

CHAPTER 12: PROPERTY AND APPRAISAL REQUIREMENTS

12.1 INTRODUCTION

Lenders must ensure the property to be purchased is eligible for the SFHGLP. The Agency's minimum property requirements serve to protect the borrower's interest, minimize the lender's loss, and reduce the potential risk to the government in the event of liquidation. It is the lender's responsibility to ensure that the property meets the Agency's standards.

SECTION 1: UNDERWRITING THE PROPERTY

[7 CFR 3555.201]

12.2 OVERVIEW

The lender must ensure the subject property meets the Agency's site guidelines. In particular, sites must be located in eligible rural areas; meet community standards regarding utilities, including water and wastewater systems; meet street and road access and maintenance requirements; and contain other amenities essential to the continued marketability of the home. This section addresses each of these standards.

12.3 RURAL AREA DESIGNATION [7 CFR 3555.201(a)]

Only loans secured by properties located in areas designated by the Agency as rural are eligible to receive a loan guarantee. This section discusses rural areas designations, how lenders are notified of changes in rural area designations and clarifies rare situations in which loans for properties in areas no longer designated as rural may receive a loan guarantee.

A. Rural Area Definition

An area's rural designation is determined by the Agency and may be changed as a result of periodic review or after the decennial census of population. The Agency conducts reviews every five years to identify areas that no longer qualify as rural. In areas experiencing rapid growth, and in eligible communities within Metropolitan Statistical Areas (MSAs), reviews take place every three years. Public notification will be given at least 30 days before the date of the final determination in order to give interested parties an adequate chance to comment. Refer to section 3550.10 of 7 CFR

3550 and HB-1-3550 Chapter 5, for additional information regarding rural area designations.

In general, rural areas are defined as:

- Open country that is not part of, or associated with, an urban area;
- Any town, village, city, or place, including the immediately adjacent densely settled area, which is not part of, or associated with, an urban area, and which:
 - Is rural in character with a population of less than 10,000; or
 - Is not contained within an MSA and has a population above 10,000 but below 20,000 and has a serious lack of mortgage credit for lower and moderate-income families. 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, 2000, or 2010 decennial census, and any area deemed to be a “rural area” any time during the period beginning January 1, 2000, and ending December 31, 2010, shall continue to be so classified until the receipt of data from the decennial census in the year 2020 if such area has a population in excess of 10,000 but not in excess of 35,000, is rural in character, and has a serious lack of mortgage credit for lower and moderate-income families.
- Two or more towns, villages, cities, or places that are contiguous may be considered separately for a rural designation if they are not otherwise associated with each other, and their densely settled areas are not contiguous.

B. Notification of Rural Area Designation

The public website noted below provides an automated system to allow users to enter addresses and determine property eligibility. Users who utilize the public website will receive one of three property eligibility decisions when an actual address is entered – “Eligible,” “Ineligible,” or “Unable to Determine.” In areas not clearly delineated, users will receive an “Unable to Determine.” With this type of determination, the lender must confirm with Agency staff the property is located in a rural area and eligible for a guarantee prior to requesting an appraisal.

USDA Rural Development Property and Income Eligibility Website:

<https://eligibility.sc.egov.usda.gov>

Attachment 12-A of this Chapter provides guidance on utilizing the public website to determine eligible rural areas.

C. Making Loans in Areas Changed to Non-rural

If an area's designation changes from rural to non-rural, loans that meet the following criteria may be approved in that area:

- Purchase transactions are eligible if the following requirements are met:
 - The application is dated and received by the lender prior to the area designation change;
 - The Loan Estimate was issued within three days of the application date;
 - The purchase contract is ratified prior to the date of the area designation change; and
 - The applicant and property meet all other loan eligibility requirements.
- Existing conditional commitments that have been issued will be honored provided the commitment was issued prior to the area designation change;
- Existing direct and guaranteed loans that meet all requirements, as outlined in Chapter 12, remain eligible for refinance transactions;
- REO property sold from Agency inventory remain eligible for purchase transactions;
- SFHGLP REO property sales and transfers with assumption may be processed in areas that have changed to non-rural;
- A supplemental loan may be made in conjunction with a transfer and assumption of a guaranteed loan.

12.4 SITE REQUIREMENTS [7 CFR 3555.201(b)]

A qualified property must be predominately residential in use, character, and design. Sites must be developed in accordance with any standards imposed by a State or local government. Therefore, the lender must verify that the following requirements are met at the time of application.

- **Site size.** There is no specific limitation to the size/acreage of the site. The appraiser must provide an explanation in the addendum of the appraisal to explain adjustments to comparable properties, how the subject compares to other properties in the area, etc.
- **Income-Producing Buildings.** The property must not include buildings principally used for income-producing purposes. Barns, silos, commercial greenhouses, or livestock facilities used primarily for the production of agricultural, farming or commercial enterprise are ineligible. However, barns, silos, livestock facilities or greenhouses no longer in use for a commercial operation, which will be used for storage do not render the property ineligible. Outbuildings such as storage sheds and non-commercial workshops are permitted if they are not used primarily for an income producing agricultural, farming or commercial enterprise. A minimal income-producing activity, such as maintaining a garden that generates a small amount of additional income, does not violate this requirement. Home-based operations such as childcare, product sales, or craft production that do not require specific commercial real estate features are not restricted.
- **Accessory Dwelling Unit.** The presence of an accessory dwelling unit (ADU) does not automatically render the property ineligible. The appraiser will determine if the ADU represents a second single family housing dwelling unit. The Agency defers to the appraiser's professional review of the property and expert opinion of the highest and best use of the subject property as a primary residence. The appraiser will include their evaluation in the site analysis section of the appraisal report if applicable.
- **Income-Producing Land.** The site must not have income-producing land that will be used principally for income producing purposes. Vacant land or properties used primarily for agricultural, farming or commercial enterprise are ineligible.
- **Multiple Parcels.** The lender will ensure the mortgage provides a valid first lien covering each parcel. Each parcel must be conveyed in its entirety and have the same zoning. Parcels must be contiguous unless divided by a road and the remaining parcel cannot be developed i.e. waterfront properties where the parcel without the residence provides access to the water. The entire property will contain only one dwelling but can have non-residential, non-income producing buildings such as a garage.

- **Properties with Solar Panels.** Dwellings with solar panels are not considered an income producing property. If the property owner (seller) is the owner of the solar panels and the solar panels will be included as part of the purchase transaction then standard eligibility requirements apply, i.e. appraisal, insurance, and title. If the solar panels are subject to a lease agreement, power purchase agreement (PPA), or similar type of agreement the following requirements apply:
 - Leases and contracts will vary by company and should be considered on a case by case basis to ensure all terms/regulations are met.
 - First lien position, by the lender, should be protected and maintained.
 - The property should maintain access to an alternative source of electric/gas power that meets community standards.
 - The energy company or lessee should not block any foreclosure or servicing actions.
 - If an agreement for an energy system lease or PPA could cause restriction upon transfer of the house, the property is subject to impermissible legal restrictions and is generally ineligible for the guaranteed loan.
 - The lease agreement or PPA should indicate that any damage that occurs as a result of installation, malfunction, manufacturing defect, or the removal of the solar panels is the responsibility of the owner of the equipment and the owner is obligated to repair the damage and return the improvements to their original or prior condition.
 - The lease agreement, PPA, or other agreement should indicate that the owner of the solar panels cannot be a loss payee on the homeowner's insurance policy.
 - If a lease includes payment for equipment it should be considered a debt and included in the total debt ratio. See Chapter 11 for additional guidance.
 - Leased solar panels are considered personal property and are not included in the appraised value.
 - Properties with Property Assessed Clean Energy (PACE) loans or assessments are ineligible for a SFHGLP loan.

- **Site Specifications.** The site must be contiguous to, and have direct access from a street, road, or driveway. Streets and roads must be hard surfaced or all weather surfaced and legally enforceable arrangements must be in place to ensure that needed maintenance will be provided.
- **Utilities.** The site must be supported by adequate utilities and water and wastewater disposal systems.
- **Zoning.** The property must comply with applicable zoning and restrictions. If an existing property does not comply with all current zoning ordinances but it is accepted by the local zoning authority, the appraiser must report the property as legal non-conforming. The appraisal must reflect any adverse effect of the legal nonconforming use on the value and marketability of the property.

SECTION 2: APPRAISALS

[7 CFR 3555.107(d)]

12.5 RESIDENTIAL APPRAISAL REPORTS

Approved lenders must ensure appraisals are completed by a qualified appraiser that is independent and objective. Approved lenders are responsible to review all appraisals for integrity, accuracy, and thoroughness, prior to submission of a complete loan application package to USDA. The lender may pass the cost of the appraisal on to the borrower. The appraisal must have been completed within 150 days of loan closing. Appraisals that are older than 150 days prior to loan closing are eligible for an appraisal update as indicated in this Chapter.

A. Qualified Appraiser.

Approved lenders must select qualified and competent appraisers that are properly licensed or certified, as appropriate, in the State in which the property is located. The appraiser must comply with the current edition of the Uniform Standards of Professional Appraisal Practice (USPAP). Lenders may verify that an appraiser is licensed or certified by checking the Appraisal Subcommittee website found at:
<https://www.asc.gov/Home.aspx>.

B. Appraisal Report.

All appraisals must comply with the reporting requirements of USPAP available at www.appraisalfoundation.org. All appraisal reports must meet the Uniform Appraisal Dataset (UAD) requirements set forth by Fannie Mae and Freddie Mac. To read

definitions of condition and quality ratings, refer to the “*Fannie Mae and Freddie Mac Uniform Appraisal Dataset Specification Version 1.2*” located online at:

https://www.fanniemae.com/content/technology_requirements/uad-specification-appendix-d.pdf

The appraiser will determine the appropriate appraisal form for the subject property. Appraisers must utilize appraisal forms acceptable to Fannie Mae, Freddie Mac, HUD, or VA. Applicable forms may include:

- *Uniform Residential Appraisal Report (FNMA Form 1004/FHLMC Form 70)* for one-unit single family dwellings;
- *Manufactured Home Appraisal Report and addendum (FNMA Form 1004C/FHLMC Form 70B)* for all manufactured homes;
- *Individual Condominium Unit Appraisal Report (FNMA Form 1073/FHLMC Form 465)* for all individual condominium units.

Appraisal considerations:

- Appraiser/client confidentiality under USPAP Ethics Rules does not permit the appraiser to discuss the appraisal with anyone other than the client, without the client’s permission. It is recommended, but not required, that USDA/RD be identified as an intended user with the lender in the appraisal report obtained.
- The market or sales comparison approach is required in all cases. Not less than three comparable sales will be used unless the appraiser provides documentation that such comparable sales are not available. The appraiser must use their knowledge of the area and apply good judgment in the selection of comparable sales that are the best indicators of value for the subject property.
- The appraiser will determine if the cost approach is required. For example, the property is unique, or has specialized improvements, or is new manufactured housing, or if the client requests the cost approach to be completed, then the appraiser will identify the source of the cost estimates and will comment on the methodology used to estimate depreciation, effective age and remaining economic life.
- The income approach is only required if the appraiser determines that it is necessary to develop credible assignment results.

- An appraisal prepared for REO purposes, loan servicing consideration, or any other purpose other than the guaranteed purchase or refinance transaction is ineligible to be used in the origination of a guaranteed loan. A new appraisal with the intent to arrive at an opinion of value for a purchase transaction must be obtained.

Photographs. Photographs in the appraisal report must be in color and be clear and descriptive to identify the property's condition and quality. Photographs must clearly represent the improvements, any physical deterioration of the property, amenities, conditions and external influences that may have a material effect on the market value or marketability of the subject property. Lenders who utilize the Agency's automated underwriting system, GUS, will upload the appraisal report at the *Lender Upload Document(s)* page as an individual document. An appraisal report with interior and exterior inspection of the subject property must include at least the following:

- A front view of the subject property;
- A rear view of the subject property;
- A street scene identifying the location of the subject property and showing neighboring improvements;
- The kitchen, main living area, bathrooms, bedrooms;
- Any other rooms representing overall condition, recent updates, such as restoration, remodeling and renovation;
- Basement, attic and crawl space;
- Comparable sales, listings, and/or pending sales utilized in the valuation analysis must include at least a front view of each comparable utilized; and
- Condominium projects should include additional photographs of the common areas and shared amenities.

Appraisal transfer. An appraisal ordered by another lender for the applicant can be transferred to the lender who will complete the purchase transaction. The initial lender must agree to the transfer of the report. A letter from the initial lender who ordered the appraisal report must be retained in the permanent loan file as evidence the lender transferred the report to the lender completing the purchase transaction. The receiving lender must assume full responsibility for the integrity, accuracy and thoroughness of the

appraisal report, including the methods that the original lender used to acquire the appraisal. The appraisal report must be no older than 150 days at loan closing to be valid.

Appraisal update. Lenders may extend the validity period of an appraisal with an appraisal update report that will be no greater than 240 days from the effective date of the initial appraisal report at loan closing (150 days for the original appraisal plus 90 days for the Appraisal Update Report). An original appraisal report can be updated one time with an Appraisal Update Report. The appraisal may be expired at the time the appraisal update is requested. The purpose of an appraisal update request is to determine if the property has declined in value since the effective date of the original appraisal. An update is not eligible to support a higher appraised value of the property.

USPAP considers the term “Appraisal Update” as a business term, but regardless of the nomenclature used, when a client seeks a more current value or analysis of a property that was the subject of a prior assignment, this is not an extension of that prior assignment that was already completed; it is simply a new assignment. Refer to USPAP Advisory Opinion 3 for additional clarification available at www.appraisalfoundation.org.

USPAP (Advisory Opinion 3) states that there are three ways that the reporting requirements can be satisfied for this type of assignment:

1. Provide a new report without incorporation of the prior report.
2. Provide a new report that incorporates by attachment specified information/analysis from the prior report.
3. Provide a new report that incorporates by reference specified information/analysis from the prior report.

The appraiser may use a pre-printed form or a narrative report to provide the appraisal update, but whichever reporting format is used, it must be in compliance with USPAP.

Fannie Mae Form 1004D/Freddie Mac Form 442, “Appraisal Update and/or Completion Report” may be utilized by the lender to report the completion of a repair and/or satisfaction of requirements and conditions noted in the original appraisal report.

Property flipping. It remains the lenders responsibility to ensure any recently sold property’s value is strongly supported when a significant increase between sales occur. The lender must perform a thorough review of the appraisal report to validate and support the property’s value and protect the applicants from possible predatory real estate lending.

C. Agency Review.

The Agency will review appraisals for all guarantee loan requests by completing *Form RD 1922-15, "Administrative Appraisal Review."* If the Agency reviewer detects concerns, the appraisal will be referred to a Regional Agency Appraiser for a technical desk or technical field review. Should the Agency licensed appraisers determine the appraisal is not adequate the lender will be informed of corrections needed prior to issuance of the conditional commitment for loan guarantee. The lender will be required to correct or complete any appraisal returned by the Agency for corrective action. The lender is responsible to communicate and initiate corrective action with the appraiser. The corrected appraisal will be subject to the same review process described in this section. The Agency retains the right to determine an appraiser is ineligible based upon their failure to comply with requirements of this section. The Agency will notify the lender when appraisals completed by ineligible appraisers will no longer be accepted for the SFHGLP.

D. Director of the Origination and Processing Division Responsibilities.

The Director of the Origination and Processing Division (Director OPD) will designate or delegate authority to the supervisory staff of the unit or other qualified personnel to conduct administrative appraisal reviews. Technical appraisal reviews must be completed by an Agency certified or licensed appraiser and need only be licensed or certified in one State or territory to perform real estate appraisal duties as Federal employees in all states and territories. Review appraisers must have recent, documented appraisal experience or other factors which clearly establish their qualifications as a reviewer.

The Director OPD will determine and establish the training needs for Rural Development staff completing appraisal reviews. The Director OPD will also assure that an adequate amount of reviews are being completed.

E. Types of Agency Reviews.

There are three types of reviews for appraisals; "Administrative," "Technical Desk" and "Technical Field." An administrative review will be completed for all transactions involving the submittal of an appraisal report. A sufficient number of technical desk and technical field reviews will be completed to ensure the Agency is getting quality appraisals for the Guaranteed Loan Program. An explanation of the review types are as follows:

1. Administrative Reviews

Administrative reviews are performed by the Agency loan approval official or qualified designee on all appraisals prior to issuance of the Conditional Commitment. This review determines if there are inconsistencies in the appraisal report that may have to be addressed, or if a technical review should be completed by the Agency staff appraiser prior to issuance of the Loan Note Guarantee. Indicators that a technical review may be required will be documented on *Form RD 1922-15*.

- Administrative reviews are completed by the Agency on *Form RD 1922-15*. This form will be signed, dated, and retained in the Agency file for scanning. This review should be completed prior to issuance of the Conditional Commitment;
- If there is a deficiency with an appraisal, the loan approval official should communicate the deficiency to the lender. These deficiencies should include items that affect loan security, value conclusions, or unacceptable property conditions.

2. Technical Desk Reviews

A technical review is performed to determine whether the appraisal was complete, was clearly reasoned, and had adequate support for the conclusion of value. Technical reviews are performed by the Agency Appraiser. Technical reviews completed by Agency appraisers must follow current USPAP.

- Technical desk reviews may be documented in any format that complies with USPAP and is acceptable for use by RD. Technical reviews should be selected in a random method. The percent of files randomly selected will be set by the direction of the SFHGLD. Field offices will be advised of these schedules and any changes.

The Director OPD or designated supervisory staff will coordinate with Program Support Staff (PSS) in National Headquarters to establish internal management controls and systems to document and substantiate residential appraisal compliance activities, which will be evaluated during State Internal Reviews, Single Family Housing program reviews, or Management Control Reviews. Technical desk review of appraisals received by the agency provide a method of internal control by the appraisal review staff and ensure that appraisals received by the agency are in compliance with USPAP and Agency regulations. The Director OPD or designated supervisory staff will support completion of technical desk reviews in coordination with PSS to achieve the appraisal quality control requirements of the agency.

A technical review may also be requested by Field staff when problems are detected on the administrative review that cannot or will not be addressed by the submitting lender or original appraiser. These problems must be significant and result in an appraisal which does not support the value conclusion. Field staff will document the nature of their concerns on *Form RD 1922-15*. The Field staff will then forward the appraisal to the regional agency appraisal review staff or other reviewers for a technical and/or field review prior to approval of the loan.

3. *Technical Field Reviews*

Field reviews will involve on-site visits to the subject property and the comparable properties used in the report. Field reviews are completed by Agency Appraisal staff on a random, spot-check basis to determine if the appraiser has followed accepted appraisal techniques and arrived at a logical conclusion.

- USPAP Standard 3 Review is used for technical field reviews. The reviewer may use any reporting format that complies with USPAP and is acceptable for use by RD. The Director OPD or designated supervisory staff and the appraisal review staff are responsible for the administration of residential appraisal compliance and training within the geographic jurisdiction of the State Office. Appropriate actions will be initiated by the Director OPD or designated supervisory staff and appraisal review staff to ensure compliance with USPAP and National Office policies governing the residential appraisal process.

F. Appraisals in Remote Rural Areas, on Tribal Lands, or in Areas Lacking Market Activity.

In remote, rural areas, on Tribal lands, or areas with a lack of market activity, as identified by the Director OPD, it may be difficult to obtain adequate comparable sales to appraise a property. When the sales comparison approach cannot be developed for a credible opinion or conclusions regarding value, the lender's appraiser may use other methods in compliance with the Uniform Standards of Professional Appraisal Practice (USPAP) and perform an appraisal without completing the sales comparison approach to value. Appraisers must explain the exclusion of the sales comparison approach to value and document their efforts to obtain comparable market data along with an explanation for any sales data not used. The primary method that the appraiser is relying on should be summarized to the extent that the user or a review appraiser can understand the reasoning and support of the valuation and conclusions.

Remote rural areas are identified by the Director OPD and are defined as areas with all of the following characteristics:

- Scattered population;
- Low density of residences;
- Lack of basic shopping facilities;
- Lack of community and public services and facilities; and
- Lack of comparable sales data.

If the appraiser is using the cost approach, external depreciation based on the remoteness of the site must not be considered; however, factors that impact the site such as immediate proximity to a feedlot, factory, or other similar considerations should be included. If the appraiser is using the income approach, they must explain why the income and expenses used are comparable to the subject property. When a market is established in these areas, the Agency will again require the sales comparison approach to be used.

12.6 WATER AND WASTEWATER DISPOSAL SYSTEMS [7 CFR 3555.201]

The site must have acceptable water and wastewater disposal systems to ensure the property is decent, safe, sanitary, and meets community standards. Public water and wastewater disposal systems are presumed to meet state and local requirements with no additional documentation or inspections. Private well and wastewater systems that meet the requirements in HUD Handbook 4000.1 or meet the requirements of local and/or state health authority do not require additional inspections other than water purity tests as discussed in this section. Evidence will be retained in the lender's permanent loan file.

A. Water

Water systems, for existing or new construction, that require continuous or repetitive treatment to be safe bacterially or chemically may be used if the individual water system, with purification, meets the requirements of the state department of health or other comparable reviewing and regulatory authority.

1. *Individual Privately Owned*

- Individual water systems are owned and maintained by the homeowner and subject to compliance with all requirements of the local and/or State Health Authority codes. Water quality tests are required as follows:
 - The water quality of the well must meet the requirements of the state or local authority. If the state or local authority does not have specific requirements, the maximum contaminant levels established by the Environmental Protection Agency (EPA) will apply.
 - The local health authority or a state certified laboratory must perform a water quality analysis. The Safe Water Drinking Act does not apply to private wells. Contact the Environmental Protection Agency (EPA) at (800) 426-4791 for referral to certified labs and other inquiries.
 - The water analysis report must be no greater than 150 days old at loan closing. If the Agency is aware of any recent environmental impacts that may render the previous analysis invalid (for example – chemical spills, natural disasters, etc.) a new report may be required.
- The well location for individual water supply systems must be measured to establish the distance from the septic system. The separation distance between the well and septic systems must meet the SF Handbook (HUD Handbook 4000.1) or be found acceptable by the Local and/or State Health Authority.
- Individual water systems/wells should be located on the subject property site. If located on an adjacent property, evidence of water rights and recorded maintenance agreement must be retained in the lender's permanent loan file as acceptance of the well as the primary source of water.

2. *Individual Privately Owned Shared*

If the property is served by a shared well or off-site facility, the lender must ensure the private system will provide a continuous and adequate supply of safe and potable water. The following requirements must also be met:

- The well serves properties that cannot feasibly be connected to an acceptable public or community water supply system. It is the lender's responsibility to make this determination.
- A shared well must have a valve on each dwelling.

- The water supply is adequate for all families served. A shared well must service no more than four living units or properties unless approved and enforced by the local code authority.
- The water quality of the well must meet the requirements of the state or local authority. If the state or local authority does not have specific requirements, the maximum contaminant levels established by the Environmental Protection Agency (EPA) will apply.
- The well must have an agreement that meets the following requirements:
 - Is binding upon all signatory parties and their successors in title;
 - Is recorded or will be recorded no later than the closing date; and
 - Makes provisions for maintenance and repair of the system and the sharing of costs to do so. These provisions must include a permanent easement that allows access for maintenance and repair.

3. *Community Owned*

If the property is served by a community water system operated by a private corporation or nonprofit property owner's association, the lender must ensure the following conditions are met:

- The system and the water supply meet all applicable federal, state and local requirements.
- The system has the capacity to provide a sufficient water supply during periods of peak demand.
- The system is operated under a legally binding agreement that allows interested third parties to enforce the obligation of the operator to provide satisfactory service.

4. *Required Inspections and Documentation*

The lender must obtain documentation the water quality meets state and local standards as discussed in this section. Lenders will retain all documentation in their permanent loan file. Inspection and documentation requirements are discussed later in this chapter.

5. *Individual Water Systems in Hawaii and the Western Pacific Region*

Due to the limited regulation provided by local ordinances and/or regulations of each jurisdiction in Hawaii and the Western Pacific Region regarding individual water systems (IWS) including rain water catchment systems, the Agency has determined that an IWS is considered an eligible water system if the following conditions are met:

- The property is located in Hawaii or the Western Pacific Region.
- Property does not have an available affordable connection to a public or private community water system.
- The alternative water supply system, rain water catchment system, complies with and/or is not prohibited by ordinances and/or regulations of the local jurisdiction in which the property is located.
- Water quality tests are not required if the state or local authority does not have specific requirements and EPA testing is not available.
- Reliance upon the rain water catchment system, does not diminish the marketability or value of the property within its marketplace. The system must be typical for the area as described by the appraiser.
- The applicant is required to acknowledge and certify of their responsibility to maintain the rain catchment system.

B. Wastewater

1. *Individual Privately Owned*

The lender is required to obtain a septic evaluation. An FHA roster appraiser who certifies the property meets required HUD's Single-Family Housing Policy Handbook, a government health authority, a licensed septic system professional, or a qualified home inspector may perform the septic evaluation. The inspector may require additional inspections as a result of the inspection. The septic system must be free of observable evidence of failure. Existing dwellings appraised by a HUD roster appraiser, who has indicated the dwelling meets the required HUD handbook policy does not require further septic certification.

If the property is served by an individual sewage disposal system, the lender must ensure the system:

- Meets any applicable requirements of the state or local health authority with jurisdiction;
- Is located entirely on the subject property. If any part of the system is located on an adjacent property (for example leach lines), evidence such as a perpetual encroachment easement must be recorded to establish the rights of the property owner's permitted use; and
- Is operating properly and has the capacity to dispose of all domestic wastes in a manner that will not create a nuisance or endanger public health.

2. *Community Owned*

If the property is served by a community wastewater system operated by a private corporation or nonprofit property owner's association, the lender must ensure that the system:

- Meets any applicable requirements of the state or local health authority with jurisdiction;
- Is licensed, operating properly and has the capacity to dispose of all domestic wastes in a manner that will not create a nuisance or endanger public health; and
- Is subject to a legally binding agreement that allows interested third parties to enforce the obligation of the operator to provide satisfactory service.

3. *Required Inspections and Documentation*

The lender must obtain documentation the wastewater system meets state and/or local standards. Lenders will retain all documentation in their permanent loan file. Inspection and documentation requirements are discussed later in this chapter.

12.7 STREET ACCESS AND ROAD MAINTENANCE [7 CFR 3555.201]

A. Access

The site must be contiguous to, and have direct access from, a public or private street, road, or driveway. Private roads or streets are acceptable provided each property has

vehicular or pedestrian access. Private roads or streets must be protected by permanent recorded easement (non-exclusive and non-revocable easement without trespass from the property to a public street) or the street must be maintained by a homeowner's association. (HOA). Shared driveways must also meet these requirements requiring a permanent recorded easement for ingress and egress. This agreement must be binding to successors and title. A copy of a title report, retained in the lender's mortgage file, may be used to evidence the easement. Private streets must have a permanently recorded easement or be owned and maintained by a Home Owners Association (HOA). All evidence of recorded easements or maintenance agreements must be reviewed and approved by the approved lender's underwriter and documented in the lender's permanent loan file.

B. Maintenance

Streets and roads must be hard surfaced or all-weather surfaced. An all-weather surface is a road surface over which emergency and the area's typical passenger vehicles can pass at all times. A publicly maintained road is automatically assumed to meet this requirement. If a HOA is responsible for maintaining streets and roads, it must meet the criteria set forth by Fannie Mae, Freddie Mac, the U.S. Department of Housing and Urban Development (HUD), or U.S. Department of Veterans Affairs (VA).

SECTION 3: DWELLING REQUIREMENTS [7 CFR 3555.202]

12.8 MODEST HOUSING

There are no maximum mortgage limits for property financed under the SFHGLP. Modest housing is defined as a new or existing dwelling that a low- or moderate-income borrower can afford based on their repayment ability. The property must not be primarily designed for income producing activity.

12.9 EXISTING AND NEW DWELLINGS

A. Existing Dwellings [7 CFR 3555.202(b)]

The objective of the SFHGLP is to assist eligible rural households in obtaining an adequate, safe, and sanitary single-family home. Information regarding financing existing manufactured and modular homes may be found in Chapter 13 of this Handbook.

An existing dwelling may be attached, detached or semi-detached dwellings and must be inspected to determine that the dwelling meets the current minimum property requirements of:

- *Single Family Housing Policy Handbook (SF Handbook; HUD Handbook 4000.1)* or as superseded by HUD.

An existing dwelling has been completed for more than 12 months or has been completed less than 12 months but has been previously occupied.

Required repairs under the noted handbooks are limited to those repairs necessary to preserve the continued marketability of the property and to protect the health and safety of the occupants. Applicants are encouraged to obtain a detailed home inspection of the property independent of the inspection noted above.

As stated in SF Handbook (HUD Handbook 4000.1), the responsibility for enforcing code rests with the local municipalities. All repair items required by the appraiser or underwriter must be inspected and the clearance documented and retained in the lender's permanent loan file.

Licensed or certified appraisers who are on the Federal Housing Administration (FHA) roster of approved appraisers can certify the HUD Handbook standards have been met. Licensed or certified appraisers who are not FHA roster appraisers may also certify the HUD Handbook standards have been met if the lender determines the non-FHA roster appraiser is thoroughly familiar with the *SF Handbook (HUD Handbook 4000.1.)* Appraisers who are not thoroughly familiar with the HUD Handbook standards should not certify that a property meets those standards. Doing so would constitute a misrepresentation. If the licensed or certified appraiser is not an FHA roster appraiser or familiar with the HUD Handbook standards, the lender should obtain a home inspection report provided by a home inspector deemed qualified by the lender. Lenders are responsible to determine if any repairs will be required to meet HUD Handbook standards. Lenders are reminded they are responsible for the acts of their agents, including appraisers.

- HUD Handbooks and forms can be downloaded over the internet at <https://allregs.com/login/login.aspx> or obtained by calling 1-800-848-4904.
- FHA roster appraisers can be identified at <https://entp.hud.gov/idapp/html/apprlook.cfm>

The appraiser may certify the requirements of the *SF Handbook (HUD Handbook 4000.1)* (also known as “HUD Handbook”) have been met on page three of the appraisal form in the “comment” section or in an addendum to the appraisal.

Termite/pest inspections are not required unless the lender, appraiser, inspector or State law requires the inspection to confirm the property is free of active infestation.

An inspection to confirm thermal standards is not required for existing dwellings. The Agency may approve dwellings with in-ground swimming pools.

A property which an FHA roster appraiser indicates is in average or good condition may be considered in good repair, though repairs may still be required by the lender. Regardless of whether the appraisal is performed by an FHA roster appraiser or not, the appraiser must report all readily observable property deficiencies as well as any adverse conditions discovered performing the research involved in completing the appraisal. When lending to low- and moderate-income borrowers under the SFHGLP, lenders are expected to use professional judgment and rely upon prudent underwriting practices in determining when a property condition requires additional inspections or repairs.

Conditions that would warrant additional repairs include those that pose a threat to the safety of the occupants, jeopardize the soundness and structural integrity of the property, or adversely affect the likelihood of a low- or moderate-income borrower from becoming a successful homeowner.

B. New Dwellings [7 CFR 3555.202(a)]

New dwellings must be designed and constructed in accordance with certified plans and specifications. Certifications may be accepted from individuals or organizations trained and experienced in the compliance, interpretation, or enforcement of the applicable development standards for drawings and specifications. Information regarding financing new manufactured and modular homes may be found in Chapter 13 of this Handbook.

New Construction Certified Plans and Specifications

The lender’s file must contain evidence the plans and specifications comply with all development standards* applicable to the new construction. Acceptable evidence includes:

1. Copy of the certification from a qualified individual or organization that the reviewed documents comply with applicable development standards. *Form RD 1924-25* is an acceptable format but may not be required by the Agency for guaranteed loans.

-OR-

2. Certificate of Occupancy issued by a local jurisdiction.

-OR-

3. Building Permit (or equivalent) issued by local jurisdiction.

The lender may accept certifications from individuals or organizations trained and experienced in the compliance, interpretation or enforcement of the applicable development standards* for drawings and specifications. Plan certifiers may be any of the following:

- (1) Licensed architects;
- (2) Professional engineers;
- (3) Plan reviewers certified by a national model code organization;
- (4) Local building officials authorized to review and approve building plans and specifications; or
- (5) National codes organizations.

* Applicable development standards. The current International Code Council (ICC) standards or current state adopted ICC code(s) for residential construction.

Evidence of construction inspections.

The lender's file must contain copies of the documents described in one of the following three options:

1. Certificate of Occupancy issued by a local jurisdiction that performs at least 3 construction phase inspections, including inspections noted in option 2 below and a 1-year builder warranty plan acceptable to Rural Development.

-OR-

2. Three construction inspections performed when:
 - Footings and foundation are ready to be poured and prior to back-filling;
 - Shell is complete, but plumbing, electrical and mechanical work is still exposed (this is not applicable to new manufactured homes);
 - Final inspection of completed work prior to occupancy;
 - A 1-year builder warranty plan acceptable to Rural Development. Builders may utilize their own warranty form, *HUD-92544* or *Form RD 1924-19*. Applicants who build their own homes cannot provide a self-warranty.
 - New manufactured home construction only requires footing and final inspections.

-OR-

3. Final inspection and a 10-year insured builder warranty.

Evidence of thermal standards for new construction.

The lender's file must contain evidence thermal standards meet or exceed the International Energy Conservation Code (IECC) in effect at the time of construction. Evidence of thermal standards are typically included in the plans and specs to which the dwelling is built. The final inspection or Certificate of Occupancy issued by a local jurisdiction meets this requirement. Otherwise, documentation of conformance may be by one of the following options:

1. The builder may certify confirmation with the IECC standards.
2. A qualified, registered architect or a qualified, registered engineer may certify confirmation with IECC standards.

In general, the lender has primary responsibility for all loan origination activities. The Agency has primary responsibility to review lenders' actions and monitor participants' compliance with program requirements. The Agency will not require the lender to routinely submit documentation maintained in the lender's file regarding new construction that is not required to be submitted under program guidelines, such as:

- Copies of plans, drawings, and specifications;
- Certifications regarding the plans, drawings, and specifications (although lenders may voluntarily elect to use *Form RD 1924-25*, this form is not a required form for the SFHGLP. The certification may be on the plans and drawings, a separate form, or on any document that conveys the necessary information);
- Building permits;
- Copies of new construction inspections;
- Occupancy certificates; and
- Copies of construction warranties.

The Agency has the option to request any of these documents in appropriate situations such as:

- The Agency is performing a processing review of a newly approved lender;

- The Agency is performing a periodic review of the lender's compliance with program regulations;
- The Agency believes the lender is not fulfilling the obligations of the Lender Agreement and/or program guidelines; or
- The Agency is reviewing a loss claim.

New home purchase transactions that cannot meet the minimum required plan certification, inspections and warranty document requirements outlined in this paragraph are limited to a 90 percent loan to value (LTV). The lender may loan the one-time upfront guarantee fee in addition to the limiting 90 percent LTV.

C. Repair Escrows for Existing and New Dwellings, Post Issuance of the Loan Note Guarantee [7 CFR 3555.202(c)]

Repair escrows, post issuance of the Loan Note Guarantee, are acceptable provided the home is habitable, as determined by the lender. All items of new construction or repairs must be 100 percent (100%) complete in accordance with plans and specifications except for minor items not affecting the livability of the structure or that cannot be completed due to weather conditions. This section does not apply to the Single Close Combination Construction to Permanent Loans or Rehabilitation or Repair Loans. The lender assumes responsibility for completion of repairs in accordance with the conditions set forth in this Section for any repair escrow established.

Repair items will be required to be completed within 180 days of loan closing. This period may be extended, at the discretion of the Agency, for homes that need exterior repairs but are in an area experiencing inclement weather conditions. The maximum exterior repair escrow period when an extension is granted is limited to 240 days. Extensions may be granted beyond 180 days for exterior escrows only.

The Agency may issue a Loan Note Guarantee prior to the completion of interior or exterior repairs provided all the following conditions are met:

- The incomplete work does not affect the livability of the dwelling, nor the health or safety of the occupants;
- A signed contract between the borrower and the contractor is in effect for the proposed work;

- The funds to be escrowed are not less than 100 percent of the repair cost contract. The loan underwriter may determine the escrow amount, which could exceed the repair cost;
- The Closing Disclosure 1 reflects the holdback;
- The development will be complete within 180 days of closing, unless an extension is granted by the Agency for inclement weather conditions; and
- The escrow account is established in a federally supervised financial institution.
- An inspection report certifying the defect/repair has been properly repaired. Certification of completion is required to verify the work was completed and must:
 - Be completed by the appraiser;
 - State that the improvements were completed in accordance with the requirements and conditions in the original appraisal report;
 - Be accompanied by photographs of the completed improvements; and
 - The individual performing the final inspection of the property must sign the completion report.

The lender is responsible for monitoring the completion of the work and the release of funds to pay for the work. All documentation supporting the development and confirmation of the completion will be retained in the lender's permanent mortgage file and is subject to the certification of *Form RD 3555-18/18E*. Any funds remaining in the escrow account upon completion of the work, that are representative of loan funds or a seller concession as part of the sales contract, will be used to reduce the unpaid principal balance of the mortgage. Personal funds of the applicant utilized to fund the repair escrow (excluding loan funds or a seller concession) may be returned to the applicant. A seller's personal funds utilized to fund the repair escrow (excluding a seller concession as part of the sales contract) may be returned to the seller.

Escrow completion for interior or exterior repairs on an existing dwelling – without the assistance of a contractor

When a borrower will complete the planned interior or exterior development on an existing dwelling without the services of a contractor, the requirement for an executed contract noted in this section is waived when these three conditions are met:

- The estimated cost to complete the work is not greater than 10 percent of the total loan amount; and
- The escrow amount is less than or equal to \$10,000; and
- The lender has determined the borrower has the knowledge, skills and time necessary to complete the work within the maximum 180-day limit.

All remaining requirements as noted at Paragraph 12.9 C are applicable. The lender is responsible for monitoring the completion of the work and the release of funds for payment of the work. All documentation supporting the planned development and completion will be retained in the lender's permanent mortgage file and is subject to the certification of *Form RD 3555-18/18E*. Funds remaining in the escrow account upon completion of the work, that are representative of loan funds or a seller concession, as part of the sales contract, will be used to reduce the unpaid principal balance of the mortgage. Personal funds of the applicant utilized to fund the repair escrow (excluding loan funds or a seller concession) may be returned to the applicant. A seller's personal funds utilized to fund the repair escrow (excluding a seller concession as part of the sales contract) may be returned to the seller.

SECTION 4: ENVIRONMENTAL REQUIREMENTS

[7 CFR 3555.5]

12.10 HAZARD IDENTIFICATION

A. Due Diligence

Lenders are required to utilize due diligence with regard to potential environmental hazards to ensure the property is, safe, sanitary, and has sufficient value to adequately secure the loan. The property must be free of known hazards that may have adverse effects on the health and safety of the occupants. The structural soundness of the dwelling must ensure customary use and enjoyment of the property by the occupants. While the Agency does not specify how the lender's due diligence must be conducted, the level of review must be equivalent to the standards established by Fannie Mae, Freddie Mac, the Federal Housing Authority (FHA), or the United States Veterans Administration (VA).

Appraisers play an important role in identifying potential environmental hazards by notifying the lender of concerns identified during their visit to the property. The appraiser is required to note readily observable conditions. If the lender knows or is informed by another party of a potential hazard, the information must be disclosed to the appraiser. Lenders must follow up on all potential environmental hazards identified by an appraiser to determine the nature and scope of the problem, and the impact the problem is likely to have on the property's value. If potential environmental hazards are noted, the lender must carefully document the suspected problem and the findings of its investigation.

If the lender's investigation reveals an environmental hazard does exist, the lender must ensure the hazard is mitigated before requesting the loan guarantee.

B. Flood Hazards

The lender must complete, or arrange for a contractor to complete, *FEMA Form 086-0-32, "Standard Flood Hazard Determination Form (SFHDF)"* to determine whether the dwelling is located in a Special Flood Hazard Area (SFHA) in accordance with the National Flood Insurance Reform Act of 1994.

Existing dwellings are eligible under the SFHGLP only if flood insurance, through FEMA's National Flood Insurance Program (NFIP), is available for the community and flood insurance whether NFIP, "write your own," or private flood insurance, as approved by the lender, is purchased by the borrower. Lenders are required to accept private flood insurance policies that meet the requirements of 42 USC 4012a (b)(1)(A). Insurance must be obtained as a condition of closing and maintained for the life of the loan for existing residential structures when any portion of the structure is determined to be located in a SFHA, including decks and carports, etc. However, according to the Homeowner Flood Insurance Affordability Act (HFIAA) of 2014, flood insurance is not required for any additional structures that are located on the property but are detached from the primary residential structure and do not serve as a residence, such as sheds, garages, or other ancillary structures. Existing dwellings financed through the SFHGLP are not subject to the requirement within RD Instruction 1970, Subpart F, which requires a search for practicable off-site alternatives to purchasing an existing dwelling within the SFHA.

New or proposed construction in an SFHA is ineligible for a loan guarantee unless:

- A final Letter of Map Amendment (LOMA) or final Letter of Map Revision (LOMR) removes the property for the SFHA is obtained from FEMA; or

- The lender obtains a FEMA National Flood Insurance Program Elevation Certificate (FEMA Form 086-0-33). The flood elevation certificate must document that the lowest floor (including the basement) of the residential building, and all related improvements/equipment essential to the value of the property, are built at or above the 100-year flood elevation in compliance with National Flood Insurance Program (NFIP) criteria. The flood elevation certificate must be prepared by a licensed engineer or surveyor;
- Documentation is included in the file in accordance with RD Instruction 1970 Subpart F, that there is a demonstrated need for the SFHGLP and there are no practicable alternatives to new construction within the SFHA that are acceptable to the applicant(s). Examples include but are not limited to the following: the entire community is located within the SFHA, there are no comparable homes to the proposed new dwelling, the existing housing stock is unacceptable to the applicant, etc.

Note: Part of the site may be located in the SFHA without triggering these requirements, as long as no part of the dwelling is located in the SFHA. At the lender's discretion they may require flood insurance even if the residential building and related improvements to the property are not located within the SFHA, but the lender has reason to believe that the building and related improvements to the property may be vulnerable to damage from flooding.

Flood insurance must cover the lesser of the outstanding principal balance of the loan or the maximum amount of coverage allowed under FEMA's National Flood Insurance Program (NFIP). Unless a higher amount is allowed by state or federal law (which includes FEMA policies), the maximum deductible clause for a flood insurance policy should not exceed the greater of \$1,000, or one percent of the face amount of the policy, or the minimum deductible offered by the borrower's chosen insurance carrier. Existing dwellings for the SFHGLP are eligible if flood insurance is available.

Existing dwellings and newly constructed dwellings located within the SFHA which are not served by public sewer systems and have on-site septic or sewage treatment systems must have a drinking water supply which is protected from cross contamination from the onsite septic/sewage treatment during flooding. A property serviced by an on-site septic or sewage treatment system is eligible under this Section, provided one of the following can be met:

- The property is served by a publicly provided water supply.

- The property is serviced by a private drinking water well/supply with a fitted sanitary well cap which prevents backflow floodwater from entering the drinking supply well.
- The property is served by a private drinking water well/supply whose opening is located above the base flood elevation of the SFHA. Additional documentation, such as an elevation certificate, will be required to verify this type of property.

SECTION 5: CONDOMINIUMS

[7 CFR 3555.205]

12.11 CONDOMINIUMS AND PLANNED UNIT DEVELOPMENTS

A. Condominiums

Condominium projects typically consist of multi-unit buildings governed by an HOA. Each unit is individually owned, and the common areas such as hallways and recreational facilities are owned by all the unit owners.

Although less common, it is possible for condominium projects to consist of detached or attached single family dwellings. In these cases, it is the HOA and not the individual unit owner who is responsible for maintaining the exterior of the dwellings in addition to the common areas.

HOA dues for dwellings in a condominium project must be included in total debt-to-income. Units in a condominium project are eligible for a guarantee if the condominium has been approved or accepted by HUD/FHA, VA, Fannie Mae or Freddie Mac. Lenders who meet the conditional authority and who have staff with knowledge and expertise in reviewing and approving condominium projects in accordance with HUD/FHA, VA, Fannie Mae or Freddie Mac, as applicable, may determine the acceptability of the condominium project. Lender representation and certification of project approval may be accepted as long as the lender meets the self-certification criteria set forth by HUD/FHA, VA, Fannie Mae or Freddie Mac and is done so consistently with standards and regulations set forth by each entity. By submitting the request for Conditional Commitment for Loan Note Guarantee, the lender represents the condominium project meets the requirements set forth by HUD/FHA, VA, Fannie Mae or Freddie Mac. Lenders must retain evidence they have reviewed condominium documentation that supports the project's approval or acceptance by HUD/FHA, VA, Fannie Mae, or Freddie Mac and that the documentation remains available in the lender file for verification purposes. When requested, the lender must provide such documentation to Agency staff

for verification of compliance with HUD/FHA, VA, Fannie Mae, or Freddie Mac regulations.

Applicants remain responsible to obtain individual homeowners' insurance or flood insurance as applicable. The lender is responsible for ensuring that the HOA obtains and maintains adequate flood and hazard insurance for buildings in a condominium project located within a SFHA. A Condominium Rider must supplement the Mortgage or Deed of Trust.

1. Ineligible Condominiums

Certain types of condominium projects are not eligible under HUD, Fannie Mae, Freddie Mac, or VA guidelines. They are:

- Condominium hotels;
- Timeshares;
- Houseboat projects;
- Multi-dwelling unit condominiums that permit an owner to hold title to more than one dwelling by a single deed and mortgage;
- Any project for which the owner's association is named a party to current litigation or for a project that has not been turned over to the association for which the project sponsor or developer is named a party to current litigation;
- Condominiums that represent a legal, but non-conforming use of the land, if zoning regulations prohibit rebuilding the improvements to current density in the event of their full or partial destruction;
- Investment Securities – A project in which ownership is characterized or promoted as an investment opportunity; and/or projects that have documents in file with the Securities and Exchange Commission;
- Common interest apartments or community apartment projects – Any project or building that is owned by several owners as tenants-in-common or by a HOA in which individuals have an undivided interest in a residential apartment building and land and have the right of exclusive occupancy of a specific apartment in the building;

- A project with non-incidental business operations owned or operated by the owners' association such as, but not limited to, a restaurant, spa, health club, etc.

2. *Site Condominium Eligibility*

Project approval may not be required for site condominiums if they meet the following criteria:

- Single Family totally detached dwelling encumbered by a declaration of condominium covenant or condominium form of ownership;
- The unit has no shared garage or any other attached buildings (i.e. archways, breezeways); and
- The condominium unit consists of the entire structure, site and air space and is not considered to be common areas or limited common areas.

Appraisal data will be collected on *Individual Condominium Unit Appraisal Report (FNMA Form 1073/FHLMC Form 465)*. A Condominium Rider must supplement the Mortgage or Deed of Trust. Insurance and maintenance costs will be the responsibility of the unit owner. Site condominiums that do not meet the criteria must follow Section 12.11.A above for condominium approval.

3. *Underwriting with a Condominium Unit:*

For all loans secured by a condominium unit, in a condominium project, the lender must perform an underwriting review of the condominium project to ensure the unit is approved or accepted by HUD/FHA, VA, Fannie Mae, or Freddie Mac. Participating lenders may certify to Rural Development that they have reviewed the condominium documentation that supports project approval or acceptance, and that the condominium is in compliance with HUD/FHA, VA, Fannie Mae, or Freddie Mac guidelines. The lender may indicate compliance by stating the project classification on the *Uniform Underwriting and Transmittal Summary (FNMA Form 1008, FHLMC Form 1077)*. The lender may utilize Rural Development's Attachment 12-B to this Chapter, "Rural Development Condominium Certification." Use of the Condominium Certification Form is optional. Those lenders who utilize the Agency's automated underwriting system, GUS and receive an "Accept" underwriting recommendation may be requested to present documentation confirming the condominium unit meets the eligibility criteria of this section.

Lenders may refer to HUD/FHA, VA, Fannie Mae or Freddie Mac for additional guidance in performing their underwriting review of the condominium project. Aside from the lender certification to Rural Development, all condominium documentation should remain in the lender's permanent loan file and should be available upon request. Full documentation will be requested if the lender fails to certify the condominium unit meets the requirements of HUD/FHA, VA, Fannie Mae or Freddie Mac project approval or acceptance.

When there is an indication that a condominium unit or project does not meet the requirements of HUD/FHA, VA, Fannie Mae or Freddie Mac, the Agency will request additional documentation from the lender. If the condominium unit or project does not meet the stated requirements as certified or warranted by the lender, the Agency may refuse to issue a conditional commitment or loan note guarantee.

B. Planned Unit Developments [7 CFR 3555.207]

A planned unit development (PUD) is a project or subdivision that includes common property that is owned and maintained by a homeowner's association (HOA) for the benefit of use by the individual PUD unit owners. A PUD can consist of condominiums, townhomes or detached single family homes that are served by a HOA.

HOA dues for dwellings in a PUD must be included in total debt-to-income calculations.

The mortgage industry, including other Government housing programs like FHA, now recognize that PUD dwellings do not pose any more risk than single family dwellings not part of a PUD. Loans may be guaranteed for PUD single family dwellings the same as for single family dwellings not in a PUD.

SECTION 6: COMBINATION CONSTRUCTION TO PERMANENT LOANS

[7 CFR 3555.105]

A combination construction to permanent loan, also known as a "single-close loan," can be offered to eligible applicants by approved lenders with appropriate construction lending experience and adequate controls for interim construction cost disbursements. The criteria for this type of loan are described in the following sections below.

12.12 SINGLE-CLOSE FEATURES

A single-close loan combines the features of a construction loan, which is a short-term interim loan for financing the cost of construction, and the traditional long-term permanent residential mortgage. The approved lender makes the loan to an eligible applicant. Since there is only one closing, which can save considerable closing costs, for upfront guarantee purposes, this type of loan is considered a purchase transaction by the Agency, however the lender should identify and code the loan as “construction only” in GUS/GLS. Closing occurs prior to the start of construction. At closing funds are disbursed to cover the cost of land and applicable closing costs subject to the maximum loan to value. The lender will be responsible for managing the disbursement of the loan proceeds to the builder or contractor for the balance of mortgage proceeds, known as the “lenders construction holdback,” as construction progresses. The lender must obtain written approval from the borrower prior to each draw payment.

If the borrower’s current principal residence is pending sale, but the transaction will not be complete prior to the commencement of the borrower’s new SFHGLP construction loan, the existing PITI payment and the proposed PITI payment must be used in qualifying the borrower for the new guaranteed mortgage loan. The lender may exclude the existing PITI payment under the following conditions:

- The new loan is a SFHGLP single close construction loan.
- The lender can document an executed sales contract for the current residence, and
- The lender can confirm that any financing contingencies have been cleared.

The permanent mortgage loan interest rate, which is used for underwriting, is established at closing.

The Loan Note Guarantee may be issued once the interim construction loan is closed without waiting for completion of the subject property. An optional checklist, Attachment 12-C of this Chapter, has been developed to assist lenders with their project review.

12.13 LENDER REQUIREMENTS

Approved lenders will be responsible for monitoring construction of the subject property, overseeing disbursement of mortgage proceeds, and obtaining documentation that confirms the construction of the subject property is complete. The lender must meet the following conditions to offer this loan feature:

- Lenders will ensure the utilization of a fixed price construction contract;
- Provide a fully executed *Form RD 3555-16* lender agreement and self-certify that they have staff with two or more years' experience making and administering construction loans or employ a construction loan management company with two or more years of experience as their agent. Lenders will ensure the builder's experience is relevant to the type of loan. Repair and renovation experience will not substitute for experience making and administering new construction loans;
- Conduct investigations and obtain documentation to confirm the eligibility of construction contractors/builders, and their construction loan management company if they contract one;
- Approve construction contractors, construction loan management companies, or builders upon submittal and review of evidence the contractor/builder meets requirements set forth in Paragraph 12.14 of this Chapter;
- Agree to retain evidence of contractor/builder/construction loan management company approval for future review by the Agency;
- For loans closed prior to commencement of construction:
 - Loans securitized individually may disburse proceeds for the cost of the land, or the balance owed on the land, and Agency allowed closing costs. Any balance of the mortgage proceeds, including the "custodial reserve account," must be placed into a reserve account.
 - Lenders utilizing a warehouse line of credit will not be required to disburse all funds at closing nor required to reserve all funds prior to the commencement of construction.
- Approve and disburse mortgage proceeds in accordance with the construction loan agreement, with prior written approval by the borrower and confirmation of work completion prior to disbursement. The lender must maintain a draw and disbursement ledger for each single close loan.

The lender is representing they meet the criteria of this paragraph when requesting a commitment for loan note guarantee.

12.14 CONSTRUCTION CONTRACTOR-BUILDER REQUIREMENTS

A key to the success of the loan feature will be the financial stability and reputation of the builder constructing the home. The approved lender and their agent, if any, will be responsible for approving participating builders. Each builder seeking to participate will be subjected to a process that involves license verification, insurance validation, credit examination, reference verification and a criminal background check. Minimum credit examination will include obtaining a commercial credit report on the business. Owner-builders are ineligible for this loan feature. Lenders are required to document their determination for eligibility of the builder to participate in the Rural Development mortgage transaction as further described in Handbook Chapter 15.

Construction contractors or builders of homes financed with the single close loan must have:

- Two or more years of experience building and constructing all aspects of single-family dwellings similar to the type of project being proposed;
- Evidence of a state-issued construction or contractor license, as required by state law or local law;
- Evidence of commercial general liability insurance with a minimum coverage of \$500,000;
- The builder/contractor must have an acceptable credit history being free of open judgments, collections or liens related to previous construction projects. The builder/contractor must not have a previous felony criminal record. A background check will be performed by the approved lender. This information may be obtained by such means as an individual credit report, business report, information published by the Securities and Exchange Commission (SEC), State Corporation Commission (SCC), LexisNexis, or Dun and Bradstreet; and
- Contractors or builders who are constructing their own residence are ineligible.

The lender is representing the builder meets the criteria of this paragraph when requesting a commitment for loan note guarantee.

12.15 ELIGIBLE LOAN COSTS

The loan will be used to finance the construction of a new single-family housing residence, which can include modular and manufactured home construction.

Condominiums, including detached condominiums and site condominiums, are ineligible for this type of loan feature.

Any item included in the cost to construct the home must be commonly and customarily included in the cost to construct other homes in the area where the subject property is located. A contingency reserve to cover eligible expenses associated with unplanned problems with construction or change orders may be utilized. If used, the reserve is limited to 10% of the cost of construction (including labor, materials and soft costs). Reserve funds must be deposited into the construction reserve account. The cost to construct must not include items such as furniture, electronic and home entertainment equipment or other personal items.

Loan costs which may be included in the loan amount are subject to the maximum loan to value and will be reasonable and customary construction costs such as:

Land

- Acquisition cost of the land;
- Payoff the balance of land to be utilized in the construction of the dwelling.

Construction Hard Costs

- Costs inside the contract to be detailed on the construction budget agreed upon by the builder and borrower; and
- Costs outside of the contract, paid to subcontractors, for contributive work such as well and septic installation, roads/driveways, utility hookups, landscaping, etc.

Construction Soft Costs

- Appraisal fees
- Inspection fees
- Survey
- Permits
- Plan review fees
- Architecture or design fees

- Engineering fees
- Title updates
- Lender construction administration fees
- Contingency reserve
- Interest reserve including interim interest as accrued, during the construction period, on a warehouse line of credit up to 12 months
- Principal, interest, taxes, and insurance (PITI) payment reserve up to 12 months
- Project review fees
- Builder acceptance or review fees
- Tax and insurance reserve

Other reasonable and customary closing costs are allowable as defined in Chapter 6 of this Handbook, as long as the costs do not exceed the maximum loan to value described in Chapter 7.

12.16 PLAN AND THERMAL CERTIFICATION

Certification of plans and confirmation of thermal requirements are required in accordance with Paragraph 12.9.B of this Chapter.

12.17 APPRAISALS

The fair market value, as determined by a licensed or certified appraiser in accordance with regulation 3555.107(d), of the proposed (to-be constructed) subject property will be utilized to establish the maximum loan amount. Land value is based on the value as reported in the Appraisal Report, with no seasoning requirement.

12.18 BUILDER WARRANTY

A builder's warranty will be provided the borrower in accordance with Paragraph 12.9.B of this Chapter.

12.19 LOAN APPROVAL PROCESS

Issuance of a Conditional Commitment will be in accordance with Chapter 15 of this Handbook. The approved lender must submit the construction contract executed by the applicant and builder with each single-close request.

12.20 LOAN CLOSING

Standard industry closing documents are utilized when closing a single-close loan. The lender is responsible for ensuring all applicable security documents, including a valid and enforceable Note, are complete at loan closing. The lender is responsible for any state specific construction related requirements that may influence the validity of the first lien or the construction disbursement process. The date of closing will be the date the interim construction loan is closed. These construction documents may be in any form acceptable to the lender.

At closing, the term of the loan is for thirty years. During construction, interest on the construction loan is payable monthly either directly from the borrower or indirectly drawn from an established reserve account. If the lender elects to not establish a reserve account and the borrower will pay these expenses directly, clear documentation that they possess the ability to do so must be demonstrated in the application package. The interest rate during the construction period must be a fixed rate. Adjustable interest rates during construction are not allowed.

- Warehouse line of credit lenders may opt for dual loan disclosures to the borrower disclosing the terms of the interim construction period and a separate disclosure for the terms of the permanent loan, or they may choose a single disclosure method that blends the terms of the construction portion and the permanent loan. Lenders may establish an interest only or PITI reserve account. If the lender elects not to collect a PITI reserve account to make the regularly scheduled PITI payment during the construction period, only interest payments on the advanced construction loan balance will be due and paid during the construction phase. Once construction has been completed, excess funds from the contingency reserve account, if any, will be applied as principal curtailment. The loan may be reamortized to achieve full repayment for the remainder of the loan term. When a loan is reamortized via a modification, the lender can also reduce the permanent interest rate. In such cases, the lender must provide an executed loan reamortization agreement (modification agreement) to confirm the existence of the permanent loan and the corresponding amortizing interest rate on the mortgage loan. Amortization must begin no later than the first of the month 60 days from the final inspection.

- Lenders who securitize the loan immediately after loan closing may elect to establish a reserve account for the borrower's regularly scheduled PITI payment from the original loan closing. The established PITI reserve account will then be utilized to make the monthly loan payments on the amortized loan during the construction period. This alleviates the requirement for a loan modification or reamortization at the end of the construction period and allows the lender to securitize the loan prior to the completion of construction. Once construction has been completed, excess funds from the contingency reserve account, if any, will be applied as principal curtailment.

Annual guaranteed fees will begin to accrue upon loan closing and will be due and payable each year upon the anniversary of the initial loan closing.

The approved lender monitoring the construction of the subject dwelling should retain a certification stating the dwelling has been completed properly and can be occupied by the borrower, construction phase inspections have been made and the required warranty coverage has been obtained. The lender should obtain the appraisers final inspection, a certificate of occupancy, and a final endorsement to the title policy clear of all liens. The lender will also retain evidence, in the permanent work file, that any remaining reserve account funds have been applied as a principal curtailment once construction is complete. Attachment 12-D of this Chapter is an example of a lender certification.

Select *Lender Origination* to view the document regarding *Identification of Electronic Delivery*.

The Agency will receive the documents from lenders and will image them permanently into the Agency's imaging repository as a miscellaneous document. Refer to Chapter 2 of this Handbook for further guidance regarding imaging documents.

12.21 AGE OF DOCUMENTS

Credit and verification documents must be dated within 120 days of the original closing date to be valid. If the documentation exceeds the condition time frame, the lender must obtain updated credit and/or appraisal documents and re-qualify the borrower before the loan note guarantee can be requested and/or issued.

12.22 ISSUANCE OF THE LOAN NOTE GUARANTEE

The loan guarantee may be issued by Rural Development prior to the construction of the home being complete. The loan guarantee will be for the full amount of the loan closed. The guarantee fee structure for a single-close loan will be equal to a purchase transaction. Prior to requesting the guarantee, the lender is responsible for ensuring that

the loan is properly closed, closing conditions are met and the guarantee fee is collected. Loan closing instructions in accordance with Chapter 16 and Electronic Status Reporting (ESR) in accordance with Chapter 17 of this Handbook are applicable.

12.23 CONSTRUCTION DRAWS

Draws and disbursements will be managed by the approved lender. The lender is required to maintain a draw and disbursement ledger for any loan guarantee request. The borrower and lender will be jointly responsible for approving disbursements to the builder during the construction phase. Total disbursements should not exceed the value of the realized material cost and the percentage of work in place with the exception of an initial disbursement to commence construction. When funds are disbursed, the lender is warranting to Rural Development the work was done as specified. The lender will maintain documentation in their file evidencing the work was completed for the draw which was disbursed. At a minimum, documentation should include evidence of a third-party inspection, signed conditional lien waiver from the contractor/builder, and a title insurance endorsement for each draw.

12.24 CHANGE ORDERS

Lenders will approve any change orders during construction. The borrower(s) will be responsible for any costs related to change orders that exceed available funds in the contingency reserve account, or for ineligible loan purposes that occur post loan closing. Proposed changes, during the course of construction, should not affect the scope of the project and/or affect the appraised value.

12.25 CASH BACK TO BORROWER

The borrower is not to receive funds after closing. Lenders must apply any excess funds from the construction proceeds to reduce the principal balance of the permanent loan. In the event funds remain after closing from unused prepaid expenses including, but not limited to per diem interest to the end of the month on the new loan, hazard insurance premium deposits, and/or real estate tax deposits needed to establish the escrow accounts, the borrower may receive cash back if the borrower paid these items from their personal funds and they do not represent loan funds. Funds that remain in the contingency reserve account, after the completion of construction, may be utilized for an eligible loan purpose or applied to the principal balance of the permanent loan.

12.26 MORTGAGE FILE DOCUMENTATION

The lender's permanent mortgage file must contain the following information to support the single close transaction, in addition to documentation outlined in this Handbook:

- Sufficient documentation to validate the actual cost to construct the subject home. (For example, purchase contracts with the builder, Construction Loan Agreement, plans and specifications, receipts, invoices, lien waivers, etc.);
- All closing disclosures and closing documents executed by all parties to the transaction and evidencing all costs to the homebuyer and property seller at the time of loan closing;
- A final title insurance policy endorsement ensuring the lender remains in a first lien position and that no junior liens exist against the property;
- All canceled checks, paid receipts, draw requests, lien waivers, change orders, title endorsements, etc. for all property-related requirements for new construction;
- The appraiser's certificate of completion and a photograph of the completed property; and
- All third-party inspections and warranties as defined in this Chapter.

12.27 UNPLANNED CHANGES DURING CONSTRUCTION

Should a life change occur with the borrower, such as loss of job or death occurs, the lender remains responsible to work with the builder to complete the home. The loan will be serviced in accordance with Chapters 18 through 20 of this Handbook, as applicable.

12.28 REHABILITATION AND REPAIR WITH PURCHASE OF EXISTING DWELLINGS

The rehabilitation and repair feature of the SFHGLP allows borrowers to finance the cost of repairs to improve an existing dwelling at the time of purchase. The maximum loan amount cannot exceed the cost of acquisition plus the cost of repairs up to the as-improved market value, plus the guarantee fee, if financed. The borrower obtains one loan at a fixed interest rate to finance both the acquisition and the rehabilitation of the property. The loan is guaranteed after the loan has closed, prior to the completion of the repairs which minimizes the risk to the lender.

Unless otherwise specified, the rehabilitation and repair construction loan process should be closed and managed following the same procedures described in the single-close feature for new construction.

A. Type of Loans

1. *Non-Structural Repairs up to \$35,000*

This feature allows borrowers to finance up to \$35,000 for repairs such as those identified by a home inspector or appraiser. There is no required minimum repair amount. The repairs must be non-structural, and the home must be considered habitable at the time of closing to be eligible for this feature. Since the dwelling is habitable, the loan is not eligible for reserve accounts for PITI payments during the construction period.

2. *Structural Repairs and Repairs Exceeding \$35,000*

This feature allows borrowers to finance structural repairs or improvements greater than \$35,000 for extensive rehabilitation. If the dwelling is not habitable at the time of closing, reserves for principal, interest, taxes and insurance may be established to cover the mortgage payments for up to 6 months or until the home is determined to be habitable by a third-party inspector deemed qualified by the lender during the construction period.

B. Property Eligibility

New construction or incomplete constructions are not eligible. Evidence that the home has been completed for 12 months or older must be obtained. Evidence of completion such as a Certificate of Occupancy or documentation from local taxing entities is acceptable.

If the dwelling must be demolished as part of the rehabilitation, the complete existing foundation must still be in place and will be used. Properties where the foundation has been demolished or where only the footings remain, are not eligible. Evidence by a licensed engineer that the existing foundation is structurally sound and supports the proposed construction will be required.

1. *Prohibited Loan Purposes*

- Installation of new inground swimming pools, hot tubs, or saunas;
- Repairs to new or existing manufactured homes;
- Repairs to condominiums;

- Converting structures to SFH dwellings (barns, schoolhouses, etc.);
- Alterations that allow income-producing features;
- Installation of luxury items (exterior fireplaces and kitchens, etc.); and
- Repairs or improvements to common space areas (community meeting rooms, playgrounds, etc.).

2. *Eligible Loan Costs*

Loan proceeds must be used for the acquisition of the land and dwelling plus the total amount for repairs that include but are not limited to:

- Removing safety and health hazards;
- Making the dwelling accessible to persons with disabilities;
- Repair or installation of septic system and water wells;
- Additions, structural alterations or reconstruction of an existing;
- Addition of a garage, attached or detached;
- Modernizations (kitchens and bathrooms, interior floor cover, exterior siding, etc.);
- Installation of energy conservation or weatherization features;
- Repairs to existing swimming pools, hot tubs, or saunas; and
- Repairs to accessory dwelling units.

Applicable soft costs as defined in Paragraph 12.15 are allowable in addition to:

- Contingency reserves; 10% when utilities are on, 15% when they are off for all transactions;
- Principal, Interest, Tax and Insurance payments for up to six months for reserves, when applicable; and
- Inspection/Consultant fees, if applicable.

C. Managing Construction

Originating lenders do not need to have construction experience if the servicing lender will administer the construction phase. Servicing lenders must meet the requirements outlined in Paragraph 12.13 of this Handbook. Builder/contractors must meet the requirement outlined in Paragraph 12.14. The borrower may not act as the general contractor. A pre-construction conference with all parties is strongly encouraged.

The lender may engage any inspector or consultant deemed qualified by the lender to evaluate the property, write up the necessary improvements, conduct periodic inspections, and to act as a liaison between the borrower, builder, and lender.

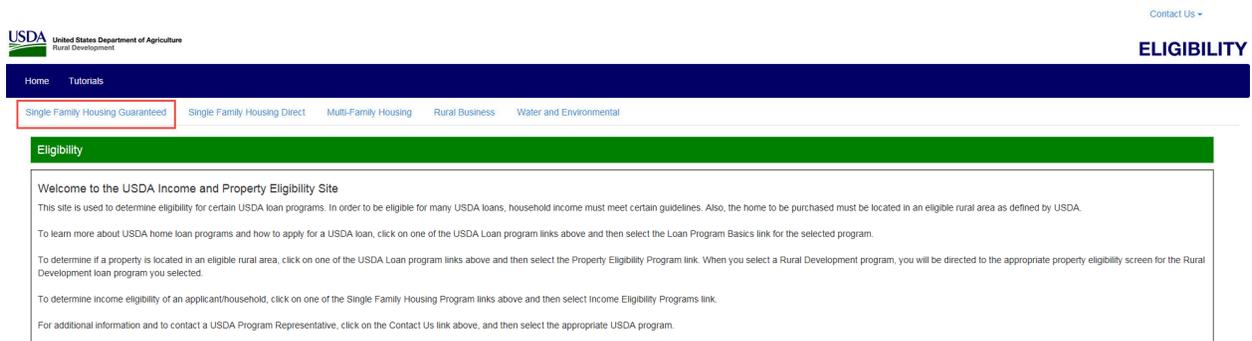
- **Inspector/Consultant fees:** For structural repairs and those exceeding \$35,000, an inspector will perform a thorough inspection of the property and prepare a detailed write-up of the work to be repaired and include estimated costs for labor and materials and associated fees that are customary and typical for the area. This write-up will be used to obtain cost estimates from contractors. Inspectors or consultants are selected by the lender. An inspector or consultant is not required for non-structural repairs of \$35,000 or less.
- **Cost Estimate:** The borrower must obtain a detailed and fixed cost estimate that fully describes the work being performed to include itemized costs for labor and material. The cost estimate must identify the borrower's name, subject property address, contractor's name, contact information and license number, where applicable. For work repairs \$35,000 or less, the cost estimate must indicate that the repairs are non-structural.
- **Appraisals:** The appraisal report must support the "As Improved" market value of the property with the assumption that all repairs are completed. A copy of the original write-up, or the cost estimate including reserves will be provided to the appraiser.
- **Construction Period:** The Construction period should typically not exceed 6 months from the date of closing for all transactions. However, contract deadline extensions may be approved at the lender's discretion.
- **Construction Contract:** The lender must ensure the utilization of a fixed price contract. The total amount in the construction contract must match the total cost breakdown of the bid proposal, must have a start and end date, must be signed by the contractor and borrower(s) and must be referenced and made part of the Security Instrument.

- **Additions:** New structures or additions to the existing dwelling must comply with local codes and applicable national codes.
- **Unpermitted work:** When unpermitted work is discovered in the existing dwelling, the lender must ensure that the owner and/or contractor contact the appropriate code enforcement office to obtain retroactive permitting or devise a plan to permit the previous construction. The lender must ensure that the borrower obtains a rehabilitation loan permit certification prior to the loan closing so that all permit fees associated with the new and/or previous construction are included in the total bid.
- **PITI Reserve:** The lender will be responsible for making the borrower's monthly PITI payments, during the period of rehabilitation up to a maximum of 6 months or when the dwelling is determined to be habitable by a qualified third-party inspector.

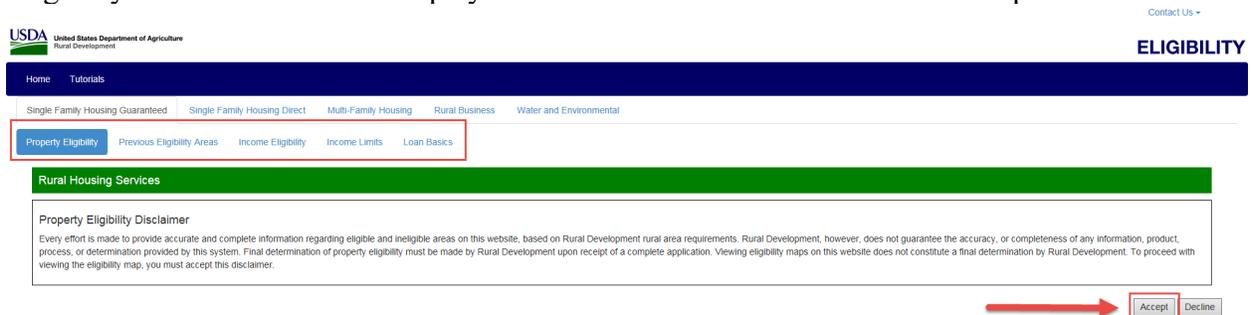
ATTACHMENT 12-A Determining Eligible Areas Using the Public Website

<https://eligibility.sc.egov.usda.gov>

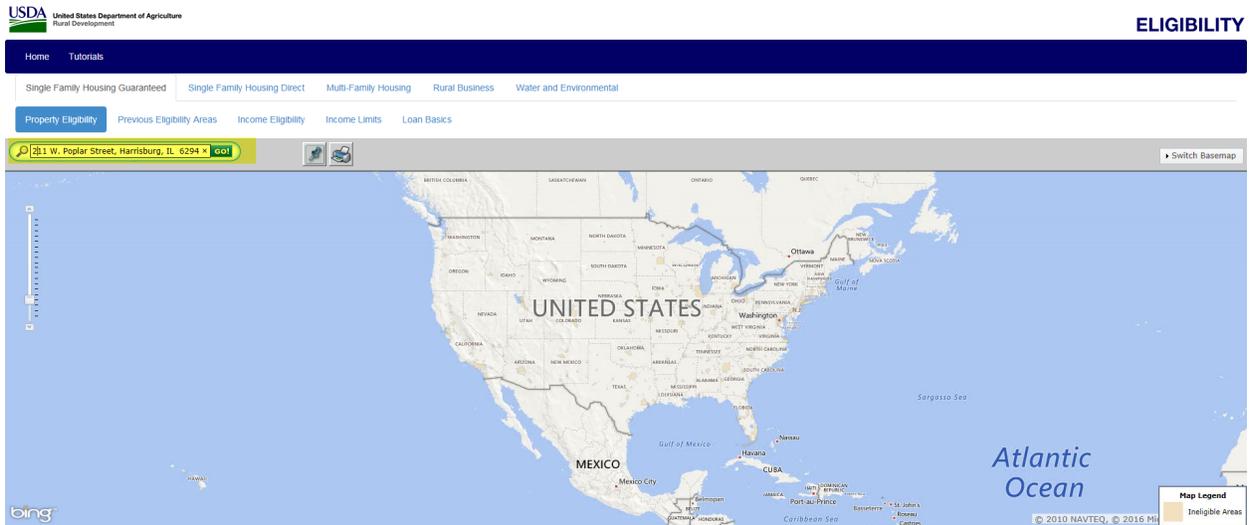
Select “Single Family Housing Guaranteed” from the menu.



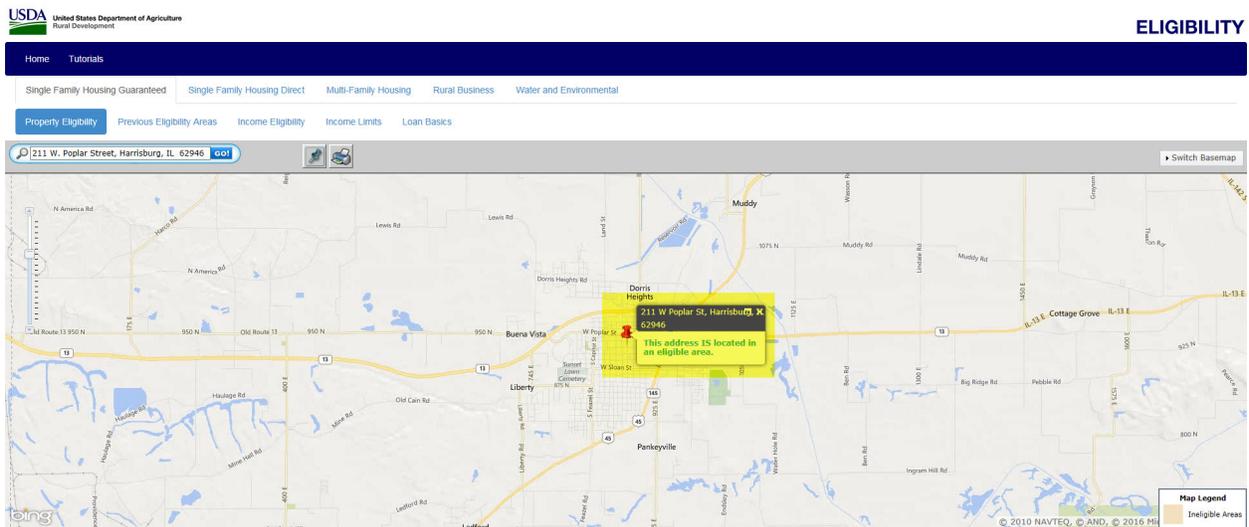
The additional menu options for the guaranteed loan program will be available. The “Property Eligibility Disclaimer” will be displayed. Read the disclaimer and select “Accept.”



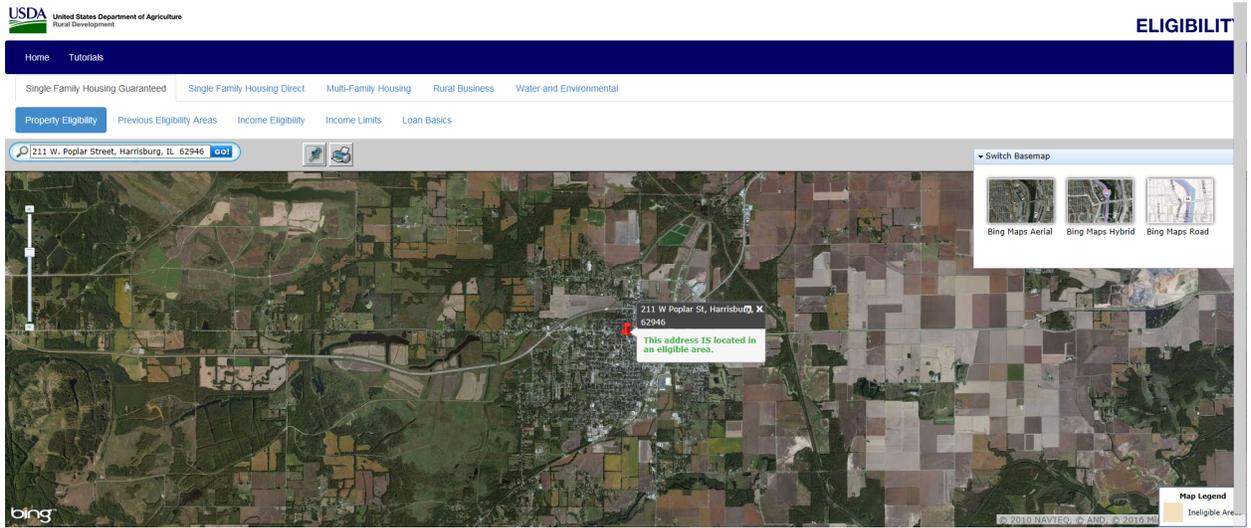
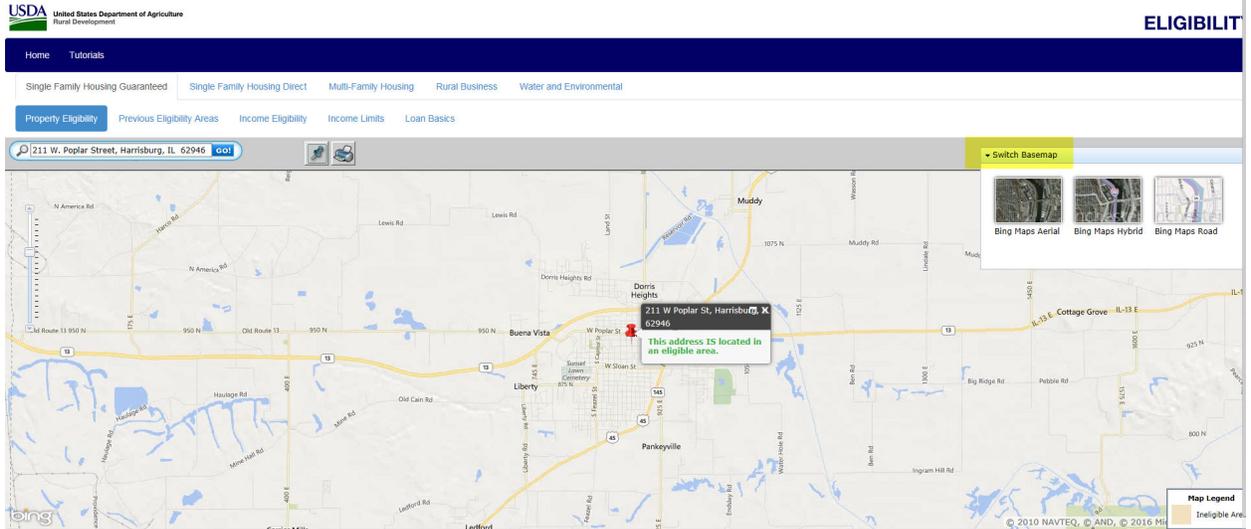
Enter the address of the property to determine if it is located in an eligible rural area. Every effort is made to ensure eligible rural areas inquires are provided an accurate response. If a property is deemed “Ineligible” or “Unable to Determine”, please contact your USDA State Office where the property is located for additional assistance.

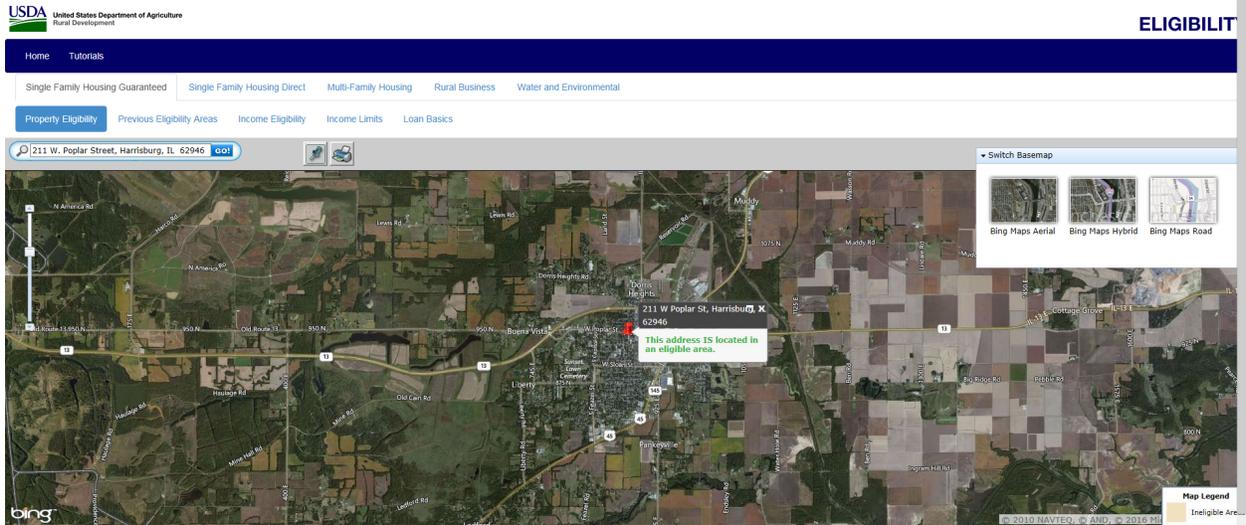


The eligibility determination is returned. It may be Eligible, Ineligible, or Unable to Determine. In the example below the property is eligible.

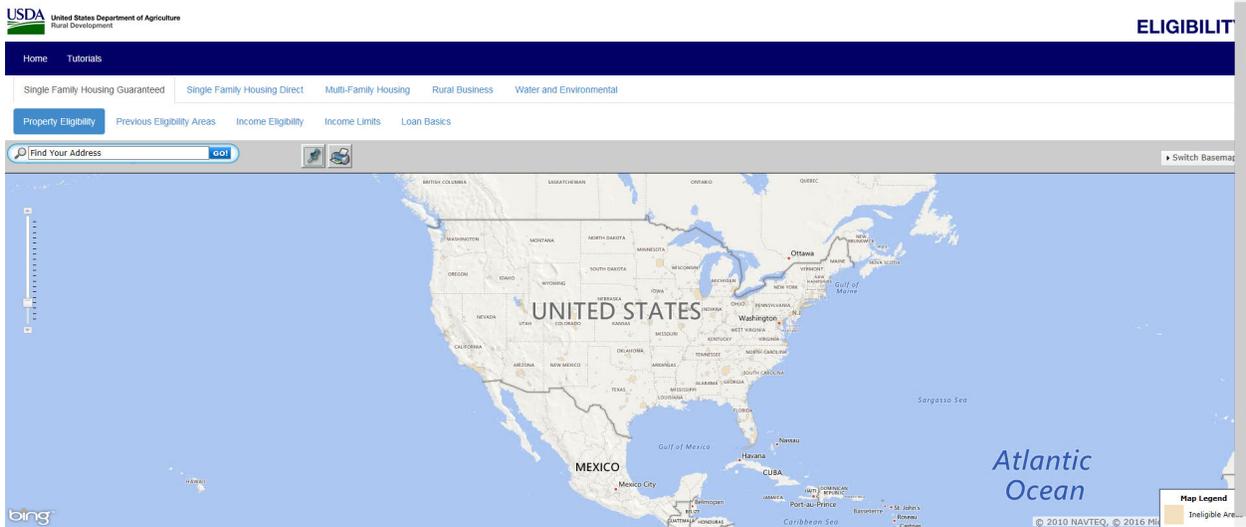


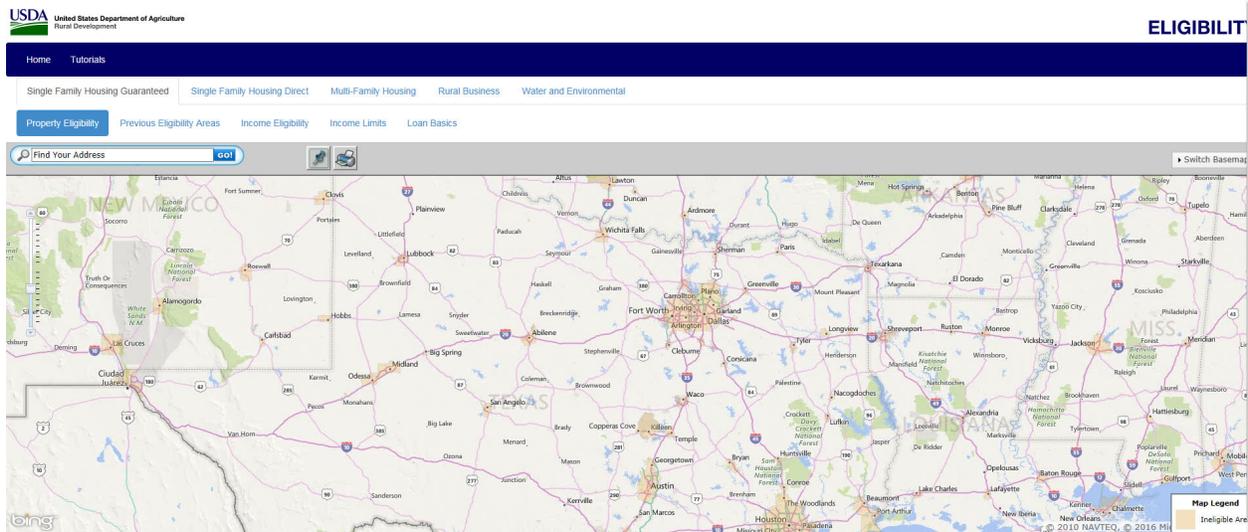
The map view may be changed by selecting the “Switch Basemap” option.





If an exact address is unknown, the user may click on a State from the U.S. map to review eligible and ineligible areas.





This is a closer look at Texas. Each click on the map will provide a zoom view. The darker colored areas will provide users with a good idea of eligible and ineligible areas.

All property eligibility determinations will be made by USDA. Questions regarding property eligibility determinations made from this online tool should be directed to the USDA State Office for additional clarification.

ATTACHMENT 12-B

RURAL DEVELOPMENT CONDOMINIUM CERTIFICATION

This warranty certifies the dwelling served by the homeowners association and identified below has been approved or accepted by HUD, VA, Fannie Mae, or Freddie Mac. Documentation supporting this certification will be maintained in the lender's files and will be available for inspection by Rural Housing Service, United States Department of Agriculture upon request.

Borrower(s): _____

Property Address: _____

Lender: _____

Lender Representative Name: _____

Representative Signature: _____

Date: _____

ATTACHMENT 12-C

PROJECT REVIEW

Documentation of contractor-builder requirements.

See Paragraph 12.14 of Chapter 12.

Budget – Cost Breakdown

- Must match Construction Contract.
- Must be eligible loan costs. See Paragraph 12.15.
- Contingency reserves are limited to 10% of construction costs.

Plans, Drawings and Specifications

- Must be certified in accordance with Paragraph 12.9B.
- Must fully describe work to be completed.

Construction Contract

- Evidence of all pages.
- Must contain a time frame for work to be completed (start/end).
- The cost of change orders will be the responsibility of the borrower.
- Must be signed by the contractor-builder and borrower.
- Amount must match the total amount of budget-cost breakdown.

ATTACHMENT 12-D
APPROVED LENDER CERTIFICATION
Completion of New Construction

Borrower:	_____
Co-Borrower:	_____
Property Address:	_____
City, State, Zip Code:	_____

In accordance with Paragraph 12.20 of Chapter 12, HB-1-3555, I include a copy of the loan amortization agreement if the loan was reamortized or modified after construction. In addition, whether the loan was reamortized or not, I certify the following:

1. Construction is complete in accordance with approved plans, specifications and change orders.
2. The property can be occupied by the borrower.
3. The following is complete. Evidence is retained in our permanent loan case file for further review by Rural Development:
 - a. Plans, drawings and specifications have been certified in accordance with Paragraph 12.9B of Chapter 12, HB-1-3555. Evidence is retained in the lender's permanent loan case file;
 - b. Required construction phase inspections have been completed in accordance with Paragraph 12.9B of Chapter 12, HB-1-3555. Evidence is retained in the lender's permanent loan case file;
 - c. Thermal standards meet or exceed the 2009 International Energy Conservation Code (IECC) or subsequently issued code. Evidence is retained;

- d. Construction warranties have been issued the borrower;
- e. Evidence of the construction contract, cost breakdown and construction ledger related to the construction of this home.

Approved Lender Certification:

I am duly authorized to represent this organization. I certify that we have originated, underwritten, closed and monitored the completion of new construction of the above loan in accordance with all Agency loan requirements of 7 CFR 3555.

Lender's Signature

Title of Lender's Representative

Date Executed

Name of Approved Lender
