program properties, or purchase and rehabilitation of MFH and related facilities to serve eligible persons in rural areas. The Agency encourages the use of such financing in conjunction with funding or financing from other sources.

§3560.53 Eligible use of funds.

Funds may be used for the following purposes.

(a) Construct housing. Funds may be used to construct MFH.

(b) Purchase and rehabilitate buildings. Funds may be used to purchase and rehabilitate buildings that have not been previously financed by the Agency.

(1) Rehabilitation must meet the definition of either moderate or substantial rehabilitation as defined in 7 CFR part 1924, subpart A.

(2) The building to be rehabilitated must be structurally sound and the improvements to the building must be necessary to meet the requirements of decent, safe, and sanitary living units.

(3) The total development cost (TDC) for the purchase and rehabilitation of existing buildings must not be more than the estimated TDC for construction of a similar type and unit size property in the same area.

(c) Subsequent loans. Funds may be used to provide subsequent loans in accordance with the provisions of §3560.73.

(d) Purchase and improve sites. Funds may be used to purchase and improve the site on which MFH will be located, provided that the amount of loan funds used to purchase the site does not exceed the appraised market value of the site immediately prior to purchase.

(e) Develop and install necessary systems. Funds may be used to install streets, a water supply, sewage disposal, heating and cooling systems, electric, gas, solar, or other power sources for lighting and other features necessary for the housing. If such facilities are located off-site, loan funds may only be used if the following additional requirements are met:

(1) The loan applicant will hold title to the facility or have a legal right to use the facility in the form of an easement or other instrument acceptable to the Agency for a period of at least 50 percent longer than the term of the loan or grant and the title or right is transferable to any subsequent owner of the housing.

(2) The facilities will either be provided for the exclusive use of the proposed housing project, or Agency funds are limited to the prorated part of the total cost of the facility according to the use and benefit to the MFH project. If entities other than the housing project financed by the Agency use the facilities on a reimbursable fee basis, the loan applicant must agree, in writing, to apply any fees collected in excess of operating expenses to their Agency loan account as an extra loan payment.

(f) Landscaping and site development. Funds may be used to provide landscaping and site development related to a MFH project such as lighting, walks, fences, parking areas, and driveways.

(g) Tenant-related facilities. Funds may be used to develop tenant-related facilities appropriate to the size, economics, and prospective tenants of a MFH project, such as a community room, development of space for education and training purposes for tenants, central laundry facility, outdoor seating, space for passive recreation, tot lots, and a small emergency care infirmary. In congregate housing and group homes, funds may be used for central cooking and dining areas.

(h) Management-related facilities. Funds may be used to develop management-related facilities appropriate to the size and economics of a MFH project such as a maintenance workshop, storage facilities, office, and living quarters for a resident manager and other personnel.

(i) Purchase and install equipment and appliances. Funds may be used to purchase and install equipment and appliances affixed to the property as customary and appropriate for the area in which the housing is located.

(j) Household furnishings (Section 514/516). For farm labor housing sections 514 and 516 only, funds may be used to purchase household furnishings.

(k) Initial operating capital. Loan funds equal to 2 percent of total development cost or appraised value, whichever is less, may be used by a state or political subdivision thereof, Indian tribe, consumer cooperative, or any public or private nonprofit borrower who is not receiving low-income housing tax credits (LIHTC), to make the initial operating capital contribution required by §3560.64. Other borrowers must use their own resources to make the required initial operating capital contribution and may not use loan funds for that purpose.

(l) Builder's profit, overhead and general requirements. Subject to the following limits, funds may be used for builder's profit, overhead and general requirements.

(1) Up to 10 percent of the construction contract may be used for builder's profit.

(2) Up to 4 percent of the construction contract may be used for general overhead.

(3) Up to 7 percent of the construction contract may be used for general requirements.

(m) Legal, technical and professional services. Funds may be used for the costs of legal, technical, and professional services related to the borrower's MFH project, including appraisals, environmental documentation, and construction plans and specifications.

(n) Permit and application fees. Funds may be used for required MFH permits and application fees.

(o) Reimbursement to nonprofit organizations and public bodies. Funds may be used to reimburse a nonprofit organization or public body for up to 2 percent of total development costs for section 515, or up to 4 percent of total development costs for off-farm labor housing, for costs that are reasonable and typical for the area, including:

(1) Development and packaging of a loan application and a MFH proposal; and

(2) Legal, technical, and professional fees incurred in the formation of the loan application and MFH proposal; or

(3) Technical assistance from another nonprofit organization to assist in the organization's formation and in the development and packaging of a loan application and MFH proposal.

(p) Educational programs. Funds may be used for educational programs related to owning and managing a cooperative housing project for the board of directors of a housing cooperative during the first year of the housing operation. Such funds will be available from the initial operating account. The amount of the funds disbursed will be subject to Agency approval and availability of financial resources from the project.

(q) Interest and customary charges. Funds may be used for interest accrued and customary charges necessary to obtain interim financing.

(r) Purchase housing from an interim lender. Funds may be used to purchase MFH from an interim lender that holds fee simple title to Agency-financed housing upon which construction commenced and a letter of commitment had been issued by the Agency but the original applicant for whom funds were obligated will not or cannot continue with construction of the housing. In order for the purchase to take place, there must be no outstanding unpaid obligations in connection with the housing.

(s) Uniform Relocation Assistance and Real Property Acquisition Act of 1970. Funds may be used for necessary costs incurred to comply with the Uniform Relocation Assistance and Real Property Acquisition Act of 1970.

(t) Demonstration programs. With the RHS Administrator's approval, funds may be used to construct demonstration housing involving innovative units and systems which do not meet existing published standards, rules, regulations, or policies but meet the intent of providing affordable, decent, safe, and sanitary rural housing, and are consistent with the requirements of Title V of the Housing Act of 1949.

(u) Conversion of section 502 properties. In accordance with §3560.506, loan funds may be used to finance the conversion of real estate owned units originally financed under Section 502 of the Housing Act of 1949, to MFH authorized by section 515 of the Housing Act of 1949.

§3560.54 Restrictions on the use of funds.

(a) Ineligible uses of funds. Funds may not be used for:

(1) Housing intended to serve temporary and transient residents, with the exception of housing to serve migrant farm workers in accordance with §3560.554;

(2) Special care facilities or institutional-type homes;

(3) Facilities which are not in compliance with the design requirements specified in §3560.60;

(4) Any costs associated with space in a housing project that is leased for commercial use or any commercial facilities except essential service-type facilities when otherwise not conveniently available;

(5) Specialized equipment for training and therapy;

(6) Operating capital for a central dining facility or any items which do not become affixed to the real estate security with the exception of household furnishings for farm labor housing units financed under sections 514 and 516;

(7) Compensation to a loan applicant for value of land contributed in excess of the equity contribution requirements in §3560.63 (c);

(8) Refinancing of an applicant's debt except when the debt involves interim financing or when refinancing is necessary to obtain a release of an existing lien on land owned by a nonprofit organization;

(9) Payment of any fee, charge, or commission to a broker or anyone else as a developer's fee or for referral of a prospective loan applicant or solicitation of a loan;

(10) Payment to any officer, director, trustee, stockholder, member, or agent of an applicant; or

(11) Purchasing land for a site in excess of what is needed, except when:

(i) The applicant cannot acquire an alternate site or cannot acquire the needed land as a separate parcel;

(ii) The applicant agrees to sell the excess land as soon as practical and to apply the proceeds to the loan; and

(iii) Program site density requirements are met in accordance with the site requirements established under §3560.58.

(b) Obligations incurred before loan approval. Funds may not be used for expenses incurred by an applicant prior to approval except when all the following conditions are met:

(1) The debts were incurred for eligible purposes;

(2) Contracts, materials, construction, and any land purchased meet Agency standards and requirements;

(3) Payment of the debts will remove any attached liens and any basis for liens that may attach to the property on account of such debts; and

(4) The appropriate level of environmental review in accordance with 7 CFR part 1940, subpart G has been completed.

§3560.55 Applicant eligibility requirements.

Applicants for off-farm labor housing loans and grants should also refer to §3560.555, and applicants for on-farm labor housing loans should refer to §3560.605.

(a) General. To be eligible for Agency assistance, applicants must meet the following requirements:

(1) Be a U.S. citizen or qualified alien(s); a corporation; a state or local public Agency; an Indian tribe as defined in §3560.11; or a limited liability company (LLC), nonprofit organization, consumer cooperative, trust, partnership, or limited partnership in which the principals are U.S. citizens or qualified aliens;

(2) Be unable to obtain similar credit elsewhere at rates that would allow for rents within the payment ability of eligible residents;

(3) Possess the legal and financial capacity to carry out the obligations required for the loan or grant;

(4) Be able to maintain, manage, and operate the housing for its intended purpose and in accordance with all Agency requirements;

(5) With the exception of applicants who are a nonprofit organization, housing cooperative or public body, be able to provide the borrower contribution from their own resources (this contribution must be in the form of cash, or land, or a combination thereof);

(6) Have or be able to obtain a minimum of 2 percent of the total development costs for use as initial operating capital (for nonprofit organizations, cooperatives, or public bodies, this amount may be financed through Agency funds); and

(7) Not be suspended, debarred, or excluded based on the "List of Parties Excluded from Federal Procurement and Nonprocurement Programs." The list is available to Federal agencies from the U.S. Government Printing Office. Non-federal parties should contact the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, (202) 512-1800.

(8) Not delinquent on Federal debt or a Federal judgment debtor, with the exception of those debtors described in §3560.55 (b).

(b) Additional requirement for applicants with prior debt. If an applicant or the managing general partner of a borrower, as well as any affiliated entity having a 10 percent or more ownership interest, has a prior or existing Agency debt, the following additional requirements must be met.

(1) The applicant must be in compliance with any existing loan or grant agreements and with all legal and regulatory requirements or must have an Agency-approved workout agreement and be in compliance with the provisions of the workout agreement. The Agency may require that applicants with monetary or non-monetary deficiencies be in compliance with an Agency-approved workout agreement for a minimum of 6 consecutive months before becoming eligible for further assistance.

(2) The applicant must be in compliance with the Title VI of the Civil Rights Act of 1964, section 504 of the Rehabilitation Act of 1973, and all other applicable civil rights laws.

(c) Additional requirements for nonprofit organizations. In addition to the eligibility requirements of paragraphs (a) and (b) of this section, nonprofit organizations must meet the following criteria:

(1) The applicant must have received a tax-exempt ruling from the IRS designating the applicant as a 501(c)(3) or 501(c)(4) organization.

(2) The applicant must have in its charter the provision of affordable housing.

(3) No part of the applicant's earnings may benefit any of its members, founders, or contributors.

(4) The applicant must be legally organized under state and local law.

(5) In the case of off-farm labor housing loans and grants, nonprofit organizations must be “broad-based” nonprofit organizations (refer to §3560.555(a)(1)).

(d) Additional requirements for limited partnerships. In addition to the applicant eligibility requirements of paragraphs (a) and (b) of this section, limited partnership loan applicants must meet the following criteria:

(1) The general partners must be able to meet the borrower contribution requirements if the partnership is not able to do so at the time of loan request.

(2) The general partners must maintain a minimum 5 percent financial interest in the residuals or refinancing proceeds in accordance with the partnership organizational documents.

(3) The partnership must agree that new general partners can be brought into the organization only with the prior written consent of the Agency.

(e) Additional requirements for Limited Liability Companies (LLCs). In addition to the applicant eligibility requirements of paragraphs (a) and (b) of this section, LLC loan applicants must meet the following criteria:

(1) One member who holds at least a 5 percent financial interest in the LLC must be designated the authorized agent to act on the LLC's behalf to bind the LLC and carry out the management functions of the LLC.

(2) No new members may be brought into the organization without prior consent of the Agency.

(3) The members must commit to meet the equity contribution requirements if the LLC is not able to do so at the time of loan request.

§3560.56 Processing section 515 housing proposals.

Processing requirements for farm labor housing proposals are found in subpart L of this part for Off-Farm and subpart M of this part for On-Farm.

(a) Notice of Funding Availability (NOFA) responses.

(1) The Agency will publish an annual NOFA with deadlines and other information related to submission of new construction MFH proposals, including expansion of existing MFH in designated places selected in accordance with §3560.57.

(2) To be eligible for funding consideration, MFH proposals must be submitted in accordance with the NOFA and must provide information requested in the NOFA for the Agency to score and rank the proposals.

(3) MFH proposals needing rental subsidies must include requests for Agency rental assistance or a description of any non-Agency rental subsidy to be used with the proposal and must provide information required by §3560.260 (c).

(4) The Agency will consider housing proposals requesting rental assistance in rank order to the extent rental assistance is available. When there is no rental assistance available, the Agency will consider only those housing proposals in rank order that do not require rental assistance.

(b) Preliminary proposal assessment. The Agency will make a preliminary assessment of the application using the following criteria and will reject those applications which do not meet all of these criteria:

(1) The proposal was received by the submission deadline specified in the NOFA,

(2) The proposal is complete as specified in the NOFA,

(3) The proposal is for an authorized purpose, and

(4) The applicant meets Agency eligibility requirements.

(c) Scoring and ranking project proposals. The Agency will score and rank each housing proposal that meets the criteria of paragraph (b) of this section.

(1) The following criteria will be used to score housing proposals as more completely established in the NOFA:

(i) The presence and extent of leveraged assistance in the proposal for the units that will serve tenants meeting Agency income limits at basic rents comparable to what the rent would be if the Agency provided full financing.

(ii) The proposal will provide rental units in a colonia, tribal land, Rural Economic Area Partnership (REAP) community, Enterprise Zone or Empowerment Community (EZ/EC) or in a place identified in the state Consolidated Plan or a state needs assessment as a high need community for MFH.

(iii) The proposal supports Agency initiatives announced in the NOFA.

(iv) The proposal uses a donated site which meets the following conditions:

(A) The site is donated by a state, unit of local government, public body or a nonprofit organization;

(B) The site is suitable for the housing proposals and meets Agency requirements;

(C) Site development costs do not exceed what they would be to purchase and develop an alternative site;

(D) The overall cost of the MFH is reduced by the donation of the site; and

(E) A return on investment is not paid to the borrower for the value of the donated site nor is the value of the site considered as part of the borrower's contribution.

(2) The Agency will rank housing proposals based on their scoring.

(i) When proposals have an equal score, preference will be given to Indian tribes as defined in §3560.11 and local nonprofit organizations or public bodies whose principal purposes include low-income housing that meet the conditions of §3560.55(c) and the following conditions.

(A) Is exempt from Federal income taxes under section 501(c)(3) or 501(c)(4) of the Internal Revenue code;

(B) Is not wholly or partially owned or controlled by a for-profit or limited-profit type entity;

(C) Whose members, or the entity, do not share an identity of interest with a for-profit or limited-profit type entity;

(D) Is not co-venturing with another entity; and

(E) The entity or its members will not be receiving any direct or indirect benefits pursuant to LIHTC.

(ii) A drawing will be held in the event of a tie score, first for proposals from applicants who meet the conditions of paragraph (c)(2)(i) of this section and next for proposals from applicants for which paragraph (c)(2)(i) of this section is not applicable. Each proposal will be numbered in the order in which it is drawn.

(3) The Agency will request initial loan applications from parties who submitted the housing proposals with the highest ranking, taking into consideration available funds. The Agency will notify non-selected parties with the reasons for their non-selection, and the process that may be used to seek a review of the non-selection decision.

(d) Processing initial loan applications. The Agency will review all initial loan applications submitted in accordance with Agency requirements to further evaluate the eligibility and feasibility of the housing proposals. This determination will include:

(1) A review of the preliminary plans and cost estimates,

(2) A market feasibility review,

(3) An Agency site visit to gather preliminary environmental information and determine that the proposed site meets the site requirements of §3560.58,

(4) A review of the Affirmative Fair Housing Marketing Plan,

(5) An analysis of current credit reports,

(6) A review of Civil Rights Impact Analysis in accordance with 7 CFR part 2006, subpart P, and

(7) Completion of the appropriate level of environmental review in accordance with 7 CFR part 1940, subpart G.

(e) Processing order of initial loan applications. The Agency will process initial loan applications in rank order, taking into account available funds. If any initial loan applications are withdrawn, rejected, or delayed for a period of time that will not permit funding in the current funding cycle, the Agency will process, in rank order, the next initial loan application as funding levels permit.

(f) Other assistance. During each stage of loan application processing, loan applicants must notify the Agency of all other assistance, including other Federal Government assistance proposed or approved for use in connection with the loan application.

(g) Proposal withdrawal or rejection. An applicant may withdraw a housing proposal, an initial loan application, or a final loan application at any time during the Agency review process with a written request. The Agency may reject a housing proposal, an initial loan application, or a final loan application at any time during the Agency review process when an applicant fails to provide information requested by the Agency within the time frame specified by the Agency.

(h) Final applications. Applicants, with initial loan applications that are selected by the Agency for further processing, must submit a final application, with any additional information requested by the Agency, to confirm and document a housing proposal's eligibility and feasibility, including an affirmative fair housing marketing plan. The Agency will notify applicants with initial loan applications that are not selected for further processing of their non-selection, the reasons for their non-selection, and the process that may be used to seek a review of the non-selection decision.

(i) Rural cooperative housing proposals. Rural cooperative housing loan proposals will be solicited through a NOFA and will be assessed and processed in the same manner described in paragraphs (a) through (h) of this section.

§3560.57 Designated places for section 515 housing.

(a) Establish a list of designated places. The Agency will establish a list of designated places from which loan proposals will be accepted. The list is updated each fiscal year and is available when the NOFA is published. The NOFA provides information on obtaining the list. This list will be developed from a list of rural places which the Agency identifies as having the greatest need for multifamily housing based on the following factors:

(1) Qualification as a rural area as defined in §3560.11,

(2) Lack of mortgage credit, and

(3) Demonstrated need for MFH based on:

(i) The incidence of poverty,

(ii) The existence of substandard housing,

(iii) The lack of affordable housing, and

(iv) The following high need areas:

(A) Places identified in the state Consolidated Plan or similar state plan or needs assessment report,

(B) Indian reservations or communities located within the boundaries of tribal allotted or trust land, and

(C) EZ/EC or REAP communities.

(b) Establishing partnership designated place list. The Agency, in states with an active leveraging program and formal partnership agreement with the state agency, may establish a partnership designated place list consisting of places identified by the partnership as high need areas based on criteria consistent with the Agency's and the state's authorizing statutes. The partnership agreement and partnership designated place list must have the concurrence of the Administrator.

(c) Administrator's discretion. The Administrator may add to the list of designated places any place that is determined to have a compelling need for MFH, for example, a place that has had a substantial increase in population not reflected in the most recent census data, or a place that has experienced a loss of affordable housing because of a natural disaster.

(d) Restrictions on loans in certain designated places.

(1) Initial loan applications will not be requested and final loan applications will not be closed for housing proposals in designated places where any of the following conditions exist:

(i) The Agency has selected another MFH proposal in the designated place for processing.

(ii) A previously funded Agency, the U.S. Department of Housing and Urban Development (HUD), low-income housing tax credit or other similar assisted MFH in the designated place has not been completed or has not reached projected occupancy levels.

(iii) Existing assisted MFH in the designated place is experiencing high vacancy levels.

(iv) A special note rent or other loan servicing tool is pending or in effect for other assisted housing in the designated place, or

(v) The need in the market area is for additional rental assistance and not additional rental units.

(2) Exceptions to the provisions in §3560.57(d)(1) may be made:

(i) When a group home is proposed for persons with disabilities in an area where the existing MFH is insufficient or unavailable for their needs; or

(ii) There is a compelling need for additional MFH, for example when the units that have been approved or are under development represent only a small portion of the total units needed in the community.

§3560.58 Site requirements.

(a) Location.

(1) New construction section 515 loans will be made only in designated places selected by the Agency in accordance with the requirements of §3560.57.

(2) Agency-financed MFH must be located in residential areas as part of established rural communities, except as permitted in §3560.58(b), and for farm labor housing units financed under sections 514 and 516, which may be developed in any area where a need for farm labor housing exists.

(3) Communities in which Agency-financed MFH is located must have adequate facilities and services to support the needs of tenants.

(4) Housing complexes will not be located in areas where there are undesirable influences such as high activity railroad tracks; adjacent to or near industrial sites; bordering sites or structures which are not decent, safe, or sanitary; or bordering sites which have potential environmental concerns such as processing plants. Sites which are not an integral part of a residential community and do not have reasonable access, either by location or terrain, to essential community facilities such as water, sewerage removal, schools, shopping, employment opportunities, medical facilities, may not be acceptable. Consistent with Federal law and Departmental Regulation, the Agency must conduct an environmental assessment and a civil rights impact analysis before a site can be accepted. Sites may be determined by the Agency to be unacceptable if any of the adverse conditions described in this paragraph exist.

(b) Structures located in central business areas. The Agency will consider financing construction or the purchase and substantial rehabilitation of an existing structure located in the central business area of a rural community. With prior consent from the Agency, a portion of such a structure may be designated for commercial use on a lease basis. RHS funds may not be used to finance any cost associated with the commercial space.

(c) Site development costs and standards. The cost of site development must be less than or comparable to the cost of site development at other available sites in the community and the site must be developed in accordance with 7 CFR part 1924, subpart C and any applicable standards imposed by a state or local government.

(d) Densities. Allowable site densities will be determined based on the following criteria:

(1) Compatibility and consistency with the community in which the MFH is located;

(2) Impact on the total development costs; and

(3) Size sufficient to accommodate necessary site features.

(e) Flood or mudslide-prone areas.

(1) The Agency will not approve sites subject to 100-year floods when non-floodplain sites exist. The environmental review process will assess the availability of a reasonable site outside the 100-year floodplain.

(2) Sites located within the 100 year floodplain are not eligible for federal financial assistance unless flood insurance is available through the National Flood Insurance Program (NFIP). The Agency will complete Federal Emergency Management Agency (FEMA) Form 81-93, Standard Flood Hazard Determination, to document the site's location in relation to the floodplain and the availability of insurance under NFIP.

§3560.59 Environmental requirements.

Under the National Environmental Policy Act, the Agency is required to assess the potential impact of the proposed action on protected environmental resources. Measures to avoid or at least mitigate adverse impacts to protected resources may require a change in the site or project design. Therefore, a site cannot be approved until the Agency has completed the environmental review in accordance with 7 CFR part 1940, subpart G, or any successor regulation. Likewise, the applicant should be informed that the environmental review must be completed and considered before the Agency can make a commitment of resources to the project.

§3560.60 Design requirements.

(a) Standards. All Agency-financed MFH will be constructed in accordance with 7 CFR part 1924, subpart A and will consist of two or more rental units plus appropriate related facilities. Single family structures may be used for group homes and cooperative housing. Also, manufactured homes may be used to create MFH and single family housing originally financed through section 502 of the Housing Act of 1949 may be converted to MFH. Maintenance requirements are listed in §3560.103(a)(3).

(b) Residential design. All MFH must be residential in character, except as provided for in §3560.58(b), and must meet the needs of eligible residents.

(c) Economical construction, operation and maintenance. Taking into consideration life-cycle costs, all housing must be economical to construct, operate, and maintain and must not be of elaborate design or materials.

(1) Economical construction means construction that results in housing of at least average quality with amenities that are reasonable and customary for the community and necessary to appropriately serve tenants.

(2) Economical operating and maintenance means housing with operational and maintenance costs that allow a basic rent structure less than or consistent with conventional rents for comparable units in the community or in a similar community except that when determined necessary by the Agency to allow for decent, safe and sanitary housing to be provided in market areas where conventional rents are not sufficient to cover necessary operating, maintenance, and reserve costs. Basic rents may be allowed to exceed comparable rents for conventional units, but in no case may the rent exceed 150% of the comparable rent for conventional unit rent level.

(3) In meeting the Agency objective of economical construction, operation and maintenance, housing proposals must:

(i) Contain costs without jeopardizing the quality and marketability of the housing;

(ii) Employ life-cycle cost analyses acceptable to the Agency to determine the types of materials which will reduce overall costs by lowering operation and maintenance costs, even though their initial costs may be higher; and

(iii) Provide assurances that costs will be reduced when the Agency determines that housing costs are not economical. If assurances cannot be provided, funding may be withdrawn.

(4) The housing proposal will give maximum consideration to energy conservation measures and practices.

(d) Accessibility. All housing will meet the following accessibility requirements.

(1) For new construction of MFH, at least 5 percent of the units (but not less than one) must be constructed as fully accessible units to persons with disabilities. The Uniform Federal Accessibility Standards (UFAS) will be followed. Individual copies of these standards are available from the Architectural and Transportation Barriers Compliance Board, 1331 F Street, NW, Suite 1000, Washington, DC 20004-1111, Telephone: (202) 272-0080, TTY: (202) 272-0082, e-mail address: info@access-board.gov. When calculating how many accessible units are required, always round up to the next whole number to ensure the 5 percent requirement is met.

(2) For existing properties that do not have fully accessible units, the 5 percent requirement will apply when making substantial alterations as defined by UFAS. The UFAS defines substantial alteration as “alteration to any building or facility is to be considered substantial if the total cost for a twelve month period amounts to 50 percent or more of the full and fair cash value of the building * * *” UFAS further defines full and fair cash value as “the assessed valuation of a building or facility as recorded in the assessor's office of the municipality and as equalized at one hundred percent (100%) valuation, or the replacement cost, or the fair market value.” The 5 percent rule will also apply to repair or renovation work on a single unit. For instance, if a unit is damaged by fire and extensive repair is necessary, to the extent possible the unit is to be converted to a fully accessible unit.

(3) The variety of bedroom quantities of fully accessible units will be comparable to the variety of bedroom quantities of units which are not fully accessible. Borrowers will not, however, be required to exceed the 5 percent requirement simply to have an accessible unit of each bedroom quantity. In addition, accessible units should be distributed throughout the complex so not to concentrate the units in one location.

(4) All MFH must meet:

(i) The accessibility requirements as contained in section 504 of the Rehabilitation Act of 1973;

(ii) The requirements of the Fair Housing Amendments Act of 1988;

(iii) The requirements of the Americans with Disabilities Act of 1990, as applicable; and

(iv) All other Federal, State, and local requirements. When architectural standards differ, the most stringent standard will be followed.

§3560.61 Loan security.

(a) General. Each loan made by the Agency will be secured in a manner that adequately protects the financial interest of the Federal Government throughout the period of the loan.

(b) Lien position.

(1) The Agency will seek a first or parity lien position on Agency-financed property in all instances. The Agency may accept a junior lien position if the Federal Government's interests are adequately secured.

(2) The Agency will seek a first or parity lien on revenue from rent; Agency, HUD, state or private rental subsidy payments; chattels; assignments; and operating and reserve accounts. The Agency will accept a junior lien position if the Federal Government's interests are adequately secured.

(c) Liability. Personal liability will be required of all individual borrowers. Personal liability will not be required for the members or stockholders of any corporation or trust or any partners in a limited partnership.

(d) Housing and land ownership. Applicants must own the MFH and related land for which the loan is being requested, or become the owner when the loan is closed or have a leasehold interest in the land. If an applicant is not the owner of the housing and the related land, the following conditions must be met prior to or at loan closing.

(1) A recorded mortgage on the improvements is given as collateral.

(2) The amount of the loan against the collateral does not exceed its estimated security value.

(3) The unexpired term of the lease on the date of loan closing is at least 50 percent longer than the term of the loan and rent charged for the lease does not exceed the rate being paid for similar leases in the area.

(4) The applicant's leasehold interest is not subject to summary foreclosure or cancellation.

(5) The lease permits:

(i) The Agency to foreclose the mortgage and to transfer the lease;

(ii) The Agency to bid at a foreclosure sale or to accept voluntary conveyance of the security in lieu of foreclosure;

(iii) The Agency to occupy the property, sublet the property, or sell the leasehold for cash or credit if the leasehold is acquired through foreclosure, if the Agency accepts voluntary conveyance in lieu of foreclosure, or if the borrower abandons the property; and

(iv) The applicant, in the event of default or inability to continue with the lease and the loan, to transfer the leasehold subject to the mortgage to a transferee that will assume the property ownership obligations.

§3560.62 Technical, legal, insurance, and other services.

(a) Legal services. Applicants must have written contracts for any legal services that are to be paid out of Agency loan funds.

(b) Title clearance. Applicants must obtain title clearance in accordance with the provisions of 7 CFR part 1927, subpart B applicable to title clearance, which would include title insurance or title opinion, unless the loan applicant is leasing the property or is an organization or an individual with special title or loan closing problems, in which case title clearance and related legal services will be obtained in accordance with procedures approved by the Agency.

(c) Architectural services. Applicants must obtain a written contract for architectural services in accordance with the provisions of 7 CFR part 1924, subpart A.

(d) Insurance. Applicants must have property and liability coverage at loan closing as well as flood insurance, if needed. Fidelity coverage must be in force as soon as there are assets within the organization and it must be obtained before any loan funds or interim financing funds are made available to the borrower. At a minimum, applicants must meet the property, liability, flood, and fidelity insurance requirements in §3560.105.

(e) Surety bonding. Applicants must comply with the surety bonding provisions of 7 CFR part 1924, subpart A.

§3560.63 Loan limits.

(a) Determining the security value. The security value for an Agency loan is the lesser of the total development cost (exclusive of any developer's fee as provided by paragraph (d)(2) of this section) or the housing project's security value as determined by an appraisal conducted in accordance with subpart P of this part, minus any prior or parity liens on the housing project. For purposes of determining security value:

(1) Total development cost must be calculated excluding costs not considered allowable under §3560.54(a), and excluding costs related to compliance with the Uniform Relocation Assistance and Real Property Acquisition Act of 1970.

(2) The appraisal, which will determine the market value, subject to restricted rents, will be obtained by the Agency and conducted in accordance with subpart P of this part.

(b) Limitations on loan amounts. The Agency will not make any loans without adequate security. The following limitations will be set on loan amounts:

(1) For all loan applicants who will receive benefits from the low-income housing tax credit program, the amount of Agency financing for the housing will not exceed 95 percent of the security value available for the Agency loan.

(2) For all loan applicants who will not receive low-income housing tax credit benefits and who are comprised solely of nonprofit organizations, consumer cooperatives, or state or local public agencies, the amount of the loan will be limited to the security value available for the Agency loan, plus the 2 percent initial operating capital and any necessary relocation costs incurred.

(3) For all other loan applicants who will not receive low-income housing tax credit benefits, the loan amount will be limited to no more than 97 percent of the security value available for the Agency loan.

(c) Equity contribution. Loan applicants, with the exception of nonprofit organizations, consumer cooperatives, or state or local public agencies who will not be receiving tax credits, must make an equity contribution from their own resources.

(1) Loan applicants who will receive benefits from the low-income housing tax credit program must make an equity contribution in the amount of 5 percent of the Agency loan. The maximum Agency loan will be determined in accordance with §3560.63(b).

(2) Loan applicants who will not receive benefits from the low-income housing tax credit program and are not nonprofit organizations, consumer cooperatives, or state or local public agencies must make an equity contribution in the amount of 3 percent of the Agency loan. The maximum Agency loan will be determined in accordance with §3560.63(b).

(d) Review of assistance from multiple sources. The Agency will analyze Federal Government and other assistance provided to any MFH project to establish the maximum loan amount and to assure that the assistance is not more than the minimum necessary to make the housing affordable, decent, safe, and sanitary to potential tenants.

(1) Determining minimum assistance. For purposes of determining minimum assistance, the total amount paid for builder's profit, overhead, and general requirements may not exceed 21 percent of the construction contract. Unless specified differently in a Memorandum of Understanding between the Agency and the state agency that allocates low-income housing tax credits, limits will be those specified in §3560.53(l).

(2) Developer's fee. While, in accordance with §3560.54(a)(9), payment of a developer's fee is not an eligible use of Agency loan funds, the Agency will include in total development costs a developer's fee paid from other sources when analyzing the Federal Government assistance to the housing. The Agency may recognize a developer's fee paid from other sources on construction or rehabilitation of up to 15 percent of the total development costs authorized for low-income housing tax credit purposes, or by another Federal Government program. Likewise for transfer proposals that include acquisition costs, the developer's fee on the acquisition cost may be recognized up to 8 percent of the acquisition costs only when authorized under a Federal Government program providing assistance. The developer's fee is not included in determining the Agency's maximum debt limit and loan amount.

(e) Limits on equity loans. For equity loans to avert prepayment, the amount of the Agency equity loan will be limited to no more than the difference between 90 percent of market value of the property when appraised as conventional unsubsidized MFH and all current unpaid balances. For information on appraisal issues, refer to subpart P of this part.

(f) Cost overruns.

(1) All applicants must agree in writing to provide funds at no cost to the housing and without pledging the housing as security to pay any cost for completing planned construction after the maximum debt limit is reached.

(2) After loan approval, the Agency will only approve cost increases for housing proposals involving new construction or major rehabilitation when the additional costs will not cause the limits specified in §3560.53(l) or the maximum debt limit to be exceeded and the cost increases were caused by:

(i) Unforeseen factors that are determined by the Agency to be beyond the borrower's control;

(ii) Design changes required by the Agency, state, or the local government; or

(iii) Financing changes approved by the Agency.

§3560.64 Initial operating capital contribution.

Borrowers are required to make an initial operating capital contribution to the general operating account in the amount of at least 2 percent of the total development cost or appraised value, whichever is less.

(a) Borrowers that are nonprofit organizations, consumer cooperatives, or state or local public agencies and are not receiving low-income housing tax credits, may use loan funds for their initial operating capital contribution. All other borrowers must fund the initial operating capital contribution from their own resources.

(b) Borrowers must provide to the Agency for approval a list of materials and equipment to be funded from the general operating account for initial operating expenses. As specified in §3560.304(b), initial operating capital may be used only to pay for approved budgeted expenses. If total initial operating expenses exceed 2 percent, the additional amount must be paid by the borrower from its own resources, except that borrowers meeting the provisions of §3560.64(a) who do not have sufficient resources for this purpose may request Agency assistance. Withdrawals from the reserve account will not be approved for such expenses.

(c) Borrowers must provide the Agency with documentation of their initial operating capital contribution deposited into the general operating account prior to the start of construction or loan closing, whichever comes first, and such funds thereafter, may only be used for authorized budgeted purposes.

(d) If the conditions specified in §3560.304(c) are met, funds contributed as initial operating capital may be returned to the borrower.

§3560.65 Reserve account.

To meet major capital expenses of a housing project, borrowers must establish and fund a reserve account that meets requirements of §3560.306. At a minimum, the borrower must agree to make monthly contributions to the reserve account at the rate of 1 percent annually of the amount of the total development cost until the reserve account equals 10 percent of the total development cost.

§3560.66 Participation with other funding or financing sources.

(a) General requirements. The Agency encourages the use of funding or financing from other sources in conjunction with Agency loans. When the Agency is not the sole source of financing for MFH, the following conditions must be met.

(1) The Agency will enter into a participation (or intercreditor) agreement with the other participants that clearly defines each party's relationship and responsibilities to the others.

(2) The rental units that will serve tenants eligible for housing under the Agency's income standards must meet Agency standards and the number of units that will serve the Agency's tenants are at least equal to the units financed by the Agency.

(3) All rental units must be operated and managed in compliance with the requirements of the Agency and the other sources. To the extent these requirements overlap, the most stringent requirement must be met. The Agency may negotiate the resolution of overlapping requirements on a case-by-case basis; however, at a minimum, Agency requirements must be met.

(4) If the number of units subject to the LIHTC rent and income restrictions is greater than the number of units projected to receive Agency rental assistance (RA) or similar tenant subsidy, the market feasibility documentation must clearly reflect a need and demand by LIHTC income-eligible households financially able to afford the projected rents without such a subsidy for the units not receiving RA or similar tenant subsidy.

(b) Rental assistance. The Agency may provide rental assistance with MFH loans participating with other sources of funding under the following conditions:

(1) The Agency's loan equals at least 25 percent of the housing's total development cost.

(2) The rental assistance is provided only to those rental units where the basic rents do not exceed what basic rents would have been had the Agency provided full financing.

(3) The provisions of subpart F of this part are met.

(c) Security requirements. The security requirements of 3560.61 must be met for all Agency-financed MFH participating with other sources of funding.

(d) Reserve requirements. Reserve account requirements will be determined on a case-by-case basis, taking into consideration the reserve requirements of the other participating lenders, so that the aggregate fully funded reserve account is consistent with the requirements of §3560.65. Reserve requirements and procedures for reserve account withdrawals must be agreed upon by all lenders and included in the intercreditor or participation agreement.

(e) Design requirements. Housing and related facilities must be planned and constructed in accordance with 7 CFR 1924, subparts A and C. If housing includes non-Agency financed common facilities, the following conditions must be met:

(1) The non-Agency-financed common facility's operating and maintenance costs must be paid through collection of a user fee from residents who use the facility,

(2) The non-Agency-financed common facility must be designed and operated with appropriate safeguards for the health and safety of tenants, and

(3) The facility must be fully available and accessible to all tenants.

§3560.67 Rates and terms for section 515 loans.

Rates and terms for farm labor housing loans are found in subpart L of this part for Off-Farm and subpart M of this part for On-Farm.

(a) Interest. Loans will be closed at the lower of the interest rate in effect at the time of loan approval or the interest rate that is in effect at time of loan closing.

(b) Interest credit. The Agency will provide interest credit to subsidize the interest on the Agency loan to a payment rate of 1 percent for all of the Agency's initial and subsequent loans.

(c) Amortization period and term.

(1) Except for manufactured housing, loans will be amortized over a period not to exceed the lesser of the economic life of the housing being financed or 50 years and paid over a term not to exceed 30 years from the date of loan. The Agency may make a loan to the borrower to finance the final payment of a loan in accordance with §3560.74.

(2) Loans for manufactured housing will be amortized and paid over a term not to exceed 30 years as specified in §3560.70(c).

§3560.68 Permitted return on investment (ROI).

(a) Permitted return. Borrowers operating on a limited profit basis will be permitted a return not to exceed 8 percent of their required initial investment determined at the time of loan approval in accordance with §3560.63(c).

(b) Calculation of permitted return. The permitted return will be based on the borrower's contributions from their own resources, which, when added to the Agency loan amount and all sources of funding or financing, do not exceed the security value of the MFH project as specified in §3560.63(a).

(1) Proceeds received by the borrower from the syndication of low-income housing tax credit and contributed to the MFH project may be considered funds from the borrower's own resources for the portion of the proceeds which exceeds:

(i) The allowable developer's fee determined by the state agency administering the low-income housing tax credit, and

(ii) The borrower's expected contribution to the transaction, as determined by the state agency administering the low-income housing tax credit.

(2) A building site contributed by the borrower will be appraised by the Agency to determine its market value. A return may not be allowed on the amount above the equity contribution required by §3560.63(c) if the market value as determined by the Agency, when added to the loan and grant amounts from all sources, exceeds the security value of the MFH project as specified in §3560.63(a).

(c) Return on additional investment. The initial investment may exceed the equity contribution required by §3560.63(c) and a return allowed on the investment if the additional return does not increase basic rents and rental assistance costs above what basic rents and rental assistance costs would have been with the Agency financing 95 or 97 percent of the total development cost.

(d) Compensation to nonprofit organizations. Although nonprofit organizations are not eligible to take a return on investment, with prior Agency approval, cooperatives and nonprofit organizations may use housing project funds to pay asset management expenses directly attributable to ownership responsibilities, as described in §3560.303(b)(1)(ii).

§3560.69 Supplemental requirements for congregate housing and group homes.

(a) General. Congregate housing and group homes must be planned and developed in accordance with 7 CFR part 1924, subparts A and C.

(b) Design criteria. Congregate housing and group homes must be designed to accommodate all special services that will be provided.

(c) Services. Congregate housing and group home loan applicants, as part of their loan request, must submit a plan to make affordable services available to residents to assist the residents in living independently. The plan must address the availability of this assistance from service providers throughout the term of the loan.

(1) For congregate housing, the resident services plan must address how the following services will be provided or made available:

(i) One cooked meal per day, seven days per week;

(ii) Transportation to and from the property;

(iii) Assistance in housekeeping;

(iv) Personal services;

(v) Recreational and social activities; and

(vi) Access to medical services.

(2) For group homes, the resident services plan must address how access to the following services will be provided or made available:

(i) A common kitchen in which to prepare meals;

(ii) Transportation;

(iii) Nearby recreational and social activities which may be coordinated by the resident assistant, if applicable; and

(iv) Medical services as necessary.

(d) Necessary items. Borrowers must ensure items such as tables, chairs, and cookware necessary to furnish common areas are made available to congregate housing or group homes. The 2 percent initial operating capital may be used to purchase these items.

(e) Association with other organizations. Congregate housing and group homes may coordinate services or training with another organization, such as a workshop for the developmentally disabled. However, the housing facility must be a separate entity and not dependent on the other organization.

(f) Market feasibility documentation. Market feasibility documentation for congregate housing and group homes is subject to the following requirements:

(1) Must address the need for housing with services and include information concerning alternative service providers;

(2) Must contain demographic information pertaining to the population that is to be served by the congregate housing or group home project; and

(3) May consider an expanded market area that includes nondesignated places, but the facility must be located in a designated place.

(g) Rental assistance for group homes. A unit in a group home consists of a space occupied by a specific tenant household, which may be an apartment unit, a bedroom, or a part of a bedroom. Agency rental assistance will be made available to tenants sharing a unit so long as the total rent for the unit does not exceed conventional rents for comparable units in the area or a similar area.

§3560.70 Supplemental requirements for manufactured housing.

(a) Design requirements. Manufactured housing must meet the requirements of 7 CFR part 1924, subpart A applicable to manufactured housing.

(b) Eligible properties. The manufactured housing must include two or more housing units. The applicant will become the first owner purchasing the manufactured homes for purposes other than resale. The following exceptions may be made to this provision:

(1) A housing proposal may include the purchase of the real property with existing manufactured housing which will be redeveloped with the placement of new manufactured homes.

(2) A housing proposal may include the rehabilitation of existing manufactured housing only if the units to be rehabilitated are currently financed by the Agency. The proposal will include the results of the applicant's consultation with the manufacturer to determine if the proposed rehabilitation work will affect the structural integrity of the unit and, if so, the statement will include an explanation as to how.

(c) Terms. The maximum loan amount will be determined in accordance with the requirements of §3560.63. The amortization period and term of loans for manufactured housing will not exceed the lesser of the economic life of the housing being financed or 30 years.

(d) Security. A mortgage or deed of trust will be taken on the entire property purchased or improved with the loan. The encumbered property must be covered under a standard real estate title insurance policy or attorney's title opinion that identifies the housing as real property and insures or indemnifies against any loss if the manufactured home is determined not to be part of the real property. The property must be taxed as real estate by the jurisdiction where the housing is located if such taxation is permitted under applicable law when the loan is closed.

(e) Special warranty requirements. The general contractor or dealer-contractor, as applicable, must provide a warranty in accordance with the provisions of 7 CFR part 1924, subpart A.

(1) The warranty must establish that the manufactured homes, foundations, positioning and anchoring of the units to their permanent foundations, and all contracted improvements, are constructed in conformity with applicable approved plans and specifications.

(2) The warranty must include provisions that the manufactured homes sustained no hidden damage during transportation and, for double-wide units, that the sections were properly joined and sealed.

(3) The general contractor or dealer contractor must warrant that the manufacturer's warranty is in addition to and does not diminish or limit all other warranties, rights, and remedies that the borrower or lender may have.

(4) The seller of the manufactured homes must deliver to the borrower the manufacturer's warranty with an additional copy for RHS. The warranty must identify the units by serial number.

§3560.71 Construction financing.

(a) Construction financing plan. Prior to loan approval, applicants must submit to the Agency for its concurrence a plan for the construction financing and securing of the loan.

(b) Interim financing. Interim financing is required by the Agency for any construction, except as noted in paragraph (c) of this section.

(1) The Agency reserves the right to review and approve the interim financing arrangements proposed by the applicant.

(2) When interim financing is used, the Agency will obligate the funds and provide an interim financing letter to the lender that will confirm the procedures and conditions for the construction financing. The take-out loan will be closed and the interim lender paid off when the conditions of the interim financing letter have been met.

(3) The applicable provisions of 7 CFR part 1924, subpart A will be used to monitor the construction.

(4) An environmental review must be completed in accordance with 7 CFR part 1940, subpart G, prior to issuance of the interim financing letter.

(c) Multiple advances. When interim financing is not available or when it is in the best interest of the Federal Government, the Agency may provide for multiple advances of the funds to cover the cost of construction.

(1) The Agency will review and approve the multiple advances proposed by the borrower.

(2) When multiple advances are used, the Agency will close the loan prior to any advancement of funds and the relevant provisions of 7 CFR part 1924, subpart A will be used to monitor the construction.

(3) The loan check will be handled in accordance with 7 CFR part 1902, subpart A.

§3560.72 Loan closing.

(a) Requirements. Loans will be closed in accordance with 7 CFR part 1927, subpart B and any state supplements. In all cases, the borrower must:

(1) Provide evidence that an Agency-approved accounting system is in place;

(2) Execute a restrictive-use contract acceptable to the Agency that establishes the borrower's obligation to operate the housing for program purposes for the term of the Agency loan;

(i) For all section 514 loans, except as provided in §3560.621, made pursuant to a contract entered into on or after the effective date of this regulation, the following language will be included in the mortgage

and deed of trust: "The borrower and any successors in interest agree to use the housing for the purpose of housing people eligible for occupancy as provided in sections 514 and 516 of title V of the Housing Act of 1949, and Rural Housing Service regulations then in effect. The restrictions are applicable for a term of 20 years from the date on which the last loan was closed. No eligible person occupying the housing will be required to vacate nor any eligible person denied occupancy for housing prior to the close of such period because of a prohibited change in the use of the housing. A tenant or person wishing to occupy the housing may seek enforcement of this provision as well as the Government."

(ii) All other loans are subject to restrictive-use provisions as outlined in subpart N of this part.

(3) Provide evidence that construction financing arrangements are adequate when interim financing is going to be used;

(4) Provide evidence that all the funds from other sources as proposed in the application are available and that there have been no changes in the Sources and Uses Comprehensive Evaluation (SAUCE).

(5) Provide evidence of the title to all security required by the Agency;

(6) Provide a certification that all construction in the case of interim financing has been or, in the case of multiple advances, will be paid;

(7) Provide, in the case of interim financing, a dated and signed statement from the owner's architect certifying to substantial completion of the housing project;

(8) Provide a certification that all construction in the case of interim financing has been or, in the case of multiple advances, will be in accordance with the plans and specifications concurred in by the Agency;

(9) Provide evidence, if applicable, that the conditions of the interim financing letter have been met; and

(10) Attend a pre-occupancy conference with the Agency.

(b) Cost certification. In all cases, the borrower must report actual construction costs. Whenever the State Director determines it appropriate, and in all situations where there is an identity of interest as defined in 7 CFR 1924.4 (i), the borrower, contractor and any subcontractor, material supplier, or equipment lessor having an identity of interest must each provide certification as to the actual cost of the work performed in connection with the construction contract in accordance with 7 CFR part 1924, subpart A. The construction costs must also be audited in accordance with Governmental Auditing Standards, by a Certified Public Accountant (CPA). In some cases, the Agency will contract directly with a CPA for the cost certification. Funds that were included in the loan for cost certification and which are ultimately not needed because Agency contracts for the cost certification will be returned on the loan. Agency personnel will utilize exhibit M of 7 CFR part 1924, subpart A to assist in the evaluation of the cost certification process.

(c) Notification of loan cancellation. Loans may be canceled after approval and before loan closing. The Agency will notify all parties of the cancellation and the reasons for the cancellation in accordance with 7 CFR part 1927, subpart B.

§3560.73 Subsequent loans.

(a) Applicability. The Agency may make a subsequent loan to a borrower to complete, improve, repair, or make modifications to MFH initially financed by the Agency or for equity for preservation purposes. Loan requests to add units to comply with accessibility requirements may be processed as a subsequent loan; however, loan requests to add units to meet market demand will be processed as an initial loan request and must compete under the NOFA.

(b) Application requirements and processing. Upon receipt of a subsequent loan request, the Agency will inform the applicant what information is required based on the nature and purpose of the loan request. Subsequent loan requests do not have to compete for funding against initial loan proposals.

(c) Amortization and payment period. Subsequent loans will be amortized over a period not to exceed the lesser of the economic life of the housing being financed or 50 years and paid over a term not to exceed the lesser of the economic life of the housing or 30 years from the date of the loan.

(d) Equity contribution. Applicants for subsequent loans must make contributions on the loans in the same proportion as outlined in §3560.63(c). Loan applicants will not be given consideration for any increased equity value that the property may have since the initial loan.

(1) Excess initial investment on an initial loan may be credited toward the required investment on a subsequent loan.

(2) An initial operating capital contribution to the general operating account as described in §3560.64 is required for a subsequent loan approved under the conditions set in §3560.63(f) to complete housing construction but is not required for a subsequent loan to repair or improve existing housing.

(e) Environmental requirements. Subsequent loans are subject to the completion of an environmental review in accordance with 7 CFR part 1940, subpart G.

(f) Design requirements. All improvements, repairs, and modifications will be in accordance with 7 CFR part 1924, subparts A and C.

(g) Architectural services. The applicant must obtain architectural services when any of the following conditions exist:

(1) Enclosed space is being added,

(2) When required by state law, and

(3) When the Agency determines that the work being proposed requires architectural services.

(h) Restrictive-use requirements. Subsequent loans are subject to restrictive-use provisions as outlined in §3560.662(a) and borrowers must execute a restrictive-use contract in accordance with §3560.72(a)(2).

(i) Designation changes from rural to nonrural. If the designation of an area changes from rural to nonrural after the initial loan is made, a subsequent loan may be made only to make necessary improvements and repairs to the property or for equity when needed to avert prepayment.

(j) Agency's discretion. The Administrator may approve a subsequent loan in a place that is not on the list of designated places as a servicing action, for example, to replace units destroyed by a natural disaster.

§3560.74 Loan for final payments.

(a) Use. The Agency may finance final payments for borrowers holding existing loans for which the Agency approved an amortization period that exceeded the term of the loan.

(b) Requirements. The Agency may finance final payments if documentation regarding the market area shows that a need for low-income rental housing still exists for that area and one of the following conditions has been met.

(1) It is more cost efficient and serves the tenant base more effectively to maintain existing MFH than to build another property in the same location; or

(2) The MFH has been maintained to such an extent that it can be expected to continue providing affordable, decent, safe and sanitary housing for 20 years beyond the date of the loan to finance a final payment; and

(3) Funds are available.

(c) Term. The term of Agency loans to finance final payments will not exceed 20 years from the date of the initial loan final payment.

§§3560.75-3560.99 [Reserved]

§3560.100 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart C--Borrower Management and Operations Responsibilities

§3560.101 General.

This subpart sets forth borrower obligations regarding management and operations of multi-family housing (MFH) projects financed by the Agency. As noted in §3560.6, the borrower requirements listed in this subpart must be complied with by the borrower. The borrower may designate in writing a person to act as the borrower's authorized agent.

§3560.102 Housing project management.

(a) General. Borrowers hold final responsibility for housing project management and must ensure that operations comply with the terms of all loan or grant documents, Agency requirements and applicable local, state and Federal laws and ordinances.

Project operations shall be conducted to meet the actual needs and necessary expenses of the property or for any other purpose authorized under Agency regulations. Any party not meeting these responsibilities may be subject to penalties. It is expected that only typical and reasonable expenses be incurred for the services rendered. Consequently, methods to inflate, duplicate, obscure, or failure to disclose the true nature and cost of work performed for the services rendered will cause the Agency to deny budget requests for the services or issue a demand for recovery and reimbursement for unauthorized actions.

(b) Management plan. Borrowers must develop and maintain a management plan for each housing project covered by their loan or grant. The management plan must establish the systems and procedures necessary to ensure that housing project operations comply with Agency requirements.

(1) At a minimum, management plans must address the following items:

(i) Maintenance systems, including procedures for routine maintenance, capital item repair and replacement, and effective energy conservation practices;

(ii) Personnel policies, job descriptions, staffing plans, training procedures for on-site staff. The Borrower will include specific dutiesand responsibilities of each property manager, site manager and caretaker;

(iii) Front-line management functions to be performed by off-site staff;

(iv) Plans and procedures for providing supplemental services including laundry, vending, and security;

(v) Plans for accounting, record keeping and meeting Agency reporting requirements;

(vi) Procurement procedures;

(vii) Rent and occupancy charge collection procedures, and procedures for requesting and implementing changes in rents, utility allowances, or occupancy charges;

(viii) Plans and procedures for marketing rental units and maintaining compliance with the Affirmative Fair Housing Marketing Plan in accordance with §3560.104;

(ix) Unit leases and leasing policies and procedures, including procedures for maintaining and purging waiting lists, determining applicant eligibility, certifying and recertifying income, tenant selection, and occupancy policies such as security deposit amounts, occupancy rules, termination of leases or occupancy agreements and eviction;

(x) Plans for allowing tenant participation in property operations and for fostering tenant relationships with management;

(xi) Procedures for applicant and tenant appeals; and

(xii) Describe how management will make known to tenants and applicants that management will provide reasonable accommodations under the Fair Housing Act, section 504 of the Rehabilitation Act of 1973, and regulations implemented there under at the borrower's expense unless to do so would cause an undue financial or administrative burden, how such requests are to be made, and who within management will have the authority to approve or disapprove a request for an accommodation.

(2) Loan or grant applicants must submit a management plan before the Agency will give final approval to the loan or grant application. The plan must address the required items identified in paragraph (b)(1) of this section in sufficient detail to enable the Agency to monitor housing project performance.

(c) Management plan effective period. A management plan remains in effect as long as it accurately reflects housing project operations and the housing project is in compliance with the Agency requirements.

(1) Borrowers must submit an updated management plan to the Agency if operations change or are no longer consistent with the management plan on file with the Agency.

(2) When there are no changes in operations, borrowers must submit a certification to the Agency every 3 years stating that operations are consistent with the management plan and the plan is adequate to assure compliance with the loan and grant documents and Agency requirements or applicable local, state and Federal laws.

(3) If the Agency determines that operations are in compliance with Agency requirements, loan or grant agreements, or applicable local, state, and Federal laws, but are not consistent with the management plan, the Agency will require the borrower to:

(i) Revise the management plan to accurately reflect housing operations;

(ii) Take actions to ensure the management plan is followed; or

(iii) Advise the Agency in writing of the action taken.

(4) When a housing project is being transferred from one borrower to another, the transferee must submit a management plan that addresses the required items identified in paragraph (b)(1) of this section in sufficient detail to enable the Agency to give final approval of the transfer.

(d) Housing projects with compliance violations. Upon receiving notice of compliance violations in accordance with §3560.354, borrowers must submit to the Agency:

(1) Revisions to the management plan establishing the changes in housing operations that will be made to restore compliance;

(2) If the borrower determines the compliance violations were due to a failure to follow the management plan, the borrower must certify to the Agency that the management plan is adequate to assure compliance with the applicable requirements of this part and submit a written description of the actions they will take to ensure the management plan is followed; or

(3) If the Agency discovers continued discrepancies between a management plan and housing project operations or compliance violations, the Agency may require the borrower to install a different management agent acceptable to the Agency as described in paragraph (e) of this section.

(e) Acceptable management agents. Borrowers must obtain Agency approval of the agent proposed to manage a housing project prior to entering into any formal agreement with the agent and prior to allowing the agent to assume responsibility for housing project operations. Borrowers that plan to self-manage a housing project also must receive Agency approval before assuming responsibility for housing operations.

(1) Borrowers must submit a written request for Agency approval of the proposed management agent at least 45 days prior to the date the agent is to assume responsibility for operations. This request must include a profile of the proposed management agent that provides sufficient information to allow the Agency to evaluate whether the agent is acceptable.

(2) The Agency will deny approval of any proposed management agent that cannot provide evidence of at least two years of experience and satisfactory performance in directing and overseeing the management of similar federally-assisted MFH.

(3) The Agency may issue approval of a management agent that does not meet the requirements of §3560.102(e)(2) if the management agent can provide evidence that indicates the ability to successfully manage a MFH project in accordance with Agency requirements.

(4) If a borrower enters into an agreement with a management agent or begins to self-manage prior to receiving Agency approval, the Agency will place the borrower in non-monetary default status and will require the borrower to immediately terminate the contract with the management agent.

(f) Self-management. Borrowers may self-manage a housing project but must receive Agency approval before assuming responsibility for housing operations. Borrowers that plan to self-manage must meet all requirements of §3560.102, except for paragraph (h) of this section.

(g) Identity-of-interest disclosure. Borrowers and management agents must disclose to the Agency all identity-of-interest relationships which they have with firms and must receive Agency approval to use such firms prior to entering into any contractual relationships with such entities that involve Agency funds.

(1) This disclosure must include any identity-of-interest relationships between:

(i) The borrower and the management agent;

(ii) The borrower or management agent and the providers of supplies and services to the housing project; and

(iii) The borrower or the management agent and employees of any of the above.

(2) Failure to disclose such relationships may subject the borrower, the management agent, and the other firms or employees found to have an identity of interest relationship to suspension, debarment, or other remedies available to the Agency.

(3) After disclosure of an identity-of-interest relationship:

(i) The borrower, management agent, and supplier of goods and services must provide documentation proving that use of identity-of-interest firms is in the best interest of the housing project;

(ii) Any supplier of goods and services must certify in writing to the Agency that the individual or organization has a viable, on-going trade or business qualified and licensed, if appropriate, to do the work for which a contract is being proposed;

(iii) The borrower, management agent, and supplier of goods and services must agree, in writing, that all records related to the housing project will be made available to the Agency, Office of the Inspector General (OIG), General Accountability Office (GAO), or a representative of the Agency, upon request; and

(iv) The Agency will deny the use of an identity-of-interest firm when the Agency determines such use is not in the best interest of the Federal Government or the tenants.

(h) Management agreement. Borrowers contracting with a management agent must execute a management agreement that establishes:

(1) The management agent's responsibility to comply with Agency requirements and local, state, and Federal laws;

(2) That the management fee is payable out of the housing project's general operating account consistent with the requirements of paragraph (i) of this section; and

(3) The Agency's authority to terminate the agreement for failure to operate the housing project in accordance with Agency requirements or local, state, or Federal laws.

(i) Management fees. Management fees will be an allowable expense to be paid from the housing project's general operating account only if the fee is approved by the Agency as a reasonable cost to the housing project and documented on the management certification. Management fees must be developed in accordance with the following:

(1) The management fee may compensate the management entity only for the specifically identified bundle of services to be provided to the housing project. Costs and services to be paid as part of the bundle of services include:

(i) Supervision by the management agent and its staff (time, knowledge, and expertise) of overall operations and capital improvements of the site.

(ii) Hiring, supervision, and termination of on-site staff.

(iii) General maintenance of project books and records (general ledger, accounts payable and receivable, payroll, etc.). Preparation and distribution of payroll for all on-site employees, including the costs of preparing and submitting all appropriate tax reports and deposits, unemployment and workers' compensation reports, and other IRS- or state-required reports.

(iv) Training provided to on-site staff at the project site.

(v) Preparation and submission of proposed annual budgets and negotiation of approval with the Agency, other governmental agencies and the borrowers.

(vi) Preparation and distribution of the Agency or other governmental agency forms and routine financial reports to borrowers.

(vii) Preparation and distribution of required year-end reports to the Agency or other governmental agency and borrowers.

(viii) Preparation of requests for reserve withdrawals, rent increases, or other required adjustments.

(ix) Arranging for preparation by outside contractors of energy audits and utility allowance analysis. Implement appropriate changes.

(x) Preparation and implementation of Affirmative Fair Housing Marketing Plans as well as general marketing plans and efforts.

(xi) Review of tenant certifications and submission of monthly rental assistance requests, and overage. Submission of payments where required.

(xii) Preparation, approval, and distribution of operating disbursements; oversight of project receipts; and reconciliation of deposits.

(xiii) Overhead of management agent, including:

(A) Establish, maintain, and control an accounting system sufficient to carry out accounting supervision responsibilities.

(B) Maintain agent office arrangements, staff, equipment, furniture, and services necessary to communicate effectively with the properties, the Agency or other governmental agency and with the borrowers.

(C) Postage expenses related to the normal responsibility for mailings to the properties, the Agency or other governmental agency, the tenants, the vendors, and the owners.

(D) Expense of telephone and facsimile communication to the properties, tenants, the Agency or other governmental agency, and the borrowers.

(E) Direct costs of insurance (fidelity bonds covering central office staff, computer and data coverage, general liability, etc.) directly related to protection of the funds and records of the borrower.

(F) Central office staff training and ongoing certifications.

(G) Maintenance of all required profession and business licenses and permits. (This does not include project site office permits or licenses.)

(H) Insurance coverage for agent's office and operations (Property, Auto, Liability, E&O, Casualty, Workers Compensation, etc.)

(I) Travel of agent staff to the properties for on-site inspection, training, or supervision activities.

(J) Agent bookkeeping for their own business.

(xiv) Attendance at meetings (including travel) with tenants, owners, and the Agency or other governmental agency.

(xv) Development, preparation, and revision of management plans or agreements.

(xvi) Coordination of U.S. Department of Housing and Urban Development (HUD) certifications or vouchers with tenants, including all reporting to all pertinent agencies and borrowers.

(xvii) Directing the investment of project funds into required accounts.

(xviii) Maintenance of bank accounts and monthly reconciliations.

(xix) Preparation, request for, and disbursement of borrower's initial operating capital (for new projects) as well as administration of annual owner's return on investment.

(xx) Account maintenance, settlement, and disbursement of security deposits.

(xxi) Working with third party auditors for initial set-up of audits and annually thereafter for audit preparation and review. Assistance with supplemental letters and preparation of Agency financial reports or other governmental agency reports.

(xxii) Storage of records and adherence to records retention requirements.

(xxiii) Assist on-site staff with tenant relations and problems. Provide assistance to on-site staff in severe actions (eviction, death, insurance loss, etc.).

(xxiv) Oversight of general and preventive maintenance procedures and policies.

(xxv) Development and oversight of asset replacement plans.

(xxvi) Oversight of preparation of section 504 reviews, development of plans, and implementation of improvements necessary to comply with plans and section 504 requirements.

(xxvii) Reporting to general and limited partners and State agencies for Low Income Housing Tax Credit (LIHTC)-compliance purposes.

(2) Management fees may consist of a base per occupied unit fee and add-on fees for specific housing project characteristics. Management entities may be eligible to receive the full base per occupied unit fee for any month or part of a month during which the unit is occupied.

(i) Periodically, the Agency will develop a range of base per occupied unit fees that will be paid in each state. The Agency will develop the fees based on a review of housing industry data. The final base for occupied unit fees for each state will be made available to all borrowers.

(ii) Periodically, the Agency will develop the amount and qualifications to receive add-on fees. The final set of qualifications will be made available to all borrowers.

(3) Allowable Administrative Expenses.

(i) Identifying the Type of Administrative Expense. Management Plans and Agreements must describe if administrative expenses are to be paid from the management fee or paid for as a project cost.

(A) A management plan is required for all projects. The management plan should describe administrative expenses paid from management agent fees or project operations. The management plan should provide job descriptions for the site manager, the management agent and other personnel. It is important that these documents accurately reflect the duties being performed by the various personnel. The management plan must meet the standards set out in this rule.

(B) A task list should be used to identify which services are included in the management fee, which services are included in project operations, and which are pro-rated along with the methodology used to pro-rating of expenses between management agent fees and project operations. Some property responsibilities are completed at the property and some offsite. Agent responsibilities may be performed at the property, the management office, or at some other location.

(C) Disputes may arise as to who performs certain services. The management plan and job descriptions should normally provide sufficient clarity to avoid or resolve any such disputes; however, sometimes clarifications and supporting materials may be required to resolve disputes. The decision must be made based on the most complete evaluation of the facts presented.

(ii) Allowable Administrative Expenses. Payroll related administrative expenses are allowable expenses. Postage expense to mail out rental applications, third-party (asset income and adjustments to income) verifications, application processing correspondence (acceptance or denial letters), mailing project invoice payments, required correspondence, and report submittals to various regulatory authorities for the managed property are allowable project expenses no matter what location or point of origin the mail is generated. Photocopying or printing expense related to actual production of project brochures, marketing pieces, forms, reports, notices, and newsletters are allowable project expenses no matter what location or point of origin the work is performed including outsourcing the work to a professional printer. Correspondence or reports required for record retention or project compliance are allowable project expenses. The cost or expense of equipment and any related equipment service contract is a management agent direct expense, unless the machine becomes the property of the project after purchase.

(iii) Determining if Expenses are Reasonable. Generally, expenses charged to project operations, whether for management agent services or other expenses, must be reasonable, typical, necessary and show a clear benefit to the residents of the property. Services and expenses charged to the property must show value added and be for authorized purposes. If such value is not apparent, the service or expense should be examined.

(A) Administrative expenses for project operations exceeding 23 percent, or those typical for the area, of gross potential basic rents and revenues (i.e., referred to as gross potential rents in industry publications) highlight a need for closer review for unnecessary expenditures. Budget approval is required and project resources may not always permit an otherwise allowable expense to be incurred if it is not fiscally prudent in the market.

(B) Excessive administrative expenses can result in inadequate funds to meet other essential project needs, including expenditures for repair and maintenance needed to keep the project in sound physical condition. Actions that are improper or not fiscally prudent may warrant budget disapproval and/or a demand for recovery action.

(4) Unallowable Administrative Expenses.

(i) Certain expenses are not allowable such as legal fees, association dues, bonuses or monetary performance awards, parties, computer hardware and some software, and telephone purchases.

(ii) It is inappropriate to charge for legal services to represent any interest other than the borrower's interest (i.e., representing a general partner or limited partner to defend their individual owner interest is not allowable).

Where there is no finding of a borrower's fault, commercially reasonable legal expenses and costs for defending or settling lawsuits (without admission of liability) are allowable.

(iii) Charging for payment of penalties, including opposition legal fees resulting from an award finding improper actions on the part of the owner or management agent is generally an inappropriate project expense. The party responsible generally pays such expenses for violating the standards or by their insurance carriers.

(iv) Association dues to be paid by the project should only be related to training for site managers or management agents. To the extent that association dues can document training for site managers or management agents related to project activities by actual cost or pro-ration, a reasonable expense may be billed to the project.

(v) It is inappropriate for the project to pay for bonuses or monetary performance awards to site managers or management agents that are not clearly provided for by the site manager salary contract.

(vi) Billing the project for parties that are large or unreasonable, such as renting expensive party halls or hotel rooms and payment for alcoholic beverages or gifts to management agent staff are also inappropriate.

(vii) It is inappropriate to bill the project for computer hardware, some software, and internal connections that are beyond the scope and size reasonably needed for the services supplied (i.e., purchasing equipment or software for use by a site manager that is clearly beyond that needed to support project operations). Note that computer learning center activities benefiting tenants are not covered in this prohibition.

(viii) It is inappropriate to bill the project for practices that are inefficient such as routine use of collect calls from a site manager to a management agent office.

(j) Management certification.

(1) As a condition of approval of the management agent and the management fee, the borrower and the management agents must execute an Agency-approved certification establishing an allowable management fee to be paid out of the housing project's general operating account and certifying that:

(i) The borrower and management agent agree to operate the housing project in accordance with the management plan;

(ii) The borrower and the management agent will comply with Agency requirements, loan or grant agreements, applicable local, state and Federal laws and ordinances, and contract obligations, will certify that no payments have been made to anyone in return for awarding the management contract to the management agent, and will agree that such payments will not be made in the future;

(iii) The borrower and the management agent will comply with Agency notices or other policy directives that relate to the management of the housing project;

(iv) The management agreement between the borrower and management agent complies with the requirements of this section;

(v) The borrower and the management agent will comply with Agency requirements regarding management fees as specified in paragraph (i) of this section, and allocation of management costs between the management fee and the housing project financial accounts specified in §3560.302(c)(3);

(vi) The borrower and the management agent will not purchase goods and services from entities that have an identity-of-interest (IOI) with the borrower or the management agent until the IOI relationship has been disclosed to the Agency according to paragraph (g) of this section, not denied by the Agency under paragraph (d)(3) of this section, and it has been determined that the costs are as low as or lower than arms-length, open-market purchases; and

(vii) The borrower and the management agent agree that all records related to the housing project are the property of the housing project and that the Agency, OIG, or GAO may inspect the housing records and the records of the borrower, management agent, and suppliers of goods and services having an IOI with the borrower or with a management agent acting as an agent of the borrower upon demand.

(2) A certification will be executed each time a management agent is proposed and a management agreement is executed or renewed. Any amendment to a management certification must be approved by the Agency and the borrower.

(k) Procurement. The borrower and the agents of the borrower must obtain contracts, materials, supplies, utilities, and services at a reasonable cost and seek the most advantageous terms to the housing project. Any discounts, rebates, fees, proceeds, or commissions obtainable with respect to purchases, service contracts, or other transactions must be credited to the housing project.

(l) Electronic Submission of Data to Agency. For properties with eight or more housing units, the Agency may specify that borrowers submit information required by this part electronically.

§3560.103 Maintaining housing projects.

(a) Physical maintenance.

(1) The purposes of physical maintenance are the following:

(i) Provide decent, safe, and sanitary housing; and

(ii) Maintain the security of the property.

(2) Borrowers are responsible for the long-term, cost-effective preservation of the housing project.

(3) At all times, borrowers must maintain housing projects in compliance with local, state and federal laws and regulations and according to the following Agency requirements for affordable, decent, safe, and sanitary housing. Agency design requirements are discussed in §3560.60. The Agency acknowledges that property maintenance is an ongoing process and will not penalize borrowers for less than 100 percent compliance as long as it is evident that the borrower is striving to achieve the standards listed in this paragraph. In addition, the Agency understands that although its multifamily housing portfolio is relatively homogeneous, no one standard is appropriate for all properties.

(i) Utilities. The housing project must have an adequate and safe water supply, a functional and safe waste disposal system, and must be free of hazardous waste material.

(ii) Drainage and erosion control. The housing project must have drainage that effectively protects the housing project from water damage from standing water and erosion. Units, basements, and crawl spaces must be free of water seepage.

(iii) Landscaping and grounds. The housing project must be landscaped attractively. Lawns, plants and shrubs must be maintained and must allow air to windows, vents, and sills. Recreation areas must be maintained in a safe and clean manner and trash collection areas must be adequately sized, screened, and maintained.

(iv) Drives, parking services and walks. The housing project must have drives, parking lots, and walks that are free of holes and deterioration. Walks with changes in height between slabs of approximately \1/2\ inch or greater will be considered unacceptable.

(v) Exterior signage. All signs at the housing project, including those related to the housing project name, buildings, parking spaces, unit numbers and other informational directions must be visible and well-kept. Sign requirements must conform to §3560.104(d).

(vi) Fences and retaining walls. The housing project must have fence lines that are free of trash, weeds, vines, and other vegetation. Fences must be free of holes and damaged or loose sections. The bases of all retaining walls must be erosion free and drainage weep holes must be cleaned out to prevent excessive pressure behind the retaining wall.

(vii) Debris and graffiti. The housing project, including common areas, must be free of trash, litter, and debris. Public walkways, walls of buildings and common areas must be free of raffiti.

(viii) Lighting. The housing project must have functional exterior lighting and functional interior lighting in common areas which permits safe access and security.

(ix) Foundation. The housing project must have a foundation that is free of evidence of structural failure, such as uneven settlement indicated by horizontal cracks or severe bowing of the foundation wall. Structural members must not have evidence of rot or insect or rodent infestation.

(x) Exterior walls and siding. The housing project must have walls that are free from deterioration which allows elements to infiltrate the structure, eaves, gables, and window trim that are free from deterioration, exterior wall coverings that are intact, securely attached, and in good condition. Brick veneers must be free of missing mortar or bricks.

(xi) Roofs, flashing, and gutters. The housing project must have gutters and downspouts, where appropriate for climatic conditions, that are securely attached, clean, and finished or painted properly with splash blocks or extenders that direct water flow away from the building. The housing project must have a roof that is free of leaks, defective covering, curled or missing shingles and which is not sagging or buckling. Fascia and soffits must be intact.

(xii) Windows, doors, and exterior structures. The housing project must have screens that are free of tears, breaks and rips and windows that are unbroken. Window thermopane seals must be unbroken and caulking on the exterior of windows and doors must be continuous and free of cracks. Doors must be weather tight, free of holes, and provide security with functional locks. Porches, balconies, and exterior stairs must be free of broken, missing, or rotting components.

(xiii) Common area accessibility. The housing project must have accessible, designated handicapped parking spaces with handicapped space signs properly posted. Common areas must be accessible through walks, ramps, porches, and thresholds. The laundry room must have accessible appliances and mailboxes must be at an accessible level. Elevators or mechanical lifts must be functional and kept in good repair.

(xiv) Common area signage. The following must be posted in a conspicuous place in a common area: “Justice for All” poster, HUD equal housing opportunity poster including the Spanish version if there are Hispanic Limited English Proficiency tenants or applicants, current affirmative fair housing marketing plan, the tenant grievance and appeal procedure, housing project occupancy rules, office hours and phone number, and emergency hours and phone number.

(xv) Flooring. If a housing project has carpeting, the carpet must be clean, without excessive wear, and seams that are secure and stretched properly. If the housing project has resilient flooring, the flooring must be clean, unstained, free of tears and breaks, and seams that are secure.

(xvi) Walls, floors, and ceilings. The housing project must have walls, floors, and ceilings that are free of holes, evidence of current water leaks, and free of material that appears in danger of falling. The housing project must have wallboard joints that are secure and free of cracks.

(xvii) Doors and windows. The housing project must have doors that are free of holes, secure, unbroken and easily operable hardware, deadbolt locks which are in place and secure, and, if doors are metal, free of rust. The housing project must have windows which are easily operated, free of bent blinds or torn curtains, and window interiors must be free of evidence of moisture damage.

(xviii) Electrical, air conditioning and heating. The housing project must have heating and cooling units that are free of bare wires and which are functioning properly, including thermostats. The housing project must not have uncovered outlets or other evident safety hazards, switches which work improperly, or light fixtures which are broken and inoperable.

(xix) Water heaters. The housing project must have water heaters which are operating properly, free of leaks, supply adequate hot water, and are fitted with temperature and pressure relief valves.

(xx) Smoke alarms. The housing project must have smoke alarms which are properly located according to local code and which operate properly.

(xxi) Emergency call system. If a housing project has an emergency call system, the switches must be located in the bathroom and bedroom, furnished with a pull cord, with the down position set to “ON”, and must operate properly.

(xxii) Insect or vermin infestation. The housing project must have all units free of visible signs of insects or rodents and must be free of signs of insect or rodent damage.

(xxiii) Range and range hood. The housing project must have range units in which all elements are operable, electrical connections are secure and insulated, doors and drawers which are secure, control knobs and handles which are in place and secure, and housing which is sound and the finish is free of chips, damage, or signs of rust. The range hood fan and light must be operable.

(xxiv) Refrigerator. The housing project must have refrigerators in which the cooler and freezer are operating properly, the shelves and door containers are secure and free of rust, door gaskets are in good condition and functioning properly, and the housing is sound and the finish is free of chips, damage, or signs of rust.

(xxv) Sinks. The housing project must have sinks in which the fittings work properly and are free of leaks, plumbing connections under the cabinet which are free of leaks, the finish is free of chips, damage, or signs of rust, the strainer is in good condition and in place, and which are secured to a wall, counter, or vanity top.

(xxvi) Cabinets. The housing project must have cabinets and vanities which are secure to walls or floor and have faces, doors, and drawer fronts that are in good condition and free of breaks and peeling. Shelving must be in place, fastened securely, and free of warps. The housing project must have counter tops which are secure and free of burn marks or chips, bottoms under sinks which are free of evidence of warping, breaks, or being water soaked. Kitchen counter, vanity tops, and back splashes must be properly caulked.

(xxvii) Water closets. The housing project must have the base of the water closets at the floor properly caulked. The tanks must be free of cracks or leaks and have a lid which fits and is in good condition. The seats must be secure and in good condition, and the flushing mechanisms must be in good condition and operating properly. The stools must be free of cracks and breaks and be securely fastened to the floor.

(xviii) Bathtub and shower stalls. The housing project must have tubs or shower stalls which are free of cracks, breaks, and leaks, and a strainer in good condition and in place. The housing project must have walls and floors of the bathtubs which are properly caulked, tops and sides of shower stalls must be properly caulked, and the finish is free of chips, damage, or signs of rust.

(4) The Agency expects that upon discovery of a condition not in compliance with the standards listed in this section that the borrower will remedy the situation in a timeframe required by the Agency. The Borrower must provide documentation and justification for any failure to meet such timeframe. Properties with deficiencies in the process of being addressed will not be deemed to be out of compliance unless there are so many deficiencies that it would result in a declaration of substantial noncompliance and call into questions the viability of the property and the effectiveness of the borrower's maintenance program. Failure to make such corrections or repairs constitutes a non-monetary default under §3560.452(e).

(b) Maintenance systems. Borrowers must establish the following maintenance systems and must describe these systems in their management plan.

(1) A system for routine maintenance, including:

(i) Regular maintenance tasks that can be prescheduled or planned; and

(ii) Tasks performed on a regular basis to maintain compliance with the standards established in paragraph (a)(3) of this section.

(2) A system for responsive maintenance including:

(i) A process for responding to requests for maintenance from tenants;

(ii) A process for responding to unexpected malfunctions of equipment or damages to building systems such as a furnace breakdown or a water leak; and

(iii) A ‘work order’ process for managing and tracking responses to maintenance requests and the performance of maintenance tasks.

(3) A system for preventive maintenance including:

(i) Maintenance of mechanical systems, building exteriors, elevators, and heating and cooling systems which require specially trained personnel; and

(ii) Maintenance that supports energy-efficient operation of the housing project.

(4) A system for correcting deficiencies identified by periodic inspections, which must include:

(i) A move-in inspection;

(ii) A move-out inspection; and

(iii) An annual inspection of occupied units.

(c) Capital budgeting and planning.

(1) Borrowers must develop a capital budget as part of their annual housing project budget required under §3560.303. The capital budget must include anticipated expenditures on the long-term capital needs of the housing project to assure adequate maintenance and replacement of capital items.

(2) If the borrower requests an increase in the project's reserve for replacement account, the borrower must have a capital needs assessment prepared and submitted to the Agency to reflect anticipated needs of the housing project for replacement of capital equipment and systems. The cost for preparation of a capital needs assessment will be approved by the Agency as an eligible housing project expense provided the capital needs assessment is reasonable in cost and meets Agency requirements.

(3) [Reserved].

(4) As a part of the annual budget process, borrowers may request an increase in the amount to be contributed and held in the housing project reserve account to fund the needs identified in an Agency-approved capital needs assessment.

(5) At any time, borrowers may request and the Agency may approve amendments to loan or grant documents to increase the amount of funds to be contributed and held in a reserve account to cover the cost of capital improvements based on the needs identified in an Agency approved capital needs assessment. Borrowers must assure improvements are performed as specified in the capital needs assessment.

§3560.104 Fair housing.

(a) General. Borrowers must comply with the requirements of the Fair Housing Amendments Act of 1988, and this section to meet their fair housing responsibilities.

(b)Affirmative Fair Housing Marketing Plan.

(1) Borrowers with housing projects that have four or more rental units must prepare and maintain an Affirmative Fair Housing Marketing Plan (AFHMP) as defined in 24 CFR part 200, subpart M.

(2) Loan or grant applicants must submit an AFHMP for Agency approval prior to loan closing or grant approval. Plans must be updated by the borrower whenever components of the plan change.

(3) Borrowers must post the approved AFHMP for public inspection at the housing project site, rental office, or at any other location where tenant applications for the project are received.

(4) When developing the plan, the following items must be considered by the borrower:

(i) Direction of marketing activities. The plan should be designed to attract applications for occupancy from all potentially eligible groups of people in the housing marketing area, regardless of race, color, religion, sex, age, familial status, national origin, or disability. The plan must show which efforts will be made to reach very low-income or low-income groups who would least likely be expected to apply without special outreach efforts.

(ii) Marketing program. The applicant or borrower should determine which methods of marketing such as radio, newspaper, TV, signs, etc., are best suited to reach those very low-income or low-income groups who are in the market area but who are least likely to apply for occupancy. Marketing must not rely on "word of mouth" advertising.

(A) Advertising.

(1) Frequency. The borrower should advertise availability of housing units in advance of their availability to allow time to receive and process applications. Advertising by newsprint or electronic media must occur at least annually to promote project visibility, even if there is an adequate waiting list.

(2) Posters, brochures, etc. Any radio, TV or newspaper advertisement, pamphlets, or brochures used must identify that the complex is operated on an equal housing opportunity basis. This must be done through the use of the equal housing opportunity statement, slogan, or logo type. Copies of the proposed material must be sent when requesting approval of the plan.

(B) Community contacts. Community leaders and special interest groups such as community, public interest, religious organizations, and organizations for the disabled must be contacted. Owners and managers of projects with fully accessible apartments must adopt suitable means to ensure that information regarding the availability of accessible units reaches eligible persons with disabilities. In addition, owners and managers of elderly housing must ensure that information regarding eligibility reaches people who are less than 62 years old but who are eligible because they are disabled. Appropriate contacts are with physical rehabilitation centers, hospitals, workshops for the disabled, commissions on aging, and veterans' organizations.

(C) Rental staff. All staff persons responsible for renting the units must have had training provided on Federal, state, and local fair housing laws and regulations and in the requirements of fair housing marketing and in those actions necessary to carry out the marketing plan. Copies of instructions to the staff regarding fair

housing and a summary of the training they have received must be attached to the plan when requesting approval.

(iii) Marketing records. Records must be maintained by the borrower reflecting efforts to fulfill the plan. These records will be reviewed by the Agency during civil rights compliance reviews. Plans will be updated as needed.

(c) Accommodations and communication. The borrower must take appropriate steps to ensure effective communication with applicants, tenants, and members of the public with disabilities. At a minimum, the following steps must be taken:

(1) Furnish appropriate auxiliary aids (electronic, mechanical, or personal assistance) where necessary, to afford an individual with disabilities an equal opportunity to participate in and enjoy the benefits of Agency financed housing.

(i) In determining what auxiliary aids are necessary, the borrower must give primary consideration to the requests of individuals with disabilities.

(ii) The borrower is not required to provide individually prescribed devices, readers for personal use or study, or other devices of a personal nature.

(2) Where a borrower communicates with applicants and tenants by telephone, telecommunication devices for deaf persons or equally effective communication systems must be available for use.

(3) The borrower must implement procedures to ensure that interested persons, including persons with impaired vision or hearing, can obtain information concerning the existence and location of accessible services, activities, and facilities in the housing project and community.

(4) The borrower is required to provide reasonable accommodations at the project's expense unless doing so would result in undue financial or administrative burden on the project. Examples of reasonable accommodations may include such items as the installation of grab bars, ramps, and roll-in showers. Reasonable accommodations may also include the modification of rules or policies such as permitting a disabled tenant to have a two-bedroom unit to accommodate a resident assistant or to permit a disabled tenant to have a companion animal. The decision whether the requested accommodation is reasonable or unreasonable or whether to provide the accommodation would cause an undue financial or administrative burden lies with the borrower and would be for the borrower to defend should a complaint subsequently be filed. Borrowers may wish to consult with their legal counsel prior to denying a request. If the borrower takes the position that providing an accommodation would cause an undue financial or administrative burden, the borrower must permit the tenant to make reasonable modifications at the tenant's expense. Requests for reasonable accommodations must be handled in accordance with the management plan.

(d) Housing sign requirements.

(1) A permanent sign identifying the housing project is required for all housing projects approved on or after September 13, 1977. Permanent signs are recommended for all housing projects approved prior to September 13, 1977. The sign must meet the following requirements:

(i) Must be located at the primary site entrance and be readable and recognizable from the roadside;

(ii) Must be located near the site manager's office when the housing project has multiple sites and portable signs must be placed where vacancies exist at other site locations of a “scattered site” housing project;

(iii) May be of any shape;

(iv) Must be not less than 16 square feet of area for housing projects with 8 or more rental units (smaller housing projects may have smaller signs);

(v) Must be made of durable material including its supports;

(vi) Must include the housing project name;

(vii) Must show rental contact information including but not limited to the office location of the housing project and a telephone number where applicant inquiries may be made;

(viii) Must show either the equal housing opportunity logotype (the house and equal sign, with the words equal housing opportunity underneath the house); the equal housing opportunity slogan “equal housing opportunity”; or the equal housing opportunity statement, “We are pledged to the letter and spirit of U.S. policy for the achievement of equal housing opportunity throughout the nation. We encourage and support an affirmative advertising and marketing program in which there are no barriers to obtaining housing because of race, color, religion, sex, handicap, familial status, or national origin.” If the logotype is used, the size of the logo must be no less than 5 percent of the total size of the project sign.

(ix) May display the Agency or Department logotype; and

(x) Must comply with state and local codes.

(2) Accessible parking spaces must be reserved for individuals with disabilities by a sign showing the international symbol of accessibility. The sign must be mounted on a post at a height that is readily visible from an occupied vehicle. In snow areas, the sign must be visible above piled snow. If there is an office, the designated parking space must be van accessible.

(3) When the continuous unobstructed ingress or egress disabled accessibility route to a primary building entrance is other than the usual or obvious route, the alternate route for disabled accessibility must be clearly marked with international accessibility symbols and directional signs to aid a disabled person's ingress or egress to the building, through an accessible entrance, and to the accessible common use and public and living areas.

§3560.105 Insurance and taxes.

(a) General. Borrowers must purchase and maintain property insurance on all buildings included as security for an Agency loan. Also, borrowers must furnish fidelity coverage, liability insurance, and any other insurance coverage required by the Agency in accordance with this paragraph to protect the security of the asset. Failure to maintain adequate insurance coverage or pay taxes may lead to a non-monetary default under §3560.452(c).

(b) General insurance requirements. All insurance policies must meet the requirements established by the loan documents and this section.

(1) At loan closing, prior to loan approval, applicants must provide documentary evidence that insurance requirements have been met. The borrower must maintain insurance in accordance with requirements of their loan or grant documents and this section until the loan is repaid

(2) Insurance companies must meet the requirements of paragraph (e) of this section.

(3) Insurance coverage amount, terms, and conditions must meet the requirements of paragraph (f) of this section.

(4) The Agency must be named as loss co-payee on all property insurance policies where it holds first lien position. The Agency must be named as an additional insured if its lien position is other than first.

(c) Borrower failure or inability to meet insurance requirements. The Agency will take the following actions in cases where a borrower is unwilling or unable to meet the Agency's insurance requirements:

(1) The Agency will obtain insurance for Agency financed property if the borrower fails to do so. If borrowers refuse to pay the insurance premium, the Agency will pay the insurance premium and charge the premium payment amount to the borrower's Agency account and will place the borrower in default as described in §3560.452(c).

(2) If borrowers habitually fail to pay premiums in a timely manner, the Agency will require borrowers to escrow amounts appropriate to pay insurance premiums.

(3) If insurance that meets the Agency's specified requirements is not available (e.g. flood or hurricane insurance), the Agency may accept the insurance policy that most nearly conforms to established requirements.

(4) If the best insurance policy a borrower can obtain at the time the borrower receives the loan or grant contains a loss deductible clause greater than that allowed by paragraph (f)(8) of this section, the insurance policy and an explanation of the reasons why more adequate insurance is not available must be submitted to the Agency prior to loan or grant approval.

(d) Credits, refunds, or rebates. Borrowers must credit any refund or rebate from an insurance company to the project's general operating account or reserve account.

(e) Insurance company requirements. All insurers, insurance agents, and brokers must meet the following requirements:

(1) Be licensed or authorized to do business in the state or jurisdiction where the housing project is located; and

(2) Be deemed reputable and financially sound as determined by the Agency.

(f) Property insurance. The following conditions apply to property insurance purchased for Agency-financed housing projects.

(1) At a minimum, borrowers must obtain the following types of property insurance:

(i) Hazard insurance. A policy which generally covers loss or damage by fire, smoke, lightning, hail, explosion, riot, civil commotion, aircraft, and vehicles. These policies may also be known as “Fire and Extended Coverage,” “Homeowners,” “All Physical Loss,” or “Broad Form” policies.

(ii) Flood insurance. This coverage is required for properties located in Special Flood Hazard Areas (SFHA) as defined in 44 CFR part 65, as determined by the Federal Emergency Management Agency (FEMA).

(iii) Builder's risk insurance. A policy that insures dwellings under construction or rehabilitation.

(iv) Elevators, boiler, and machinery coverage. This coverage is required for properties that operate elevators, steam boilers, turbines, engines, or other pressure vessels.

(2) Other types of insurance that the Agency may require:

(i) Windstorm Coverage.

(ii) Earthquake Coverage.

(iii) Sinkhole Insurance or Mine Subsidence Insurance.

(3) For property insurance, the minimum coverage amount must equal the “Total Estimated Reproduction Cost of New Improvements,” as reflected in the housing project's most recent appraisal. At a minimum, property insurance coverage must be adequate to cover the lesser of the depreciated replacement value of essential buildings or the unpaid balance of all secured debt, unless such coverage is financially unfeasible for the housing project.

(i) If the cost of the minimum level of property insurance coverage exceeds what the housing project can reasonably afford, the borrower, with Agency concurrence, must obtain the maximum amount of property insurance coverage that the housing project can afford.

(ii) If the coverage amount is less than the depreciated replacement value of all essential buildings, borrowers must obtain coverage on one or more of the most essential buildings, as determined by the Agency.

(iii) When required, the coverage amount for flood insurance must equal the outstanding loan balance or the maximum coverage allowed by FEMA's “National Flood Insurance Program.”

(4) Except for flood insurance, property insurance is not required if the housing project:

(i) Has a depreciated replacement value of $2,500 or less; or

(ii) Is in a condition which the Agency determines makes insurance coverage not economical.

(5) Policies for several buildings or properties located on noncontiguous sites are acceptable if the insurer provides proof that each secured building or property related to the housing project is as fully protected as if a separate policy were issued.

(6) Borrowers must notify the Agency and their insurance company agents of any loss or damage to insured property and collect the amount of the loss.

(7) When the Agency is in the first lien position and an insurance settlement represents a satisfactory adjustment of a loss, the insurance settlement will be deposited in the housing project's general operating account unless the settlement exceeds $5,000. If the settlement exceeds $5,000, the funds will be placed in the reserve account for the housing project.

(i) Insurance settlement funds which remain after all repairs, replacements, and other authorized disbursements have been made retain their status as housing project funds.

(ii) If the indebtedness secured by the insured property has been paid in full or the insurance settlement is in payment for loss of property on which the Agency has no claim; a loss draft which includes the Agency as co-payee may be endorsed by the Agency without recourse and delivered to the borrower.

(8) When the Agency is not in the first lien position and the insurance settlement represents satisfactory adjustment of the loss, the Agency will release the settlement funds to the primary mortgagee upon agreement of all parties to the provisions contained in agreements between the Agency and the primary lienholder.

(9) Allowable deductible amounts are as follows:

(i) Hazard/Property Insurance.

(A) $1,000 on any housing project with an insurable value under $200,000; or

(B) One-half of one percent (0.0050) of the insurable value, up to $10,000 on housing projects with insurance values over $200,000.

(ii) Flood Insurance. The Agency allows a maximum deductible of $5,000 per building.

(iii) Windstorm Coverage. When windstorm coverage is excluded from the “All Risk” policy, the deductible must not exceed five percent of the total insured value.

(iv) Earthquake Coverage. In the event that the borrower obtains earthquake coverage, the Agency is to be named as a loss payee. The deductible should be no more than 10 percent of the coverage amount.

(v) Sinkhole Insurance or Mine Subsidence Insurance. The deductible for sinkhole insurance or mine subsidence insurance should be similar to what would be required for earthquake insurance.

(10) Deductible amounts (excluding flood, windstorm, earthquake and sinkhole insurance or mine subsidence insurance) must be accounted for in the replacement reserve account. Borrowers who wish to increase the deductible amount must deposit an additional amount to the reserve account equal to the difference between the Agency's maximum deductible and the requested new deductible. The Borrower will be required to maintain this additional amount so long as the higher deductible is in force.

(g) Liability insurance. The borrower must carry comprehensive general liability insurance with coverage amounts that meet or exceed Agency requirements. This coverage must insure all common areas, commercial space, and public ways in the security premises. Coverage may also include borrower exposure to certain risks such as errors and omissions, environmental damages, or protection against discrimination claims. The insurer's limit of liability per occurrence for personal injury, bodily injury, or property damage under the terms of coverage must be at least $1 million.

(h) Fidelity coverage. Borrowers must provide fidelity coverage on any personnel entrusted with the receipt, custody, and disbursement of any housing monies, securities, or readily salable property other than money or securities. Borrowers must have fidelity coverage in force as soon as there are assets within the organization and it must be obtained before any loan funds or interim financing funds are made available to the borrower. In addition, the following conditions apply to fidelity insurance:

(1) Fidelity insurance coverage must be documented on a bond form acceptable to the Agency.

(2) Fidelity coverage policies must declare in the insuring agreements that the insurance company will provide protection to the insured against the loss of money, securities, and property other than money and securities, through any criminal or dishonest act or acts committed by any employee, whether acting alone or in collusion with others, not to exceed the amount of indemnity stated in the declaration of coverage.

(i) The fidelity insurance policy, at a minimum, must include an insuring agreement that covers employee dishonesty.

(ii) Fidelity coverage amounts and deductible:

Fidelity coverage	Deductible level
Under $50,000	$1,000
In the area of $100,000	2,500
In the area of $250,000	5,000
In the area of $500,000	10,000
In the area of $1,000,000	15,000

(3) Blanket crime insurance coverage or fidelity bonds are acceptable types of fidelity coverage.

(4) At a minimum, borrowers must provide an endorsement, listing all of the borrower's Agency financed properties and their locations covered under the policy or bond as evidence of required fidelity insurance. The policy or bond may also include properties or operations other than Agency financed properties on separate endorsement listings.

(5) Individual or organizational borrowers must have fidelity coverage when they have employees with access to the MFH complex assets. Borrowers who use a management agent with exclusive access to housing assets must require the agent to have fidelity coverage on all principals and employees with access to the housing assets. If active management reverts to the borrower, the borrower must obtain fidelity coverage, as a first course of business.

(6) Fidelity coverage is not required under the following circumstances:

(i) The borrower is an individual or a general partnership and the individual or general partner will be responsible for the financial activities of the housing project.

(ii) In the case of a land trust where the beneficiary is responsible for management, the beneficiary will be treated as an individual.

(iii) A limited partnership (or its general partners) unless one or more of its general partners perform financial acts within the scope of the usual duties of an “employee.”

(7) The premium for fidelity coverage of employees and general partners at a housing project is an eligible operating account expense.

(i) The premium of a management agent's fidelity coverage for the agent's principals and employees will be the management agent's business expense (i.e., it is included within the management fee).

(ii) When a housing project employee is covered under the “umbrella” of the management agent's fidelity coverage, the premium may be prorated among the housing projects covered..

(8) Borrowers must review fidelity coverage annually and adjust it as necessary to comply with the requirements of this section.

(i) Taxes. The borrower is responsible for paying all taxes and assessments on a housing project before they become delinquent.

(1) An exception to the above may be made if the borrower has formally contested the amount of the property assessment and escrowed the amount of taxes in question in a manner approved by the Agency.

(2) Failure to pay taxes and assessments when due will be considered a default. If a borrower fails to pay outstanding taxes and assessments, the Agency will pay the outstanding balance and charge the tax or assessment amount, assessed penalties, and any additional incurred costs to the borrower's Agency account.

(3) The Agency will require borrowers who have demonstrated an inability to pay taxes in a timely manner to escrow amounts sufficient to pay taxes.

§§3560.106-3560.149 [Reserved].

§3560.150 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart D--Multi-Family Housing Occupancy

§3560.151 General.

(a) Applicability. This subpart contains borrower and tenant requirements and Agency responsibilities related to occupancy of Agency-financed multi-family housing (MFH) projects. Occupancy eligibility requirements apply to the following:

(1) Family housing projects, including farm labor housing;

(2) Elderly housing projects; and

(3) Congregate housing or group homes for persons with special needs.

(b) Civil rights requirements. All occupancy policies must meet applicable civil rights requirements, as stated in §3560.2.

§3560.152 Tenant eligibility.

(a) General requirements. Except as specified in paragraph (b) of this section, a tenant eligible for occupancy in Agency-financed housing must either:

(1) Be a United States citizen or qualified alien, and

(2) Qualify as a very low-, low-, or moderate-income household; or

(3) Be eligible under the requirements established to qualify for housing benefits provided by sources other than the Agency, such as U.S. Department of Housing and Urban Development (HUD) Section 8 assistance or Low Income Housing Tax Credit (LIHTC), when a tenant receives such housing benefits.

(b) Exception. Households with incomes above the moderate-income level may occupy housing projects with an Agency loan approved prior to 1968 with a loan agreement that does not restrict occupancy by income.

(c) Requirements for elderly housing, elderly units in mixed housing, congregate housing, and group homes. In addition to the requirements of paragraph (a) of this section, the following occupancy requirements apply to elderly housing, elderly units in mixed housing, and congregate housing or group homes:

(1) For elderly housing, elderly units in mixed housing, and congregate housing the following provisions apply:

(i) Households must meet the definition of an elderly household in §3560.11 to be eligible for occupancy in elderly or congregate housing.

(ii) If non-elderly persons are members of a household where the tenant or co-tenant is an elderly person, the non-elderly persons are eligible for occupancy in the tenant's or co-tenant's rental unit.

(iii) Applicants who will agree to participate in the services provided by a congregate housing project may be given occupancy priority.

(2) For group homes, the following provisions apply:

(i) Occupancy may be limited to a specific group of tenants, such as elderly persons or persons with developmental disabilities, or mental impairments, if such an occupancy limitation is contained in the borrower's management plan.

(ii) Tenants must be able to demonstrate a need for the special services provided by the group home.

(iii) Tenants cannot be required to participate in an ongoing training or rehabilitation program.

(iv) Tenants must be selected from the market area prior to considering applicants from other areas.

(d) Ineligible tenant waiver. The Agency may authorize the borrower in writing, upon receiving the borrower's written request with the necessary documentation, to rent vacant units to ineligible persons for temporary periods to protect the financial interest of the Government. Likewise, this provision may extend to a cooperative. This authority will be for the entire project for periods not to exceed one year. Within the period of the lease, the tenant may not be required to move to allow an eligible applicant to obtain occupancy, should one become available. The Agency must make the following determinations:

(1) There are no eligible persons on a waiting list.

(2) The borrower provided documentation that a diligent but unsuccessful effort to rent any vacant units to an eligible tenant household has been made. Such documentation may consist of advertisements in appropriate publications, posting notices in several public places, including places where persons seeking rental housing would likely make contacts, holding open houses, making appropriate contacts with public housing agencies and organizations, Chambers of Commerce, and real estate agencies.

(3) The borrower agrees to continue with aggressive efforts to locate eligible tenants and retain documentation of all marketing.

(4) The borrower is temporarily unable to achieve or maintain a level of occupancy sufficient to prevent financial default and foreclosure. The Agency's approval of the waiver would then be for a limited duration.

(5) The lease agreement will not be more than 12 months and at its expiration will convert to a month-to-month lease. The monthly lease will require that the unit be vacated upon 30 days notice when an eligible applicant is available.

(6) Tenants residing in Rural Rental Housing (RRH) units who are ineligible because their adjusted annual income exceeds the maximum for the RRH project will be charged the Rural Housing Service (RHS) approved note rent for the size of unit occupied in a Plan II RRH project. In projects operated under Plan I, ineligible tenants will be charged a rental surcharge of 25 percent of the approved note rent.

(e) Tenant certification and verification. Tenants and borrowers must execute an Agency-approved tenant certification form establishing the tenant's eligibility prior to occupancy. In addition, tenant households must be recertified and must execute a tenant certification form at least annually or whenever a change in household income of $100 or more per month occurs. Borrowers must recertify for changes of $50 per month, if the tenant requests that such a change be made.

(1) Tenant requirements.

(i) Tenants must provide borrowers with the necessary income and other household information required by the Agency to determine eligibility.

(ii) Tenants must authorize borrowers to verify information provided to establish their eligibility or determination of tenant contribution.

(iii) Tenants must report all changes in household status that may affect their eligibility to borrowers.

(iv) Tenants who fail to comply with tenant certification and recertification requirements will be considered ineligible for occupancy and will be subject to unauthorized assistance claims, if applicable, as specified in subpart O of this part.

(2) Borrower requirements.

(i) Borrowers must verify household income and other information necessary to establish tenant eligibility for the requested rental unit type, in a format approved by the Agency, prior to a tenant's initial occupancy and prior to annual or other recertifications.

(ii) Borrowers must review all reported changes in household status and assess the impact of these changes on the tenant's eligibility or tenant contribution.

(iii) Borrowers must submit initial or updated tenant certification forms to the Agency within 10 days of the effective date of an initial certification or any changes in a tenant's status. The effective date of an initial or updated tenant certification form will always be a first day of the month.

(iv) Since tenant certifications are used to document interest credit and rental assistance eligibility and are a basic responsibility of the borrower under the loan documents, borrowers who fail to submit annual or updated tenant certification forms within the time period specified in paragraph (e)(2)(iii) of this section will be charged overage, as specified in §3560.203(c). Unauthorized assistance, if any, will be handled in accordance with subpart O of this part.

(v) Borrowers must submit tenant certification forms to the Agency using a format approved by the Agency.

(vi) Borrowers must retain executed tenant certification forms and any supporting documentation in the tenant file for at least 3 years or until the next Agency monitoring visit or compliance review, whichever is longer.

(3) The Agency maintains the right to independently verify tenant eligibility information.

§3560.153 Calculation of household income and assets.

(a) Annual income will be calculated in accordance with 24 CFR 5.609.

(b) Adjusted income will be calculated in accordance with 24 CFR 5.611.

§3560.154 Tenant selection.

(a) Application for occupancy. Borrowers must use tenant application forms that collect sufficient information to properly determine household eligibility and to enable the Agency to monitor compliance with the Fair Housing Act, section 504 of the Rehabilitation Act of 1973, and title VI of the Civil Rights Act of 1964 during compliance reviews. At a minimum, borrowers must use application forms that collect the following information:

(1) Name of the applicant and present address;

(2) Number of household members and their birthdates;

(3) Annual income information calculated in accordance with §3560.153(a);

(4) Adjustments to income calculated in accordance with §3560.153(b);

(5) Net assets calculated in accordance with §3560.153(c);

(6) Indication of a need for a unit accessible to individuals with disabilities and any disability adjustments to income;

(7) Certification by the applicant that the unit will serve as the household's primary residence, and a certification that the applicant is a U.S. citizen or a qualified alien as defined in §3560.11;

(8) Signature of the applicant and date;

(9) Race, ethnicity, and sex designation. The following disclosure notice shall be used:

"The information regarding race, ethnicity, and sex designation solicited on this application is requested in order to assure the Federal Government, acting through the Rural Housing Service, that the Federal laws prohibiting discrimination against tenant applications on the basis of race, color, national origin, religion, sex, familial status, age, and disability are complied with. You are not required to furnish this information, but are encouraged to do so. This information will not be used in evaluating your application or to discriminate against you in any way. However, if you choose not to furnish it, the owner is required to note the race, ethnicity, and sex of individual applicants on the basis of visual observation or surname," and

(10) Social security number.

(b) Additional information. Applicants are to be provided a list of any additional information that must be submitted with the application for the application to be considered complete (an application will be considered complete without verification of the applicant information). The list of information will be restricted to the same items for all Agency-assisted properties of a particular type, such as a family or elderly complex.

(c) Application submission. Borrowers must establish when applications may be submitted. Information on the place and times for tenant application submission must be documented in the housing project's management plan and Affirmative Fair Housing Marketing Plan.

(d) Selection of eligible applicants.

(1) Applicants may be determined ineligible for occupancy based on selection criteria other than Agency requirements only if such criteria are contained in the borrower's management plan. Borrower established selection criteria may not contain arbitrary or discriminatory rejection criteria, but may consider an applicant's past rental and credit history and relations with other tenants.

(2) Borrowers with projects receiving low-income housing tax credits (LIHTCs), may leave a housing unit vacant if they are required to rent the available unit to an LIHTC-eligible applicant, and none of the applicants on the waiting list meet the applicable LIHTC eligibility requirements.

(e) Recordkeeping. Borrowers must retain all tenant application forms for at least 3 years. The Agency may require borrowers to submit application information for Agency review.

(f) Waiting lists.

(1) When an applicant has submitted an application form the borrower must place the applicant on the waiting list. All applications, whether complete, eligible, or ineligible, will be placed on the list. The waiting list will document the final disposition of all applications (rejected, withdrawn, or placed in a unit).

(2) The date and time a complete application was submitted will be recorded on the waiting list and will establish priority for selection from the list. If an applicant submits an incomplete application (see paragraph (a) of this section), they must be notified in writing within 10 days of the items that are needed for the application to be considered complete and that priority will not be established until the additional items are received.

(3) The race and the ethnicity of each applicant shall be recorded on the waiting list. This information shall be collected for statistical purposes only and must not be used when making eligibility determinations or in any other discriminatory manner. The information shall be recorded using the race and ethnicity codes that are utilized on the Agency tenant certification form available in the servicing office.

(4) Within 10 days of receipt of a complete application, the Borrower must notify the applicant in writing that he has been selected for immediate occupancy, placed on a waiting list, or rejected.

(5) Selections from the completed applications on the waiting list shall be made in the following priority order:

(i) Very low-income applicants;

(ii) Low-income applicants; and

(iii) Moderate-income applicants.

(g) Priorities and preferences for admission.

(1) Eligible applicants that meet the following conditions must be given priority for occupancy over all other tenants regardless of income. Such applicants, however, will be ranked among themselves by income level, giving priority first to very low-income households, then to low-income households, and finally to moderate-income households.

(i) Persons who require the special design features of a unit accessible to individuals with disabilities will have priority only for units with these features.

(ii) In congregate housing facilities, persons who agree to use the services provided by the facility will have priority over other applicants.

(2) Eligible applicants that meet any of the following conditions must be given priority over other applicants in their same income category.

(i) The applicant has a Letter of Priority Entitlement (LOPE) issued in accordance with §3560.660(c).

(ii) The applicant was displaced from Agency-financed housing but was not issued a LOPE.

(iii) The applicant was displaced in a Federally declared disaster area.

(3) Borrowers receiving Section 8 project-based assistance may establish preferences in accordance with U.S. Department of Housing and Urban Development (HUD) regulations. The use of such preferences must be documented in the project's management plan.

(h) Notices of ineligibility or rejection. Borrowers must provide written notification to applicants who are determined to be ineligible or who are rejected for occupancy. Notices of ineligibility or rejection must give specific reasons for the ineligibility determination or rejection and, in accordance with §3560.160, the notice must advise the applicant of "the right to respond to the notice within ten calendar days after receipt" and of "the right to a hearing in accordance with §3560.160 which is available upon request." When an applicant is rejected based on the information from a credit bureau report, the source of the credit bureau report must be revealed to the applicant in accordance with the Fair Credit Reporting Act.

(i) Purging waiting list. Procedures used by borrowers to purge waiting list must be documented in the project's management plan and must be based on the length of the waiting list or the extent of time an applicant will be expected to wait for housing. At a minimum, borrowers must document removal of any names from the waiting list with the time and date of the removal. If an electronic waiting list is used, borrowers must periodically print out electronic waiting lists or preserve backup copies showing how the waiting list appeared before and after the removal of each name.

(j) Criminal activity. Borrowers may deny admission for criminal activity or alcohol abuse by household members in accordance with the provisions of 24 CFR 5.854, 5.855, 5.856, and 5.857.

§3560.155 Assignment of rental units and occupancy policies.

(a) General. Available rental units are assigned in accordance with the requirements of this section and the priorities and preferences outlined in §3560.154.

(b) Rental units accessible to individuals with disabilities. If a rental unit accessible to individuals with disabilities is available and there are no applicants that require the features of the unit, borrowers may rent the unit to a non-disabled tenant subject to the inclusion of a lease provision that requires the tenant to vacate the unit within 30 days of notification from management that an eligible individual with disabilities requires the unit and provided the accessible unit has been marketed as an accessible unit, outreach has been made to organizations representing the disabled, and marketing of the unit as an accessible unit continues after it has been rented to a tenant who is not in need of the special design features.

(c) Transfer of existing tenants within a housing project. When a rental unit becomes available for occupancy and an eligible tenant in the housing project is either over housed or under housed as provided for in paragraph (e) of this section, the borrower must use the available unit for the over housed or under housed tenant, if suitable, prior to selecting an eligible applicant from the waiting list.

(d) Applicant placement. When a specific rental unit type becomes available for occupancy, borrowers must select eligible applicants suitable for the available unit according to the priorities established in §3560.154.

(e) Occupancy policies. Borrowers must establish occupancy policies for each housing project. Households living in a rental unit with more bedrooms than persons in the household will be considered over housed and must be relocated in accordance with paragraph (c) of this section. Households under housed as defined by the project's occupancy standards must be relocated in accordance with paragraph (c) of this section. Borrowers with no one-bedroom units in a housing project may make an exception to this requirement in their occupancy policies. In addition, a borrower's occupancy policies must establish:

(1) Reasonable standards for determining when a tenant household is considered under housed. The standards will describe the maximum number of persons that may occupy units of a given size based on occupancy guidelines provided by the Agency or another governmental source;

(2) The order in which eligible applicants and existing tenants will be housed or re-housed; and

(3) How fair housing requirements will be met, including how reasonable accommodations will be made for applicants and tenants with disabilities.

(f) Agency concurrence. The Agency must concur with a borrower's occupancy rules prior to initial occupancy of the housing project. All modifications to occupancy rules must be posted for tenant comment in accordance with §3560.160 and receive Agency concurrence prior to implementation.

§3560.156 Lease requirements.

(a) Agency approval. Borrowers must use a lease approved by the Agency. The lease must be consistent with Agency requirements and the requirements of all programs participating in the housing project. Prior to submitting the lease to the Agency for approval, borrowers must have their attorney certify that the lease complies with state and local laws, Agency requirements, and the requirements of all programs participating in the housing project. If there are conflicting requirements the borrower shall notify the Agency of the conflict and request guidance. Borrowers must execute their Agency approved lease with each tenant household prior to tenant occupancy of a rental unit.

(b) Lease requirements.

(1) All leases must be in writing.

(2) Initial leases must be for a 1-year period.

(3) If the tenant is not subject to occupancy termination according to §3560.158 and §3560.159, a renewal lease or lease extension must be for a 1-year period.

(4) In areas with a concentration of non-English speaking populations, leases (including the occupancy rules) must be available in both English and the non-English language.

(5) Leases must give the address of the management agent to which tenants may direct complaints.

(6) Leases must include a statement of the terms and conditions for modifying the lease.

(c) Required items and provisions.

(1) Leases for tenants who hold a Letter of Priority Entitlement (LOPE) issued according to §3560.655(d) and are temporarily occupying a unit for which they are not eligible must include a clause establishing the tenant's responsibility to move when a suitable unit becomes available in the housing project.

(2) Leases must contain a clause permitting escalation in the tenant contribution when there is an Agency-approved change in basic or note rate rents prior to the expiration of the lease. The escalation clause also must specify that the tenant contribution may be changed prior to expiration of the lease if the change is due to changes in tenant status, as documented on the tenant certification form, or the tenant's failure to properly recertify.

(3) Leases must specify that no change in the tenant contribution will occur due to monetary or non-monetary default or when rental assistance or interest credit, is suspended, canceled, or terminated due to the borrower's fault. For information on tenant contributions when a borrower prepays the Agency loan, refer to subpart N of this part.

(4) Leases must contain a requirement that tenants make restitution when unauthorized assistance is received due to applicant or tenant fraud or misrepresentation and a statement advising tenants that submission of false information could result in legal action.

(5) Leases must include a statement that the housing project is financed by the Agency and that the Agency has the right to further verify information provided by the applicant.

(6) Leases must state that the housing project is subject to:

(i) Title VI of the Civil Rights Act of 1964;

(ii) Title VIII of the Fair Housing Act;

(iii) Section 504 of the Rehabilitation Act of 1973; and

(iv) The Age Discrimination Act of 1975.

(7) Leases must establish the tenant's responsibility according to the housing project's occupancy rules to move to the next available appropriately sized rental unit if the household becomes over housed or under housed in the unit they occupy.

(8) Leases must include provisions that establish when a guest will be considered a member of the household and be required to be added to the tenant certification.

(9) Leases must include a provision stating that tenancy continues until the tenant's possessions are removed from the housing either voluntarily or by legal means, subject to state and local law.

(10) Leases must include a requirement that tenants who are no longer eligible for occupancy under the housing project's occupancy rules or do not meet the criteria set forth in §3560.155(c) and (e) must vacate the property within 30 days of being notified by the borrower that they are no longer eligible for occupancy or at the expiration of their lease, or whichever is greater, unless the conditions cited in §3560.158(c) exist;

(11) Leases for rental units receiving rental assistance must include clauses that specify that the tenant's monthly tenant contribution and a description of the circumstances under which the tenant's contribution may change.

(12) Leases must include a requirement that tenants notify borrowers when changes occur in their income or assets, their qualifications for adjustments to income, their citizenship status, or the number of persons living in the unit.

(13) A requirement that tenants agree to fulfill the tenant income verification and certification requirements established under §3560.152.

(14) Leases for tenants living in Plan II interest credit rental units must include provisions establishing the net monthly tenant contribution.

(15) Leases, including renewals, must include the following language:

“It is understood that the use, or possession, manufacture, sale, or distribution of an illegal controlled substance (as defined by local, State, or federal law) while in or on any part of this apartment complex or cooperative is an illegal act. It is further understood that such action is a material lease violation. Such violations (hereafter called a “drug violation”) may be evidenced upon the admission to or conviction of the use, possession, manufacture, sale, or distribution of a controlled substance (as defined by local, state, or Federal law) in any local, state, or Federal court.

The landlord may require any lessee or other adult member of the tenant household occupying the unit (or other adult or non-adult person outside the tenant household who is using the unit) who commits a drug violation to vacate the leased unit permanently, within timeframes set by the landlord, and not thereafter to enter upon the landlord's premises or the lessee's unit without the landlord's prior consent as a condition for continued occupancy by the remaining members of the tenant's household. The landlord may deny consent for entry unless the person agrees to not commit a drug violation in the future and is either actively participating in a counseling or recovery program, complying with court orders related to a drug violation, or has successfully completed a counseling or recovery program.

The landlord may require any lessee to show evidence that any non-adult member of the tenant household occupying the unit, who committed a drug violation, agrees not to commit a drug violation in the future, and to show evidence that the person is either actively seeking or receiving assistance through a counseling or recovery program, complying with court orders related to a drug violation, or has successfully completed a counseling or recovery program within timeframes specified by the landlord as a condition for continued occupancy in the unit. Should a further drug violation be committed by any non-adult person occupying the unit the landlord may require the person to be severed from tenancy as a condition for continued occupancy by the lessee.

If a person vacating the unit, as a result of the above policies, is one of the lessees, the person shall be severed from the tenancy and the lease shall continue among any other remaining lessees and the landlord. The landlord may also, at the option of the landlord, permit another adult member of the household to be a lessee.

Should any of the above provisions governing a drug violation be found to violate any of the laws of the land the remaining enforceable provisions shall remain in effect. The provisions set out above do not supplant any rights of tenants afforded by law."

(16) Leases for rental units accessible to individuals with disabilities occupied by those not needing the accessibility features must establish the tenant's responsibility to move to another unit when an appropriate unit becomes available or when the unit is needed by an eligible individual with disabilities. Additionally, the lease clause must require the borrower to provide tenants written notification of the date by which they must move to another unit in the project.

(17) If loan prepayment occurs and the housing project is subject to restrictive use provisions, leases and renewals must be amended to include a clause specifying the tenant protections required under subpart N of this part.

(18) All leases must contain the following information and provisions:

(i) The name of the tenant, any co-tenants, and all members of the household residing in the rental unit;

(ii) The identification of the rental unit;

(iii) The amount and due date of monthly tenant contributions, any late payment penalties, and security deposit amounts;

(iv) The utilities, services, and equipment to be provided for the tenant;

(v) The tenant's utility payment responsibility;

(vi) The certification process for determining tenant occupancy eligibility and contribution;

(vii) The limitations of the tenant's right to use or occupancy of the dwelling;

(viii) The tenant's responsibilities regarding maintenance and consequences if the tenant fails to fulfill these responsibilities;

(ix) The agreement of the borrower to accept the tenant contribution toward rent charges prior to payment of other charges that the tenant owes and a statement that borrowers may seek legal remedy for collecting other charges accrued by the tenant;

(x) The maintenance responsibilities of the borrower in buildings and common areas, according to state and local codes, Agency regulations, and Federal fair housing requirements;

(xi) The responsibility of the borrowers at move-in and move-out to provide the tenant with a written statement of rental unit's condition and provisions for tenant participation in inspection;

(xii) The provision for periodic inspections by the borrower and other circumstances under which the borrower may enter the premises while a tenant is renting;

(xiii) The tenant's responsibility to notify the borrower of an extended absence;

(xiv) A provision that tenants may not assign the lease or sublet the property;

(xv) A provision regarding transfer of the lease if the housing project is sold to an Agency-approved buyer;

(xvi) The procedures that must be followed by the borrower and the tenant in giving notices required under terms of the lease including lease violation notices;

(xvii) The good-cause circumstances under which the borrower may terminate the lease and the length of notice required;

(xviii) The disposition of the lease if the housing project becomes uninhabitable due to fire or other disaster, including rights of the borrower to repair building or terminate the lease;

(xix) The procedures for resolution of tenant grievances consistent with the requirements of §3560.160;

(xx) The terms under which a tenant may, for good cause, terminate their lease, with 30 days notice, prior to lease expiration; and

(xxi) The signature and date clause indicating that the lease has been executed by the borrower and the tenant.

(d) Prohibited provisions. Borrowers are prohibited from including any of the following clauses in the lease:

(1) Clauses prohibiting families with children under 18;

(2) Clauses requiring prior consent by tenant to any lawsuit that borrowers may bring against the tenant in connection with the lease;

(3) Clauses authorizing borrowers to hold any of a tenant's property until the tenant fulfills an obligation;

(4) Clauses in which tenants agree not to hold borrowers liable for anything they may do or fail to do;

(5) Clauses in which tenants agree that borrowers may institute suit without any notice to the tenant that the suit has been filed;

(6) Clauses in which tenants agree that borrowers may evict the tenant or sell their possessions whenever borrowers determine that a breach or default has occurred;

(7) Clauses authorizing the borrower's attorneys to appear in court on behalf of the tenant, and to waive the tenant's right to a trial by jury;

(8) Clauses authorizing the borrower's attorneys to waive the tenant's right to appeal or to file suit; and

(9) Clauses requiring the tenant to agree to pay legal fees and court costs whenever the borrower takes action against the tenant, even if the court finds in favor of the tenant.

(e) Housing projects and units receiving HUD assistance.

(1) In housing projects receiving Section 8 project-based assistance, borrowers may use the HUD model lease. The provisions of the HUD model lease will prevail, unless they conflict with Agency lease requirements in accordance with this section. If there is conflict between HUD requirements and Agency requirements, the provision that will be enforced will be the one that is most favorable to the tenant.

(2) For units occupied by Section 8 certificate and voucher holders, borrowers may use:

(i) A standard HUD-approved lease;

(ii) A HUD-approved lease that includes a number of modifications from the standard HUD-approved lease; or

(iii) An Agency-approved lease may be used if acceptable by HUD or the local housing authority.

(f) State and local requirements. Borrowers must use a lease that is consistent with state and local requirements.

(1) If any lease provision is in violation of state or local law, the lease may be modified to the extent needed to comply with the law, but any changes must be consistent with the provisions established in paragraph (c) of this section.

(2) Leases must include a procedure for handling tenant's abandoned property, as provided by state or local law.

§3560.157 Occupancy rules.

(a) General. The purpose of a borrower's occupancy rules is to outline the basis for the tenant and management relationship. Prior to Agency approval of occupancy rules, borrowers must provide written certification from their attorney that the housing project's occupancy rules are consistent with applicable Federal, state, and local laws, as well as Agency requirements, and the requirements of all programs participating in the housing project. Borrowers must obtain Agency approval of the occupancy rules prior to initial occupancy and obtain Agency approval prior to the implementation date of any subsequent modifications to the rules.

(b) Requirements. The occupancy rules must be in writing and posted for easy tenant access. A copy of these rules must be attached to the tenant's lease upon initial occupancy. At a minimum, the occupancy rules must address:

(1) The tenant's rights and responsibilities under the lease or occupancy agreement;

(2) The rent payment or occupancy charge policies;

(3) The policies regarding periodic inspection of units;

(4) The system for responding to tenant complaints;

(5) The maintenance request and work order procedures;

(6) The housing services and facilities available to tenants or members;

(7) The office locations, hours, and emergency telephone numbers;

(8) The restrictions on storage and prohibitions on non-functional vehicles in the housing project area;

(9) Other requirements related to a subsidy provided to a tenant from non-Agency sources;

(10) When a guest becomes a member of the tenant household; and

(11) The procedures tenants must follow to request reasonable accommodations.

(c) Modification of occupancy rules. The Agency must concur with any modification to the occupancy rules prior to implementation. Proper notice must be given to each tenant at least 30 days in advance of implementation of such rules in accordance with §3560.160.

(d) Federal, state and local requirements. The occupancy rules must be consistent with Federal, state, and local law.

(e) Pets/Assistance Animals. All housing projects should establish reasonable written pet rules. No rules may be promulgated that would prevent occupancy by a household member who requires a service or assistance animal. In elderly housing, borrowers must not prohibit tenants from keeping domestic animals in their rental units as pets.

(f) Tenant organizations. Borrowers must not infringe on the rights of tenants to organize an association of tenants. Borrowers (or a designated management representative) should be available and willing to work with a tenant organization.

(g) Community rooms. Borrowers may not place unreasonable restrictions on tenants that desire to use a community room.

§3560.158 Changes in tenant eligibility.

(a) General requirements. Tenants must continue to meet the requirements of §3560.152 to remain eligible for occupancy.

(b) Tenants no longer eligible. Tenants who are no longer eligible for occupancy under the housing project's occupancy rules or do not meet the criteria set forth in §3560.155(c) and (e) must vacate the property within 30 days of being notified by the borrower that they are no longer eligible for occupancy or at the expiration of their lease, whichever is greater, unless the conditions specified in paragraph (c) of this section exist.

(c) Temporary continuation of tenancy. If conditions described in §3560.454(b) or the following conditions exist, borrowers may permit tenants who are no longer eligible for occupancy to continue to reside at the housing project with prior approval of the Agency.

(1) The waiting list for the specific rental unit type has no eligible applicants; or

(2) The required time period for vacating the rental unit would create a hardship on the tenant household.

(d) Surviving and remaining household members.

(1) Members of a household may continue to reside in a housing project after the departure or death of the tenant or co-tenant, provided that:

(i) They are eligible with respect to adjusted income;

(ii) They occupied a rental unit in the housing project at the time of the departure or death of the tenant or co-tenant;

(iii) They execute a tenant certification form establishing their own tenancy; and

(iv) They have the legal ability to sign a lease for the rental unit, except where a legal guardian may sign when the tenant or member is otherwise eligible.

(2) Surviving or remaining members of the household may remain in the housing project, taking into consideration the conditions of paragraph (d)(1) of this section, but must move to a suitably sized rental unit within 30 days of its availability.

(3) After the death of a tenant or co-tenant in elderly housing, the surviving members of the household, regardless of age but taking into consideration the conditions of paragraph (d)(1) of this section, may remain in the rental unit in which they were residing at the time of the tenant's or co-tenant's death, even if the household is over housed according to the housing project's occupancy rules as follows:

(i) Continued occupancy of the rental unit will not be allowed when in either situation of paragraph (d)(1) or (d)(3) of this section, the rental unit has accessibility features for individuals with disabilities, the household no longer has a need for such accessibility features, and the housing project has a tenant application from an individual with a need for the accessibility features;

(ii) If the housing project does not have a tenant application from an individual with a need for the accessibility features, the household may remain in the rental unit with such features until the housing project receives an application from an individual with a need for accessibility features. The household in the unit with accessibility features will be required to move within 30 days of the housing project's receipt of a tenant application requiring accessibility features if another suitably sized unit without accessibility features is available in the project. If a suitably sized unit is not available in the project within 30 days, the tenant may remain in the unit with accessibility features until the first available unit in the project becomes available and then must move within 30 days.

§3560.159 Termination of occupancy.

(a) Tenants in violation of lease. Borrowers, in accordance with lease agreements, may terminate or refuse to renew a tenant's lease only for material non-compliance with the lease provisions, material non-compliance with the occupancy rules, or other good causes. Prior to terminating a lease, the borrower must give the tenant written notice of the violation and give the tenant an opportunity to correct the violation. Subsequently, termination may only occur when the incidences related to the termination are documented and there is documentation that the tenant was given notice prior to the initiation of the termination action that their activities would result in occupancy termination.

(1) Material non-compliance with lease provisions or occupancy rules, for purposes of occupancy termination by a borrower, includes actions such as:

(i) Violations of lease provisions or occupancy rules that are substantial and/or repeated;

(ii) Non-payment or repeated late payment of rent or other financial obligations due under the lease or occupancy rules; or

(iii) Admission to or conviction for use, attempted use, possession, manufacture, selling, or distribution of an illegal controlled substance when such activity occurred on the housing project's premises by the tenant, a member of the tenant's household, a guest of the tenant, or any other person under the tenant's control at the time of the activity.

(2) Good causes, for purposes of occupancy terminations by a borrower, include actions such as:

(i) Actions by the tenant or a member of the tenant's household which disrupt the livability of the housing by threatening the health and safety of other persons or the right of other persons to enjoyment of the premises and related facilities;

(ii) Actions by the tenant or a member of the tenant's household which result in substantial physical damage causing an adverse financial effect on the housing or the property of other persons; or

(iii) Actions prohibited by state and local laws.

(b) Lease expiration or tenant eligibility. A tenant's occupancy in an Agency-financed housing project may not be terminated by a borrower when the lease agreement expires unless the tenant's actions meet the conditions described in paragraph (a) of this section, or the tenant is no longer eligible for occupancy in the housing. Borrowers must handle terminations of occupancy due to a change in tenant eligibility status in accordance with §3560.158. At a minimum, the occupancy termination notice must include the following information:

(1) A specific date by which lease termination will occur;

(2) A statement of the basis for lease termination with specific reference to the provisions of the lease or occupancy rules that, in the borrower's judgment, have been violated by the tenant in a manner constituting material non-compliance or good cause; and

(3) A statement explaining the conditions under which the borrower may initiate judicial action to enforce the lease termination notice.

(c) Other terminations. If occupancy is terminated due to conditions which are beyond the control of the tenant, such as a condition related to required repair or rehabilitation of the building, or a natural disaster, the tenants who are affected by such a circumstance are entitled to benefits under the Uniform Relocation Act and may request a Letter of Priority Entitlement (LOPE) from the Agency. If tenants need additional time to secure replacement housing, the Agency may, at the tenant's request, extend the LOPE entitlement period.

(d) Criminal activity. Borrowers may terminate tenancy for criminal activity or alcohol abuse by household members in accordance with the provisions of 24 CFR 5.858, 5.859, 5.860, and 5.861.

§3560.160 Tenant grievances.

(a) General.

(1) The requirements established in this section are designed to ensure that there is a fair and equitable process for addressing tenant or prospective tenant concerns and to ensure fair treatment of tenants in the event that an action or inaction by a borrower, including anyone designated to act for a borrower, adversely affects the tenants of a housing project.

(2) Any tenant/member or prospective tenant/member seeking occupancy in or use of Agency facilities who believes he or she is being discriminated against because of age, race, color, religion, sex, familial status, disability, or national origin may file a complaint in person with, or by mail to the U.S. Department of Agriculture's Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW., Washington DC 20250-9410 or to the Office of Fair Housing and Equal Opportunity, U.S. Department of Housing and Urban Development (HUD), Washington, DC 20410. Complaints received by Agency

employees must be directed to the National Office Civil Rights Staff through the State Civil Rights Manager/Coordinator.

(b) Applicability.

(1) The requirements of this section apply to a borrower action regarding housing project operations, or the failure to act, that adversely affects tenants or prospective tenants.

(2) This section does not apply to the following situations:

(i) Rent changes authorized by the Agency in accordance with the requirements of §3560.203(a);

(ii) Complaints involving discrimination which must be handled in accordance with §3560.2(b) and paragraph (a)(2) of this section;

(iii) Housing projects where an association of all tenants has been duly formed and the association and the borrower have agreed to an alternative method of settling grievances;

(iv) Changes required by the Agency in occupancy rules or other operational or management practices in which proper notice and opportunity have been given according to law and the provisions of the lease;

(v) Lease violations by the tenant that would result in the termination of tenancy and eviction;

(vi) Disputes between tenants not involving the borrower; and

(vii) Displacement or other adverse actions against tenant as a result of loan prepayment handled according to subpart N of this part.

(c) Borrower responsibilities. Borrowers must permanently post tenant grievance procedures that meet the requirements of this section in a conspicuous place at the housing project. Borrowers also must maintain copies of the tenant grievance procedure at the housing project's management office for inspection by the tenants and the Agency upon request. Each tenant must receive an Agency summary of tenant's rights when a lease agreement is signed. If a housing project is located in an area with a concentration of non-English speaking individuals, the borrower must provide grievance procedures in both English and the non-English language. The notice must include the telephone number and address of USDA's Office of Civil Rights and the appropriate Regional Fair Housing and Enforcement Agency.

(d) Reasons for grievance. Tenants or prospective tenants may file a grievance in writing with the borrower in response to a borrower action, or failure to act, in accordance with the lease or Agency regulations that results in a denial, significant reduction, or termination of benefits or when a tenant or prospective tenant contests a borrower's notice of proposed adverse action as provided in paragraph (e) of this section. Acceptable reasons for filing a grievance may include:

(1) Failure to maintain the premises in such a manner that provides decent, safe, sanitary, and affordable housing in accordance with §3560.103 and applicable state and local laws;

(2) Borrower violation of lease provisions or occupancy rules;

(3) Modification of the lease;

(4) Occupancy rule changes;

(5) Rent changes not authorized by the Agency according to §3560.205; or

(6) Denial of approval for occupancy.

(e) Notice of adverse action. In the case of a proposed action that may have adverse consequences for tenants or prospective tenants such as denial of admission to occupancy and changes in the occupancy rules or lease, the borrower must notify the tenant or prospective tenant in writing. In the case of a Borrower's proposed adverse action including denial of admission to occupancy, the Borrower shall notify the applicant/tenant in writing. The notice must be delivered by certified mail return receipt requested or a hand-delivered letter with a signed and dated acknowledgement of receipt from the applicant/tenant. The notice must give specific reasons for the proposed action. The notice must also advise the tenant or prospective tenant of “the right to respond to the notice within ten calendar days after date of the notice” and of “the right to a hearing in accordance with §3560.160 (f), which is available upon request.” The notice must contain the information specified in paragraph (a)(2) of this section. For housing projects in areas with a concentration of non-English speaking individuals, the notice must be in English and the non-English language.

(f) Grievances and responses to notice of adverse action. The following procedures must be followed by tenants, prospective tenants, or borrowers involved in a grievance or a response to an adverse action.

(1) The tenant or prospective tenant must communicate to the borrower in writing any grievance or response to a notice within 10 calendar days after occurrence of the adverse action or receipt of a notice of intent to take an adverse action.

(2) Borrowers must offer to meet with tenants to discuss the grievance within 10 calendar days of receiving the grievance. The Agency encourages borrowers and tenants or prospective tenants to make an effort to reach a mutually satisfactory resolution to the grievance at the meeting.

(3) If the grievance is not resolved during an informal meeting to the tenant or prospective tenant's satisfaction, the borrower must prepare a summary of the problem and submit the summary to the tenant or prospective tenant and the Agency within 10 calendar days The summary should include: The borrower's position; the applicant/tenant's position; and the result of the meeting. The tenant also may submit a summary of the problem to the Agency.

(g) Hearing process. The following procedures apply to a hearing process.

(1) Request for hearing. If the tenant or prospective tenant desires a hearing, a written request for a hearing must be submitted to the borrower within 10 calendar days after the receipt of the summary of any informal meeting.

(2) Selection of hearing officer or hearing panel. In order to properly evaluate grievances and appeals, the borrower and tenant must select a hearing officer or hearing panel. If the borrower and the tenant cannot agree on a hearing officer, then they must each appoint a member to a hearing panel and the members selected must appoint a third member. If within 30 days from the date of the request for a hearing, the tenant and borrower have not agreed upon the selection of a hearing officer or hearing panel, the borrower must notify the Agency by mail of the situation. The Agency will appoint a person to serve as the sole hearing officer. The Agency may not appoint a hearing officer who was earlier considered by either the borrower or the tenant, in the interest of ensuring the integrity of the process.

(3) Standing hearing panel. In lieu of the procedure contained in paragraph (g)(2) of this section for each grievance or appeal presented, a borrower may ask the Agency to approve a standing hearing panel for the housing project.

(4) Examination of records. The borrower must allow the tenant the opportunity, at a reasonable time before a hearing and at the expense of the tenant, to examine or copy all documents, records, and policies of the borrower that the borrower intends to use at a hearing unless otherwise prohibited by law or confidentiality agreements.

(5) Scheduling of hearing. If a standing hearing panel has been approved, a hearing will be scheduled within 15 calendar days after receipt of the tenant's or prospective tenant's request for a hearing. If a hearing officer or hearing panel must be selected, a hearing will be scheduled within 15 calendar days after the selection or appointment of a hearing panel or a hearing officer. All hearings will be held at a time and place mutually convenient to both parties. If the parties cannot agree on a meeting place or time, the hearing officer or hearing panel will designate the place and time.

(6) Escrow deposits. If a grievance involves a rent increase not authorized by the Agency, or a situation where a borrower fails to maintain the property in a decent, safe, and sanitary manner, rental payments may be deposited by the tenant into an escrow account, provided the tenant's rental payments are otherwise current.

(i) The escrow account deposits must continue until the complaint is resolved through informal discussion or by the hearing officer or panel.

(ii) The escrow account must be in a Federally-insured institution or with a bonded independent agent.

(iii) Failure to make timely rent payments into the escrow account will result in a termination of the tenant grievance and appeals procedure and all sums will immediately become due and payable under the lease.

(iv) Receipts of escrow account deposits must be available for examination by the borrower.

(7) Failure to request a hearing. If the tenant or prospective tenant does not request a hearing within the time provided by paragraph (f)(1) of this section, the borrower's disposition of the grievance or appeal will become final.

(h) Requirements governing the hearing. The following requirements will govern the hearing process.

(1) Subject to paragraph (f)(2) of this section, the hearing will proceed before a hearing officer or hearing panel at which evidence may be received without regard to whether that evidence could be used in judicial proceedings.

(2) The hearing must be structured so as to provide basic due process safeguards for both the borrower and the tenants or prospective tenants, which must protect:

(i) The right of both parties to be represented by counsel or other person chosen as their representative;

(ii) The right of the tenant or prospective tenant to a private hearing unless a public hearing is requested;

(iii) The right of the tenant or prospective tenant to present oral or written evidence and arguments in support of their grievance or appeal and to cross-examine and refute the evidence of all witnesses on whose testimony or information the borrower relies; and

(iv) The right of the borrower to present oral and written evidence and arguments in support of the decision, to refute evidence relied upon by the tenant or prospective tenant, and to confront and cross-examine all witnesses in whose testimony or information the tenant or prospective tenant relies.

(3) At the hearing, the tenant or prospective tenant must present evidence that they are entitled to the relief sought, and the borrower must present evidence showing the basis for action or failure to act against that which the grievance or appeal is directed.

(4) The hearing officer or hearing panel must require that the borrower, the tenant or prospective tenant, counsel, and other participants or spectators conduct themselves in an orderly manner. Failure to comply may result in exclusion from the proceedings or in a decision adverse to the interests of the disorderly party and granting or denial of the relief sought, as appropriate.

(5) If either party or their representative fails to appear at a scheduled hearing, the hearing officer or hearing panel may make a determination to postpone the hearing for no more than five days or may make a determination that the absent party has waived their right to a hearing under this subpart. If the determination is made that the absent party has waived their rights, the hearing officer or hearing panel will make a decision on the grievance. Both the tenant or prospective tenant and the borrower must be notified in writing of the determination of the hearing officer or hearing panel.

(i) Decision. Hearing decisions must be issued in accordance with the following requirements.

(1) The hearing officer or hearing panel has the authority to affirm or reverse a borrower's decision.

(2) The hearing officer or hearing panel must prepare a written decision, together with the reasons thereof based solely and exclusively upon the facts presented at the hearing within 10 calendar days after the hearing. The notice must state that the decision is not effective for 10 calendar days to allow time for an Agency review as specified in paragraphs (i)(3) and (i)(4) of this section.

(3) The hearing officer or hearing panel must send a copy of the decision to the tenant, or prospective tenant, borrower, and the Agency.

(4) The decision of the hearing officer or hearing panel shall be binding upon the parties to the hearing unless the parties to the hearing are notified within 10 calendar days by the Agency that the decision is not in compliance with Agency regulations.

(5) Upon receipt of written notification from the hearing officer or hearing panel, the borrower and tenant must take the necessary action, or refrain from any actions, specified in the decision.

§§3560.161-3560.199 [Reserved]

§3560.200 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart E--Rents

§3560.201 General.

This subpart sets forth the requirements for establishing and collecting rents charged to occupants of multi-family housing (MFH) projects financed by the Agency.

§3560.202 Establishing rents and utility allowances.

(a) General. Rents and utility allowances for rental units in Agency-financed housing projects are set by the borrower and must be based on the operating, management and maintenance expenses and other costs related to the housing project including loan payment amounts due to the Agency.

(b) Agency approval. All rents and utility allowances set by borrowers are subject to Agency approval.

(c) Rents. As applicable, borrowers must establish the following rents:

(1) Note rent;

(2) Basic rent;

(3) U.S. Department of Housing and Urban Development (HUD) contract rents; and

(4) Low-income housing tax credit (LIHTC) rents.

(d) Utility allowances. In projects where tenants pay the utilities, borrowers must establish utility allowances for each size and type of rental unit in the housing project based on estimated utility costs. Borrowers must review utility allowances annually, adjust for accuracy, and submit any utility allowance changes to the Agency for approval. If no changes are needed, the borrower must notify the Agency that no changes were made. Documentation to justify utility allowances must be maintained in the housing project files.

(e) Funds contributed to reduce rents. If borrowers use funds contributed from sources other than the Agency (e.g., state or local grants, private contributions) to reduce general operating and management expenses, housing project rents must be reduced to reflect the funding being used to offset housing project expenses. When funds contributed from sources other than the Agency are used for housing project expenses, the borrower must certify to the Agency, in writing, that the funds provided will not need to be repaid with Agency funds. Funds from borrower contributions or rehabilitation loans will not be counted towards reducing rents.

(f) Rents for resident manager, caretaker, or owner-occupied unit.

(1) If approved as a part of a management plan, a borrower may occupy a rental unit in a housing project when they are acting as a management agent or resident manager as specified in §3560.102(e).

(2) If the rental unit being occupied by a borrower or resident manager is designated as a revenue-producing unit, borrowers must calculate the rental charge to the borrower or resident manager in the same manner as tenant contributions.

(3) If the rental unit being occupied by a borrower or resident manager is designated as a non-revenue producing unit, borrowers must treat the cost of providing the unit the same as other non-revenue producing portions of the housing project.

(g) LIHTC. Borrowers who receive LIHTCs may establish rents in accordance with LIHTC requirements. However, borrowers are obligated to ensure that sufficient annual funds are available to cover expenses in the housing project's approved budget, including the required payments on the borrower's Agency loan. Borrowers must not use housing project funds to make up any difference between rents required under Agency program requirements and the maximum allowed rents under the LIHTC program.

§3560.203 Tenant contributions.

(a) Tenant contributions. A tenant's contribution to rent charged for a rental unit in an Agency financed housing project is based on the tenant's income, as calculated on the Agency's tenant certification forms, and the availability of Agency or non-Agency rental subsidies.

(1) Tenant contributions. Borrowers must set tenant contributions to rent at the highest of the following standards but never more than the note rent:

(i) Thirty percent of monthly adjusted income;

(ii) Ten percent of gross monthly income;

(iii) An amount equal to the portion of an assistance payment specifically designated to meet the household's shelter costs if the household is receiving assistance payments from a public agency; or

(iv) The basic rent, unless RHS rental assistance is provided to the household.

(2) Tenant contribution surcharge. Tenants in a Plan I housing project with incomes above the eligibility standards set in §3560.152(a)(1) must pay a 25 percent surcharge in addition to note rent.

(b) Adjustment of tenant contribution. Borrowers must adjust the tenant contribution whenever there is a change in tenant household status or income sufficient to generate a revised tenant certification in accordance with §3560.152(e) or an Agency approved rent or utility allowance change that affects the tenant contribution amount.

(c) Overage. If a tenant's tenant contribution is higher than basic rent, borrowers must remit to the Agency the rent collected in excess of the basic rent and up to the note rent.

§3560.204 Security deposits and membership fees.

(a) General. Borrowers may collect security deposits when it is reasonable and customary for the area in which the housing is located. Borrowers must hold security deposits in a separate bank or bookkeeping account in accordance with §3560.302(c)(3).

(b) Allowable amounts. Borrowers may charge security deposits that are typical for the area in which the housing is located, as long as the security deposit charged a tenant does not exceed that tenant's net contribution for one month's rent or basic rent, whichever is greater.

(1) As noted in §3560.102(b)(1)(viii) and §3560.156(c)(18)(iii), borrowers must specify in the housing project's management plan how the amount to be charged as a security deposit will be established and must specify the amount to be charged to individual tenants in the lease to be signed by the tenant.

(2) Borrowers may charge security deposits to households receiving HUD assistance in accordance with HUD requirements.

(3) Members of a cooperative shall be required to pay a membership fee no greater than one month's occupancy charge.

(4) Additional security deposits for pets may be charged as long as the additional deposit is not greater than basic rent for 1 month. No additional security deposit for assistance animals is allowed where an assistance animal is necessary for the normal functioning of a household member with a disability.

(5) Borrowers must not charge additional security deposits based on disabilities of tenants or other personal characteristics.

(c) Payment plans. Borrowers must offer, for persons who are eligible for rental assistance or Section 8 assistance, the option of paying the security deposit on an installment payment plan. Should installments not be met, the total charge may become due and payable in full.

(d) Charges for damage or loss. Borrowers may charge tenants for damage or loss caused or allowed by the tenant equal to the cost of the damage or loss.

(1) Borrowers must consider expenses due for addressing normal wear and tear as normal operating expenses and must not charge tenants a fee or withhold security deposits to pay for such costs.

(2) Borrowers may withhold security deposits and may charge tenants for damage or loss costs above security deposit amounts.

(e) State and local security deposit requirements. Borrowers must follow all state and local laws and other requirements governing the handling and disposition of security deposits.

(1) Resolution of any security deposit disputes must be handled in accordance with state and local law.

(2) Any interest earned on security deposits will accrue in accordance with state law.

(f) Unclaimed security deposits. Any funds in the housing project's security deposit account unclaimed by a tenant must be deposited into the housing project's general operating account.

§3560.205 Rent and utility allowance changes.

(a) General. Borrowers must fully document that changes to rents and utility allowances are necessary to cover housing or utility costs allowed under the approved budget for the housing. Any changes must apply to all similar units in the housing project.

(b) Agency approval. Borrowers must submit a fully documented request to the Agency to effect any rent or utility allowance change.

(1) Borrowers must obtain written consent or approval from the Agency as specified in paragraph (e) of this section before implementing any changes in the rents or utility allowances.

(2) If a borrower implements an unauthorized rent or utility allowance charge, the Agency will require the borrower to roll back rents to the last authorized rent charge, and the borrower must reimburse tenants for any unauthorized rents collected.

(c) Timing of request for changes. Borrowers must submit rent and utility allowance change requests in conjunction with the annual budget submission as required under §3560.303(d). The effective dates of any approved changes will coincide with the start of the housing project's fiscal year or the start of the season for seasonally occupied farm labor housing. However, the Agency will accept borrower requests for rent or utility

allowance changes anytime during the year if a change is necessary to preserve the financial integrity of the housing complex and the financial distress is due to circumstances beyond the borrower's control.

(d) Tenant notification. Borrowers must notify tenants and solicit their comments to proposed rent or utility allowance change requests that are submitted to the Agency at the same time that the initial request is made to the Agency.

(1) Tenants will be given 20 calendar days to provide their comments to the Agency.

(2) Borrowers must deliver the proposed rent or utility allowance change request notice to each tenant and post at least one copy of the notice at the housing project site in a visible location frequented by tenants.

(e) Approval. If the Agency approves a rent or utility allowance increase request on which the comments were solicited, the borrower will deliver a notice announcing the rent or utility allowance change to the tenants to be effective 30 calendar days from the date of the notification.

(f) Denial of change request. The Agency may deny a rent or utility allowance increase request in the following circumstances.

(1) The Agency determines that the borrower did not provide sufficient information to justify operating costs.

(2) The borrower is out of compliance with Agency requirements including any corrective action requirements agreed to in a workout agreement developed according to subpart J of this part.

(3) Sufficient funds are being collected under existing rents to meet approved expenses.

(g) Notice of denial. If the rent change will not be approved as requested, the Agency will notify the borrower of the denial in accordance with §3560.303(d).

§3560.206 Conversion to Plan II (Interest Credit).

The Agency encourages any borrower not on Plan II to convert to Plan II to provide more favorable rent costs to very-low, low, and moderate-income households.

§3560.207 Annual adjustment factors for Section 8 units.

(a) General. For rental units receiving project-based Section 8 assistance, the Agency will review rents annually without regard to HUD's automatic annual adjustment.

(b) Establishing rents in housing with HUD rent assistance. Borrowers will set note and basic rents for housing receiving HUD project based Section 8 assistance, as specified in §3560.202(c)(3).

(1) Borrowers must notify the Agency of any HUD rent changes.

(2) If allowed by the interest credit agreement, the borrower will remit the amount collected in excess of the basic rent up to the note rent to the Agency as overage.

(3) When HUD contract rents exceed note rents, borrowers must deposit HUD funds equal to the difference between the Agency approved note rent and the HUD approved rent into the reserve account for the housing project.

(c) Excess HUD rents. When permitted by the Agency interest credit agreement, the Agency may reduce or cancel the interest credit on the housing, if excess HUD rents deposited in the reserve account result in the reserve account being funded beyond the fully funded level approved by the Agency.

§3560.208 Rents during eviction or failure to recertify.

(a) Rents during eviction. If a tenant is appealing an eviction and the borrower refuses to accept rent payment during the appeal of the eviction, the tenant must escrow required rent payments to safeguard their occupancy, unless State or local laws specify otherwise.

(b) Rents when tenants fail to recertify. If a borrower can document that a tenant received a notice specifying a tenant recertification date and the tenant fails to comply by the specified date or fails to cooperate with verification or other procedures related to the tenant's recertification so that the tenant recertification cannot be completed by the recertification date, the borrower, within 10 days of the recertification date, shall give the tenant and the Agency written notification that:

(1) Termination proceedings are being initiated, in accordance with §3560.159; and

(2) The tenant will be charged note rent until the tenant's lease is terminated.

(c) Unauthorized assistance due to tenant recertification failure. Any unauthorized assistance received because of the tenant's failure to be recertified will be collected in accordance with the provisions of subpart O of this part.

(d) Rents when borrowers fail to recertify tenants. If a borrower cannot document that a tenant received a recertification notice, and a tenant is not recertified within 12 months of the most recently executed tenant certification, tenants shall continue to make net tenant contributions to rent based on their most recent tenant certification and the borrower must remit to the Agency full overage as if the tenant was paying the note rent until the tenant is recertified.

(e) Unauthorized assistance due to borrower recertification failure. Any unauthorized assistance received as a result of the borrower's failure to recertify a tenant will be collected from the borrower in accordance with the provisions of subpart O of this part and may not be paid from housing project funds or funds collected from the tenant.

§3560.209 Rent collection.

(a) General. Borrowers must collect rents on a monthly basis and maintain a system for collecting and tracking rents.

(b) Fees for late rent payments. Borrowers may adopt a late fee schedule for overdue rental payments. Late fee schedules must be submitted to the Agency for approval as part of the housing project's management plan, be in accordance with State and local law, and consistent with the following requirements:

(1) A grace period of 10 days from the rental payment due date must be allowed for all tenants.

(2) The late fee must not exceed the higher of $10 or an amount equal to 5 percent of the tenant's gross tenant contribution.

(3) Tenants receiving housing benefits from sources other than the Agency may be subject to the late rent fee requirements of the other funding sources.

(c) Improperly advanced rents. Improperly advanced interest credit or rental assistance is considered unauthorized assistance and is subject to recapture in accordance with subpart O of this part.

§3560.210 Special note rents (SNRs).

When a Plan II housing project is experiencing severe vacancies due to market conditions, the Agency may allow the borrower to charge an SNR, which is less than note rent but higher than basic rent, to attract or retain tenants whose income level would require them to pay special note rent. The requirements for requesting and receiving an SNR are established under §3560.454.

§§3560.211-3560.249 [Reserved]

§3560.250 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart F--Rental Subsidies

§3560.251 General.

This subpart contains policies for borrower administration and tenant use of rental subsidies in Agency financed multi-family housing (MFH) projects.

§3560.252 Authorized rental subsidies.

(a) General. The purpose of rental subsidies is to reduce amounts paid by tenants for rent. Rental subsidies equal the difference between the approved shelter costs and tenant contributions as calculated in accordance with §3560.203(a)(1).

(b) Forms of rental subsidies. Rental subsidies may be in the form of:

(1) Agency rental assistance;

(2) HUD section 8 assistance, including project-based and vouchers;

(3) Private rental subsidies; or

(4) State or local government rental subsidies.

(c) Multiple rent subsidies.

(1) Multiple types of rent subsidies may be used in the same MFH project.

(2) Tenants with subsidies from sources other than the Agency may be eligible for Agency rental assistance if the following conditions are met.

(i) The tenant qualifies for Agency rental assistance.

(ii) The rental subsidy the tenant is receiving is not a HUD voucher.

(iii) The rental subsidy being received by the tenant is less than the full amount of Agency rental assistance for which the tenant would qualify. In such cases, the Agency may provide the difference between the subsidy received by the tenant and the amount of Agency rental assistance for which the tenant qualifies.

(d) Agency rental assistance (RA). Agency RA is obligated to MFH projects on a rental unit basis. The obligation is composed of a number of rental units and associated dollar amounts of RA specified in a RA agreement with a borrower. The following types of Agency RA may be obligated to a housing project.

(1) Renewal units. RA may be assigned to a housing project to replace existing rental unit obligations because funds associated with the units have been fully disbursed.

(2) New construction units. RA may be provided in conjunction with initial Agency loans for construction or substantial rehabilitation of MFH projects.

(3) Servicing units. Additional RA may be provided to operational MFH projects as a part of the Agency's general loan servicing or preservation activities.

§3560.253 [Reserved]

§3560.254 Eligibility for rental assistance.

(a) Eligible housing. Housing projects eligible for Agency RA include the following types of projects.

(1) Housing projects that operate under an Interest Credit Plan II RA agreement.

(2) Housing projects financed with an Agency off-farm labor housing loan or grant. On-farm labor housing is not eligible for rental assistance.

(3) Housing projects financed with a direct or insured Rural Rental Housing loan approved prior to August 1, 1968, and operated under an interest credit agreement that identifies the housing project as a Plan RA project.

(4) Housing projects financed from Agency and other sources if the conditions of §3560.66 are met.

(b) Eligible units. Borrowers may not request RA for rental units that the Agency determines are not habitable in accordance with §3560.103.

(c) Eligible households. Households eligible for rental assistance are those:

(1) With very low-or low-incomes who are eligible to live in MFH;

(2) Whose net tenant contribution to rent determined in accordance with §3560.203(a)(2) is less than the basic rent for the unit;

(3) Whose head of the household is a U.S. citizen or a legal alien as defined in §3560.11;

(4) Who meet the occupancy rules established by the borrower in accordance with §3560.155(e); and

(5) Who have a signed, unexpired tenant certification form on file with the borrower.

§3560.255 Requesting rental assistance.

(a) Submitting requests. Borrowers seeking an allocation of rental assistance for MFH must request the rental assistance from the Agency as follows.

(1) Renewal rental assistance. To the extent sufficient funds are available, the Agency will automatically renew expiring rental assistance agreements at the existing number of units.

(2) New construction units. Loan applicants proposing to use Agency rental assistance must include their request for rental assistance in their loan proposal in accordance with §3560.56.

(3) Servicing units. Borrowers requesting rental assistance must have tenants or eligible tenant applicants on a waiting list who are RA eligible.

(b) Denial of requests.

(1) If a rental assistance request is denied due to the loan applicant's or borrower's ineligibility, the Agency will send the loan applicant or borrower written notification of the decision with an explanation of the denial.

(2) If a rental assistance request to renew expiring rental assistance agreements is denied because funding is not available, the Agency will notify the borrower and the borrower must notify the tenants of rent increases in accordance with their lease and state and local law. Tenants losing rental assistance due to a lack of Agency funding may quit the lease and vacate the housing without penalty in accordance with the terms of their lease.

(3) Loan applicants or borrowers determined to be eligible for RA as a result of an appeal or funding review will receive RA, if RA funding is available, beginning with the month following the date of the appeal or funding review decision or beginning in the first month that RA funding becomes available.

§3560.256 Rental assistance payments.

(a) Borrower submission requirements. The borrower must submit monthly requests for RA payments to the Agency based on occupancy as of the first day of the month previous to the month in which the request is being made.

(b) Basis of RA requests. Borrower requests for RA payments must be based on the difference between the basic rent plus utility allowances for each rental unit eligible for RA and the net tenant contribution of the tenant.

(c) Payments to borrower. Prior to making RA payments to a borrower, the Agency will deduct from the approved RA payment amount any unpaid loan payments, late fees, and other amounts which the borrower owes to the Agency.

(d) Utility payments to tenants. The borrower must pay tenants the difference between the utility allowance and the tenant's net contribution to rent when a tenant receiving RA is billed directly for utilities and the utility allowance exceeds the net tenant contribution to rent. Such utility payments to tenants must be made on a monthly basis.

(e) Administrative errors. Borrowers are responsible for correcting borrower errors made in regard to RA requests for payments. In accordance with subpart O of this part, borrowers will be required to repay the Agency for any unauthorized RA received or any unauthorized use of RA except in certain cases of tenant error or fraud.

§3560.257 Assigning rental assistance.

(a) Priorities for rental assistance.

(1) Borrowers must use the following priorities when assigning available rental assistance.

(i) First priority is to eligible very low-income tenants paying the highest percentage of their adjusted annual income for Agency approved shelter costs.

(ii) Second priority, if the housing project has vacant rental units, is to eligible very low-income applicants on the waiting list.

(iii) Third priority is to eligible low-income tenants paying the highest percentage of their adjusted annual income for Agency approved shelter costs.

(iv) Fourth priority, if the housing project has vacant rental units, is to eligible low-income applicants on the waiting list.

(v) Fifth priority is to households which are residing in a rental unit for which they do not qualify on the basis of an occupancy waiver or other special approval situations.

(2) In order to provide rental assistance to the third, fourth, and fifth priority categories, a borrower must fully document either that there are no very low-income households on the housing project's waiting list or that occupancy by low-income households is limited as follows:

(i) For housing occupied on or after November 30, 1983, no more than 5 percent of the units in the housing are occupied by low-income households; or

(ii) For housing occupied before November 30, 1983, no more than 25 percent of the units in the housing are occupied by low-income households.

(b) Continued eligibility. Tenants receiving rental assistance may continue to do so as long as they remain eligible for occupancy and for rental assistance under §3560.254(c), and as long as rental assistance units are available.

(c) Assignment of rental assistance. Except as provided in §3560.454(c) and using the priorities given in paragraph (a) of this section, borrowers must assign available rental assistance units as soon as rental assistance units become available.

(1) When a rental assistance unit is assigned to an eligible existing tenant on a day other than the first day of a month, the Agency will not provide the borrower rental assistance for the newly assigned existing tenant and the tenant will not pay reduced rental charges until the first of the month following the assignment of the rental assistance.

(2) When an eligible applicant moves into a rental assistance unit on a day other than the first day of a month, they will pay a prorated rent based on the number of days they occupy the rental assistance unit and the amount of rental assistance they will be receiving.

(d) Incorrectly assigned rental assistance. Incorrectly assigned rental assistance is viewed as unauthorized assistance and handled in accordance with subpart O of this part.

§3560.258 Terms of agreement.

(a) Term of agreement. Rental assistance agreements will be consistent with available funding. Rental assistance agreements expire when the funds obligated for rental assistance units are fully disbursed in accordance with the conditions of the agreement.

(b) Replacing expiring obligations. To the extent funds are available for replacement units, the Agency will renew rental assistance agreements.

§3560.259 Transferring rental assistance.

(a) Agency authority. The Agency may transfer rental assistance in the following instances:

(1) To accompany the transfer of a housing project to a different borrower;

(2) After a voluntary conveyance or a foreclosure sale;

(3) After a liquidation or prepayment;

(4) To the extent permitted by law, when any rental assistance units have not been used for a 6-month period; or

(5) When the loan cannot be closed.

(b) Agency review before transferring rental assistance. The Agency must perform a review to determine if all eligible tenants in the project are receiving rental assistance before the Agency transfers it to another project.

(c) Transferring rental assistance for displaced tenants. The Agency may transfer rental assistance from one housing project to another eligible housing project for a tenant who is moving due to displacement as a result of prepayment, liquidation, or a natural disaster. The tenant must begin using the rental assistance within 4 months of the transfer or the RA will become available for use by the next rental assistance eligible tenant in the housing project.

§3560.260 Rental subsidies from non-Agency sources.

(a) General. The Agency may authorize the use of rental subsidies from sources other than the Agency in Agency financed housing projects. The Agency will make no commitment to providing Agency rental assistance at the expiration of the rental subsidies from other sources.

(b) HUD vouchers. For tenants with HUD vouchers, the borrower must set the rental unit rent at the basic rent or the rent standard set by the public housing authority, whichever is less. The public housing authority distributing the HUD vouchers may set the utility allowance.

(c) Loan proposals using non-Agency rental subsidy. Loan applicants or borrowers proposing to use rental subsidy from sources other than the Agency must provide:

(1) Documentation demonstrating that a market exists for households eligible for the subsidy and the households are at income levels that would benefit from the amount of rental subsidy that will be provided;

(2) A plan describing actions to be taken when the rental subsidy expires to minimize the impact on tenants losing the rental assistance and to avoid displacement; and

(3) A copy of the project-based rental assistance agreement to be signed by the borrower and the provider of the rental assistance.

(d) Rental subsidy agreement. The borrower and the provider of rental subsidies from sources other than the Agency must execute a rental subsidy agreement and submit a copy of the agreement to the Agency. At a minimum, the rental subsidy agreement between the borrower and the source of the rental subsidy must include the following provisions:

(1) A description of how the subsidy will be paid. The rental subsidy payments may be paid directly to the tenants, to the borrower on behalf of the tenants, or deposited to a separate account established for the subsidy. The tenants must be advised of the amount and source of the subsidy through the lease or a supplement to the lease.

(2) The life of a project-based rental subsidy agreement with a non-Agency source must be similar to existing or current Agency rental assistance funding levels and sufficient funds must be set aside to assure availability of the rental subsidy for this term. The method of supplying the funds must be clearly established.

§3560.261 Improperly advanced rental assistance.

Improperly advanced RHS rental assistance resulting from tenant or borrower error or fraud constitutes unauthorized assistance and the provisions of subpart O of this part apply.

§§3560.262-3560.299 [Reserved]

§3560.300 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

§3560.301 General.

This subpart contains requirements for the financial management of Agency-financed multi-family housing (MFH) projects, including accounts, budgets, reports, and engagements. Financial management systems and procedures must cover all housing operations and provide adequate documentation to ensure that program objectives are met.

§3560.302 Accounting, bookkeeping, budgeting, and financial management systems.

(a) General. Borrowers must establish the accounting, bookkeeping, budgeting and financial management procedures necessary to conduct housing project operations in a financially safe and sound manner. Borrowers must maintain records in a manner suitable for an engagement and must be able to report accurate operational results to the Agency from these accounts and records.

(b) Acceptable methods of accounting.

(1) Borrowers may use a cash, accrual, or modified accrual method of accounting, bookkeeping, and budget preparations as long as the method is consistent with the statements required by the engagement in accordance with the standards identified in §3560.308.

(2) Borrowers must describe their accounting, bookkeeping, budget preparation, and financial reporting procedures, including Agency-approved engagements, in their management plan.

(3) Borrowers must notify the Agency of any changes in their accounting, bookkeeping, budget preparation, and financial management reporting systems through a revision of their management plan.

(c) Account requirements.

(1) As used in this paragraph, the term account is used interchangeably to mean a bookkeeping account (ledger) or a bank account.

(2) At a minimum, borrowers must maintain the accounts required by their loan agreement or resolution.

(3) The following list identifies the financial accounts that are required for each housing project. Additional accounts may be required by third-party lenders. Accounts are to be funded in the following priority order, except that paragraphs (c)(3)(iv), (v), and (vi) of this section are funded directly by tenant security deposits or patron capital receipts respectively:

(i) General operating account;

(ii) Real estate tax and insurance account (if not part of the general operating account);

(iii) Reserve account;

(iv) Tenant security deposit account;

(v) Membership fee account for cooperative housing; and

(vi) For cooperative housing only, a patron capital account.

(4) Amounts escrowed for taxes and insurance may be kept in the general operating account as long as the accounting system reflects the amount escrowed.

(5) Regardless of the number or types of accounts established, the borrower must meet the following requirements:

(i) All housing project funds must be held only in financial institution accounts insured by an agency of the Federal Government, backed by collateral provided by the bank, or held in securities meeting the conditions in this subpart.

(ii) Funds maintained in an institution may not exceed the limit established for Federal deposit insurance. If funds exceed the amount covered by Federal deposit insurance, borrowers must obtain a collateral pledge from the institution to cover all funds or must move funds to an institution that will insure the funds.

(iii) All funds and proceeds in any account must be used only for authorized purposes as described in Agency's regulations, loan or grant documents. Use of funds for non-program purposes constitutes non-monetary default as described in §3560.452(c).

(iv) All funds received and held in any account, except the tenant security deposit, membership fee, and patron capital accounts, must be held in trust by the borrower for the loan obligation until used and serve as security for the Agency loan or grant.

(v) Borrowers must be able to account for housing project funds with accounting methods or practices that maintain the proprietary identity of the funds for each project. A borrower may operate one account for multiple projects as long as the funds for each project themselves are accounted for separately.

(vi) Each borrower must have access to at least one demand deposit or checking account.

(vii) Housing project funds may not be pledged as collateral for debts without Agency approval. If such a need arises for an eligible program purpose, the borrower must obtain prior Agency approval.

(6) Tenant security deposit accounts or membership fee accounts and patron capital accounts must be maintained in a separate account in trust for the tenants or members and handled in a manner consistent with state and local laws.

(d) Documentation of separate accountability. Housing project funds may be combined in one or more bank accounts for two or more housing projects as long as the borrower's accounting system segregates and tracks funds for each project separately.

(1) When borrowers request Agency approval of an accounting system that combines funds from two or more housing projects, they must demonstrate to the Agency that the accounting systems are structured to segregate and maintain separate accountability for each housing project. Such demonstration must include a statement issued by a Certified Public Accountant (CPA) stating that the accounting system is structured to meet this principle of separate accountability.

(2) The accounting system and management plan must document the method for prorating revenue and expenses that are not clearly identifiable as being associated with a particular housing project.

(3) Funds for housing projects managed by the same management company must not be co-mingled.

(e) Records.

(1) Borrowers must retain all housing project financial records, books, and supporting material for at least three years after the issuance of the engagement and financial reports. Upon request, these materials will immediately be made available to the Agency, its representatives, the USDA Office of the Inspector General (OIG), or the General Accountability Office (GAO).

(2) Borrower accounts and records will be kept or made available in a location with reasonable access for inspection, review, and copying by the Agency, other authorized representatives of the USDA, OIG, or GAO.

(3) Automated records may be used if they meet the conditions of paragraph (f) of this section.

(f) Forms generated by automated systems.

(1) The forms and formats approved for use by borrowers may be prepared on automated systems when they meet the requirements of this paragraph.

(2) Forms may be automated if they meet the following requirements:

(i) The identical wording and nomenclature of an official form must be included in the automated version of the form, including the Office of Management and Budget (OMB) approval number.

(ii) The logic or mathematical calculation of an official form must be the same in an automated version of the form.

(iii) The name or logo of the source of the automated form must be visible on each output of the automated form.

(iv) Output size must be 8\1/2\ x 11 inches.

(v) Nominal spacing adjustment and colored paper are allowed.

(g) Farm Labor Housing. Borrowers with on-farm labor housing units will be considered in compliance with this section by virtue of completing the record keeping and reporting requirements outlined in subpart M of this part.

§3560.303 Housing project budgets.

(a) General requirements.

(1) Using an Agency-approved format, borrowers must submit to the Agency for approval a proposed annual housing project budget prior to the start of the housing project's fiscal year. The capital budget section of the annual project budget must include anticipated expenditures on the project's long-term capital needs as specified in §3560.103(c).

(2) Budget projections regarding income, expenses, vacancies, and contingencies must be realistic given the housing project's history, current circumstances, and market conditions.

(3) Borrowers must document that the operating expenses included in the budget accurately reflect reasonable and necessary costs to operate the housing project in a manner consistent with the objectives of the loan and in accordance with the applicable Agency requirements.

(4) Borrower must submit supporting documentation to justify housing project utility allowances.

(5) Upon Agency request, borrowers must submit any additional documentation necessary to establish that applicable Agency requirements have been met.

(b) Allowable and unallowable project expenses. Expenses charged to project operations, whether for management agent services or other expenses, must be reasonable, typical, necessary and show a clear benefit to the residents of the property. Services and expenses charged to the property must show value added and be for authorized purposes.

(1) Allowable expenses. Allowable expenses include those expenses that are directly attributable to housing project operations and are necessary to carry out successful operations.

(i) Housing project expenses must not duplicate expenses included in the management fee as defined in §3560.102(i).

(ii) Actual costs for direct personnel costs of permanent and part-time staff assigned directly to the project site. This includes managers, maintenance staff, and temporary help including their:

(A) Gross salary;

(B) Employer FICA contribution;

(C) Federal unemployment tax;

(D) State unemployment tax;

(E) Workers compensation insurance;

(F) Health insurance premiums;

(G) Cost of fidelity or comparable insurance;

(H) Leasing, performance incentive or annual bonuses;

(I) Direct costs of travel to off-site locations by on-site staff for property business or training; and/or

(J) Retirement benefits.

(iii) Legal fees directly related to the operation and management of the property including tenant lease enforcement actions, property tax appeals and suits, and the preparation of all legal documents.

(iv) All outside account and auditing fees, if required by the Agency, directly related to the preparation of the annual audit, partnership tax returns and 401-K's, as well as other outside reports and year-end reports to the Agency, or other governmental agency.

(v) All repair and maintenance costs for the project including:

(A) Maintenance staffing costs and related expenses.

(B) Maintenance supplies.

(C) Contract repairs to the projects (e.g., heating and air conditioning, painting, roofing).

(D) Make ready expenses including painting and repairs, flooring replacement and appliance replacement as well as drapery or mini-blind replacement. (Turnover maintenance).

(E) Preventive maintenance expenses including occupied unit repairs and maintenance as well as common area systems repairs and maintenance.

(F) Snow removal.

(G) Elevator repairs and maintenance contracts.

(H) Section 504 and other Fair Housing compliance modifications and maintenance.

(I) Landscaping maintenance, replacements, and seasonal plantings.

(J) Pest control services.

(K) Other related maintenance expenses.

(vi) All operational costs related to the project including:

(A) The costs of obtaining and receiving credit reports, police reports, and other checks related to tenant selection criteria for prospective residents.

(B) The cost of duplicating forms for those properties not owning a copier. This will include the costs of producing or purchasing forms and mailing or delivering those forms to the project site.

(C) All bank charges related to the property including purchases of supplies (e.g., checks, deposit slips, returned check fees, service fees).

(D) Costs of site-based telephone including initial installation, basic services, directory listings, and long-distances charges.

(E) All advertising costs related specifically to the operations of that project. This can include advertising for applicants or employees in newspapers, newsletters, radio, cable TV, and telephone books.

(F) Postage and delivery costs from the site including expenses to the Agency or other governmental agencies, tenants, verifying third parties, central management offices, etc.

(G) Partnership or corporate business expenses including state taxes and other mandated state or local fees as well as other relevant expenses required for operation of the property by a third-party governmental unit. Costs of continuation financing statements and site license and permit costs.

(H) Expenses related to site utilities including actual costs and surcharges as well as deposits and expense of utility bonds in lieu of bonds.

(I) Site office furniture and equipment including site based computer and copiers. Service agreements and warranties for copiers, telephone systems and computers are also included (if approved by the Agency).

(J) Real estate taxes (personal tangible property and real property taxes) and expenses related to controlling or reducing taxes.

(K) All costs of insurance including property liability and casualty as well as fidelity or crime and dishonesty coverage for on-site employees and the owners.

(L) Costs of collecting rents on-site including bookkeeping supplies and recordkeeping items.

(M) Costs of preparing and maintaining tenant files and processing tenant certifications including all office supplies, copies and other associated expenses.

(N) Public relations expense relative to maintaining positive relationships between the local community and the tenants with the management staff and the borrowers. Chamber of Commerce dues, contributions to local charity events, and sponsorship of tenant activities, are examples.

(O) Tax Credit Compliance Monitoring Fees imposed by HFAs.

(P) All insurance deductibles as well as adjuster expenses.

(Q) Professional service contracts (audits and compilations, tax returns, energy audits, utility allowances, architectural, construction, rehabilitation and inspection contracts, etc.)

(R) On-site training pre-approved by the Agency provided by outside training vendors.

(S) Site manager salary for additional hours associated with congregate housing.

(vii) With prior Agency approval, cooperatives and nonprofit organizations may use housing project funds to pay asset management expenses directly attributable to ownership responsibilities. Such expenses may include:

(A) Errors and omissions insurance policy for the Board of Directors.

(B) Board of Director review and approval of proposed Agency's annual operating budgets, including proposed repair and replacement outlays and accruals.

(C) Board of Director review and approval of capital expenditures, financial statements, and consideration of any management comments noted.

(D) Long-term asset management reviews.

(2) Unallowable expenses. Housing project funds may not be used for any of the following:

(i) Equity skimming as defined in 42 U.S.C. 543 (a).

(ii) Purposes unrelated to the housing project.

(iii) Reimbursement of inaccurate or false claims.

(iv) Settlement agreements, court ordered decrees, legal fees, or other costs that result from the filing of civil rights complaints or legal action alleging the borrower, or a representative of the borrower, has committed a civil rights violation.

(v) Fines, penalties, and legal fees where the borrower or a borrower's representative has been found guilty of violating laws, including, but not limited to, civil rights, and building codes.

(vi) Association dues to be paid by the project should be related to training for site managers or management agents. To the extent that association dues can document training for site managers or management agents related to project activities by actual cost or pro-ration, a reasonable expense may be billed to the project.

(vii) Pay for bonuses or monetary performance awards to site managers or management agents that are not clearly provided for by the site manager salary contract.

(viii) Billing for parties that are large or unreasonable, such as renting expensive party halls or hotel rooms and payment for alcoholic beverages or gifts to management agent staff.

(ix) Billing for practices that are inefficient such as routine use of collect calls from a site manager to a management agent office.

(c) Priorities. The priority order of planned and actual budget expenditures will be:

(1) Senior position lienholder, if any;

(2) Operating and maintenance expenses, including taxes and insurance;

(3) Agency debt payments;

(4) Reserve account requirements;

(5) Other authorized expenditures; and

(6) Return on owner investment.

(d) Agency review and approval.

(1) The Agency will only approve housing project budgets that meet the requirements of paragraphs (a), (b) and (c) of this section.

(2) If no rent change is requested, borrowers must submit budget documents for Agency approval 60 calendar days prior to the start of the housing project's fiscal year. The Agency will notify borrowers if the budget submission does not meet the requirements of paragraphs (a), (b), and (c) of this section. The borrower will have 10 days to submit the additional material.

(3) If a rent change is requested, the borrower must submit budget documents to the Agency and notify tenants of the requested rent change at least 90 calendar days prior to the start of the housing project's fiscal year.

(i) The Agency will notify borrowers if the budget submission does not meet the requirements of paragraphs (a), (b), and (c) of this section, or if the rent and utility allowance request has been denied in accordance with §3560.205(f). The borrower will have 10 days to submit the additional material to address any issues raised by the Agency.

(ii) The rent change is not approved until the Agency issues a written approval. If there is no response from the Agency within the 30-day period, the rent change is considered automatic. The following budgets are not eligible for automatic approval:

(A) Budgets with rent increases above $25 per unit; and

(B) Budgets that are submitted late or that miss other deadlines set by the Agency.

(4) If the Agency denies the budget approval, the Agency will notify the borrower in writing.

(5) If budget approval is denied, the borrower shall continue to operate the housing project on the basis of the most recently approved budget.

§3560.304 Initial operating capital.

(a) Purpose. To provide a source of capital for start-up costs, such as the purchase of equipment, and paying operating, maintenance, and debt service expenses. Borrowers are required to make an initial operating capital contribution to the general operating account as described in §3560.64.

(b) Authorized uses of initial operating capital. Initial operating capital may be used only to pay for approved budgeted expenses.

(c) Withdrawal of initial operating capital. Initial operating capital funds may be withdrawn by a borrower if:

(1) The initial operating capital was provided from the borrower's own funds;

(2) The borrower requests the withdrawal after the second year of housing project operations and prior to the 7th year of operations;

(3) The housing project has had a 90 percent occupancy rate for a period of 12 months prior to the withdrawal request;

(4) The withdrawal will not affect the financial viability of the housing project;

(5) Contributions to the reserve account are at authorized levels;

(6) The withdrawal request will not result in rent increases; and

(7) There are no outstanding deficiencies in management's physical maintenance of the housing project.

§3560.305 Return on investment.

(a) Borrower's return on investment. Borrowers may receive a return on their investment (ROI) in accordance with the terms of their loan agreement and the following:

(1) If there is a positive net cash flow in housing project operations, the ROI may be taken by the borrower after the housing project's fiscal year, provided that the balance of the reserve account is equal to or greater than required deposits minus authorized withdrawals. If the annual financial reports indicate that an ROI should not have been taken, borrowers will be required to return any unauthorized ROI.

(2) If there is negative cash flow in housing project operations, the Agency may authorize the borrower to take the ROI only after the Agency has reviewed the housing project's annual financial reports and determines:

(i) Surplus cash exists in either the general operating account as defined in §3560.306(d)(1) or the reserve account, if the balance is greater than the required deposits minus authorized withdrawals.

(ii) The housing project has sufficient funds to address identified capital or operational needs.

(b) Unpaid return on investment. An earned, but unpaid ROI for the previous year only may be requested by the borrower and authorized by the Agency under the provisions of §3560.305(a)(2) provided the current year's ROI has been paid first and a rent increase is not required to generate funds to pay the unpaid ROI.

§3560.306 Reserve account.

(a) Purpose. To meet the major capital expense needs of a housing project, borrowers must establish and maintain a reserve account.

(b) Financial management of the reserve account. Borrower management of the reserve account is subject to the requirements of 7 CFR part 1902, subpart A regarding supervised bank accounts.

(c) Funding of the reserve account. Borrowers must make payments to the reserve account in the amount established in loan documents, beginning with the first loan payment or a date specified in loan documents.

(d) Transfer of surplus general operating account funds.

(1) The general operating account will be deemed to contain surplus funds when the balance at the end of the housing project's fiscal year, after all payables, exceeds 20 percent of the operating and maintenance expenses. If the borrower is escrowing taxes and insurance premiums, include the amount thatshould be escrowed by year end and subtract such tax and insurance premiums from operating and maintenance expenses used to calculate 20 percent of the operating and maintenance expenses.

(2) If a housing project's general operating account has surplus funds at the end of the housing project's fiscal year, the Agency will require the borrower to use the surplus funds to address capital needs, make a deposit in the housing project's reserve account, reduce the debt service on the borrower's loan, or reduce rents in the following year. At the end of the borrower's fiscal year, if the borrower is required to transfer surplus funds from the general operating account to the reserve account, the transfer does not change the future required contributions to the reserve account.

(e) Account requirements. Borrowers must establish and maintain the reserve account according to §3560.65, §3560.302(c)(5), and the following requirements:

(1) Reserve accounts must be deposited in interest-bearing accounts or securities; and

(2) Reserve accounts must be supervised accounts that require Agency countersignatures on all withdrawals.

(f) Funds invested in securities. In addition to the requirements specified in paragraph (e) of this section, the following requirements apply when reserve funds are invested in securities:

(1) The reserve account must be held either at a Federally insured domestic institution such as a bank, savings and loan association, credit union, or at a domestic institution authorized to sell securities.

(2) The borrower must record the price actually paid for the securities. When designated as a reserve deposit, the price paid must equal the required contribution to reserves.

(3) Borrowers must be knowledgeable about industry practices and consider the impact of typical fees and charges for purchases and sales and maintenance of an account when making investment decisions. Such fees may be paid for out of reserves, only with the consent of the Agency. Housing project funds may not be used to pay for a financial advisor.

(g) Use of the reserve account.

(1) Borrowers must request Agency approval of reserve account withdrawals prior to the withdrawal. Borrowers must inform the Agency of planned uses of reserve accounts in their annual capital budget if known at budget planning time. Any item on the approved capital budget does not require additional pre-approval by the Agency.

(2) The Agency will indicate any conditions governing withdrawals from a reserve account at the time it approves the withdrawal.

(3) In emergency situations, the Agency may specify special procedures to provide an expedited approval process for the use of the reserve account.

(4) The Agency may approve the use of reserve funds for operating costs when circumstances that are determined by the Agency to be beyond the borrower's control have resulted in a shortfall in the housing project's general operating account.

(h) Allowable uses. Allowable uses of reserve funds include the following:

(1) Major capital improvements and replacements.

(2) Housing project operating expenses provided the requirement of paragraph (g)(4) of this section has been met, including:

(i) Payments due on the loan, or

(ii) Payment of a return on investment at the end of the borrower's fiscal year if such payment comes from surplus operating funds in the reserve account.

(3) With Agency approval, borrowers operating on a for-profit or a limited profit basis may make an annual withdrawal from the reserve account, equal to no more than 25 percent of the interest earned on a reserve account during the prior year.

(4) For other purposes, which in the judgment of the Agency will promote the loan purposes, strengthen the security or facilitate, improve, or maintain the housing and the orderly collection of the loan without jeopardizing the loan or impairing the adequacy of the security.

(i) Records. Borrowers must maintain records documenting all expenses that were paid by withdrawals from the reserve account.

(j) Changes to reserve requirements.

(1) As projects age, the required reserve account level may be adjusted to meet anticipated “life-cycle” needs, including equipment and facility replacement costs, by amending the loan agreement/resolution.

(2) The Agency may approve a change in the reserve account funding level based on the findings of an approved capital needs assessment. The approval to increase reserve account funding levels will take into consideration the housing project's approved budget and the housing project's ability to support increased reserve account deposits without causing basic rents to exceed conventional rents for comparable units in the area.

(k) Excess reserves. Amounts in the reserve account which exceed the total required by the loan or grant agreement must be used, at the direction of the Agency, for any of the following:

(1) Pay for expenses specified in a long-term capital plan;

(2) Make payments and reamortize the Agency loan;

(3) Reduce rents by a transfer to the general operating account;

(4) Fund preservation incentives authorized in subpart N of this part; or

(5) Cover other expenditures determined to be related to the purpose of the housing project and in the best interest of the Federal Government.

(l) Procurement. The requirements of §3560.102(g), (j), and (k), and all other Agency requirements relating to procurement, bidding, identity-of-interest, cost-reasonableness, and construction management apply to any work or services paid out of reserve funds. Structural repairs and other significant work on major building systems such as heating or air conditioning must be done in accordance with the requirements of 7 CFR part 1924, subpart A.

§3560.307 Reports.

(a) Required reports. Borrowers must submit required reports using Agency-approved formats.

(b) Quarterly and monthly reports. The Agency may require quarterly or monthly reports to monitor financial progress when closer supervision is warranted.

§3560.308 Annual financial reports.

(a) General. Borrowers must submit annual financial reports that meet the requirements of this section. The annual financial reports to be submitted are the Multi-Family Housing (MFH) Project Budget with actual expenditures and the MFH Balance Sheet. Annual financial reports are due to the Agency within 90 days of the end of the borrower's fiscal year.

(1) Borrowers with 16 or more units in their housing project must base their annual financial reports on an engagement report completed according to agreed upon procedures established by the Agency as specified in paragraph (b) of this section. Borrowers must include the engagement report with their annual financial reports submitted to the Agency.

(2) Borrowers with less than 16 units in their housing project must submit annual financial reports using a limited scope engagement based on Agency approved procedures and certify that the housing meets the performance standards established in paragraph (c) of this section. Borrowers may use a CPA to prepare this report. For properties that prepare a limited scope engagement, the Agency may undertake random audits, once every two or three years.

(3) If a third party requires it, the borrower may have a CPA prepare an audit in accordance with generally accepted government auditing standards (GAGAS). Costs incurred to obtain this audit are an allowable project expense.

(b) Engagement requirements. Borrowers required to submit annual financial reports based on an engagement performed by a CPA must meet the following requirements:

(1) Borrowers must use an Agency approved engagement letter. Borrowers must submit the results of an engagement that examines specific records using agreed upon procedures established by the Agency and that describes the borrower's performance in meeting the standards described in paragraph (c) of this section.

(2) The engagement will be initiated by the borrower using the Agency's engagement letter, which will specify the engagement program and establish the reporting requirements for the engagement.

(3) The engagement must be conducted by a CPA in accordance with American Institute of Certified Public Accountant (AICPA) Standards and Agency requirements.

(4) All engagement reports must be prepared for use by the Agency.

(c) Performance standards. Borrowers must ensure that:

(1) Required accounts are properly maintained and tracked separately;

(2) Payments from operating accounts are disclosed and accurately represented on financial reports;

(3) The reserve amount is at the authorized level and there are no encumbrances;

(4) Tenant security deposit accounts are fully-funded and are maintained in separate accounts and meet state and local requirements;

(5) Amount of payment of owner return was consistent with the terms of the applicable loan agreement;

(6) The borrower has maintained proper insurance in accordance with the requirements of §3560.105(b); and

(7) All financial records are adequate and suitable for examination.

(d) Other financial reports.

(1) Nonprofit and public borrower entities must submit audits in accordance with 7 CFR part 3052 that must also include the requirements set forth in the limited scope engagement.

(2) The Agency may require additional opinions of financial condition and compliance, such as audits, to assure the security of the asset, determine whether the housing project is being operated at a reasonable cost, or to detect fraud, waste, or abuse.

(3) Any audits independently obtained by the borrower also must be submitted to the Agency.

§3560.309 Advancement (loan) of funds to a RRH project by the owner, member of the organization, or agent of the owner.

(a) Prior written approval by the Servicing Office is required. Such advances may be authorized when justified by unusual short-term conditions. When conditions are not short-term in nature, a servicing plan may be developed and advances may be approved in accordance with the provisions set out in §3560.453 of this part. Justification will be based on the following:

(1) A review of the documented circumstances and the project operating budget before any funds are advanced (loaned). The financial position of the project must not be jeopardized.

(2) Funds are not immediately available from any of the following sources:

(i) Reserve funds;

(ii) Initial operating capital; and

(iii) An imminent rent increase.

(b) The funds will be applied to ordinary project operating and maintenance expenses.

(c) Interest may be charged or paid on the loan from project income; however, interest must be reasonable. The proposal may be denied if Rural Development financing can be provided to resolve the problem in a more cost-effective manner.

(d) No lien in connection with the loan will be filed against the property securing the Rural Development loan or against project income. The advance may show as an unsecured project liability on financial statements prepared for year-end reports until such time as it is authorized to be repaid.

(e) The payback of the advance (loan) may be permitted by the Servicing Official provided the terms and conditions were mutually agreed to by the borrower and Rural Development at the time of the advance and the financial position of the project will not be jeopardized. Payback should only be permitted on the advance when the Rural Development debt is current and the reserve requirements are being maintained at the authorized levels.

§§3560.310-3560.349 [Reserved]

§3560.350 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart H--Agency Monitoring

§3560.351 General.

This subpart contains policies for Agency monitoring of operations and management at multi-family housing (MFH) projects.

§3560.352 Agency monitoring scope, purpose, and borrower responsibilities.

(a) Scope of Agency monitoring activities. The Agency will review reports, records, and other materials related to the housing project, including borrower financial reports, housing project records, and other communications. The Agency also will review material related to a housing project submitted by a tenant or other source. To assess conditions such as a housing project's physical condition, record keeping procedures, and operations and management activities, including borrower compliance with Federal, state, and local laws and Agency requirements, the Agency will conduct periodic on-site monitoring reviews of a housing project.

(b) Purpose of Agency monitoring activities. Agency monitoring activities are designed to assess borrower and tenant compliance with Agency requirements, and to:

(1) Ensure housing projects are managed in accordance with the goals and objectives of the Agency's MFH programs and are maintained in accordance with Agency requirements for affordable, decent, safe, and sanitary housing;

(2) Preserve the value of the Agency-financed housing projects;

(3) Detect waste, fraud, and abuse in housing project operations or management and to ensure the cost of operations and management are necessary and reasonable;

(4) Verify compliance with Affirmative Fair Housing Marketing requirements, Title VI of the Civil Rights Act of 1964, Title VIII of the Civil Rights Act of 1968, as amended, section 504 of the Rehabilitation Act of 1973, the Age Discrimination Act of 1975, Americans with Disabilities Act of 1990, other applicable Federal laws, and Agency requirements related to occupancy and tenant eligibility.

(c) Borrower responsibilities. The borrower is responsible for cooperating fully and promptly with Agency monitoring activities. Agency monitoring activities do not diminish borrower operation and management responsibilities and do not relieve borrowers from any Agency requirements including, but not limited to, borrower requirements to comply with:

(1) The terms of all agreements with the Agency, including the loan or grant agreement, assurance agreement, loan resolution, promissory note, mortgage, interest credit agreement, rental assistance agreement, mitigation measures contained in the environmental review document, and workout agreement;

(2) The requirements contained in this part;

(3) The requirements of Title VI of the Civil Rights Act of 1964, Title VIII of the Civil Rights Act of 1968, as amended; section 504 of the Rehabilitation Act of 1973, the Age Discrimination Act of 1975, Americans with Disabilities Act of 1990; and

(4) Applicable Federal, state, and local laws.

§3560.353 Scheduling of on-site monitoring reviews.

Generally, the Agency will provide the borrower prior notice of an on-site monitoring review and will conduct the on-site monitoring review in the presence of the borrower. However, the Agency may visit a housing project, without prior notice, to observe physical conditions, operations and management activities, or other borrower or tenant activities. In addition, the Agency may conduct on-site reviews without the presence of the borrower, the management agent, or other designated representative of the borrower.

§3560.354 Borrower response to monitoring review notifications.

The Agency will notify borrowers, in writing, whenever Agency monitoring activities result in deficiency findings or compliance violations. The monitoring review notification will describe the deficiencies findings or compliance violations and will specify a time period by which corrective action must be taken by the borrower. The notification will offer borrowers an opportunity to discuss the reported deficiency findings or compliance violations with the Agency and will explain enforcement actions that the Agency may take if corrective action is not taken within the time period specified in the monitoring review notification. When civil rights non-compliance is found, the State Civil Rights Coordinator or Manager (SCRC/M) will be notified. If voluntary compliance cannot be obtained, appropriate enforcement or remedial action will be taken.

§§3560.355-3560.399 [Reserved]

§3560.400 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart I--Servicing

§3560.401 General.

(a) Purpose. This subpart contains actions the Agency may take to service and collect loans or other debts owed by multi-family housing (MFH) borrowers. The loan servicing and other actions set forth are designed to protect Agency and tenant interests and assist borrowers in meeting program objectives.

(b) General servicing policies. Borrowers must repay loans or other amounts due to the Agency according to provisions specified in promissory notes, loan agreements and resolutions, mortgages, deeds-of-trust, assumption agreements, reamortization agreements, or other agreements executed between the borrower and the Agency.

(c) Special servicing actions. The Agency will not agree to any proposal for loan servicing or debt collection action other than actions consistent with this section, debt instruments, and other agreements. When payments due to the Agency from a borrower remain unpaid for more than 30 days after the due date, past due, after the Agency may initiate the special servicing actions described in subpart J of this part.

§3560.402 Loan payment processing.

(a) Predetermined Amortization Schedule System (PASS) requirements. All loans, except the loans specified in paragraph (c) of this section, must be closed and serviced using the PASS.

(b) Required conversion to PASS. Borrowers with Daily Interest Accrual System (DIAS) accounts must convert to PASS whenever a loan servicing action on the account involves a change in the loan rates or terms or whenever a subsequent loan to the borrower is closed.

(c) Exceptions. Seasonal farm labor housing loans and on-farm labor housing loans may be closed on DIAS, monthly, or annual payment schedules.

§3560.403 Account servicing.

(a) Payment due dates. Loan or other payments due to the Agency are due on the first day of each month unless otherwise established in the debt instrument or other agreement executed with the Agency.

(b) Payment application order. Loan payments will be applied to the borrower's account in the following order of priority:

(1) Amortized audit receivables. (i.e., amounts due to the Agency, over a period of time, as a result of a finding from an audit or other monitoring activity.)

(2) Unamortized audit receivables. (i.e., amounts due to the Agency, in a lump sum payment, as a result of a finding from an audit or other monitoring activity.)

(3) Late fees. (i.e., amounts due to the Agency as a result of late payments.)

(4) Amortized recoverable costs. (i.e., amounts due to the Agency, over a period of time, as a result of Agency payments made on behalf of a borrower for housing project related expenses such as taxes or insurance premiums.)

(5) Unamortized recoverable costs. (i.e., amounts due to the Agency, in a lump sum payment, as a result of Agency payments made on behalf of a borrower for housing project related expenses such as taxes or insurance premiums.)

(6) Overage. (i.e., amounts due to the Agency as a result of a tenant's tenant contribution being higher than basic rent.)

(7) Interest. (i.e., amounts due to the Agency as a result of scheduled interest on a loan and as a result of interest charged on unpaid delinquent principal amounts.)

(8) Principal. (i.e., amounts due to the Agency as the loan principal.)

(9) Advance payments. (Any funds remaining after disbursement of a payment to all other payment priorities will be applied to the borrower's account as an advance regular payment unless a borrower specifically designates, in writing, another application.)

(c) Late fees. If payments on a borrower's account, under PASS, are more than $15 delinquent after the close of business on the 10th day after the payment due date, a late fee will be charged to the borrower's account.

(1) Late fees charged to a borrower's account will equal 6 percent of the total regular payments due as specified in any promissory notes, assumption agreements, or reamortization agreements related to the borrower's account.

(2) Late fees are a borrower expense and must not be paid from housing project funds.

(3) The Agency may waive late fees for circumstances beyond a borrower's control and when a waiver is determined by the Agency to be in the best financial interest of the Federal Government.

(d) Interest on unpaid overdue principal. On the first day of the month following a payment due date, the Agency will charge interest at the note rate on any unpaid principal payment due according to the loan's amortization schedule (i.e., interest will be charged on delinquent principal). The interest charged on the unpaid principal payment due will be charged to the borrower in addition to the scheduled interest due on payments according to the loan's amortization schedule.

§3560.404 Final loan payments.

(a) Payoff statements. At the borrower's request, the Agency will provide a statement indicating the pay off amount necessary to pay the borrower's account in full.

(b) Final payments. A borrower's final loan payment must include repayment of all outstanding obligations to the Agency.

(1) Any supervised funds being held by the Agency will be applied to the borrower's account or, at the borrower's option, will be returned to the borrower following acceptance of final payment on all outstanding obligations.

(2) If a balance due remains on a borrower's account after Agency acceptance of a final payment, due to borrower error or fraud or Agency error, the Agency will initiate collection action in accordance with the unauthorized assistance collection procedures described in subpart O of this part.

(c) Final payment loans. Borrowers with loans for which the Agency approved an amortization period that exceeded the term of the loan may request a loan to finance the final payment in accordance with the requirements of §3560.74.

(d) Loan prepayment requests. If prepayment of an Agency loan is requested, the applicable preservation requirements of subpart N of this part, including the execution of any appropriate restrictive-use agreements, must be met prior to the Agency's acceptance of a final loan payment under the prepayment request.

(e) Payment forms. Final payments may be made by cashier's check, certified check, money order, bank draft, or other withdrawal instruments approved by the Agency.

(1) If borrowers use forms of payment requiring special handling, the borrower is responsible for the cost of the special handling.

(2) When payment is provided in a form that is not the equivalent of cash, the Agency will consider the payment to be received at the time the payment has been converted to cash and funds have been transferred to the Agency.

(f) Release of security instruments. The Agency will release security instruments, subject to applicable restrictive-use agreements referenced in subpart N of this part, when full payment of all outstanding obligations to the Agency has been received, accepted, and the funds have been transferred to the Agency.

(1) If the Agency and the borrower agree to settle an account for less than the full amount owed, the Agency will release security instruments when the borrower has paid in full all agreed upon obligations.

(2) Recording costs for the release of the security instruments will be the responsibility of the borrower, except where state law requires the mortgagee to record or file the satisfaction.

(g) Special circumstances--Refund of entire principal. If the entire principal of the loan is refunded after the loan is closed, the borrower must pay interest from the date of the note to the date of receipt of the refund.

§3560.405 Borrower organizational structure or ownership interest changes.

(a) General. The requirements of this section apply to changes in a borrower entity's organizational structure or to a change in a borrower entity's controlling interest. If 100 percent of a borrower entity's ownership interest is transferred, within a 12-month period, the change will be considered a housing project transfer and the provisions of §3560.406, which covers transfers or sales of housing projects, will apply.

(b) Agency requirements. Borrowers must notify the Agency prior to the implementation of any changes in a borrower entity's organizational structure. The Agency must give its consent prior to the implementation of changes in a borrower entity's controlling interest.

(1) Borrowers must submit written requests for Agency consent to the Agency at least 45 days prior to the anticipated effective date of the proposed organizational change. The request must document that the proposed changes will not adversely affect the program purposes or security interest of the Agency and will not adversely affect tenants.

(2) If the controlling interest change involves a transfer of interest to an entity not previously holding an ownership interest in the borrower entity, the request for consent must include a written certification, executed by the party receiving the ownership interest, certifying that the recipient of the ownership interest agrees to assume responsibilities and obligations required of a borrower as established in Agency program requirements including requirements in the promissory note, loan agreement, or other document related to Agency loans held by the borrower entity.

(3) The Agency will not take a consent request for a controlling interest change under consideration if the borrower's request fails to meet the requirements specified in paragraph (b)(2) of this section.

(c) Documentation of organizational structures and ownership interest. Borrowers must annually document their organizational structure and ownership.

(1) Documentation must be submitted with the annual financial reports required by §3560.308 and must reflect any changes made during the 12-month period preceding the submission of the annual financial reports.

(2) If no changes in a borrower entity's organizational structure or ownership were made during the 12-month period prior to submission of the annual financial reports, borrowers are not required to submit documentation, but must submit a statement certifying that no changes have been made in the documents on file with the Agency.

(3) Organizational structure and ownership documentation must include the following items:

(i) A current organization description reflecting all approved changes in the organizational structure of the borrower entity and listing the names, addresses, and tax identification numbers of all parties with an ownership interest in the borrower entity; and

(ii) A written statement by the borrower certifying that the changes in the borrower entity's organizational structure or ownership interests were completed in compliance with state and local laws and in accordance with organizational requirements of the borrower entity.

§3560.406 MFH ownership transfers or sales.

(a) General. The provisions of this section apply to ownership transfers or sales (e.g., title transfers) involving an Agency financed housing project. The provisions cover situations where Agency loans are being assumed as a part of a housing project transfer or sale.

(b) Agency consent requirements. Agency consent must be obtained prior to an ownership transfer or sale and Agency consent will only be given when the transfer or sale is in the best interest of the Federal Government. Any ownership transfer or sale without the consent of the Agency will be considered a default and will be handled in accordance with subpart J of this part.

(1) Priority consideration will be given to ownership transfers or sales needed to remove a hardship to the borrower that was caused by circumstances beyond the borrower's control.

(2) Ownership transfers or sales with an assumption of debt at an amount less than the borrower's debt amount will only be approved by the Agency when all persons in the borrower entity who are transferring their ownership interest or are involved in the selling of the property are not part of the transferee organization.

(c) Consent request requirements. Borrowers must submit written requests for Agency consent to an ownership transfer or sale of a housing project to the Agency at least 45 days prior to proposed ownership transfer or sale date. The consent request must document that the proposed transfer or sale meets the requirements of paragraph (d) of this section and must include the following items:

(1) A statement disclosing any identity-of-interest between the borrower and the party to which the housing project ownership is being transferred or sold.

(2) A statement certifying that the housing project's financial accounts are funded at required levels, less authorized withdrawals, and that payments due for operation and maintenance expenses, tax assessments, insurance premiums, any required tenant security deposit accounts, and other obligations incurred as a part of the housing project operations are paid in full with no overdue balances or a statement explaining the housing project's financial situation and the reasons for overdue payments or under funded accounts.

(3) A proposed housing project budget covering the partial year, if applicable, and first full year operation following the ownership transfer or housing project sale.

(4) A written statement, signed by the proposed transferee or buyer, certifying that the transferee or buyer will assume the borrower responsibilities and obligations specified in Agency program requirements including requirements in a promissory note, loan agreement or other documents related to Agency loans held by the borrower entity.

(5) A certification from the borrower and the proposed transferee or buyer that the borrower does not and will not have a reversionary interest in the housing project.

(d) Requirements for ownership transfers or sales. An ownership transfer or sale of a housing project with an assumption of Agency loans by the transferee or buyer must comply with the following conditions:

(1) The transferee or buyer must be an eligible borrower under the requirements established by subpart B of this part;

(2) The transferee or buyer must agree to set basic rents at the housing project covered by the assumed loans at levels that do no exceed conventional rents for comparable units in the area, except that when determined necessary by the Agency to allow for decent, safe and sanitary housing to be provided in market areas where conventional rents are not sufficient to cover necessary operating, maintenance, and reserve costs. Basic rents may be allowed to exceed comparable rents for conventional units, but in no case by more than 150% of the comparable rent for conventional unit rent level; and

(3) The value of the housing project covered by the loans to be assumed, at the time of an ownership transfer or sale, must be sufficient to ensure that all Agency loans being assumed and all subsequent loans being offered as a part of the transfer or sale can be secured to a level that fully protects the Agency's interest. Loans from third-party sources that are not dependent on project revenue for payment will not be included in this determination.

(i) If the total value of the loans being offered as a part of an ownership transfer or sale is $100,000 or less, the security value of the housing project may be determined through either: An Agency review of

monitoring reports conducted in accordance with the requirements in subpart H of this part or an appraisal paid for by the borrower and conducted in accordance with subpart P of this part.

(ii) If the total value of the loans being offered as a part of an ownership transfer or sale exceeds $100,000, the security value of the housing project must be determined through an appraisal obtained by the Agency and conducted in accordance with subpart P of this part.

(iii) The Agency may approve a loan write-down, in accordance with §3560.455, prior to an ownership transfer or sale to reduce the amount of debt being assumed by the transferee or buyer.

(4) Prior to Agency approval of an ownership transfer or sale, an environmental review, as required under the National Environmental Policy Act and in accordance with 7 CFR part 1940, subpart G, must be conducted on all property related to the ownership transfer or sale. If contamination from hazardous substances or petroleum products is found on the property, the finding must be disclosed to the Agency and the transferee or buyer and must be taken into consideration in the determination of the housing project's value.

(5) All immediate and long-term repair and rehabilitation needs must be identified by a capital needs assessment. The reserve requirements for the housing project will be reviewed by the Agency and adjusted, if necessary, to adequately cover the cost of addressing the property's capital needs. The Agency may approve the release of the current reserve amount to the transferor provided the transferee agrees to deposit the amount to cover the project's immediate needs into the reserve account at closing.

(6) The borrower and transferee must disclose to the Agency all terms, conditions, or other considerations related to the ownership transfer or sale. All side or other agreements must be disclosed and all sources and uses of funds related to the ownership transfer or sale must be disclosed.

(7) An agreement must be signed between the borrower and the transferee listing all repairs known by the borrower to be necessary to bring the housing project into compliance with Agency requirements for decent, safe, and sanitary housing as listed in subpart C of this part.

(i) The agreement must include repairs required to correct compliance violations cited in a compliance violation notice issued by the Agency.

(ii) The agreement must specify whether each repair listed will be completed by the borrower prior to the ownership transfer or by the transferee in accordance with a workout agreement developed in accordance with the requirements of §3560.453 and executed between the transferee or buyer and the Agency.

(8) A civil rights compliance review, as required by 7 CFR part 1901, subpart E, will be conducted by the Agency prior to the ownership transfer or sale.

(9) During or immediately after the transfer, a review of the property must be conducted to ensure that it complies with or will comply with section 504(c) of the Americans with Disabilities Act (ADA), which covers accessibility requirements, and the Title VI of the Fair Housing Act of 1968.

(10) A transferee must ensure that tenant certifications in compliance with subpart D of this part for all occupied rental units are on file with the Agency.

(11) A transferee must comply with insurance and bonding requirements established in subpart C of this part at the time of the transfer.

(12) A transferee must agree to submit financial reports to the Agency according to subpart G of this part.

(13) A transferee must establish that there are no liens, judgments, or other claims against the housing project other than those by the Agency and those to which the Agency has previously agreed.

(14) A limited profit Rural Rental Housing transferee's initial investment and return on investment will remain the same as that originally provided to the transferor unless:

(i) The property is transferred to a non-profit entity and the return on investment is eliminated; or

(ii) The transferee contributes additional funds for repair or rehabilitation and the Agency agrees to recognize a higher initial investment.

(e) Equity payments. The Agency will withhold any equity payment due to the borrower, as part of an ownership transfer or sale, if any of the following conditions exist:

(1) The borrower's indebtedness to the Agency has not been paid in full or is not being assumed by the transferee. The Agency will require that all or part of an equity payment be applied against other Agency loans owed by the borrower if payments on the other loans are not current.

(2) Any non-Agency prior liens against a housing project are not paid in full.

(3) Any housing project financial accounts are not funded at required levels, less authorized withdrawals, or any payments due for operation and maintenance expenses, tax assessments, insurance premiums, tenant security deposits or other obligations incurred as a part of housing project operations are not paid in full.

(4) Any management deficiencies cited in a compliance violation notice issued by the Agency to the borrower have not been corrected or the housing project is not operating under an approved management plan or, if applicable, an approved management agreement.

(5) Any operation and maintenance deficiencies cited in compliance violation notices issued by the Agency have not been corrected or are not scheduled for correction in a workout agreement developed in accordance with the requirements of §3560.453.

(6) The borrower entity is, at the time of the ownership transfer or sale, cited by the Agency or other Federal, state, or local agencies for violations of Fair Housing or Equal Opportunity requirements.

(7) The borrower entity is, at the time of the ownership transfer or sale, cited by the Agency or any other entity involved in the financing of the housing project for misappropriation of funds.

(f) Equity payment funding sources. Equity may be provided in cash or through a loan. If a full equity payment to the transferor is not paid at the time of the ownership transfer or sale or has not been paid through an Agency equity loan or third-party equity loan approved by the Agency to the borrower, the transferee must certify that equity payments due to the borrower will be paid from sources other than housing project's funds and must identify the sources of such payments.

(g) Restrictive-use requirement. Transferees assuming Agency loans, including loans approved prior to December 21, 1979, will be required to execute a restrictive-use agreement that contains the language specified in §3560.662. The restrictive-use agreement will require the housing project to be used for program purposes for a specified period of time beyond the date that the ownership transfer or sale is closed. When an equity loan is involved at the time of transfer, the restrictions will be for 30 years.

(h) Subsequent loans. The Agency may approve a subsequent loan or permit a loan from a third-party source in conjunction with an ownership transfer or sale of a housing project. The subsequent loan may be in the form of a junior or parity lien.

(1) Subsequent loans on a housing project proposed in conjunction with an ownership transfer or sale must be requested and processed in accordance with the Agency loan origination requirements in subpart B of this part.

(2) The Agency may amortize the subsequent loan over a period not to exceed the remaining economic life of the housing or 50 years, whichever is less.

(3) The Agency may extend the term of the existing loan to a period not to exceed 30 years or the remaining economic life of the housing, whichever is less.

(i) Loan assumption interest rates. The interest rate for Agency loans assumed in conjunction with an ownership transfer or sale will be determined as follows:

(1) The interest rate for all loans, except farm labor housing loans, will be set at the lower of:

(i) The note rate of the existing Agency loan;

(ii) The Agency note rate on the day the transfer is approved;

(iii) The Agency note rate on the day the transfer is closed; or

(iv) If the rents are increased due to a transfer, the transfer will be done under new rates and terms when the Agency determines that it is in the best interest of the government. Subsequent loan may be in the form of a senior, junior or parity lien or soft second.

(2) The interest rate on farm labor housing loans will be the rate specified in the note, except that loans transferred to public bodies, nonprofit organizations of farm workers, and broadly-based nonprofit corporations for farm labor housing purposes may be at a one percent interest rate regardless of the rate specified in the note if the Agency determines that such a reduction is necessary to maintain affordable rental rates for tenants.

(j) Loan assumption terms. The amount of the loan balance that may be assumed through an ownership transfer or sale must not exceed the security value of the housing project determined according to §3560.406(d)(3)(i).

(1) The Agency may reamortize a loan assumed e time of the transfer or sale, to a monthly payment amortization and will be made subject to PASS. When on- or off-farm labor housing projects are involved in an ownership transfer or sale, the related loans may be transferred on a DIAS basis or converted to PASS if the Agency determines that such a conversion will not be detrimental to the operation of the farm labor housing.

(k) Processing ownership transfers or sales.

(1) At the time of the transfer, the Agency will require the borrower to transfer all equipment, related facilities, and housing project financial accounts to the transferee including the operation and maintenance account, reserve account, tenant security deposit account, tax and insurance escrow accounts.

(i) Any funds remaining in a rental assistance contract not dispersed by the transferor will be assigned to the transferee unless the rental assistance is not needed for tenants or another form of rental subsidy is to be used.

(ii) Any rental assistance determined to be unnecessary will be reassigned to other housing projects in accordance with the provisions of subpart F of this part.

(2) The Agency will require that appropriate loan documents are executed by the transferee. The Agency may require such documents to be referenced in security instruments (e.g., mortgage or deed of trust).

(3) If all of a borrower's outstanding Agency debt is not assumed or paid off at the time of the transfer or sale, the Agency will not release a borrower from liability unless the Agency determines that the borrower is unable to pay the remaining debt from assets taken as security through the debt settlement procedure in accordance with §3560.457.

(l) Ownership transfers or sales under special rates, terms, and conditions. Housing projects may be transferred or sold to entities that do not meet borrower eligibility requirements for the type of loans being assumed. However, such a transfer or sale will only be considered when it is determined by the Agency to be in the best interest of the Federal Government and the objectives of the original loan can no longer be met. The following special rates, terms, and conditions will apply to such situations.

(1) The transferee makes a down payment of at least 10 percent of the remaining loan balance to be assumed.

(2) The transferee has the ability to pay the Agency debt.

(3) Monthly or annual installments will be amortized over the term of the loan and the interest rate will be at a rate of interest at least one percent higher than the interest rate offered to eligible borrowers as specified in paragraphs (i)(1) or (2) of this section.

§3560.407 Sales or other disposition of security property.

(a) General. Borrowers must obtain Agency approval prior to selling or exchanging all or a part of, or an interest in, property serving as security for Agency loans. Agency approval also must be requested and received prior to the granting or conveyance of rights-of-way through property serving as security property. An environmental review must be completed in accordance with 7 CFR part 1940, subpart G, before the Agency approves all such sales or other dispositions of security property.

(b) Request requirements. Requests for Agency approval of transactions related to security property must document that the following conditions will be met.

(1) The borrower's ability to repay the Agency debt will not be impaired;

(2) The transaction will not interfere with the successful operation of the housing project or prevent the borrower from carrying out the purpose for which the loan was made.

(3) The monetary or other consideration offered in the transaction is equal to or greater than the market value of the security property being disposed of or the rights being granted, except that right-of-way easements may be granted or conveyed with minimal or no consideration being offered if:

(i) The value of the security property will not be reduced;

(ii) The suitability of the security property for the intended purpose will not be impaired; and

(iii) The easement is granted to allow the borrower to develop additional lots or units that will be integrated into the housing project or for enhancement of streets, utilities or other services provided by a public body.

(4) The property that will remain as security for Agency loans, after any transaction related to security property, will fully secure the borrower's debt to the Agency.

(5) Borrowers must report to the Agency the total of all proceeds derived from the sale or other disposition of property serving as security for Agency loans. The proceeds from the disposition of the security property will be used for purposes approved by the Agency.

§3560.408 Lease of security property.

(a) General. Borrowers must obtain Agency approval prior to entering into a lease agreement related to any property serving as security for Agency loans. An environmental review must be completed in accordance with 7 CFR part 1940, subpart G, before the Agency can give lease approval for real property serving as security for Agency loans.

(b) Leases to public housing authorities. Borrowers may not lease all or part of their housing facilities to a housing authority. Lease agreements in place prior to the effective date of this regulation may be continued provided that leases are in a form acceptable to the housing authority and are on terms that will enable the borrower to comply with Agency program requirements, to meet Agency program objectives, and make loan and other required payments to the Agency on an Agency approved schedule.

(c) Lease of a portion of the security property. The Agency may, subject to the applicable provisions governing loan purposes found in of §3560.53, §3560.553 and §3560.603, approve the leasing of facilities related to a housing project (e.g., central kitchens, recreation facilities, laundry rooms, and community rooms) when the borrower will continue to operate the facilities for the purposes for which the loan was made. Agency approval is not required for leases with a term of less than 30 days. The Agency will only approve a lease with a term over 30 days if the following conditions are met:

(1) The lease is in the best interest of the borrower, the tenants, and the Federal Government.

(2) The amount of the consideration agreed to in the lease is adequate to pay all prorated operating and maintenance expenses, a prorated share of the annual reserve deposit, and the prorated part of the loan amortization at the note rate of interest.

(3) All compensation and considerations, whether payments, a share of proceeds, or improvements to the property paid for by the lessee, must be disclosed to the Agency. No payments or compensation for entering into a lease shall flow to the borrower or any identity-of-interest related to the borrower.

(4) The lease provides at its termination for the restoration of the leased space to its original condition or a condition acceptable to the owner and the Federal Government.

(5) Consent to the lease will not exceed 3 years at a time unless the Agency determines that a longer lease is advantageous to the borrower, the tenants, and the Federal Government.

(6) When another lienholder's mortgage requires that lienholder's consent to a lease, the borrower must obtain written consent from the lienholder before the Agency will consider approving the lease.

(d) Mineral leases. Mineral leases will be handled according to 7 CFR 3550.159 except that all references to County Supervisor will be construed to mean District Director when applied to the MFH Programs.

§3560.409 Subordinations or junior liens against security property.

(a) General. Borrowers must obtain Agency consent prior to entering into any financial transaction that will require a subordination of the Agency security interest in the property (i.e., granting of a prior interest to another lender.) An environmental review must be completed in accordance with 7 CFR part 1940, subpart G, before the Agency can consent to a subordination or junior lien against the property. Borrowers must use an Agency approved subordination agreement.

(1) If a lien is placed against property serving as security for an Agency loan without prior Agency consent, the Agency will declare the borrower to be in

default and will pursue liquidation of the borrower's loans in accordance with the procedures specified in §3560.457, unless an agreement can be reached between the borrower and the Agency to work out removal of the lien or post approve the lien.

(2) Subordinations or junior liens need not encompass the entire site, (e.g., a subordination or junior lien requested to permit an interim lender to advance construction funds may only cover the portion of the site proposed for construction.)

(3) The subordination or junior lien must be for a specific amount.

(4) The subordination or junior lien must not adversely impact the Agency's ability to service the loan according to the requirements of this part.

(b) Consent request requirements. Borrowers proposing to have the Agency subordinate its interest to another lender or to give a creditor a junior lien against property serving as security for an Agency loan must submit a consent request to the Agency. The consent request must document the following:

(1) The action will enable the borrower to obtain financial resources for improvements or repairs on the security property that are consistent with the purposes of the Agency loan secured by the property.

(2) The action will not adversely impact the borrower's financial condition and the borrower's ability to repay the Agency loan being secured by the property.

(3) The action will not result in basic rents at the security property that exceed conventional rents for comparable units in the area.

(4) The terms and conditions of the credit to be secured by the subordination or junior lien are not expected to adversely affect the borrowers ability to meet the terms and conditions of the Agency loan secured by the property.

(5) The proposed use of the funds obtained through the granting of a subordination or junior lien will not adversely affect the borrower's ability to meet Agency program requirements or to operate and manage the housing project in a manner consistent with program objectives.

(6) The creditor receiving the “subordination” of interest in the property or the junior lien will agree that a foreclosure or acceptance of a deed-in-lieu of foreclosure will not be initiated without at least 30 days prior notice to the Agency.

(7) The subordination or junior lien is not being secured with any funding from housing project financial accounts.

(8) The “subordination” of interest or junior lien will not cause the debt from all sources to exceed the value of the security property.

(9) The transaction related to the placement of a “subordination” of interest or junior lien against the property serving as security for an Agency loan is in the best interest of the Federal Government.

(c) Required conditions for subordinations and junior liens. Subordinations of interest in or junior liens against property serving as security for an Agency loan may be approved by the Agency only if they improve a borrower's financial condition and allow for improvements or repairs that are consistent with the purposes of the Agency loan secured by the property.

(1) Farm Labor Housing loans on farm tracts may be subordinated for essential farm improvements and operations.

(2) Any proposed development must be planned and performed according to 7 CFR part 1924, subpart A, or in a manner directed by the other lienholder that meets the objectives of 7 CFR part 1924, subpart A.

(d) Other liens against a property or other assets.

(1) Borrowers must not enter into any agreements to place a lien on a housing project or any equipment related to a housing project without prior Agency approval and unless the following conditions are met:

(i) The transaction will not adversely affect the Agency's security position;

(ii) The lien is not related to a non-program eligible action;

(iii) The items to be acquired by the funding related to the lien is needed for the operation of the property; and

(iv) The financing arrangements are otherwise sound.

(2) In cases where the above criteria are met, borrowers must complete and provide the Agency a copy of the financing statement, loan document, or contract, as applicable, as well as a security agreement acceptable to the Agency.

§3560.410 Consolidations.

(a) General. With Agency approval, loans, loan agreements, or loan resolutions may be consolidated to reduce the administrative burden (i.e., record keeping, budgeting), to improve the cost effectiveness and efficiencies of housing project operations, and to effectively utilize facilities common to housing projects.

(b) Loan consolidations. Loan consolidations will only be considered when:

(1) Multiple loans to the one borrower entity are being transferred to a different borrower entity in accordance with §3560.406, or

(2) One borrower entity has an initial loan and one or more subsequent loans for the same housing project and all the loans were closed on the same date and with the same rates and terms.

(c) Loan agreement or loan resolution consolidations. Loan agreements or loan resolutions may be consolidated, even if the loans related to the agreement or resolution are not consolidated, to allow borrowers to comply with reporting, accounting, and other Agency requirements as a single housing project.

(1) The loan agreements or loan resolutions may only be consolidated when they are related to loans made for the same purposes, to the same borrower, and operating under the same type of interest credit, if applicable.

(2) All of a borrower's loan accounts must be current after the loan agreement or loan resolution consolidation is processed, unless otherwise approved by the Agency.

§§3560.411-3560.449 [Reserved]

§3560.450 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart J--Special Servicing, Enforcement, Liquidation, and Other Actions

§3560.451 General.

This subpart contains special servicing, enforcement, liquidation, and other actions that the borrower may request or the Agency may implement when compliance violations, monetary defaults, or non-monetary defaults cannot be resolved through regular servicing.

(a) Agency obligations. The Agency is under no obligation to offer or agree to any special servicing actions.

(b) Relationship to workout agreements. Special servicing actions may be implemented either as a part of a workout agreement, developed in accordance with §3560.453, or as an action approved by the Agency separate from a workout agreement unless indicated otherwise in this subpart.

§3560.452 Monetary and non-monetary defaults.

(a) General. Borrowers are in default when they have received a compliance violation notice, issued in accordance with §3560.354, and have failed to correct the compliance violation identified in the compliance violation notice within the time period specified in the notice. Compliance violations include, but are not limited to, violations of promissory note provisions, loan or grant agreement provisions, regulatory, or other Agency requirements, including requirements imposed on a borrower through a workout agreement developed in accordance with §3560.453.

(b) Monetary defaults. A monetary default exists when any amount due to the Agency or a third party (such as real estate taxes and insurance) under a promissory note, loan or grant agreement, workout agreement, or other agreement remains due more than 30 days after the due date.

(c) Nonmonetary defaults. A nonmonetary default exists when a borrower fails to correct a compliance violation, other than a monetary amount past due, within the time period specified in a compliance violation notice issued in accordance with §3560.354. Nonmonetary defaults include, but are not limited to, failure to:

(1) Operate and manage a housing project in accordance with the Agency approved management plan or Agency requirements;

(2) Maintain the physical condition of a housing project in a decent, safe, and sanitary manner and in accordance with Agency requirements;

(3) Keep general operating expense, reserve, and other financial accounts related to a housing project at required funding levels;

(4) Occupy rental units with eligible tenants, unless granted an exception by the Agency;

(5) Charge correct rents or to correctly calculate net tenant contributions, utility allowances, or rental assistance payments or to properly administer the Agency rental assistance assigned to the housing project;

(6) Submit required annual financial reports to the Agency within time periods specified in §3560.308;

(7) Submit management plans, leases, occupancy rules, and other required materials to the Agency in accordance with Agency requirements; and,

(8) Comply with applicable Federal laws including laws related to civil rights, fair housing, disabilities, and environmental conditions.

(d) Default notice. When borrowers are in default, the Agency will notify borrowers, in writing, that they are in default. The default notice will identify the compliance violation that led to the default, will specify actions necessary to cure the default, and will establish a date by which the default must be cured to preclude Agency initiation of enforcement actions, liquidation, or other actions.

(e) Agency action. If a borrower fails to cure a default within the time period specified in the default notice, the Agency may initiate the enforcement actions described in §3560.461 or liquidation as described in §3560.456. Also, Agency compliance violation notices and related default notices may be referred to Federal, state, and local agencies with jurisdictions related to the violations for handling, in accordance with their requirements.

§3560.453 Workout agreements.

(a) General.

(1) Prevention or resolution of compliance violations or default cures are a borrower's responsibility.

(2) A borrower may develop and submit to the Agency for approval a workout agreement that proposes actions to be taken over a period of time to prevent or correct a compliance violation or to cure a monetary or non-monetary default.

(3) A borrower developed workout agreement may propose, but is not limited to, the following actions:

(i) A combination of one or more of the special servicing actions outlined in §§3560.454 and 3560.455;

(ii) A change in operations and management at a housing project; or

(iii) A commitment of additional financial resources to the housing project with the amount and source of the additional resources to be committed to the housing project specifically identified.

(b) Workout agreement approval.

(1) The Agency is under no obligation to approve a workout agreement as submitted by a borrower or to act with forbearance when a housing project is in monetary or non-monetary default.

(2) Borrower developed workout agreements may not be implemented until the borrower receives written approval from the Agency.

(3) The Agency will only approve a workout agreement if the Agency determines that the actions proposed are likely to prevent or correct compliance violations or cure a default and approval is in the best interest of the Federal Government and tenants.

(4) The Agency will only approve a workout agreement if the proposed actions are consistent with the borrower's management plan. If proposed actions are not consistent with the borrower's management plan, applicable revisions to the borrower's management plan must be made before approval of the workout agreement is given.

(c) Workout agreement required content.

(1) Workout agreements submitted to the Agency for approval must be in writing and signed by the borrower. Workout agreements must describe proposed actions in sufficient detail to demonstrate the likelihood of the actions to prevent or correct compliance violations or cure defaults.

(2) At a minimum, workout agreements must include the following.

(i) The name and address of the housing project, project number, borrower's tax identification number, and other information necessary to identify the housing project.

(ii) A description of the potential or actual compliance violation or default situation, including an explanation of related causes, such as cash flow concerns, budget revisions, deferred maintenance, vacancies, or violations of statutes.

(iii) A definition and description of the housing project's market area, including information on housing availability, rents, and vacancy rates in the market area.

(iv) A description of the proposed actions to prevent or correct compliance violations or to cure defaults along with a date specific schedule indicating when interim and final actions will be taken to correct the compliance violation or cure the default.

(v) A description of financial and other resources necessary to prevent or correct the compliance violation or cure the default including an identification of the sources for such resources.

(d) Workout agreement budgets. Budget revisions submitted as a part of a workout agreement for a housing project experiencing cash flow problems must prioritize cash disbursements in the following order:

(1) Prior lienholder, if any;

(2) Critical operating and maintenance expenses, including taxes and insurance;

(3) Agency debt payments;

(4) Reserve account requirements; and

(5) Other authorized expenditures.

(e) Workout agreement terms and cancellation.

(1) Workout agreements shall be in effect for no longer than a 2-year time period, beginning on the date of Agency approval. If an approved workout agreement calls for actions that extend beyond a 2-year period, borrowers must submit an updated and, if necessary, revised workout agreement to the Agency for approval. The updated workout agreement must be submitted to the Agency, 30 days prior to the expiration of the workout agreement in effect.

(2) The Agency may cancel a workout agreement at any time if the borrower fails to comply with the terms of the agreement. The Agency will provide notice to the borrower upon cancellation of the workout agreement.

§3560.454 Special servicing actions related to housing operations.

(a) Changing rents or revising budgets. The Agency may approve a borrower request for a rent change, rent incentives, or a revised budget, at any time during a housing project's fiscal year.

(b) Occupancy waivers. If the Agency determines that a housing project with high vacancies could be kept operationally and financially viable by allowing the borrower to accept as tenants persons with incomes above the income eligibility standards specified in §3560.152(a), the Agency, in writing, may grant the borrower an occupancy waiver to allow such persons as tenants. Occupancy waivers will be in effect only during the time period specified by the Agency when the waiver is granted. In addition, borrowers must rent to all eligible applicants on the housing projects waiting list prior to accepting persons with incomes above the Agency standards as tenants.

(c) Additional rental assistance (RA). If the Agency determines that a housing project with high vacancies could be kept operationally and financially viable by increasing the amount of RA allocated to the housing project, the Agency, subject to available funds,

may offer the housing project RA as a means of preventing or correcting a compliance violation or curing a default.

(d) Special note rents. When a Plan II housing project is experiencing severe vacancies due to market conditions, the Agency may approve a rent less than the note rent to attract and keep tenants whose incomes, according to the formula in §3560.203, would require them to pay the note rent. The reduced rent is called a Special Note Rent (SNR) and, as noted in §3560.210, approval of an SNR may affect approvals of loan proposals submitted to the Agency for the market area where the SNR is in effect.

(1) An SNR rent may only be requested as a part of a proposed workout agreement and must include documentation of market conditions, the housing project's vacancy rates, evidence of marketing efforts, and other concerns necessitating the request for an SNR.

(2) Borrowers must forego the annual return to owner for each housing project's fiscal year that an SNR is in effect for all or part of a fiscal year at a housing project.

(3) SNR's may be increased, decreased, or terminated any time during a housing project's fiscal year when market conditions, vacancy rates, or other concerns that necessitated the SNR warrant a change.

(4) In addition to any state lease law requirements that might be related to the implementation of an SNR, the borrower must notify each tenant of any change in rents or utility allowances that result from approval of an SNR, in accordance with §3560.205(c) and must submit the appropriate budget changes to the Agency for approval.

(e) Termination of management agreement. If the Agency determines that a compliance violation or loan default was caused, in full or in part, by actions or inactions of the housing project's management agent, the Agency will require the borrower to terminate the management agreement with that agent, or in the case of a borrower managed housing project, to enter an agreement with a third-party non-identity of interest management agent, unless the borrower and the Agency agree on a written plan to prevent reoccurrence of the violation. Housing project funds may not be used to pay a management fee to a management agent after the Agency has directed the borrower to terminate a management agreement with that agent, except during an Agency approved transition period.

§3560.455 Special servicing actions related to loan accounts.

(a) General. To prevent or correct a compliance violation or to prevent or cure a default in a situation that cannot be resolved through regular servicing, the Agency may approve a deferral of loan payments or a loan restructuring. Nothing herein precludes the Agency from initiating appropriate legal action to correct a compliance violation if the Agency determines such action is more in the Government's interest than entering into a special servicing agreement as provided for in this section. Procedures for debt collection are discussed in §3560.460. As part of a workout agreement, the Agency may agree to accept less than full monthly payment installments due on an Agency loan for a specified period of time, not to exceed the effective period of the workout agreement.

(b) Loan reamortizations. A loan reamortization is a restructuring of loan terms and conditions over a period of time that does not exceed the remaining useful life of the housing project.

(1) Loan reamortizations will only be approved when they are in the best interest of the Federal Government and tenants and when the following conditions are met.

(i) The Agency determines that the borrower will be unable to meet their obligations without a reduction in monthly payment installments; and

(ii) The Agency is satisfied that the security, including the potential income for debt service, will be adequate to protect the Agency's interest over the term of the reamortization and that the reamortization will not adversely affect the Federal Government's lien priority.

(2) If the Agency approves a reamortization of a loan under this section, it will be at the existing note rate, or the current interest rate at the time of reamortization closing or approval, whichever is less.

(3) Loan reamortization may be used to:

(i) Restructure loan repayments to prevent or correct a compliance violation or cure a default caused by circumstances beyond the borrower's control in situations where the borrower is otherwise in compliance with Agency requirements;

(ii) Repay principal, outstanding interest, overage, and advances made by the Agency for recoverable cost items when less than full payments were authorized under the provisions of an Agency approved workout agreement;

(iii) Restructure a borrower's loan payments in conjunction with an incentive package developed in accordance with §3560.656 to prevent prepayment of the loan;

(iv) Restructure an existing loan in conjunction with a subsequent loan for rehabilitation; or

(v) Restructure remaining debt when a portion of the property serving as loan security is sold and there is a need to reestablish the financial stability of the housing project.

(c) Loan writedowns. A loan writedown is a reduction of a borrower's debt approved by the Agency.

(1) Loan writedowns will only be approved when they are in the best interest of the Federal Government and when the following conditions exist:

(i) Sound management of the housing project is evident or sound management practices are proposed for correction in accordance with an Agency approved workout agreement; and

(ii) The housing project's financial stability is being affected by conditions beyond the borrower's control, such as market weaknesses, unforeseen site problems, or natural disasters.

(2) Prior to Agency approval for a loan writedown, the borrower must obtain an appraisal of the housing project that concludes the 'as-is' market value, subject to restricted rents, conducted in accordance with subpart P of this part. The Agency will not approve a loan write-down unless the appraisal indicates the Federal Government's interests are secured at the proposed writedown level.

(3) Any writedown will be conditioned on a finding that the borrower does not have the ability to pay a higher loan payment, even if the loan is reamortized.

(4) Loan writedowns may be used to allow for a loan transfer and assumption for less than the total amount of outstanding debt.

§3560.456 Liquidation.

Prior to any servicing action which might lead to the acquisition of real property by the Agency, the Agency must complete a due diligence report to assess any potential contamination of the property from hazardous substances, hazardous wastes, or petroleum products. The borrower must cooperate with the Agency in the development of this report.

(a) Before acceleration. Before accelerating a project loan, the Agency will consider the possibility that the borrower is forcing an acceleration to circumvent the prepayment process. If it is found that this is the borrower's motivation, the Agency will consider alternatives to acceleration, such as suing for specific performance under loan and management documents.

(b) Acceleration. When a borrower is in monetary or non-monetary default, the Agency will accelerate the loan unless the Agency decides other enforcement measures are more appropriate.

(1) If the borrower does not pay the full account balance and meet the other terms of the acceleration notice within the time period set forth in the acceleration notice, the Agency will foreclose or acquire the security property through deed in lieu of foreclosure.

(2) The Agency will suspend interest credit and rental assistance.

(3) The Agency will not accept partial payment of an accelerated loan unless required by state law.

(c) Voluntary liquidation. After acceleration, borrowers may voluntarily liquidate through either of the following mechanisms:

(1) 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.

(2) Offer by third party. If a junior lienholder or cosigner makes an offer in the amount of at least the net recovery value, RHS may assign the note and mortgage after all appeal rights have expired.

(d) Foreclosure.

(1) The Agency will initiate foreclosure when a borrower is in monetary or non-monetary default and foreclosure is in the best interest of the Federal Government.

(2) When a junior lienholder foreclosure does not result in payment in full of the Agency debt but the property is sold subject to the Agency lien, the Agency will liquidate the account.

(e) Acquisition of chattel properties.

(1) The Agency will accept voluntary conveyance of chattel property only when the borrower can convey ownership free of other liens and the Agency has agreed to release the borrower from further liability on the account.

(2) If the Agency decides to accept an offer of voluntary conveyance of chattel property, the borrower must provide an itemized listing of each chattel property item being conveyed and provide title to vehicles or other equipment, where applicable.

§3560.457 Negotiated debt settlement.

(a) Borrower proposals to settle debt. A borrower who cannot pay the full amount of loan payments may propose an offer to settle an outstanding debt for less than the full amount of that debt. The Agency may approve a negotiated debt settlement only in cases where a default is evident and doing so is in the best interest of the Federal Government and tenants.

(b) Required information. Borrowers requesting debt settlement must submit complete and accurate information from which a full determination of financial condition can be made. Debt settlement offers will not be approved by the Agency unless the financial information submitted by the borrower indicates that the borrower will be able to make the debt settlement payments as proposed.

(c) Effective date of approval. Debt settlement offers will not be accepted until the borrower receives written approval from the Agency.

(d) Appraisal requirement. No debt settlement offer will be accepted for less than the net recovery value of the security as determined by a licensed appraiser or other qualified official, and concurred in by the Agency's qualified appraisal review official or other qualified official.

(e) Disposition of security prior to offer. Borrowers are not required to dispose of security prior to making a debt settlement offer. However, if a borrower has disposed of security prior to making a debt settlement offer, the proceeds from the disposed security must be applied to the borrower's account prior to any negotiations on the debt settlement offer.

(f) Final release condition. Upon full payment of the approved debt settlement, the Agency will release the borrower from liability.

§3560.458 Special property circumstances.

(a) Abandonment. When the Agency determines that a borrower has abandoned security for a loan under this part, the Agency will take the steps necessary to protect the Federal Government's interest in the security. Costs associated with managing abandoned property are the responsibility of the borrower and will be charged to the borrower's account until liquidation is completed.

(b) Other security. The Agency will service security such as collateral assignments, assignments of rents, Housing Assistance Payments Contracts, and notices of lienholder interest according to acceptable practices in the respective states.

(c) Taking of additional security to protect Agency interests. The Agency may require borrowers to provide additional security in the form of real estate, cash reserves, letters of credit, or other security when needed to improve the chances that the Agency will not suffer a loss, and when:

(1) The account is in default; or

(2) The property has not been properly managed or maintained.

(d) Due diligence. When the Agency has completed an environmental review in accordance with 7 CFR part 1940, subpart G, and decides not to acquire security property through liquidation action or chooses to abandon its security interest in real property, whether due in whole or in part, to the presence of contamination from hazardous substances, hazardous wastes, or petroleum products, the Agency will provide the appropriate environmental authorities with a copy of its due diligence report.

§3560.459 Special borrower circumstances.

(a) Deceased borrower, bankruptcy, insolvency, and divorce actions. The Agency will address borrower accounts affected by special circumstances such as death, bankruptcy, insolvency, and divorce on a case-by-case basis. The Agency will make servicing decisions in such cases on the basis of best interest to the Federal Government and tenants. The Agency will bring a legal action to establish the legal capacity of the borrower to administer the project if found necessary to protect the government's interests. In order for the Agency to make servicing decisions in such cases, the borrower or the borrower's representative will provide to the Agency:

(1) On the part of the heirs or executor of the borrower's estate, evidence of legal action due to a will or court actions that establish who is to become the owner;

(2) The financial status of the borrower and any member pledging additional security for the debt;

(3) The status of the security property; and

(4) The impact of the identified actions on the operation of the project.

(b) Membership liability agreements. If a borrower's note is endorsed by individuals other than the borrower or a borrower has security agreements with members of the organization for the purchase of shares of stock or for the payment of a pro rata share of the loan in the event of default, or has individual liability agreements, which are usually assigned to and held by the Agency as additional security for the loan, the security and liability agreements must be adequate to protect the Agency's interest.

(c) Security issues in participation loans. When a multi-family housing (MFH) project is receiving financing or a subsidy from sources other than the Agency, the Agency will service the account in accordance with the participation agreements made with the Agency and the other funding sources under §3560.65.

§3560.460 Double damages.

(a) Action to recover assets or income.

(1) The Agency may request to the Attorney General to bring an action in a United States district court to recover any assets or income used by any person in violation of the provisions of a loan made by the Agency under this section or in violation of any applicable statute or regulation.

(2) For the purposes of this section, a use of assets or income in violation of the applicable loan, statute, or regulation includes any use for which the documentation in the books and accounts does not establish that the use was made for a reasonable operating expense or necessary repair of the project or for which the documentation has not been maintained in accordance with the requirements of the Agency and in reasonable condition for proper audit.

(3) For the purposes of this section, the term “person” means:

(i) Any individual or entity that borrows funds in accordance with programs authorized by this section;

(ii) Any individual or entity holding 25 percent or more interest in any entity that the Agency funds in accordance with programs authorized by this section; and

(iii) Any officer, director, or partner of an entity that borrows funds in accordance with programs authorized by this section.

(b) Amount recoverable.

(1) In any judgment favorable to the United States entered under this section, the Attorney General may recover double the value of the assets and income of the project that the court determines to have been used in violation of the provisions of a loan made by the Agency under this section or any applicable statute or regulation, plus all costs related to the actions, including reasonable attorney and auditing fees.

(2) Notwithstanding any other provisions of law, the Agency may use amounts recovered under this section for activities authorized under this section and such funds must remain available for such use until expended.

(c) Time limitation. Notwithstanding any other provisions of law, an action under this section may be commenced at any time during the six-year period beginning on the date that the Agency discovered or should have discovered the violation of the provisions of this section or any related statutes or regulations.

(d) Continued availability of other remedies. The remedy provided in this section is in addition to and not in substitution of any other remedies available to the Agency or the United States.

§3560.461 Enforcement provisions.

(a) Equity skimming.

(1) Criminal penalty. Whoever, as an owner, agent, employee, or manager, or is otherwise in custody, control, or possession of property that is security for a loan made under this title, willfully uses, or authorizes the use, of any part of the rents, assets, proceeds, income, or other funds derived from such property, for any purpose other than to meet actual, reasonable, and necessary expenses of the property, or for any other purpose not authorized by this title or the regulations adopted pursuant to this title, must be fined under title 18, United States Code, or imprisoned not more than five years, or both.

(2) Civil sanctions. An entity or individual who as an owner, operator, employee, or manager, or who acts as an agency for a property that is security for a loan made under this title where any part of the rents, assets, proceeds, income, or other funds derived from such property are used for any purpose other than to meet actual, reasonable, and necessary expenses of the property, or for any other purpose not authorized by this title of the regulations adopted pursuant to this title, must be subject to a fine of not more than $25,000 per violation. The sanctions provided in this paragraph may be imposed in addition to any other civil sanctions or civil monetary penalties authorized by law.

(b) Civil monetary penalties.

(1) When civil monetary penalties may be imposed. The Agency may, after notice and opportunity for a hearing, impose a civil monetary penalty in accordance with this section against any individual or entity, including its owners, officers, general partners, limited partners, or employees, who knowingly and materially violate, or participate in the violation of, the provisions of this title, the regulation issued by the Agency pursuant to this title, or agreements made in accordance to this title by:

(i) Submitting information to the Agency that is false.

(ii) Providing the Agency with false certifications.

(iii) Failing to submit information requested by the Agency in a timely manner.

(iv) Failing to maintain the property subject to loans made under this title in good repair and condition, as determined by the Agency.

(v) Failing to provide management for a project that received a loan made under this title that is acceptable to the Agency.

(vi) Failing to comply with the provisions of applicable civil rights statutes and regulations.

(2) Amount.

(i) The amount of a civil penalty imposed under this section must not exceed the greater of twice the damages the Agency or the project that is secured for a loan under this section suffered or would have suffered as a result of the violation, or $50,000 per violation.

(ii) Determination. In determining the amount of a civil monetary penalty under this section, the Agency must take into consideration:

(A) The gravity of the offense;

(B) Any history of prior offenses by the violator (including offenses occurring prior to the enactment of this section);

(C) Any injury to tenants;

(D) Any injury to the public;

(E) Any benefits received by the violator as a result of the violation;

(F) Deterrence of future violations; and

(G) Such other factors as the Agency may establish by regulation.

(3) Payment of penalties. No payment of a penalty assessed under this section may be made from funds provided under this title or from funds of a project which serve as security for a loan made under this title.

(4) Remedies for noncompliance.

(i) Judicial intervention. If a person or entity fails to comply with a final determination by the Agency imposing a civil monetary penalty, the Agency may request the Attorney General of the United States to bring an action in an appropriate district court to obtain a monetary judgment against such an individual or entity and such other relief as may be available. The monetary judgment may, in the court's discretion, include attorney's fees and other expenses incurred by the United States in connection with the action.

(ii) Reviewability of determination. In an action under this paragraph, the validity and appropriateness of a determination by the Agency imposing the penalty must not be subject to review.

(c) Conditions for renewal extension. The Agency may require that expiring loan or assistance agreements entered into under this title must not be renewed or extended unless the owner executes an agreement to comply with additional conditions prescribed by the Agency, or executes a new loan or assistance agreement in the form prescribed by the Agency.

§3560.462 Money laundering.

The Agency will act in accordance with U.S. Code Title 18, part I, chapter 95, section 1956(c)(7)(D).

§3560.463 Obstruction of Federal audits.

The Agency will act in accordance with U.S. Code Title 18, part I, chapter 73, section 1516(a).

§§3560.464-3560.499 [Reserved]

§3560.500 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart K--Management and Disposition of Real Estate Owned (REO) Properties

§3560.501 General.

This subpart contains Agency procedures and other policies related to the management and disposition of multi-family housing (MFH) projects in the Agency's inventory (Real Estate Owned (REO) property). Housing projects will not be accepted into the Agency's inventory unless one of the following has occurred:

(a) The borrower has abandoned the housing project and the Agency has performed the required steps to take the housing project into custody.

(b) The housing project title has been transferred to the Agency as a result of foreclosure, voluntary conveyance, redemption, or other action.

§3560.502 Tenant notifications and assistance.

Each tenant in an REO property designated to be sold as a non-program property will be notified by the Agency, in writing, of the housing projects' non-program designation and will be given an opportunity to obtain a Letter Of Priority Entitlement (LOPE) as specified in §3560.159(c).

§3560.503 Disposition of REO property.

(a) Preference will be given to offers from bidders who are determined eligible by the Agency to purchase REO property designated to be sold as program property. It is the Agency's priority that property previously operated as program property prior to becoming REO inventory property be sold as program property. However, REO property may be sold under whatever Agency program is most appropriate for the property and the community needs regardless of the program under which the property was originally financed or whether the property was being used to secure loans under more than one Agency program.

(b) When the Agency determines that the REO property to be sold is not decent, safe, and sanitary and/or does not meet cost effective energy conservation standards, it will disclose the basis for this determination to prospective purchasers. The deed by which such an REO property is conveyed will contain a covenant restricting it from residential use until it is decent, safe, and sanitary, and meets the Agency's cost effective conservation standards. The Agency will also notify any potential purchaser of any known lead based paint hazards.

§3560.504 Sales price and bidding process.

(a) The loan documents related to REO property sold for program purposes must contain the restrictive-use language specified in §3560.662(a).

(b) Entities bidding on REO property designated to be sold as program property must submit a loan application package that meets the requirements specified in subpart B of this part.

(1) Bidders on REO property designated to be sold as program property must meet the eligibility requirements established under §3560.55.

(2) Bidders determined by the Agency to be ineligible to purchase REO property designated to be sold as program property will be notified in writing. The bidding process will continue regardless of pending appeals.

(3) All offers from bidders determined to be eligible to purchase REO property designated to be sold as program property will be considered in the bidding process and must provide evidence of financial stability and credit worthiness.

(c) The Agency will determine the successful bidder on REO property designated to be sold as program property by conducting a drawing of sealed bids.

(1) The Agency may authorize the sale of an REO property by sealed bid or public auction when it is in the best interest of the Government. The Agency will publicly solicit requests for sealed bids and publicize auctions. If the highest bid is lower than the minimum acceptable bid established by the Agency, or if no acceptable bids are received, the Agency may negotiate a sale without further public notice.

(2) Bidders who desire to withdraw their bids must do so prior to the drawing date.

(d) Property designated to be sold as non-program property may be sold to entities that do not meet the Agency's eligible borrower requirements specified in §3560.55, and must be sold for cash or on terms approved by the Agency. Cash sales will be given first preference and will be drawn before any sales on terms.

§3560.505 Agency loans to finance purchases of REO properties.

(a) Agency loans to finance the purchase of REO property designated to be sold as program property must meet the same requirements as specified in subparts A and B of this part. In addition, the following provisions apply.

(1) At the borrower's option, the interest rate will be the prevailing rate at the time of loan approval or the prevailing rate at loan closing.

(2) Purchasers may pay closing costs from their own funds or, if allowable under subparts B, L, or M of this part, as applicable, may finance such costs as part of the Agency loan.

(b) Agency loans to finance the purchase of REO property designated to be sold as non-program property must meet the following terms.

(1) A down payment of not less than 10 percent of the purchase price is required at closing.

(2) The interest rate will equal the lesser of the prevailing interest rate at the time of loan approval or loan closing for MFH loans plus one-half percent.

(3) The note amount will be amortized over a period not to exceed 10 years. If the Agency determines that more favorable terms are necessary to facilitate the sale, the note amount may be amortized using a 30-year factor with payment in full due no later than 10 years from the date of closing (balloon payment). In no case will the term be longer than the useful life of the property.

(4) Agency loans to finance the purchase of non-program REO property are subject to the availability of funds.

(c) Loan limits and allowable uses of loan funds specified in subparts B, L, and M of this part, as applicable, are applicable to any Agency-financed (credit) sale of REO property.

(d) Title clearance and loan closing for an Agency financed sale and any subsequent loan to be closed simultaneously with the sale must meet the requirements in subpart B of this part for an initial loan, with the following exceptions:

(1) A “Quit Claim” or other non-warranty deed will be used; and

(2) The buyer must pay attorney's fees, insurance costs, recording fees and other customary fees unless they are included in a subsequent loan and the subsequent loan is for purposes other than closing costs and fees.

(e) After approval of an Agency-financed sale of occupied REO property designated to be sold as program property, but prior to closing, the purchaser must prepare a budget for housing operations in accordance with subpart B of this part. If a rent increase is necessary, procedures specified in subparts E and F of this part for calculating rents, net tenant contributions, and rental assistance will be followed by the borrower.

§3560.506 Conversion of single family type REO property to MFH use.

Single family type REO property may be sold for conversion to MFH program use under the following conditions:

(a) The Agency will allow nonprofit organizations, public bodies, or for-profit entities to purchase single family type REO property for conversion to MFH program use. When the Agency finances the sale of single family-type REO property for conversion to rural rental housing program use (i.e., MFH including group homes and homes for the elderly or disabled, farm labor housing, or rural cooperative housing), the sale price will be the lesser of the Federal Government's investment or an amount based on the “as-is” market value of the housing project as determined by an appraisal conducted in accordance with subpart P of this part.

(b) The Agency will only accept written offers to purchase two or more single family type REO properties for conversion to rural rental housing from nonprofit organizations, public bodies, or for-profit entities with a good record of providing housing under the Agency's MFH programs. The single family type properties are not required to be contiguous, however, they must be located in close enough proximity so that management capabilities are not diminished because of distance.

§§3560.507-3560.549 [Reserved]

§3560.550 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart L--Off-Farm Labor Housing

§3560.551 General.

This subpart establishes the requirements for making loans and grants for off-farm labor housing and for ongoing operations of this housing. Unless otherwise specified in this subpart, the requirements of subparts A through K, N, O, and P of this part will apply in addition to the requirements in this subpart.

§3560.552 Program objectives.

(a) In addition to the objectives stated in §3560.52, off-farm labor housing loan and grant funds will be used to increase:

(1) The supply of affordable housing for farm labor; and

(2) The ability of communities to attract farm labor by providing housing which is affordable, decent, safe and sanitary.

(b) Under section 516(i) of the Housing Act of 1949 (42 U.S.C. 1486(i)), the Agency may award technical assistance grants to encourage the development of farm labor housing.

§3560.553 Loan and grant purposes.

(a) In addition to the purposes stated in §3560.53, off-farm labor housing loan and grant funds may be used to provide facilities for seasonal or temporary residential use with appropriate furnishings and equipment. A temporary residence is a dwelling which is used for occupancy, usually for a short period of time, but is not the legal domicile for the occupant.

(b) The Agency may award technical assistance grants to eligible private and public nonprofit agencies. These grant recipients will, in turn, assist other organizations to obtain loans and grants for the construction of farm labor housing.

(c) Technical assistance services may not be used to reimburse a nonprofit or public body applicant for technical services provided by a nonprofit organization, with housing and/or community development experience, to assist the nonprofit applicant entity in the development and packaging of its loan/grant docket and project. In addition, technical assistance will not be funded by the Agency when an identity of interest exists between the technical assistance provider and the loan or grant applicant.

§3560.554 Use of funds restrictions.

Off-farm labor housing loan and grant funds may not be used for any purpose prohibited by §3560.54 except §3560.54(a)(1). Off-farm labor housing may be used to serve migrant farmworkers.

§3560.555 Eligibility requirements for off-farm labor housing loans and grants.

(a) Eligibility for loans. Applicants for off-farm labor housing loans must be:

(1) A broad-based nonprofit organization, a nonprofit organization of farmworkers, a federally recognized Indian tribe, a community organization, or an agency or political subdivision of State or local government, and must meet the requirements of §3560.55, excluding §3560.55(a)(6). A broad-based nonprofit organization is a nonprofit organization that has a membership that reflects a variety of interests in the area where the housing will be located; or

(2) A limited partnership with a non-profit general partner which meets the requirements of §3560.55(d).

(b) Eligibility for grants. To be eligible for off-farm labor housing grants, applicants must:

(1) Meet the requirements in §3560.555(a)(1); and

(2) Be able to contribute at least one-tenth of the total farm labor housing development cost from its own or other resources. The applicant's contribution must be available at the time of grant closing. An off-farm labor housing loan financed by RHS may be used to meet this requirement.

(c) Limitation. Limited partnerships eligible under paragraph (a)(2) of this section are not eligible for farm labor housing grants.

§3560.556 Application requirements and processing.

Off-farm loans and grants will be available under a Notice of Funding Availability (NOFA) that will be published in the Federal Register each fiscal year.

§3560.557 [Reserved]

§3560.558 Site requirements.

The requirements established in §3560.58 apply to all applications for off-farm labor housing loans and grants except that off-farm labor housing are not limited to rural areas.

§3560.559 Design and construction requirements.

(a) General. The requirements established in §3560.60 apply to all applications for off-farm labor housing loans and grants except that seasonal off-farm labor housing that will be occupied for eight months or less per year by migrant farmworkers while they are away from their residence, may be constructed in accordance with Exhibit I of 7 CFR part 1924, subpart A.

(b) Additional requirements. In addition to the requirements established in §3560.60, it is encouraged that the design of off-farm labor housing incorporate outdoor shower, boot washing station, and/or hose bibb facilities as necessary to protect the resident and the asset from excess dirt and chemical exposure.

(c) Davis-Bacon wage requirements. Construction financed with the assistance of a Section 516 grant will be subject to the provisions of the Davis-Bacon Act (40 U.S.C. 276(a)-276(a)(7)), and the implementing regulations published by the Department of Labor at 29 CFR parts 1, 3, and 5.

§3560.560 Security.

The security requirements established in §3560.61 will apply to all applications for off-farm labor housing loans.

§3560.561 Technical, legal, insurance and other services.

The requirements established under §3560.62 apply to all applications for off-farm labor housing loans and grants.

§3560.562 Loan and grant limits.

(a) Determining the security value. The requirements established under §3560.63(a) apply to off-farm labor housing loans.

(b) Maximum amount of loan. The requirements established in §3560.63(c)(1) and (2), regarding borrower equity contribution apply to all applications for off-farm labor housing loans. (For applicants eligible under §3560.555(a)(2), the amount of Agency financing for the housing will not exceed 95 percent of the total development cost or 95 percent of the security value available for the Agency loan, whichever is lower.) In determining the amount of the loan, the Agency will also review the capacity of the applicant to amortize such loan, considering any rental assistance provided for use in the housing, and any rents anticipated to be paid by farmworkers expected to occupy the housing.

(c) Maximum amount of grant. The amount of any off-farm labor housing grant must not exceed the lesser of:

(1) Ninety percent of the total development cost, or

(2) That portion of the total development cost which exceeds the sum of any amount provided by the applicant from their own resources plus the amount of any loans approved for the applicant, considering the capacity of the applicant to amortize the loan.

§3560.563 Initial operating capital.

The requirements for §3560.64 apply to all applications for off-farm labor housing loans and grants.

§3560.564 Reserve accounts.

The requirements for §3560.65 apply to all applications for off-farm labor housing loans and grants.

§3560.565 Participation with other funding or financing sources.

The requirements established in §3560.66 apply to all applications for off-farm labor housing loans and grants, except that the 25 percent requirements stated in paragraph §3560.66(b)(1) may consist of loan and/or grant funds.

§3560.566 Loan and grant rates and terms.

(a) Amortization period. The loan will be amortized over a period not to exceed 33 years. The amortization schedule will take into account the depreciation of the security and ensure that the loan will be adequately secured.

(b) Interest rate. The effective interest rate will be 1 percent.

(c) Term of grant agreement. The grant agreement will remain in effect for so long as there is a need for farm labor housing..

§3560.567 Establishing the profit base on initial investment.

The requirements established under §3560.68 apply to applicants eligible under §3560.555(a)(2) and operating as a limited partnership with a nonprofit general partner.

§3560.568 Supplemental requirements for seasonal off-farm labor housing.

For off-farm labor housing operating on a seasonal basis, the management plan must establish specific opening and closing dates. During the off-season, off-farm labor housing may be used as defined in subpart A of this part under short-term lease provisions. Where rents are charged on a per-unit basis and family income qualifies the household for rental assistance, rental assistance may be used.

§3560.569 Supplemental requirements for manufactured housing.

The requirements established in §3560.70 apply to all applications for off-farm labor housing loans and grants.

§3560.570 Construction financing.

The requirements established in §3560.71 apply to all applications involving off-farm labor housing loans and grants. In addition, the following requirements apply.

(a) Equity contributions being made by a borrower or grantee must be contributed and disbursed prior to any disbursement of interim loan funds and any loan or grant funds from the Agency.

(b) If the Agency is providing both loan and grant funds, loan funds must be fully released and expended prior to the release of grant funds by the Agency.

(c) If construction is financed with a Labor Housing grant, it is subject to the provisions of the Davis-Bacon Act (published in the Department of Labor regulations 29 CFR parts 1, 2, and 5).

§3560.571 Loan and grant closing.

The requirements established in §3560.72 apply to all applications for off-farm labor housing loans and grants. In addition, the following requirements apply.

(a) A nonprofit organization will have its Board of Directors adopt an Agency-approved loan and/or grant resolution, which is required as part of the loan docket before loan and/or grant approval. All other loan applicants will execute an Agency-approved loan agreement.

(b) For grants, an Agency approved grant agreement, must be executed by the applicant on the date of grant closing.

(c) The obligations incurred by the applicant, as a condition of accepting the grant, will be in accordance with the off-farm labor housing grant agreement.

(d) Off-farm labor housing loans used to build or acquire new units made pursuant to a contract entered into on or after the effective date of this regulation, will be subject to the restrictive-use provision stated in §3560.72(a)(2)(ii). All other off-farm labor housing loans are subject to the restrictive-use provisions contained in their loan documents and as outlined in subpart N of this regulation. Such restrictions must be included in the mortgage and deed of trust.

§3560.572 Subsequent loans.

The requirements established in §3560.73 will apply to all applications for subsequent off-farm labor housing loans.

§3560.573 Rental assistance.

(a) Rental assistance may be provided to income eligible tenants living in off-farm labor housing in accordance with subpart F of this part. The requirements established in §3560.252 apply to all tenants receiving rental assistance.

(b) For dormitory style facilities operating on a per bed basis, rental assistance will be made available to the housing on a per unit basis, but may be pro-rated to tenants on a per bed basis. However, total rent charged for a unit must not exceed conventional rent for comparable units in the area or a similar area and per bed rents must be comparable to per bed rents in the market.

§3560.574 Operating assistance.

Operating assistance may be used in lieu of tenant-specific rental assistance in off-farm labor housing projects financed under section 514 or section 516(i) of the Housing Act of 1949 (U.S.C. 1486(i)) that serve migrant farmworkers. Owners of eligible projects may choose tenant-specific rental assistance as described in §3560.573 or operating assistance, or a combination of both, however, any tenant or unit assisted under this section may not receive rental assistance under §3560.572. The objective of this program is to provide assistance toward the cost of operating the project so that rents may be set at rates that are affordable to very low and low-income migrant farmworkers.

(a) Project eligibility requirements. To be eligible for the operating assistance program, projects must be:

(1) Off-farm labor housing projects financed under section 514 or section 516 with units that are for migrant farmworkers. Housing units for year-round farmworker households are ineligible; and

(2) Eligible for the Agency's rental assistance program as defined in §3560.573.

(b) Operating assistance limits. The amount of operating assistance requested by the owner must be based on the project's actual income and expenses and must be approved by the Agency. In the case of a mixed project, the amount of operating assistance must be based on the portion of actual income and expenses that are attributable to the units that are for migrant farmworkers. In no instance may the annual amount of operating assistance exceed 90 percent of the annual operating costs that are attributable to the migrant units.

(c) Owner responsibilities.

(1) Requesting for operating assistance program. Owners of off-farm labor housing projects with units for migrant farmworkers may request operating assistance by submitting a request to the Agency, which must include a budget. The budget must include:

(i) Estimated operating costs for the migrant units, including authorized expenditures such as reserve deposits;

(ii) Proposed rental rates for the migrant units to generate sufficient funds for operating costs of those units, taking into consideration all other sources of project income; and

(iii) Estimated rental income from tenants, based on a tenant contribution of 30 percent of the average adjusted monthly income of migrant farmworker households in the area.

(2) Requesting operating assistance payments. Each month, the owner will submit a request for operating assistance to the Agency.

(3) Verifying tenant income eligibility. Owners are responsible for verifying tenant income eligibility. Only very low or low-income households are eligible for the operating assistance rents. Households with incomes above the low-income limits must pay the full rent.

(4) Reporting requirements.

(i) Owners will complete and submit to the Agency tenant certifications to document tenant income and eligibility.

(ii) Owners will complete and submit monthly to the Agency a project worksheet for operating assistance.

(iii) Owners must submit an annual planning budget to the Agency prior to the project's fiscal year.

§3560.575 Rental structure and changes.

Off-farm labor housing is subject to the tenant contribution and rental unit rent requirements for Plan II housing established under subpart E of this part, except where seasonal housing will be occupied for less than a 3-month period. In such instances the best available and practical income verification methods may be used with prior approval of the Agency.

§3560.576 Occupancy restrictions.

(a) Restrictions on conditions of occupancy.

(1) No borrower or grantee will be permitted to require that an occupant work on any particular farm or for any particular owner or interest as a condition of occupancy of the housing.

(2) Tenant selection should be in accordance with the loan agreement, subpart D of this part and §3560.577.

(3) No borrower or grantee will discriminate, or permit discrimination by any agent, lessee, or other operator in the use or occupancy of the housing or related facilities because of race, color, religion, sex, age, disability, familial status, or national origin.

(b) Eligible households. To be eligible for occupancy in off-farm labor housing, households must meet the following requirements.

(1) Occupational. An eligible household must include a domestic tenant or co-tenant farm laborer, a retired domestic farm laborer, or a disabled domestic farm laborer.

(2) Income. The household must meet the definition of income eligible as established in §3560.152 and the tenant or co-tenant must receive a substantial portion of income from farm labor employment. To determine if a substantial portion of income is from farm labor employment, the following measures will be used.

(i) For housing rented to farm laborers and owned by public bodies, public or private nonprofit organizations, and limited partnerships when charging rent.

(A) Actual dollars earned from farm labor by domestic farm laborers other than migrant farmworkers must equal at least 65 percent of the annual income limits indicated for the Standard Federal regions as published by the Agency for their particular region of the country. For migrant farmworkers living in seasonal housing the actual dollars earned from farm labor by a domestic farm laborer must equal at least 50 percent of annual income limits indicated for the Standard Federal regions, as published by the Agency.

(B) An alternate measure for determining substantial portion of income when actual earnings are not available may be the duration of time a farm laborer worked on a farm or other farming enterprise as a domestic farmworker during the preceding 12 months. In order to be considered as substantial the farm laborer must have worked at least 110 whole days in farm work. For purposes of this section one whole day is the equivalent of at least 7 hours. When using a period of more than 1 year, a yearly average must amount to at least 110 days per year.

(ii) For housing owned by a farmer, family-farm partnership, family-farm corporation, or an association of farmers which was initially provided on a non-rental basis, a substantial portion of
income is earned when housing is provided by the owner as part of employment compensation for farm labor.

(iii) When a natural disaster has occurred, such as a drought, flood, freeze, etc., figures for the 12 months preceding such disaster will be used to determine substantial portion of income under paragraph (b)(2) of this section.

(iv) The tenant who qualifies as a domestic farm laborer residing in a property with a nonrestrictive farm labor clause in the mortgage covenants must not have adjusted income which exceeds the moderate income limit for the appropriate household size and appropriate geographical area.

(3) Occupancy. The household must remain in compliance with the borrower's occupancy policy as established in §3560.155.

(c) Tenant eligibility requirements for operating assistance rents. To be eligible for operating assistance rents, tenants must meet the rental assistance eligibility requirements described in §3560.573 and in §3560.252.

(d) Ineligible tenants. Tenants who, at any time, fail to meet all the requirements in paragraph (b) of this section will be deemed ineligible for occupancy in off-farm labor housing. Ineligible tenants in off-farm labor housing will be addressed in accordance with the requirements of §3560.158.

(e) Non-farm laborer tenants. When there is a diminished need for housing for persons or families in the above categories, units in off-farm labor housing complexes may be made available to persons or families eligible for occupancy under §3560.152. Eligible tenants under this section may occupy the labor housing until such time the units are again needed by persons or families eligible under paragraph (b) of this section. As the basis for Agency approval or disapproval of the borrower's determination of diminished need, the borrower must submit a current analysis of need and demand to the Agency, identical to the market analysis that is required of loan applicants in the loan origination process. The borrower's determination and the State Director's recommendation should be forwarded to the National Office for concurrence. The procedures specified in §3560.158 shall be followed when tenants are required to vacate housing to allow for occupancy by persons eligible under paragraph (b) of this section.

§3560.577 Tenant priorities for labor housing.

Tenant occupancy in off-farm labor housing is based on eligible farm labor certified through the income certification process required by §3560.152 and is prioritized in the following order.

(a) First priority is to be given to eligible active farm laborer households with first priority going to very low-income households, next priority to low-income households, and last to moderate-income households.

(b) Second priority is given to retired domestic farm laborer households and disabled domestic farm laborer households who were active in the local farm labor market area at the time of retiring or becoming disabled. Occupancy priority will be given in accordance with paragraph (a) of this section.

(c) Third priority is to be given to retired domestic farm laborer households and disabled domestic farm laborer households who were not active in the local farm labor market at the time of retiring or becoming disabled. Occupancy priority will be given in accordance with paragraph (a) of this section.

§3560.578 Financial management of labor housing.

The requirements established in subpart G of this part will apply to all off-farm labor housing.

§3560.579 Servicing off-farm labor housing.

The requirements established in subparts I and J of this part will apply to all off-farm labor housing. Servicing according to subparts I and J of this part shall apply throughout the term of the loan or grant, whichever is longer.

§§3560.580-3560.599 [Reserved]

§3560.600 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart M--On-Farm Labor Housing

§3560.601 General.

This subpart contains the requirements for making loans for on-farm labor housing and for ongoing operation and management of on-farm labor housing. Unless otherwise specified in this subpart, the requirements of subparts A through K, N, O, and P of this part will apply in addition to requirements given in this subpart.

§3560.602 Program objectives.

In addition to the objectives stated in §3560.52, on-farm labor housing funds will be used to increase:

(a) The supply of affordable housing for farm labor; and

(b) The ability of the farmer to provide affordable, decent, safe and sanitary housing for farm workers.

§3560.603 Loan purposes.

On-farm labor housing loans may be made only for the purposes established in §3560.553. Grants are not available for on-farm labor housing.

§3560.604 Restrictions on use of funds.

On-farm labor housing loans may not be used for any purpose prohibited by §3560.54 except §3560.54(a)(1). On-farm labor housing may be used to serve migrant workers. In addition, on-farm labor housing loan funds may not be used to provide housing for members of the immediate family of the applicant when the applicant is an individual farm owner, family farm corporation, family farm partnership, or a member of an association of farmers. Immediate family includes mother, father, brothers, sisters, sons, and daughters of the applicant and spouse.

§3560.605 Eligibility requirements.

(a) To be eligible for an on-farm labor housing loan, the applicant must meet the requirements of §3560.55(a) with the exception of §3560.55(a)(1), (5), and (6) and the following requirements.

(1) The applicant must be a farm owner, family farm partnership, family farm corporation, or an association of farmers engaged in agricultural or aquacultural farming operations whose farming operations demonstrate a need for on-farm labor housing and who will own the housing and operate it on a nonprofit basis.

(2) The applicant must agree to use the labor housing to engage in the farming operations of the individual farm owner applicant, or in the farming operations of its members if it is a family farm corporation or partnership, or an association of farmers.

(3) The applicant must, as determined by the Agency, be unable to provide the necessary housing from the applicant's own resources and be unable to obtain credit from any other source upon terms and conditions which the applicant could reasonably be expected to fulfill. If the applicant is an association of farmers or family farm corporation or partnership, the individual members, individually and jointly, must be unable to provide the necessary housing by utilizing their own resources and be unable, by pledging their personal liability, to obtain other credit that would enable them to provide housing for farm workers at rental rates they can afford to pay. The individual resources of family farm corporation or partnership members with less than a 10 percent corporate or partnership interest should not be considered when determining if the applicant can obtain credit elsewhere.

(b) The Agency may make an exception to the requirement that an individual farm owner, family farm corporation, family farm partnership or an association of farmers be unable to obtain the necessary credit elsewhere when all of the following conditions exist:

(1) There is a housing need in the area for domestic farmworkers who are migrants and the applicant will provide such housing; and

(2) There are no qualified state or political subdivisions or public or private nonprofit organizations available, or likely to become available within 12 months of the application, that are willing and able to provide the housing.

(c) When an applicant is determined eligible under paragraph (b) of this section, the interest rate for such loans will be determined in accordance with 7 CFR part 1810, subpart A.

(d) On-farm labor housing that consists of buildings with less than three units is not subject to the requirement that five percent of the units be constructed as fully accessible units, as described in §3560.60(d).

§3560.606 Application requirements and processing.

(a) On-farm labor housing loan applications will be processed according to 7 CFR part 1940, subpart L. Applicants must submit an application in an Agency-approved format that adequately documents the need for the housing and the eligibility of the applicant.

(b) The applicant must certify that the farm workers for which the housing is intended are or will be involved in the applicant's agricultural or aquacultural farming operations.

(c) The applicant must certify that housing operations will be conducted in a non-profit manner such that income from the housing does not exceed eligible expenses associated with the housing. Eligible expenditures for the housing include, but are not limited to housing repairs and upkeep, payment of installments on the loan, taxes, insurance and reserves and other essential uses needed for success of the operations.

§3560.607 [Reserved]

§3560.608 Site and construction requirements.

(a) General. Cost and development standards for on-farm labor housing will be consistent with the requirements, standards, and cost limits specified in subpart B of this part, if the housing is a multi-family housing type structure, or consistent with section 502 of the Housing Act of 1949, if the housing is a single family type structure.

(b) Permanent units. On-farm labor housing occupied for 8 months or more of the year will be required to meet the following requirements.

(1) Housing may be multi-family or single family in type and may be located on the farm away from farm service buildings, or in the nearby community. Single-family type housing is defined as an individual or a group of individual single family detached dwelling units. All sites and housing shall be planned and constructed in accordance with 7 CFR part 1924, subparts A and C.

(2) Sites must be accessible from a public road, when feasible.

(c) Seasonal units. On-farm labor housing occupied for less than 8 months of the year will be considered seasonal housing. Such housing must meet the following requirements.

(1) Housing designed for seasonal occupancy may be either single family or multi-family.

(2) Seasonal housing may be constructed in accordance with exhibit I of 7 CFR part 1924, subpart A. If constructed in accordance with exhibit I, the housing must be suitable to allow for conversion to full-year occupancy if the need for migrant farmworkers in the area declines.

(d) Accessibility. On-farm labor housing that consists of buildings with less than three units, need not meet the requirement that five percent of the units be constructed as fully accessible units, as described in §3560.60(d). This does not, however, eliminate any other accessibility requirements.

§3560.609 [Reserved]

§3560.610 Security.

(a) Security instruments must meet the requirements established under §3560.560.

(b) When feasible, the on-farm labor housing will be located on a tract of land that is surveyed such that, for security purposes, it is considered separate and distinct from the farm. The security for the loan must include a lien on the tract of land where the on-farm labor housing is located and the security must have adequate value to protect the Federal government's interest. The Agency will seek a first or parity lien position on Agency-financed property in all instances, however, the Agency may accept a junior lien position if the Federal government's interests are adequately secured.

(c) The Agency will determine the value of the security for the loan in accordance with 7 CFR part 1922, subpart B if the farm is used as security or in accordance with section 502 of the Housing Act of 1949, if only the on-farm labor housing and related land is used for security.

(d) If necessary to provide adequate security for the loan, the Agency may require that any household furnishings purchased with loan funds also be secured.

(e) Personal liability and recourse will be required of all borrowers, including the individual members, stockholders or partners of an association of farmers, family farm corporations or partnerships, respectively.

§3560.611 Technical, legal, insurance and other services.

When technical, legal, insurance, or services are required for development of on-farm labor housing, applicants must comply with the applicable requirements of §3560.62. Regarding insurance coverage, the requirements of §3560.62(d) apply to on-farm labor housing.

§3560.612 Loan limits.

The maximum loan amount will be 100 percent of the allowable total development costs of on-farm labor housing and related facilities subject to §§3560.603, 3560.604 and 3560.608.

§3560.613 [Reserved]

§3560.614 Reserve accounts.

When on-farm labor housing operations include 12 or more units, the Agency will require such properties to comply with the reserve account requirements in §3560.65.

§3560.615 Participation with other funding sources.

The Agency encourages the use of other funding sources in conjunction with on-farm labor housing loans. Use of such financing in conjunction with an on-farm labor housing loan is subject to the approval of the Agency and must comply with the requirements of §3560.66.

§3560.616 Rates and terms.

(a) The interest rate for on-farm labor housing loans will be 1 percent.

(b) The term of the on-farm labor housing loan will not exceed 33 years.

(c) Loan amortization for on-farm labor housing may be on a monthly or an annual basis.

§3560.617 [Reserved]

§3560.618 Supplemental requirements for on-farm labor housing.

The management plan for on-farm labor housing operated on a seasonal basis must have specific opening and closing dates. During the off-season, on-farm labor housing may be used under short-term lease provisions.

§3560.619 Supplemental requirements for manufactured housing.

On-farm labor housing loan funds used for manufactured housing must comply with §3560.70. Manufactured housing located on-farm may consist of individual units.

§3560.620 Construction financing.

The requirements established in §3560.71 apply to all applications involving on-farm labor housing loans.

§3560.621 Loan closing.

Applicants for on-farm labor housing loans must execute an Agency-approved loan agreement. In addition, if determined appropriate by the Agency, on-farm labor housing loans made on or after the effective date of this regulation may be subject to the restrictive-use provisions as stated in §3560.72(a)(2)(ii). All other on-farm labor housing loans are subject to the restrictive-use provisions contained in their loan documents and as outlined in subpart N of this regulation.

§3560.622 Subsequent loans.

The requirements established in §3560.572 apply to all applications for on-farm labor housing subsequent loans.

§3560.623 Housing management and operations.

Borrowers with on-farm labor housing loans must:

(a) Develop and submit to the Agency a management plan in a format specified by the Agency. At a minimum, the management plan will detail the borrower's operational and occupancy policies, how the borrower will deal with resident complaints, and how repairs will be completed; and

(b) Maintain a lease or employment contract with each tenant specifying employment with the borrower as a condition for continued occupancy.

§3560.624 Occupancy restrictions.

(a) The immediate relatives of the borrowers are ineligible occupants for on-farm labor housing.

(b) Occupants must meet the definition of a domestic farm laborer, as defined in §3560.11.

(c) Occupancy of on-farm labor housing is restricted to employees of the borrower unless otherwise approved by the Agency.

(d) With prior written permission of the Agency, on-farm labor housing may be occupied by ineligible tenants on a short-term basis. The permission of the Agency must also be for a limited duration.

§3560.625 Maintaining the physical asset.

On-farm labor housing must meet state and local building and occupancy codes.

§3560.626 Affirmative Fair Housing Marketing Plan.

On-farm labor housing must meet the requirements of §3560.104.

§3560.627 Response to resident complaints.

The management plan submitted in accordance with §3560.623 (a) will include a provision for dealing with resident complaints.

§3560.628 Establishing and modifying rental charges.

If it becomes necessary to establish or modify a shelter cost, the borrower must obtain Agency approval as specified in subpart E of this part.

§3560.629 Security deposits.

Borrowers that require security deposits to be paid by the tenants will be required to comply with the requirements of §3560.204.

§3560.630 Financial management.

Financial information must be submitted in an Agency-approved format and will show operation of the housing in a nonprofit manner.

§3560.631 Agency monitoring.

A compliance review and physical inspection will be conducted by the Agency at least once every 3 years. The purpose of this review will be to inspect:

(a) Tenant eligibility documentation;

(b) Financial information on the operation and management of the labor housing, including relevant borrower financial materials;

(c) Payment of taxes, insurance and hazard insurance;

(d) Compliance with the security deposit requirements;

(e) Compliance with the operating plan;

(f) Compliance with the loan agreement;

(g) Compliance with Agency requirements for affordable, decent, safe, and sanitary housing; and

(h) Compliance with civil rights requirements.

[§§3560.632-3560.649 [Reserved]

§3560.650 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart N--Housing Preservation

§3560.651 General.

(a) This subpart contains the Agency's housing preservation requirements as related to prepayment requests and restrictive-use provisions (RUPs). The requirements of this subpart support the Agency's commitment to the preservation of decent, safe, sanitary, and affordable multi-family housing (MFH) for very low-, low-, and moderate-income households.

(b) The Agency will coordinate, direct, and monitor the Agency's MFH preservation activities from the National Office level.

§3560.652 Prepayment and restrictive-use categories.

(a) Loans with prepayment prohibitions include:

(1) Initial section 515 loans made on or after December 15, 1989, and

(2) Subsequent loans made on or after December 15, 1989, for additional rental units.

(b) Loans without prepayment prohibitions but with restrictive-use provisions include:

(1) All loans made after December 21, 1979, but prior to December 15, 1989;

(2) Subsequent loans made on or after December 15, 1989, for purposes other than additional rental units; or

(3) Loans subsequently restricted by servicing actions including transfers.

(c) Loans without prepayment prohibitions or restrictive-use provisions include all loans made on or before December 21, 1979, or loans that had restrictive-use provisions that have expired. Such loans are eligible to receive incentives subject to the provisions of this subpart.

(d) Loans may be prepaid if another loan or grant from the Agency imposes the same or more stringent restrictive-use provisions on the housing project covered by the loan being prepaid.

§3560.653 Prepayment requests.

(a) Borrowers seeking to prepay an Agency loan must submit a written prepayment request to the Agency at least 180 days in advance of the anticipated prepayment date and must obtain Agency approval before the Agency will accept prepayment.

(b) Prior to submitting a prepayment request, borrowers must take whatever actions are necessary to provide the following items:

(1) A clear description of the loan to be prepaid, the housing project covered by the loan being prepaid, and the requested date of prepayment.

(2) A statement documenting the borrower's ability to prepay under the terms specified.

(3) A certification that the borrower will comply with any federal, state, or local laws or regulations which may relate to the prepayment request and a statement of actions needed to assure such compliance.

(4) A copy of lease language to be used during the period between the submission date and the final resolution of the prepayment request notifying tenant applicants that the housing project has submitted a prepayment request to the Agency and explaining the potential affect of the request on the lease.

(5) Borrowers are required to submit a signed release of information form along with the prepayment request. The Agency will notify nonprofit organizations and public bodies involved in providing affordable housing or financial assistance to tenants of the receipt of a borrower's request to prepay their MFH (MFH) loan(s). Additionally, the Agency is to notify nonprofit organizations and public bodies whenever a borrower, who has requested prepayment, is required or elects to offer their property for sale to a nonprofit or public body.

(6) A certification that the borrower has notified all governmental entities involved in providing affordable housing or financial assistance to tenants in the project of the prepayment request and a statement specifying how long financial assistance from such parties will be provided to tenants after prepayment.

(7) A statement affirming that units in the property applying for prepayment will continue to be available for rent by eligible residents during the prepayment process.

(c) The Agency will review complete requests to determine if:

(1) The loan is eligible for prepayment under §3560.652(b);

(2) The borrower has the ability to prepay; and

(3) The borrower has complied or has the ability to comply with applicable Federal, state, and local laws related to the prepayment request.

(d) If a prepayment request lacks full and complete information on any item, the Agency will return the prepayment request to the borrower with a letter citing the deficiencies in the prepayment request. The Agency will offer borrowers an opportunity, within 30 days following the date of the return, to address the reasons given by the Agency for the return of the prepayment request and will allow the borrower to submit a revised prepayment request appropriately satisfies all the conditions listed in paragraph (d) of this section, the Agency will process the prepayment request and make a reasonable effort to enter into a new restrictive-use agreement with the borrower in accordance with §3560.662 or §3560.655. If the Agency determines that a loan is ineligible for prepayment or the borrower does not have the ability to prepay, the Agency will return the prepayment request to the borrower with a written explanation of the Agency's determinations.

§3560.654 Tenant notification requirements.

(a) Within 30 calendar days of receiving a complete prepayment request, the Agency will send a prepayment request notice to each tenant in the housing project. Borrowers must post the Agency's prepayment request notice in public areas throughout the housing project from the date of the notice until the final resolution of the prepayment request. The prepayment request notice will establish a date and place where tenants may meet with the Agency to discuss the prepayment request and will advise tenants that:

(1) They may review all information submitted with the prepayment request except financial information regarding the borrower entity, which the Agency will withhold from tenant review unless given written permission for the release of the information from the borrower; and,

(2) They have 30 days from the date of the prepayment request notice to give the Agency comments on the prepayment request.

(b) Borrowers may provide a prepayment request notice of their own directly to tenants and may establish a date and place where tenants may meet with the borrower to discuss the prepayment request. The Agency and other providers of housing assistance for very-low, low, and moderate-income households may attend a borrower's prepayment request meeting with tenants.

(c) If the Agency agrees to accept prepayment on a loan, the Agency will send a prepayment acceptance notice to each tenant in the housing project at least 60 days prior to the prepayment date. Borrowers must post copies of the Agency's prepayment acceptance notice in public areas throughout the housing project until prepayment is made. If the prepayment acceptance was based on a borrower's agreement to comply with restrictive-use provisions, the notice will describe the restrictive-use provisions that will apply to the housing project after prepayment and the tenant's rights to enforcement of the provisions.

(d) If the borrower withdraws the prepayment request, the Agency will provide a prepayment request cancellation notice to each tenant in the housing project. Borrowers must post copies of the prepayment request cancellation notice in the public areas throughout the housing project for a period of 60 days following the date of the prepayment request cancellation notice.

(e) If the borrower agrees to accept incentives and restrictive-use provisions, the Agency will notify each tenant, in writing, of the agreement and provide a description of the restrictive-use provision.

(f) If a borrower agrees to sell a housing project involved in a prepayment request to a nonprofit organization or public body, the Agency will notify each tenant, in writing, of the proposed sale to a nonprofit organization or public body and will explain the timeframes involved with the proposed sale, any potential impact on tenants, and the actions tenants may take to alleviate any adverse impact. Borrowers must post copies of the Agency's proposed sale notice in public areas throughout the housing project until the housing project is sold or the offer to sell is withdrawn.

(g) If a tenant applicant signs a lease in a housing project for which a prepayment request has been submitted, the borrower must provide the tenant with copies of all notifications provided to tenants by the Agency or the borrower prior to the tenant's occupancy in the housing project.

(h) If a borrower is unable to sell a housing project involved in a prepayment request to a nonprofit organization or public body within 180 days as specified in §3560.659, the Agency will send a notice to each tenant in the housing project explaining the potential impact of the borrower's inability to sell the housing project on tenants and the actions tenants may take to alleviate any adverse impact. Borrowers must post the Agency's notice in public areas throughout the housing project for a period of 60 days following the date of the notice.

§3560.655 Agency requested extension.

Before accepting an offer to prepay from a borrower with a restricted loan, the Agency must first make a reasonable effort to enter into a new restrictive-use agreement with the borrower. Under this agreement, the borrower would make a binding commitment to extend the low-income use of the housing and related facilities for 20 years for loans with interest credit, beginning on the date on which the new agreement is executed. If the borrower is unwilling to enter into a new restrictive-use provisions and restrictive-use agreement, the Agency should proceed to take the actions described in §3560.658.

§3560.656 Incentives offers.

(a) The Agency will offer a borrower, who submits a prepayment request meeting the conditions of §3560.653(d), incentives to agree to the restrictive-use period in §3560.662 if the following conditions are met:

(1) The market value of the housing project is determined by the Agency, based on an appraisal conducted in accordance with subpart P of this part.

(2) There are no restrictive-use agreements or prepayment prohibitions in affect.

(b) Specific incentives offered will be based on the Agency's assessment of:

(1) The value of the housing project as determined by the Agency based on an "as-is" market value appraisal conducted in accordance with subpart P of this part;

(2) An incentive amount that will provide a fair return to the borrower;

(3) An incentive amount that will not cause basic rents at the housing project to exceed conventional rents for comparable units; except that when determined necessary by the Agency to allow for decent, safe and sanitary housing to be provided in market areas where conventional rents are not sufficient to cover necessary operating, maintenance, and reserve costs. Basic rents may be allowed to exceed comparable rents for conventional units, but in no case by more than 150% of the comparable rent for conventional unit rent level; and

(4) An incentive amount that will be the least costly alternative for the Federal Government while being consistent with the Agency's commitment to the preservation of housing for very-low, low, and moderate income households in rural areas.

(c) The Agency may offer the following incentives:

(1) The Agency may increase the borrower's annual return on equity by one of the following two methods. The actual withdrawal of the return remains subject to the procedures and conditions for withdrawal specified in subpart G of this part.

(i) The Agency may recognize the borrower's current equity in the housing project. The equity will be determined using an Agency accepted appraisal based on the housing project's value as unsubsidized conventional housing.

(ii) When a current appraisal indicates an equity loan cannot be made, the Agency may recognize the borrower's current equity in the housing project at the higher of the original rate of return or the current 15-year Treasury bond rate plus 2 percent rounded to the nearest one-quarter percent. The equity will be determined using the most recent Agency accepted appraisal of the housing project prior to receiving the prepayment request.

(2) The Agency may agree to convert projects without interest credit or with Plan I interest credit to Plan II interest credit or increase the interest credit subsidy for loans with Section 8 assistance to lower the interest rate on the loan and make basic rents more financially feasible.

(3) The Agency may offer additional rental assistance, or an increase in assistance provided under existing contracts under Sec. §521(a)(2), 521(a)(5) of the Housing Act of 1949 (42 U.S.C. 1490a(a)(2)) or section 8 of the United States Housing Act of 1937 (42 U.S.C. §1437f).

(4) The Agency may make an equity loan to the borrower. The equity loan must not adversely affect the borrower's ability to repay other Agency loans held by the borrower and must be made in conformance with the following requirements:

(i) The equity loan must not exceed the difference between the current unpaid loan balance and 90 percent of the housing project's value as determined by an “as-is” market value appraisal conducted in accordance with subpart P of this part.

(ii) Borrowers with farm labor housing loans are not eligible to receive equity loans as incentives.

(iii) If an incentive offer for an equity loan is accepted, the equity loan may be processed and closed with the borrower or any eligible transferee.

(iv) Excess reserve funds will be used to reduce the amount of an equity loan offered to a borrower.

(v) Equity loans may not be offered unless the Agency determines that other incentives are not adequate to provide a fair return on the investment of the borrower to prevent prepayment of the loan or to prevent displacement of project tenants.

(5) The Agency will offer rental assistance to protect tenants from rent overburden caused by any rent increase as a result of a borrower's acceptance of an incentive offer or tenants who are currently overburdened.

(6) In housing projects with project-based section 8 assistance, the Agency may permit the borrower to receive rents in excess of the amounts determined necessary by the Agency to defray the cost of long-term repair or maintenance of such a project.

(d) The Agency must determine that the combination of assistance provided is necessary to provide a fair return on the investment of the borrower and is the least costly alternative for the Federal Government.

(e) At the time the incentive is developed, the Agency must take into consideration the costs of any deferred maintenance, items in the housing project's operating budget, and any expected long-term repair or replacement costs based on a capital needs assessment developed in accordance with §3560.103(c). Deferred maintenance may include specific items identified in previous Agency inspections where the borrower has had the opportunity and resources available to take corrective actions and did not.

(1) Deferred maintenance does not include routine repair and replacement that results from normal wear and tear of the physical asset. The amount required for the reserve account to be considered fully funded will be adjusted accordingly. To determine if basic rents exceed conventional rents for comparable units in the area, monthly contributions necessary to obtain the adjusted fully funded reserve account will be included in the calculation of basic rents.

(2) Deferred maintenance including any deficiencies identified in project compliance with section 504 of the Rehabilitation Act of 1973 must be addressed as part of the development of the incentive and must be completed as part of an acceptance agreement of any incentive.

(f) Existing loans must be consolidated, provided consolidation retains the Agency's lien position, and reamortized in accordance with subparts I and J of this part, provided it maintains feasibility of the housing for the tenants or reduces the debt service or the level of monthly rental assistance.

(g) The borrower must accept or reject the incentive offer within 30 days. If no answer to the offer is received within 30 days, the Agency may consider the incentive offer to be rejected.

(1) If the borrower accepts the incentive offer, procedures outlined in §3560.657 must be followed.

(2) If the borrower rejects the incentive offer, the borrower must comply with requirements listed in §3560.658.

§3560.657 Processing and closing incentive offers.

(a) Borrower responsibilities. If a borrower accepts the Agency's offer of incentives, the borrower must complete the following actions:

(1) Subject to the Agency's approval, the borrower must legally restrict the use of the project in accordance with and for the number of years stated in §3560.662.

(2) If the incentive offer accepted includes an equity loan, the borrower must complete an application for the equity loan, and the borrower must continue to qualify as an eligible borrower or transferee in accordance with subpart B of this part.

(3) If the incentive offer accepted includes rent increases, the borrower must follow the rent increase requirements established in subpart E of this part.

(b) Waiting lists. If funds for components of incentive offers are limited, the Agency will establish a waiting list of accepted incentive offers for funding in the date order that the complete prepayment request was received.

(c) Unfunded incentive offers. If the borrower accepts the incentive offer but the Agency is unable to fund the incentive within 15 months, the borrower may choose one of the following actions:

(1) The borrower may offer to sell the housing project in accordance with §3650.659. In this case the borrower will be removed from the list of borrowers awaiting incentives.

(2) The borrower may stay on the list of borrowers awaiting incentives until the borrower's incentive offer is funded. The Agency will not negotiate the incentive offer; but, at a borrower's request, may adjust the incentive amount to reflect an updated appraisal, loan balance, and terms of third party financing.

(3) The borrower may withdraw the prepayment request and be removed from the list of borrowers awaiting incentives and either continue operating the housing project for program purposes and in accordance with Agency requirements or continue processing their prepayment process in accordance with §3560.658. If the borrower chooses to withdraw their request, the borrower may resubmit an updated prepayment request, at any time, and repeat the prepayment process in accordance with this subpart.

(4) The borrower may elect to obtain a third-party equity loan provided rents will not exceed comparable rents in the market area.

§3560.658 Borrower rejection of the incentive offer.

(a) If a borrower rejects the incentive package offered by the Agency or an Agency request to extended restrictive-use provisions, made in accordance with §3560.662, the loan will only be prepaid if the borrower elects to agree to the following:

(1) The borrower agrees to sign restrictive-use provisions to extend restrictive-use by 10 years from the date of prepayment, and at the end of the restrictive-use period offer to sell the housing to a qualified nonprofit organization or public body in accordance with §3560.659.

(2) If restrictive-use provisions are in place, the borrower will agree to sign the restrictive-use provisions, as determined by the Agency, and at the end of the restrictive-use period offer to sell the housing to a qualified nonprofit organization or public body in accordance with §3560.659.

(3) If restrictive-use provisions are not in place prior to prepayment, the borrower will offer to sell the housing to a qualified nonprofit organization or public body in accordance with §3560.659.

(b) If the borrower does not elect or agree to enter an agreement in accordance with paragraph (a) of this section, then the Agency will assess the impact of prepayment on two factors: housing opportunities for minorities and the supply of decent, safe, sanitary, and affordable housing in the market area. The Agency will review relevant information to determine the availability of comparable affordable housing for existing tenants in the market area and if minorities in the project, on the waiting list or in the market area will be disproportionately adversely affected by the loss of the affordable rental housing units.

(1) If the Agency determines that prepayment will have an adverse impact on minorities, then the borrower must offer to sell to a qualified nonprofit organization or public body in accordance with the provisions of paragraph (a) of this section.

(2) If the Agency determines that the prepayment will not have an adverse effect on housing opportunities for minorities but there is not an adequate supply of decent, safe, and sanitary rental housing affordable to program eligible tenant households in the market area, the loan may be prepaid only if the borrower agrees to sign restrictive-use provisions, as determined by the Agency, to protect tenants at the time of prepayment.

(3) If the Agency determines that there is no adverse impact on minorities and there is an adequate supply of decent, safe, and sanitary rental housing affordable to program eligible tenant households in the market area the prepayment will be accepted with no further restriction.

(c) If the borrower agrees to the restrictive-use provisions, as determined by the Agency, the applicable language must be included in the release documents and the borrower must execute a restrictive-use agreement acceptable to the Agency and a deed restriction.

(d) If the borrower will not agree to applicable restrictive-use provisions, as determined by the Agency, the borrower must offer to sell to a nonprofit or public body in accordance with §3560.659 or withdraw their prepayment request.

§3560.659 Sale or transfer to nonprofit organizations and public bodies.

(a) Sales price. For the purposes of establishing a sales price when a borrower is required or elects to sell a housing project to a nonprofit organization or public body, two independent appraisals will be ordered, one by the Agency and one by the borrower. Both appraisals will conclude market value and be in accordance with subpart P of this part. If the borrower's assessment of the Agency's appraised market value indicates that no further appraisal is needed, the borrower may agree to accept the Agency's appraisal.

(1) The expense of the borrower's appraisal shall be borne by the borrower. The appraiser selected may not have an identity of interest with the borrower.

(2) If the two appraisers fail to agree on the market value, the Agency and the borrower will jointly select an appraiser whose appraisal will be binding on the Agency and the borrower. The Agency and the borrower shall jointly fund the cost of the appraisal.

(b) Marketing to nonprofit organizations and public bodies. If a borrower must offer the property for sale to a nonprofit organization or public body under this paragraph, the borrower must take the following actions to inform appropriate entities of the sale:

(1) The borrower must advertise and offer to sell the project for a minimum of 180 days. The borrower may choose to suspend advertising and other sales efforts while eligibility of an interested purchaser is determined. If the purchaser is determined to be ineligible, the borrower must resume advertising for the balance of the required 180 days.

(2) The Agency will assist the borrower in initially notifying nonprofit organizations and public bodies.

(3) The borrower must provide the nonprofit organizations and public bodies contacted with sufficient information regarding the housing project and its operations for interested purchasers to make an informed decision. The information provided must include the minimum value of the housing project based on the market value determined in accordance with paragraph (a) of this section.

(4) If an interested purchaser requests additional information concerning the housing project, the borrower must promptly provide the requested materials.

(c) Preference for local nonprofit and public bodies. Local nonprofit organizations and public bodies have priority over regional and national nonprofit organizations and public bodies. The Agency may determine that no local nonprofit organizations or public bodies are available to purchase the housing project. After this determination, the borrower may accept an offer from a regional or national nonprofit organization or public body.

(d) Eligible nonprofit organizations. To be eligible to purchase properties under the conditions of this subpart, nonprofit organizations may not have among its officers or directorate any persons or parties with an identity-of-interest (or any persons or parties related to any person with identity-of-interest) in loans financed under section 515 that have been prepaid. In addition to local nonprofit organizations, eligible nonprofit organizations include regional or national nonprofit organizations or public bodies provided no part of the net earnings of which accrue to the benefit of any member, founder, contributor or individual.

(e) Requirements for nonprofit organizations and public bodies. To purchase and operate a housing project, a nonprofit organization or public body must meet the following requirements:

(1) The purchaser must agree to maintain the housing project for very low- and low-income families or persons for the remaining useful life of the housing and related facilities. However, currently eligible moderate-income tenants will not be required to move.

(2) The purchaser must agree that no subsequent transfer of the housing project will be permitted for the remaining useful life of the housing project unless the Agency determines that the transfer will further the provision of housing for low-income households, or there is no longer a need for the housing project. Language to be included in the deed, conveyance instrument, loan resolution, and assumption agreement (as applicable) is provided in §3560.662.

(3) The purchaser must demonstrate financial feasibility of the housing project including anticipated funding.

(4) The purchaser must certify to the Agency that no identity-of-interest relationships in accordance with §3560.102(g). The purchaser must not have any identity of interest with the seller or any borrower that has previously prepaid or requested prepayment of an Agency MFH loan.

(5) The purchaser must complete an Agency-approved application and obtain Agency approval in accordance with subpart B of this part.

(6) The purchaser must make a bona fide offer taking into consideration the value of the housing project as determined in accordance with paragraph (a) of this section.

(f) Selection priorities. If more than one qualified nonprofit organization or public body submits an offer to purchase the project at the same time, priority will be given to local nonprofit organizations and public bodies over regional and national nonprofit organizations or public bodies. When selecting between offers equally meeting all other criteria, the borrower will first consider the success of the nonprofit organization's or public body's previous experience in developing and maintaining subsidized housing, with preference given to the most successful. If the offers continue to be equal, the borrower will then consider the number of years experience that the nonprofit organization or public body has had in developing and maintaining subsidized housing, with preference given to the greater number of years.

(g) Loans made by the Agency or other sources to nonprofit organizations and public bodies. Agency loans to nonprofit organizations or public bodies may be made for the purposes described in this paragraph. Agency loans will be processed in accordance with subpart B of this part. Loans from other sources will be approved by the Agency in accordance with subpart I of this part.

(1) Agency loans to nonprofit organizations or public bodies for the purchase of a housing project will be based on the appraised value determined in accordance with paragraph (a) of this section.

(2) With proper justification, an Agency loan may be made to help the nonprofit organization or public body meet the housing project's first year operating expenses if there are insufficient funds in the housing project's general operating

and expense account to meet such expenses. An Agency loan, for the purpose of covering first year operating expenses, may not exceed 2 percent of the housing project's appraised value determined in accordance with paragraph (c) of this section.

(h) Advances for nonprofit organizations and public bodies. The Agency may make advances, in accordance with section 502(c)(5)(c)(i), not in excess of limits established by Congress to nonprofit organizations or public bodies that are purchasing housing under this subpart. Grant funds may be used to cover any direct costs other than the purchase price, incurred by nonprofit organizations or public bodies in purchasing and assuming responsibility for the housing project.

(i) Waiting list. If funds for sales to nonprofit organizations and public bodies are limited, the Agency will add the funding requests to the waiting list for incentives and follow the process established in §3560.657(b) and (c).

(j) Withdrawal from sales process. A borrower may withdraw the prepayment request at any time prior to the sale of the property. The borrower will be responsible for any damages associated with breaking a sales contract established with a nonprofit organization or public body.

(k) When no offer to purchase is received. Prepayment with no further restriction may be accepted by the Agency when the borrower agrees to offer the housing project for sale to a nonprofit organization or public body in accordance with §3560.659 and no good faith offer is received within 180 days from the date that the housing project was advertised for sale to a nonprofit organization or public body, or a good faith offer was received within 180 days from the advertisement date but the offeror was unable to fulfill the terms of the offer within 24 months of the offer date, provided the owner cooperated with the potential purchaser.

§3560.660 Acceptance of prepayments.

(a) When the Agency agrees to accept prepayment, the Agency will notify borrowers, in writing, of the conditions under which the Agency will accept prepayment including the specific restrictive-use provisions to which the borrower has agreed and the date by which the borrower must make the prepayment.

(1) Prepayment must be made 180 days from the date of the Agency's prepayment acceptance notice to the borrower.

(2) If the borrower's prepayment is not received within 180 days of the prepayment acceptance notice and the Agency has not agreed to an alternative date based on a written request from the borrower, the Agency may cancel the prepayment acceptance agreement.

(b) Tenants will be notified of the prepayment acceptance agreement in accordance with §3560.654(c). If a prepayment is anticipated to result in increased net tenant contributions, displacements or involuntary relocations, the tenants, who are affected by such a circumstance, may request a Letter Of Priority Entitlement (LOPE) in accordance with §3560.159(c). Tenants must request a LOPE within one year of the prepayment acceptance notice date.

(c) Owners will provide certification stating that they will meet state and local laws prior to prepayment acceptance.

§3560.661 Sale or transfers.

(a) If a sale or transfer is to take place in conjunction with the Agency incentive offer, the sale or transfer must comply with the processing provisions of subpart I of this part.

(b) If a proposed transferee is determined not to be eligible for the transfer and assumption, the borrower will be given an additional 45 days to find another transferee.

(c) In cases where the existing owner is in program non-compliance or default, the Agency may make an offer of incentives contingent on the successful transfer of the housing to an acceptable purchaser. The Agency may offer a smaller incentive or no incentive if the borrower does not agree to transfer the project to an acceptable purchaser, or if the transfer does not take place.

§3560.662 Restrictive-use provisions and agreements.

All restrictions require Agency approval and must be in accordance with the following restrictions:

(a) The undersigned, and any successors in interest, agree to use the property (described herein) in compliance with 42 U.S.C. 1484 or 1485, whichever is applicable, and applicable regulations and the subsequent amendments, for the purpose of housing:

(1) Very low-, or low-income households when required by §3560.658(a)(3), or

(2) Very low-, low-, or moderate-income households.

(b) The period of the restriction will be inserted in accordance with the following:

(1) 10 years if required by §3560.658(a)(1);

(2) The last existing tenant (that occupied the property on the date of prepayment) voluntarily vacates if required by §3560.658(b)(2);

(3) 30 years if required by §3560.406(g);

(4) Remaining period of existing restrictive-use provisions and any agreed extension if required by §3560.655 or §3560.658 (a)(2);

(5) The remaining useful life of the housing and related facilities if required by §3560.658(a)(3); and

(6) 20 years in all other cases.

(c) When required by §3560.658(a)(1) or (a)(2), the undersigned agrees that at the end of the expiration of the period described in paragraph (b) of this section, the property will be offered for sale to a qualified nonprofit organization or public body, in accordance with previously cited statutes and regulations.

(d) The Agency and eligible tenants or applicants may enforce these restrictions.

(e) The undersigned also agrees to:

(1) To set rents, other charges, and conditions of occupancy in a manner to meet these restrictions;

(2) To post an Agency approved notice of this restriction for the tenants of the property;

(3) To adhere to applicable local, state, and Federal laws; and

(4) To obtain Agency concurrence for any rental procedures that deviate from those approved at the time of prepayment, prior to implementation.

(f) The undersigned will be released from these obligations before the termination period in paragraph (b) of this section only when the Agency determines that there is no longer a need for the housing or that financial assistance provided the residents of the housing will no longer be provided due to no fault, action or lack of action on the part of the borrower.

§3560.663 Post-payment responsibilities for loans subject to continued restrictive-use provisions.

(a) If a borrower prepays a loan and the housing project remains subject to restrictive-use provisions, the requirements of this section apply after prepayment.

(b) Owners of prepaid housing projects will be responsible for ensuring that the restrictive-use provisions agreed to as a condition of prepayment are observed.

(c) Owners must maintain appropriate documentation to demonstrate compliance with the restrictive-use provisions and must make the documentation and the housing project site available for Federal Government inspection upon request.

(1) Owners must document rent increases in accordance with subpart G of this part.

(2) Owners must document tenant eligibility in accordance with §3560.152.

(3) In an Agency approved format, owners must provide the agency with a signed and dated certification within 30 days of the beginning of each calendar year for the full period of the restrictive-use provisions establishing that the restrictive-use provisions are being met.

(d) Owners must observe Agency policies on tenant grievances as described in §3560.160. The Agency may enforce restrictive-use provisions through administrative and legal actions. Tenants may enforce the restrictive-use provisions by contacting the Agency or through legal action. The Agency will release the restrictive-use provisions when the Agency conditions have been met.

§§3560.664-3560.699 [Reserved]

§3560.700 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart O--Unauthorized Assistance

§3560.701 General.

(a) This subpart contains the policies for recapturing unauthorized assistance when the Agency determines that a borrower or tenant was ineligible for, or improperly used, assistance received from the Agency.

(b) The Agency may seek repayment of any unauthorized assistance provided to a borrower or tenant, plus the cost of collection, regardless of whether the unauthorized assistance was due to errors by the Agency, the borrower, or the tenant.

§3560.702 Unauthorized assistance sources and situations.

(a) Unauthorized assistance can be received by a borrower or tenant in the form of loans, grants, interest credit, rental assistance, or other assistance provided by the Agency including assistance received as a result of an incorrect interest rate being applied to an Agency loan. Agency officials may pursue identification and recapture of unauthorized assistance through any legal remedies available.

(b) Unauthorized assistance may result from situations such as:

(1) Assistance being provided to an ineligible borrower or tenant;

(2) Assistance to an eligible borrower or tenant being used for an unauthorized purpose;

(3) Assistance being obtained as a result of inaccurate, incomplete, or fraudulent information provided by a borrower or tenant; or

(4) Assistance being obtained as a result of errors by the Agency, borrower, or tenant.

§3560.703 Identification of unauthorized assistance.

(a) The Agency will use all available means to identify unauthorized assistance, including Agency monitoring activities, OIG reports, GAO reports, and reports from any source, if the information provided can be substantiated by the Agency.

(b) Borrowers have the primary responsibility for identifying repayment of unauthorized assistance received by tenants.

§3560.704 Unauthorized assistance determination notice.

(a) The Agency will notify borrowers, in writing, when a determination has been made that unauthorized assistance was received by the borrower. Borrowers will notify tenants, in writing, when a determination is made that unauthorized assistance was received by the tenant and will simultaneously send the Agency of copy of the written notice to the tenant.

(b) The unauthorized assistance determination notice is a preliminary notice, not a demand letter. The unauthorized assistance determination notice will:

(1) Specify the reasons the assistance was determined to be unauthorized;

(2) State the amount of unauthorized assistance to be repaid and specify the party responsible for repayment of the unauthorized assistance (i.e., the tenant or borrower) according to the provision of §3560.708;

(3) Establish a place and time when the person receiving the unauthorized assistance determination notice may meet with the Agency or, in the case of tenants, may meet with the borrower, to discuss issues related to the unauthorized assistance notice such as the establishment of a repayment schedule; and

(4) Advise the borrower or tenant that they may present facts, figures, written records, or other information within a specified period of time which might alter the determination that the assistance received was unauthorized.

(c) Upon request, the Agency or borrower, in the case of tenants, will grant additional time for discussions related to an unauthorized assistance determination notice. Borrowers must notify the Agency of schedule revisions when additional time is granted to a tenant in unauthorized assistance claims.

§3560.705 Recapture of unauthorized assistance.

(a) The Agency will seek repayment of all unauthorized assistance received by a borrower or tenant, plus the cost of collection, to the fullest extent permitted by law. Agency efforts to collect unauthorized assistance may include offsets, the use of private or public collection agents, and any other remedies available. Agency findings related to unauthorized assistance determinations will be referred to credit reporting bureaus and other federal, state, or local agencies with jurisdictions related to the unauthorized assistance findings for suspension, debarment, civil or criminal action to the fullest extent permitted by law.

(b) If a borrower or tenant agrees to repay unauthorized assistance, the amount due will be the amount stated in the unauthorized assistance determination notice unless another amount has been approved by the Agency.

(c) Repayment may be made either with a lump sum payment or through payments made over a period of time. If a borrower or tenant agrees to repay unauthorized assistance, the borrower or tenant proposed repayment schedule must be approved by Agency prior to implementation. Agency approval of a repayment schedule will take into consideration the best interest of the borrower, the tenant, and the Federal Government.

(d) Borrowers must retain copies of all correspondence and a record of all conversations between the borrower and a tenant regarding unauthorized assistance received by a tenant.

(e) When a tenant, who has received unauthorized assistance due to tenant error or fraud as determined by the Agency, moves out of a housing project, the borrower is no longer responsible for recapturing the unauthorized assistance provided that the borrower notifies the Agency of the tenant's move and transfers all records related to the tenant's unauthorized assistance to the Agency within 30 days of the tenant's move. The Agency will pursue collection of the unauthorized assistance from the tenant.

(f) If a borrower refuses to enter into an unauthorized assistance repayment schedule with the Agency, the Agency will initiate liquidation procedures, in accordance with §3560.456, or other enforcement actions, such as suspension, debarment, civil, or criminal penalties, in accordance with §3560.461. If a tenant refuses to enter into an unauthorized assistance repayment schedule, the Agency will initiate recovery actions against the tenant.

(g) Borrowers may not use housing project funds to pay amounts due to the Agency as a result of unauthorized assistance due to borrower fraud.

§3560.706 Offsets.

Offsets and any other available remedies may be used by the Agency to recapture unauthorized assistance. Guidance concerning use of offsets can be found at 7 CFR 3550.210.

§3560.707 Program participation and corrective actions.

(a) With Agency approval, a borrower or tenant, who has received unauthorized assistance, may continue to participate in the project if they have the legal and financial capabilities to do so. Approval considerations for such forbearance and repayment are in §3560.705.

(b) A borrower or tenant who was responsible for the circumstances causing the unauthorized assistance must take appropriate action to correct the problem within 90 days of the unauthorized assistance determination notice date, unless an alternative date is agreed to by the Agency.

(c) When the interest rate shown in a debt instrument resulted in the receipt of unauthorized assistance, the debt instrument will be modified to the correct interest rate. All payments made by the borrower at the incorrect interest rate will be reapplied at the correct interest rate, and remaining payments due on the loan will be recalculated on the basis of the correct interest rate, plus any amounts due to the Agency as a result of the use of an incorrect interest rate, unless the Agency agrees to a separate repayment process.

§3560.708 Unauthorized assistance received by tenants.

(a) Tenant actions that require tenant repayment of unauthorized assistance received by tenants include, but are not limited to:

(1) Knowingly or mistakenly misrepresenting income, assets, adjustments to income, or household status to the borrower as required under subpart D of this part; or

(2) Failure to properly report changes in income, assets, adjustments to income, or household status to the borrower as required in subpart D of this part.

(b) Borrower actions that require borrower repayment of unauthorized assistance received by tenants include, but are not limited to:

(1) Incorrect determination of tenant income or household status by the borrower, resulting in rental assistance or interest credit that is not allowable under the provisions of subparts D, E, or F of this part, as applicable; or

(2) Assignment of rental assistance to a household that is ineligible under the requirements of subpart F of this part.

(c) When it is determined that a tenant has received unauthorized assistance, the borrower shall notify the tenant and the Agency through the procedure specified in §3560.704.

(d) Borrowers may not charge tenants to pay amounts due to the Agency as a result of unauthorized assistance to tenants through borrower error.

(e) Borrowers must notify the Agency of all collections from tenants as repayments for unauthorized assistance and must remit or credit the amounts collected to applicable housing project accounts.

(f) When rental assistance was improperly assigned to a tenant, for any reason, the rental assistance benefit must be canceled and reassigned.

(1) Before a borrower notifies a tenant of rental assistance cancellation, the borrower must request Agency approval. If the Agency determines that the unauthorized rental assistance was received by the tenant due to borrower fraud or error, the borrower must give the tenant 30 days notice, in writing, that the unit was assigned in error and that the rental assistance benefit will be canceled effective on date that the next monthly rental payment is due after the end of the 30-day notice period.

(2) Tenants also must be notified, in writing, that they may cancel their lease without penalty at the time the rental assistance is canceled. Tenants must be offered an opportunity to meet with a borrower to discuss the rental assistance cancellation.

§3560.709 Demand letter.

(a) If a borrower fails to respond to an unauthorized assistance determination notice or fails to agree to a repayment schedule, the Agency will send the borrower a demand letter specifying:

(1) The amount of unauthorized assistance to be repaid and the basis for the unauthorized assistance determination; and

(2) The actions to be taken by the Agency if repayment is not made by a specified date.

(b) If a tenant fails to respond to the unauthorized assistance determination notice or fails to agree to a repayment schedule, the borrower will send the tenant a demand letter specifying:

(1) The amount of unauthorized assistance to be repaid and the basis for the unauthorized assistance determination;

(2) The actions to be taken if repayment is not made by a specified date, including termination of tenancy; and

(3) The appeal rights of the tenant as specified in §3560.160.

(c) A demand letter may be sent to a borrower or tenant, in lieu of an unauthorized assistance determination notice, when the evidence documenting the unauthorized assistance determination is deemed to be conclusive by the Agency or borrower sending the letter.

§§3560.710-3560.749 [Reserved]

§3560.750 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart P--Appraisals

§3560.751 General.

This subpart sets forth appraisal policies for Agency-financed multi-family housing (MFH) projects consisting of five or more rental units. Agency-financed housing projects with fewer than five rental units may be appraised in accordance with the Agency's single family housing appraisal policies established under 7 CFR 3550.62.

§3560.752 Appraisal use, request, review, and release.

(a) Appraisal uses. The Agency will use appraisals to determine whether the security offered by an applicant or borrower is adequate to secure a loan or determine appropriate servicing or preservation decisions. Appraisals used for Agency decision-making must be current, unless the Agency and the applicant, or borrower, mutually agree to the use of an appraisal that is not current. A current appraisal is an appraisal with a report date that is not more than one year old.

(b) Appraisal requests. Appraisal requests must be in writing and must specify the client and other intended users, the intended use, the purpose, and the scope of work of the appraisal, including the type and definition of the value(s) to be developed.

(1) Type of Value. The appraisal request must indicate whether the “market value”, the “market value, subject to restricted rents”, or any other type of value of the housing project and related facilities is to be concluded.

(i) A request for “market value, subject to restricted rents” means the appraisal will take into consideration any rent limits, rent subsidies, expense abatements, or restrictive-use conditions that will affect the property as a result of an agreement with the Agency or any other financing source. Each type of financing involved, including, but not limited to, interest credit subsidy, low-interest loans from other sources,

tax-exempt bond financing, tax credits, and grants, must be valued separately in the appraisal.

(ii) A request for "market value" means the appraisal will take into consideration the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

(A) Buyer and seller are typically motivated;

(B) Both parties are well informed or well advised and acting in what they consider their best interests;

(C) A reasonable time is allowed for exposure in the open market;

(D) Payment is made in terms of cash in United States dollars or in terms of financial arrangements comparable thereto; and

(E) The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

(2) "As-is Value" or "Prospective Value". The appraisal request must indicate whether the "as-is value" or "prospective value" of the housing is to be concluded.

(i) "As-is value" means the value of the housing and related facilities as of the effective date of the appraisal. It relates to what physically exists and is legally permissible at the time of the appraisal and excludes all hypothetical conditions.

(ii) "Prospective value" means the forecasted value of the housing and related facilities as of a specified future date. For Agency appraisals, this date will typically be the projected completion date of proposed new construction or rehabilitation.

(3) Section 8 project-based assistance. Depending on the intended use of the appraisal, the Agency will specify whether or not section 8 project-based assistance will be considered in the valuation of the housing. The remaining term of the section 8 contract and the probability of subsequent renewal terms being authorized will be taken into consideration when making this determination.

(4) Low-Income Housing Tax Credit (LIHTC) and other financing sources. Depending on the intended use of the appraisal, the Agency will specify whether or not tax credits and other financing sources involved in the housing will be considered in the valuation of the housing.

(c) Appraisal review. All MFH appraisals that were not written by an Agency appraiser will be reviewed by an Agency appraiser, who will write and file a technical review report that complies with the Uniform Standards of Professional Appraisal Practice (USPAP) and Agency requirements.

(d) Release of appraisals. MFH appraisals procured by the Agency will be released to owners/applicants, from their own files, upon their request.

§3560.753 Agency appraisal standards and requirements.

(a) General. The Agency recognizes USPAP as the basic standards for appraisals. Appraisals used by the Agency must comply with USPAP and this subpart.

(b) Appraisers. MFH appraisals prepared for the Agency will be written by Agency appraisers or independent fee appraisers who are state certified general appraisers, certified in the state where the property is located. Technical review reports will be written by Agency state certified general appraisers.

(c) Appraisal report. The appraisal report format may be a form appraisal or a narrative appraisal. The Agency will specify the appraisal format that is most appropriate for the scope of work involved when the appraisal is requested.

(1) Form appraisal reports. The Agency will accept appraisal report forms that meet generally accepted industry standards, comply with USPAP, and have been approved by the Agency.

(2) Narrative appraisal reports. Narrative appraisal reports must, at a minimum, contain the following items:

(i) Transmittal letter;

(ii) Factual information about the property;

(iii) Regional and neighborhood data;

(iv) Description of the subject property;

(v) Description of existing and planned improvements;

(vi) A highest and best use analysis;

(vii) A statement regarding any environmental issues, such as potential contamination of the property from hazardous substances, hazardous wastes, or petroleum products;

(viii) A cost approach analysis (if applicable);

(ix) A sales comparison approach analysis (if applicable);

(x) An income approach analysis (if applicable);

(xi) A reconciliation of the value indications derived from the included approaches to value; and

(xii) A signed and dated certification of value.

(3) At the time an appraisal is requested, the Agency will specify either a complete or a limited appraisal and one of the following types of appraisal reports, based upon the complexity of the appraisal assignment.

(i) A self-contained report that comprehensively describes all information significant to the solution of the appraisal problem;

(ii) A summary report that summarizes all information significant to the solution of the appraisal problem; or

(iii) A restricted use report, intended for Agency use only, that briefly states all information significant to the solution of the appraisal problem.

(d) Highest and best use statement and analysis. The highest and best use is to be concluded for the subject site as though it was vacant, and for the subject property as improved, if improvements have been made. If the highest and best use of a subject property is for something other than MFH, the appraisal report must provide this information to the Agency for consideration in the loan process. In addition to being reasonably probable and appropriately supported, the highest and best use of both the land as though vacant and the property as improved must meet four implicit criteria. The highest and best use must be:

(1) Physically possible;

(2) Legally permissible;

(3) Financially feasible; and

(4) Maximally productive.

(e) Valuation methods and variances. The final opinion of value presented in an appraisal report must have considered a cost approach, a sales comparison approach, and an income approach. If one of these standard approaches is not used, the reconciliation narrative will provide a full and complete explanation of the reasons the approach was excluded. The reconciliation will fully discuss and reconcile variances in the value indications concluded by each approach.

(f) Real estate history. Appraisals must contain a 5-year ownership and sales history for the housing project being appraised.

(g) Reserve accounts. Funds in the housing project's reserve account will not be considered in the valuation of the housing project.

(h) Escrow accounts. Short-term prepaid escrow accounts for general operating expenses, such as taxes and insurance, shall not be considered in the valuation of the housing project.

(i) Rental rates comparison. The appraisal report must document whether the housing project's basic rents are less than, equal to, or greater than market rents for comparable conventional, or non-subsidized, units in the area where the housing is located.

(j) Description of housing and property rights. The appraisal report must identify and describe both the real estate, which is the land and improvements, and the real property, or property rights, being appraised.

(k) Exclusion of rental units from valuation. The Agency will provide appraisers with instructions and supporting information on any rental units that do not produce rental income at the time of the appraisal.

(l) Non-contiguous sites. When a housing project has real property located on non-contiguous sites, a separate appraisal must be developed for each site.

§§3560.754-3560.799 [Reserved]

§3560.800 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

APPENDIX 2

7 CFR Part 11—NATIONAL APPEALS DIVISION

Subpart A – National Appeals Division Rules of Procedure

Sec.

11.1 Definitions.
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11.12 Effective date and implementation of final determinations of the Division.
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11.14 Filing of appeals and computation of time.

AUTHORITY: 5 U.S.C. 301; Title II, Subtitle H, Pub. L. 103-354, 108 Stat. 3228 (7 U.S.C. 6991 *et seq.)*; Reorganization Plan No. 2 of 1953 (5 U.S.C. App.).

§ 11.1 Definitions.

For purposes of this part:

Adverse decision means an administrative decision made by an officer, employee, or committee of an agency that is adverse to a participant. The term includes a denial of equitable relief by an agency or the failure of an agency to issue a decision or otherwise act on the request or right of the participant within timeframes specified by agency program statutes or regulations or within a reasonable time if timeframes are not specified in such statutes or regulations. The term does not include a decision over which the Board of Contract Appeals has jurisdiction.

Agency means:

1. The Agricultural Stabilization and Conservation Service (ASCS);
2. The Commodity Credit Corporation (CCC);
3. The Farm Service Agency (FSA);
4. The Federal Crop Insurance Corporation (FCIC);
5. The Natural Resources Conservation Service (NRCS);
6. The Risk Management Agency (RMA);
7. The Rural Business-Cooperative Service (RBS);
8. Rural Development (RD);
9. The Rural Housing Service (RHS);
10. The Rural Utilities Service (RUS) (but not for programs authorized by the Rural Electrification Act of 1936 or the Rural Telephone Bank Act, 7 U.S.C. 901 et seq.);
11. The Soil Conservation Service (SCS);
12. A State, county, or area committee established under section 8(b)(5) of the Soil Conservation and Domestic Allotment Act (16 U.S.C. 590h(b)(5)); and
13. Any predecessor or successor agency to the above-named agencies, and any other agency or office of the Department which the Secretary may designate.

Agency record means all the materials maintained by an agency related to an adverse decision which are submitted to the Division by an agency for consideration in connection with an appeal under this part, including all materials prepared or reviewed by the agency during its consideration and decisionmaking process, but shall not include records or information not related to the adverse decision at issue. All materials contained in the agency record submitted to the Division shall be deemed admitted as evidence for purposes of a hearing or a record review under §11.8.

Agency representative means any person, whether or not an attorney, who is authorized to represent the agency in an administrative appeal under this part.

Appeal means a written request by a participant asking for review by the National Appeals Division of an adverse decision under this part.

Appellant means any participant who appeals an adverse decision in accordance with this part. Unless separately set forth in this part, the term "appellant" includes an authorized representative.

Authorized representative means any person, whether or not an attorney, who is authorized in writing by a participant, consistent with §11.6(c), to act for the participant in an administrative appeal under this part. The authorized representative may act on behalf of the participant except when the provisions of this part require action by the participant or appellant personally.

Case record means all the materials maintained by the Secretary related to an adverse decision. The case record includes both the agency record and the hearing record.

Days means calendar days unless otherwise specified.

Department means the United States Department of Agriculture (USDA).

Director means the Director of the Division or a designee of the Director.

Division means the National Appeals Division established by this part.

Equitable relief means relief which is authorized under section 326 of the Food and Agriculture Act of 1962 (7 U.S.C. 1339a) and other laws administered by the agency.

Ex parte communication means an oral or written communication to any officer or employee of the Division with respect to which reasonable prior notice to all parties is not given, but it shall not include requests for status reports, or inquiries on Division procedure, in reference to any matter or proceeding connected with the appeal involved.

Hearing, except with respect to §11.5, means a proceeding before the Division to afford a participant the opportunity to present testimony or documentary evidence or both in order to have a previous determination reversed and to show why an adverse determination was in error.

Hearing Officer means an individual employed by the Division who conducts the hearing and determines appeals of adverse decisions by any agency.

Hearing record means all documents, evidence, and other materials generated in relation to a hearing under §11.8.

Implement means the taking of action by an agency of the Department in order fully and promptly to effectuate a final determination of the Division.

Participant means any individual or entity who has applied for, or whose right to participate in or receive, a payment, loan, loan guarantee, or other benefit in accordance with any program of an agency to which the regulations in this part apply is affected by a decision of such agency. The term does not include persons whose claim(s) arise under:

1. Programs subject to various proceedings provided for in 7 CFR part 1;

2. Programs governed by Federal contracting laws and regulations (appealable under other rules and to other forums, including to the Department's Board of Contract Appeals under 7 CFR part 24);

3. The Freedom of Information Act (appealable under 7 CFR part 1, subpart A);
4. Suspension and debarment disputes, including, but not limited to, those falling within the scope of 7 CFR parts 1407 and 3017;
5. Export programs administered by the Commodity Credit Corporation;
6. Disputes between reinsured companies and the Federal Crop Insurance Corporation;
7. Tenant grievances or appeals prosecutable under the provisions of 7 CFR part 1944, subpart L, under the multi-family housing program carried out by RHS;
8. Personnel, equal employment opportunity, and other similar disputes with any agency or office of the Department which arise out of the employment relationship;
9. The Federal Tort Claims Act, 28 U.S.C. 2671 et seq., or the Military Personnel and Civilian Employees Claims Act of 1964, 31 U.S.C. 3721;
10. Discrimination complaints prosecutable under the nondiscrimination regulations at 7 CFR parts 15, 15a, 15b, 15e, and 15f; or
11. Section 361, et seq., of the Agricultural Adjustment Act of 1938, as amended (7 U.S.C. 1361, et seq.) involving Tobacco Marketing Quota Review Committees.

Record review means an appeal considered by the Hearing Officer in which the Hearing Officer's determination is based on the agency record and other information submitted by the appellant and the agency, including information submitted by affidavit or declaration.

Secretary means the Secretary of Agriculture.

§ 11.2 General statement.

(a) This part sets forth procedures for proceedings before the National Appeals Division within the Department. The Division is an organization within the Department, subject to the general supervision of and policy direction by the Secretary, which is independent from all other agencies and offices of the Department, including Department officials at the state and local level. The Director of the Division reports directly to the Secretary of Agriculture. The authority of the Hearing Officers and the Director of the Division, and the administrative appeal procedures which must be followed by program participants who desire to appeal an adverse decision and by the agency which issued the adverse decision, are included in this part.

(b) Pursuant to section 212(e) of the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994, Pub. L. 103-354 (the Act), 7 U.S.C. 6912(e), program participants shall seek review of an adverse decision before a Hearing Officer of the Division, and may seek further review by the Director, under the provisions of this part prior to seeking judicial review.

§ 11.3 Applicability.

(a) Subject matter. The regulations contained in this part are applicable to adverse decisions made by an agency, including, for example, those with respect to:

1. Denial of participation in, or receipt of benefits under, any program of an agency;
2. Compliance with program requirements;
3. The making or amount of payments or other program benefits to a participant in any program of an agency; and
4. A determination that a parcel of land is a wetland or highly erodible land.

(b) Limitation. The procedures contained in this part may not be used to seek review of statutes or USDA regulations issued under Federal Law.

§ 11.4 Inapplicability of other laws and regulations.

(a) Reserved.

(b) The Federal Rules of Evidence, 28 U.S.C. App., shall not apply to proceedings under this part.

§ 11.5 Informal review of adverse decisions.

(a) Required informal review of FSA adverse decisions. Except with respect to farm credit programs, a participant must seek an informal review of an adverse decision issued at the field service office level by an officer or employee of FSA, or by any employee of a county or area committee established under section 8(b)(5) of the Soil Conservation and Domestic Allotment Act, 16 U.S.C. 590h(b)(5), before NAD will accept an appeal of a FSA adverse decision. Such informal review shall be done by the county or area committee with responsibility for the adverse decision at issue. The procedures for requesting such an informal review before FSA are found in 7 CFR part 780. After receiving a decision upon review by a county or area committee, a participant may seek further informal review by the State FSA committee or may appeal directly to NAD under §11.6(b).

(b) Optional informal review. With respect to adverse decisions issued at the State office level of FSA and adverse decisions of all other agencies, a participant may request an agency informal review of an adverse decision of that agency prior to appealing to NAD. Procedures for requesting such an informal review are found at 7 CFR part 780 (FSA), 7 CFR part 614 (NRCS), 7 CFR part 1900, subpart B (RUS), 7 CFR part 1900, subpart B (RBS), and 7 CFR part 1900, subpart B (RHS).

(c) Mediation. A participant also shall have the right to utilize any available alternative dispute resolution (ADR) or mediation program, including any mediation program available under title V of the Agricultural Credit Act of 1987, 7 U.S.C. 5101 et seq., in order to attempt to seek resolution of an adverse decision of an agency prior to a NAD hearing. If a participant:

1. Requests mediation or ADR prior to filing an appeal with NAD, the participant stops the running of the 30-day period during which a participant may appeal to NAD under §11.6(b)(1), and will have the balance of days remaining in that period to appeal to NAD once mediation or ADR has concluded.

2. Requests mediation or ADR after having filed an appeal to NAD under §11.6(b), but before the hearing, the participant will be deemed to have waived his right to have a hearing within 45 days under §11.8(c)(1) but shall have a right to have a hearing within 45 days after conclusion of mediation or ADR.

§ 11.6 Director review of agency determination of appealability and right of participants to Division hearing.

(a) Director review of agency determination of appealability.

1. Not later than 30 days after the date on which a participant receives a determination from an agency that an agency decision is not appealable, the participant must submit a written request personally signed by the participant to the Director to review the determination in order to obtain such review by the Director.

2. The Director shall determined whether the decision is adverse to the individual participant and thus appealable or is a matter of general applicability and thus not subject to appeal, and will issue a final determination notice that upholds or reverses the determination of the agency. This final determination is not appealable. If the Director reverses the determination of the agency, the Director will notify the participant and the agency of that decision and inform the participant of his or her right to proceed with an appeal.

3. The Director may delegate his or her authority to conduct a review under this paragraph to any subordinate official of the Division other than a Hearing Officer. In any case in which such review is conducted by such a subordinate official, the subordinate official's determination shall be considered to be the determination of the Director and shall be final and not appealable.

(b) Appeals of adverse decisions.

1. To obtain a hearing under §11.8, a participant personally must request such hearing not later than 30 days after the date on which the participant first received notice of the adverse decision or after the date on which the participant receives notice of the Director's determination that a decision is appealable. In the case of the failure of an agency to act on the request or right of a recipient, a participant personally must request such hearing not later than 30 days after the participant knew or reasonably should have known that the agency had not acted within the timeframes specified by agency program regulations, or, where such regulations specify no timeframes, not later than 30 days after the participant reasonably should have known of the agency's failure to act.

2. A request for a hearing shall be in writing and personally signed by the participant, and shall include a copy of the adverse decision to be reviewed, if available, along with a brief statement of the participant's reasons for believing that the decision, or the agency's failure to act, was wrong. The participant also shall send a copy of the request for a hearing to the agency, and may send a copy of the adverse decision to be reviewed to the agency, but failure to do either will not constitute grounds for dismissal of the appeal. Instead of a hearing, the participant may request a record review.

(c) If a participant is represented by an authorized representative, the authorized representative must file a declaration with NAD, executed in accordance with 28 U.S.C. 1746, stating that the participant has duly authorized the declarant in writing to represent the participant for purposes of a specified adverse decision or decisions, and attach a copy of the written authorization to the declaration.

§ 11.7 Ex parte communications.

(a) Ex parte communications.

(1) At no time between the filing of an appeal and the issuance of a final determination under this part shall any officer or employee of the Division engage in ex parte communications regarding the merits of the appeal with any person having any interest in the appeal pending before the Division, including any person in an advocacy or investigative capacity. This prohibition does not apply to:

1. Discussions of procedural matters related to an appeal; or

2. Discussions of the merits of the appeal where all parties to the appeal have been given notice and an opportunity to participate.

(2) In the case of a communication described in paragraph (a)(1)(ii) of this section, a memorandum of any such discussion shall be included in the hearing record.

(b) No interested person shall make or knowingly cause to be made to any officer or employee of the Division an ex parte communication relevant to the merits of the appeal.

(c) If any officer or employee of the Division receives an ex parte communication in violation of this section, the one who receives the communication shall place in the hearing record:

1. All such written communications;

2. Memoranda stating the substance of all such oral communications; and

3. All written responses to such communications, and memoranda stating the substance of any oral responses thereto.

(d) Upon receipt of a communication knowingly made or knowingly caused to be made by a party in violation of this section the Hearing Officer or Director may, to the extent consistent with the interests of justice and the policy of the underlying program, require the party to show cause why such party's claim or interest in the appeal should not be dismissed, denied, disregarded, or otherwise adversely affected on account of such violation.

§ 11.8 Division hearings.

(a) General rules.

1. The Director, the Hearing Officer, and the appellant shall have access to the agency record of any adverse decision appealed to the Division for a hearing. Upon request by the appellant, the agency shall provide the appellant a copy of the agency record.

2. The Director and Hearing Officer shall have the authority to administer oaths and affirmations, and to require, by subpoena, the attendance of witnesses and the production of evidence. A Hearing Officer shall obtain the concurrence of the Director prior to issuing a subpoena.

i. A subpoena requiring the production of evidence may be requested and issued at any time while the case is pending before the Division.

ii. An appellant or an agency, acting through any appropriate official, may request the issuance of a subpoena requiring the attendance of a witness by submitting such a request in writing at least 14 days before the scheduled date of a hearing.

The Director or Hearing Officer shall issue a subpoena at least 7 days prior to the scheduled date of a hearing.

iii. A subpoena shall be issued only if the Director or a Hearing Officer determined that:

A. For a subpoena of documents, the appellant or the agency has established that production of documentary evidence is necessary and is reasonably calculated to lead to information which would affect the final determination or is necessary to fully present the case before the Division; or

B. For a subpoena of a witness, the appellant or the agency has established that either a representative of the Department or a private individual possesses information that is pertinent and necessary for disclosure of all relevant facts which could impact the final determination, that the information cannot be obtained except through testimony of the person, and that the testimony cannot be obtained absent issuance of a subpoena.

iv. The party requesting issuance of a subpoena shall arrange for service. Service of a subpoena upon a person named therein may be made by registered or certified mail, or in person. Personal service shall be made by personal delivery of a copy of the subpoena to the person named therein by any person who is not a party and who is not less than 18 years of age. Proof of service shall be made by filing with the Hearing Officer or Director who issued the subpoena a statement of the date and manner of service and of the names of the persons served, certified by the person who made the service in person or by return receipts for certified or registered mail.

v. A party who requests that a subpoena be issued shall be responsible for the payment of any reasonable travel and subsistence costs incurred by the witness in connection with his or her appearance and any fees of a person who serves the subpoena in person. The Department shall pay the costs associated with the appearance of a Department employee whose role as a witness arises out of his or her performance of official duties, regardless of which party requested the subpoena.

The failure to make payment of such charges on demand may be deemed by the Hearing Officer or Director as sufficient ground for striking the testimony of the witness and the evidence the witness has produced.

vi. If a person refuses to obey a subpoena, the Director, acting through the Office of the General Counsel of the Department and the Department of Justice, may apply to the United States District Court in the jurisdiction where that person resides to have the subpoena enforced as provided in the Federal Rules of Civil Procedure (28 U.S.C. App.).

3. Testimony required by subpoena pursuant to paragraph (a)(2) of this section may, at the discretion of the Director or a Hearing Officer, be presented at the hearing either in person or telephonically.

(b) Hearing procedures applicable to both record review and hearings.

1. Upon the filing of an appeal under this part of an adverse decision by any agency, the agency promptly shall provide the Division with a copy of the agency record. If requested by the applicant prior to the hearing, a copy of such agency record shall be provided to the appellant by the agency within 10 days of receipt of the request by the agency.

2. The Director shall assign the appeal to a Hearing Officer and shall notify the appellant and agency of such assignment. The notice also shall advise the appellant and the agency of the documents required to be submitted under paragraph (c)(2) of this section, and notify the appellant of the option of having a hearing by telephone.

3. The Hearing Officer will receive evidence into the hearing record without regard to whether the evidence was known to the agency officer, employee, or committee making the adverse decision at the time the adverse decision was made.

(c) Procedures applicable only to hearings.

1. Upon a timely request for a hearing under §11.6(b), an appellant has the right to have a hearing by the Division on any adverse decision within 45 days after the date of receipt of the request for the hearing by the Division.

2. The Hearing Officer shall set a reasonable deadline for submission of the following documents:

i. By the appellant:

A. A short statement of why the decision is wrong;

B. A copy of any document not in the agency record that the appellant anticipates introducing at the hearing; and

C. A list of anticipated witnesses and brief descriptions of the evidence such witnesses will offer.

ii. By the agency:

A. A copy of the adverse decision challenged by the appellant;

B. A written explanation of the agency's position, including the regulatory or statutory basis therefor;

C. A copy of any document not in the agency record that the agency anticipates introducing at the hearing; and

D. A list of anticipated witnesses and brief descriptions of the evidence such witnesses will offer.

iii. Not less than 14 days prior to the hearing, the Division must provide the appellant, the authorized representative, and the agency a notice of hearing specifying the date, time, and place of the hearing. The hearing will be held in the State of residence of the appellant, as determined by the Hearing Officer, or at a location that is otherwise convenient to the appellant, the agency, and the Division. The notice also shall notify all parties of the right to obtain an official record of the hearing.

iv. Pre-hearing conference. Whenever appropriate, the Hearing Officer shall hold a pre-hearing conference in order to attempt to resolve the dispute or to narrow the issues involved. Such pre-hearing conference shall be held by telephone unless the Hearing Officer and all parties agree to hold such conference in person.

v. Conduct of the hearing.

i. A hearing before a Hearing Officer will be in person unless the appellant agrees to a hearing by telephone.

ii. The hearing will be conducted by the Hearing Officer in the manner determined by the Division most likely to obtain the facts relevant to the matter or matters at issue. The Hearing Officer will allow the presentation of evidence at the hearing by any party without regard to whether the evidence was known to the officer, employee, or committee of the agency making the adverse decision at the time the adverse decision was made.

The Hearing Officer may confine the presentation of facts and evidence to pertinent matters and exclude irrelevant, immaterial, or unduly repetitious evidence, information, or questions. Any party shall have the opportunity to present oral and documentary evidence, oral testimony of witnesses, and arguments in support of the party's position; controvert evidence relied on by any other party; and question all witnesses. When appropriate, agency witnesses requested by the appellant will be made available at the hearing. Any evidence may be received by the Hearing Officer without regard to whether that evidence could be admitted in judicial proceedings.

iii. An official record shall be made of the proceedings of every hearing. This record will be made by an official tape recording by the Division. In addition, either party may request that a verbatim transcript be made of the hearing proceedings and that such transcript shall be made the official record of the hearing. The party requesting a verbatim transcript shall pay for the transcription service, shall provide a certified copy of the transcript to the Hearing Officer free of charge, and shall allow any other party desiring to purchase a copy of the transcript to order it from the transcription service.

vi. Absence of parties.

i. If at the time scheduled for the hearing either the appellant or the agency representative is absent, and no appearance is made on behalf of such absent party, or no arrangements have been made for rescheduling the hearing, the Hearing Officer has the option to cancel the hearing unless the absent party has good cause for the failure to appear. If the Hearing Officer elects to cancel the hearing, the Hearing Officer may:

A. Treat the appeal as a record review and issue a determination based on the agency record as submitted by the agency and the hearing record developed prior to the hearing date;

B. Accept evidence into the hearing record submitted by any party present at the hearing (subject to paragraph (c)(6)(ii) of this section), and then issue a determination; or

C. Dismiss the appeal.

ii. When a hearing is canceled due to the absence of a party, the Hearing Officer will add to the hearing record any additional evidence submitted by any party present, provide a copy of such evidence to the absent party

or parties, and allow the absent party or parties 10 days to provide a response to such additional evidence for inclusion in the hearing record.

iii. Where an absent party has demonstrated good cause for the failure to appear, the Hearing Officer shall reschedule the hearing unless all parties agree to proceed without a hearing.

vii. Post-hearing procedure.

The Hearing Officer will leave the hearing record open after the hearing for 10 days, or for such other period of time as the Hearing Officer shall establish, to allow the submission of information by the appellant or the agency, to the extent necessary to respond to new facts, information, arguments, or evidence presented or raised at the hearing. Any such new information will be added by the Hearing Office to the hearing record and sent to the other party or parties by the submitter of the information. The Hearing Officer, in his or her discretion, may permit the other party or parties to respond to this post-hearing submission.

(d) *Interlocutory review*. Interlocutory review by the Director of rulings of a Hearing Officer are not permitted under the procedures of this part.

(e) *Burden of proof*. The appellant has the burden of proving that the adverse decision of the agency was erroneous by a preponderance of the evidence.

(f) *Timing of issuance of determination*. The Hearing Officer will issue a notice of the determination on the appeal to the named appellant, the authorized representative, and the agency not later than 30 days after a hearing or the closing date of the hearing record in cases in which the Hearing Officer receives additional evidence from the agency or appellant after a hearing. In the case of a record review, the Hearing Officer will issue a notice of determination within 45 days of receipt of the appellant's request for a record review. Upon the Hearing Officer's request, the Director may establish an earlier or later deadline. A notice of determination shall be accompanied by a copy of the procedures for filing a request for Director review under §11.9. If the determination is not appealed to the Director for review under §11.9, the notice provided by the Hearing Officer shall be considered to be a notice of a final determination under this part.

§ 11.9 Director review of determinations of Hearing Officers.

(a) Requests for Director review.

1. Not later than 30 days after the date on which an appellant receives the determination of a Hearing Officer under §11.8, the appellant must submit a written request, signed personally by the named appellant, to the Director to review the determination in order to be entitled to such review by the Director. Such request shall include specific reasons why the appellant believes the determination is wrong.

2. Not later than 15 business days after the date on which an agency receives the determination of a Hearing Officer under §11.8, the head of the agency may make a written request that the Director review the determination. Such request shall include specific reasons why the agency believes the determination is wrong, including citations of statutes or regulations that the agency believes the determination violates. Any such request may be made by the head of an agency only, or by a person acting in such capacity, but not by any subordinate officer of such agency.

3. A copy of a request for Director review submitted under this paragraph shall be provided simultaneously by the submitter to each party to the appeal.

(b) Notification of Parties. The Director promptly shall notify all parties of receipt of a request for review.

(c) Responses to request for Director review. Other parties to an appeal may submit written responses to a request for Director review within 5 business days from the date of receipt of a copy of the request for review.

(d) Determination of Director.

1. The Director will conduct a review of the determination of the Hearing Officer using the agency record, the hearing record, the request for review, any responses submitted under paragraph (c) of this section, and such other arguments or information as may be accepted by the Director, in order to determine whether the decision of the Hearing Officer is supported by substantial evidence. Based on such review, the Director will issue a final determination notice that upholds, reverses, or modifies the determination of the Hearing Officer. The Director's determination upon review of a Hearing Officer's decision shall be considered to be the final determination under this part and shall not be appealable. However, if the Director determines that the hearing record is inadequate or that new evidence

has been submitted, the Director may remand all or a portion of the determination to the Hearing Officer for further proceedings to complete the hearing record or, at the option of the Director, to hold a new hearing.

2. The Director will complete the review and either issue a final determination or remand the determination not later than—

   (a) 10 business days after receipt of the request for review, in the case of a request by the head of an agency; or

   (b) 30 business days after receipt of the request for review, in the case of a request by an appellant.

3. In any case or any category of cases, the Director may delegate his or her authority to conduct a review under this section to any Deputy or Assistant Directors of the Division. In any case in which such review is conducted by a Deputy or Assistant Director under authority delegated by the Director, the Deputy or Assistant Director's determination shall be considered to be the determination of the Director under this part and shall be final and not appealable.

(e) Equitable relief. In reaching a decision on an appeal, the Director shall have the authority to grant equitable relief under this part in the same manner and to the same extent as such authority is provided an agency under applicable laws and regulations.

§ 11.10 Basis for determinations.

(a) In making a determination, the Hearing Officers and the Director are not bound by previous findings of facts on which the agency's adverse decision was based.

(b) In making a determination on the appeal, Hearing Officers and the Director shall ensure that the decision is consistent with the laws and regulations of the agency, and with the generally applicable interpretations of such laws and regulations.

(c) All determinations of the Hearing Officers and the Director must be based on information from the case record, laws applicable to the matter at issue, and applicable regulations published in the Federal Register and in effect on the date of the adverse decision or the date on which the acts that gave rise to the adverse decision occurred, whichever date is appropriate under the applicable agency program laws and regulations.

§ 11.11 Reconsideration of Director determinations.

(a) Reconsideration of a determination of the Director may be requested by the appellant or the agency within 10 days of receipt of the determination. The Director will not consider any request for reconsideration that does not contain a detailed statement of a material error of fact made in the determination, or a detailed explanation of how the determination is contrary to statute or regulation, which would justify reversal or modification of the determination.

(b) The Director shall issue a notice to all parties as to whether a request for reconsideration meets the criteria in paragraph (a) of this section. If the request for

reconsideration meets such criteria, the Director shall include a copy of the request for reconsideration in the notice to the non-requesting parties to the appeal. The non-requesting parties shall have 5 days from receipt of such notice from the Director to file a response to the request for reconsideration with the Director.

(c) The Director shall issue a decision on the request for reconsideration within 5 days of receipt of responses from the non-requesting parties. If the Director's decision upon reconsideration reverses or modifies the final determination of the Director rendered under §11.9(d), the Director's decision on reconsideration will become the final determination of the Director under §11.9(d) for purposes of this part.

§ 11.12 Effective date and implementation of final determinations of the Division.

(a) On the return of a case to an agency pursuant to the final determination of the Division, the head of the agency shall implement the final determination not later than 30 days after the effective date of the notice of the final determination.

(b) A final determination will be effective as of the date of filing of an application, the date of the transaction or event in question, or the date of the original adverse decision, whichever is applicable under the applicable agency program statutes or regulations.

§ 11.13 Judicial review.

(a) A final determination of the Division shall be reviewable and enforceable by any United States District Court of competent jurisdiction in accordance with chapter 7 of title 5, United States Code.

(b) An appellant may not seek judicial review of any agency adverse decision appealable under this part without receiving a final determination from the Division pursuant to the procedures of this part.

§ 11.14 Filing of appeals and computation of time.

(a) An appeal, a request for Director Review, or any other document will be considered "filed" when delivered in writing to the Division, when postmarked, or when a complete facsimile copy is received by the Division.

(b) Whenever the final date for any requirement of this part falls on a Saturday, Sunday, Federal holiday, or other day on which the Division is not open for the transaction of business during normal working hours, the time for filing will be extended to the close of business on the next working day.

(c) The time for filing an appeal, a request for Director review, or any other document expires at 5:00 p.m. local time at the office of the Division to which the filing is submitted on the last day on which such filing may be made.

§ 11.15 Participation of third parties and interested parties in Division proceedings.

In two situations, parties other than the appellant or the agency may be interested in participating in Division proceedings. In the first situation, a Division proceeding may in fact result in the adjudication of the rights of a third party, e.g., an appeal of a tenant involving a payment shared with a landlord, an appeal by one recipient of a portion of a payment shared by multiple parties, an appeal by one heir of an estate. In the second situation, a party may desire to receive notice of and perhaps participate in an appeal because of the derivative impact the appeal determination will have on that party, e.g., guaranteed lenders and reinsurance companies. The provisions in this section set forth rules for the participation of such third and interested parties.

(a) Third parties. When an appeal is filed, the Division shall notify any potential third party whose rights may be adjudicated of its right to participate as an appellant in the appeal. This includes the right to seek Director review of the Hearing Officer determination. Such third parties may be identified by the Division itself, by an agency, or by the original appellant. The Division shall issue one notice to the third party of its right to participate, and if such party declines to participate, the Division determination will be binding as to that third party as if it had participated. For purposes of this part, a third party includes any party for which a determination of the Division could lead to an agency action on implementation that would be adverse to the party thus giving such party a right to a Division appeal.

(b) Interested parties. With respect to a participant who is a borrower under a guaranteed loan or an insured under a crop insurance program, the respective guaranteed lender or reinsurance company having an interest in a participant's appeal under this part may participate in the appeal as an interested party, but such participation does not confer the status of an appellant upon the guaranteed lender or reinsurance company such that it may request Director review of a final determination of the Division.

APPENDIX 3

FORMS REFERENCED IN THIS HANDBOOK

Below is a list of forms that are mentioned in the text of this handbook. Since the Rural Development forms may change more frequently than the handbook, users are encouraged to obtain the most updated copy of these forms from the Rural Development Instructions home page (http://rdinit.usda.gov/regs) for their own reference.

Form AD 343, Cancellation of Administrative Offset
Form AD 1047 Certification Regarding Debarment
Form ASTM Standard E-1528 (TSQ), Transaction Screen Questionnaire
Form FEMA 81-93, Standard Flood Hazard Determination
Form HUD 935.2, Affirmative Fair Housing Marketing Plan
Form HUD 2530, Previous Participation Certification
Form HUD 9832, Management Entity Profile
Form RD 140-4, Transmittal of Documents
Form RD 400-1, Equal Opportunity Agreement
Form RD 400-4, Assurance Agreement
Form RD 402-2, Statement of Deposits and Withdrawals
Form RD 440-34, Option to Purchase Real Estate Property
Form RD 1910-11, Applicant Certification Federal Collection Policies for Consumer or Commercial Debts
Form RD 1924-13, Estimate and Certificate of Actual Cost
Form RD 1944-37, Previous Participation Certification
Form RD 1955-40, Notice of Real Property for Sale
Form RD 1955-45, Standard Sales Contract, Sale of Real Property of the United States
Form RD 1955-46, Invitation, Bid, and Acceptance, Sale of Real Property of the United States
Form RD 1955-47, Bill of Sale 'A'
Form RD 1955-49, Quitclaim Deed
Form RD 1955-62, Request for Contract Services for Custodial/Inventory Property or Program Services
Form RD 1962-20, Notice of Judgment
Form RD 3560-1, Application for Partial Release, Subordination, or Consent
Form RD 3560-7, Multiple Family Housing Budget/Utility Allowance
Form RD 3560-8, Tenant Certification
Form RD 3560-9, Interest Credit and Rental Assistance Agreement
Form RD 3560-10, Borrower Balance Sheet
Form RD 3560-15, Reamortization Request
Form RD 3560-16, Reamortization Agreement
Form RD 3560-17, MFH Note Consolidation
Form RD 3560-17A, MFH Consolidation of Projects/Loan Agreements/Resolutions
Form RD 3560-19, MFH Advice of Mortgaged Real Estate Sold
Form RD 3560-20, Multi-Family Housing Transfer and Assumption Review and Recommendation
Form RD 3560-21, Assumption Agreement

Form RD 3560-22, Offer to Convey Security
Form RD 3560-27, Rental Assistance Agreement
Form RD 3560-28, MFH Exception to Late Fees
Form RD 3560-29, Notice of Payment Due Report
Form RD 3560-29A, Multiple Family Housing Statement of Payment Due
Form RD 3560-30, Certification of No Identity of Interest (IOI)
Form RD 3560-31, Identity of Interest Disclosure/Qualification Certificate
Form RD 3560-33, Loan Agreement
Form RD 3560-33A, Consolidated Loan Agreement
Form RD 3560-34, Loan Agreement
Form RD 3560-34A, Consolidated RRH Loan Agreement
Form RD 3560-35, Loan Resolution
Form RD 3560-35A, Consolidated Loan Resolution
Form RD 3560-50, Conversion Agreement
Form RD 3560-51, Obligation – Fund Analysis
Form RD 3560-52, Promissory Note
Form RD 3560-55, MFH Transfer of RA
Form RD 3560-56, Report on Real Estate Problem Case
Form RD 3560-57, Application for Settlement of Indebtedness
Form RD 3560-58, Satisfaction
Form RD 3560-64, Online Payment Certification Monitoring Log
Form SF 424, Application for Federal Assistance
SF 424 C, Budget Information – Construction Programs
SF 424 D, Assurances – Construction Programs
SF - LLL, Disclosure of Lobbying Activities
IRS Form 990, Return of Organization Exempt from Income Tax

APPENDIX 4

HANDBOOK LETTERS REFERENCED IN THIS HANDBOOK

Handbook Letter 301 (3560), Servicing Letter #1
Handbook Letter 302 (3560), Servicing Letter #2
Handbook Letter 303 (3560), Servicing Letter #3

Handbook Letter 301 (3560)

REFERENCE: HB-3-3560 Chapter 9

PURPOSE: Servicing Letter #1

ROUTINE NOTICE OF SERVICING RESULTS/CONCERNS

[*insert date*]

Dear [*insert name of borrower*]:

We are writing to inform you of the results of a recent review of certain selected aspects of your operations. A copy of the results of our review is attached [*Attach copy of supervisory visit report, physical inspection report, compliance review, reserve records, notice of payment due, etc.*].

Please review the attached material and note the areas of concern listed. [*if necessary, insert* "We want to especially bring to your attention the following items:"]

We are asking that you contact this office within 15 days of the date of this letter to inform us of the corrective actions you have taken, or plan to take, to correct the concerns listed. Our office address and telephone number are: [*insert address and telephone number*]

Sincerely,

_____

[*Signature and title of Official*]

Attachment

Handbook Letter 302 (3560)

REFERENCE: HB-3-3560 Chapter 9

PURPOSE: Servicing Letter #2

NOTIFICATION OF SERIOUS SERVICING CONCERNS

[*insert date*]

Dear [*insert name of borrower*]:

We are writing to inform you that certain aspects of your project operations are of serious concern to the Agency.

A brief description of the items of concern which warrant attention is [*insert either*: "provided below:" *or* "attached."]

We would like to arrange a meeting to discuss these concerns. [*insert either*: "Please contact our office to confirm if you can make the tentatively scheduled meeting at the following time, date, and location:" *or* "Please contact our office within 15 days of the date of this letter to make the necessary arrangements"]. Our address and telephone number are [*insert address and telephone number*].

Please be prepared to discuss the matters of concern identified. [*insert*: "In particular, you may want to bring the following information to the meeting:"]

We look forward to hearing from you.

Sincerely,

_____

[*Signature and title of Official*]

Attachment

Handbook Letter 303 (3560)

REFERENCE: HB-3-3560 Chapter 9

PURPOSE: Servicing Letter #3

NOTIFICATION OF INTENT TO PURSUE MORE FORCEFUL SERVICING ACTIONS

[*insert date*]

Dear [*insert name of borrower*]:

We regret that earlier attempts to resolve [*state the problems*] have not been successful. We are writing to inform you that Rural Development intends to take further action unless alternative arrangements are promptly made with this office. If you have not contacted us within 15 days, we intend to pursue the [*insert either*: "following actions:" *or* "attached actions."]

[*List actions, e.g., Forward a problem case report to the State Director, recommend an investigation by the Office of the Inspector General, demand a change in project management, place a recoverable cost charge on the account, forward a recommendation to the State Director to issue a Notice of Acceleration, etc.*]

We are hopeful we can avoid the necessity of taking the steps outlined above. Unfortunately, we will be forced to do so unless we hear from you within 15 days from the date of this letter.

Please contact our office immediately if you wish to avoid the actions described above.

Sincerely,

_____

[*Signature and title of Official*]

Attachment