Rural Housing Service Single Family Housing Guaranteed Loan Program

Introduction

The Rural Housing Service (RHS) is part of the U.S. Department of Agriculture (USDA). It offers a variety of programs to build or improve housing and essential community facilities in rural areas. The RHS provides direct loans (made and serviced by the USDA) and guarantees loans for mortgages originated and serviced by banks, including national banks and federal savings associations (collectively, banks). This fact sheet focuses on loans guaranteed by RHS to finance the purchase of single-family residences.

The RHS Single Family Housing Guaranteed Loan Program (RHS Guaranteed Loan Program) is designed to serve residents in eligible areas who have a steady low- or moderate-income but are unable to obtain a mortgage through conventional financing. These loans enable such residents to acquire modestly priced housing for their own use as a residence through the purchase of a new or existing dwelling.

Program Basics

Under the RHS Guaranteed Loan Program, a commercial lender, such as a qualifying bank, makes the loan directly to an eligible borrower, and RHS guarantees 90 percent of the loan note. This guarantee substantially reduces the risk for lenders, encouraging them to make loans to borrowers who have only modest incomes and little collateral.

Loans are available to eligible home buyers regardless of whether they have previously owned a home. The program is limited to 30-year fixed-rate mortgages. The RHS Guaranteed Loan Program may be used to finance the purchase of an existing or new residence. The RHS also offers refinance opportunities to current guaranteed loan borrowers.

The RHS assesses an up-front guarantee fee for all loans. As of April 28, 2016, the up-front guarantee fee is 1.0 percent of the loan amount.[1] This fee is charged to the lender but may be passed on to the borrower.

The RHS also charges lenders an annual fee for each guaranteed loan. As of April 28, 2016, the annual fee is 0.35 percent of the loan amount.[2] The lender may pass the annual fee on to the borrower. In that case, the lender typically collects the annual fee as part of the monthly mortgage payment. Lenders are responsible for remitting annual fee payments to the RHS.

An adjusted annual income limit determines whether the household is eligible to

[1] Single Family Housing Guaranteed Loan Program Upfront Guarantee Fee and Annual Fee for Fiscal Year 2017, Unnumbered Letter, March 31, 2016.
[2] Ibid.

participate in the guaranteed loan program. The maximum loan amount, including reasonable and customary expenses, is based on what the borrower can afford, as determined by the borrower's income and repayment ability. Housing and total debt ratios determine a borrower's repayment ability. The maximum loan amount cannot exceed the fair market value of the property. The loan-to-value can exceed 100 percent of the market value of the property only if the excess is used to finance the guarantee fee.[3]

What Are the Benefits of the RHS Guaranteed Loan Program?

The RHS Guaranteed Loan Program provides banks the opportunity to lend to consumers with low- or moderate-incomes who may be experiencing difficulties in obtaining mortgages. RHS guaranteed loans are structured like conventional mortgages but have different rules concerning down payment and mortgage insurance. Unlike conventional mortgages, RHS guaranteed loans have no down payment requirement, allowing a buyer to finance 100 percent of a home's purchase price, and no private mortgage insurance requirement.

The RHS Guaranteed Loan Program does not require a minimum credit score, allowing lenders to accept non-traditional credit histories as evidence that the borrower has the ability and willingness to meet repayment obligations.

Lenders may use all eligible assistance programs to enhance the borrower's ability to afford the loan (e.g., mortgage credit certificates and Section 8 Homeownership Voucher). The RHS has no limits on the amount of gifts, grant fund programs, or down payment assistance that is used. Seller concessions and other non-gift financial contributions made by interested third-party are limited to 6 percent of the property's sale price.[4]

In addition, a bank can receive a conclusive presumption of compliance, or a safe harbor, under the ability-to-repay standard for covered mortgages under Regulation Z, which implements the Truth in Lending Act, if the bank originates the mortgage under the RHS Guaranteed Loan Program and otherwise complies with the regulation.[5] These mortgages are "qualified mortgages" under Regulation Z.

How Can Banks Participate in the RHS Guaranteed Loan Program?

A lender must meet certain requirements to be eligible for the RHS Guaranteed Loan Program. Federally supervised lenders, including OCC-supervised banks, may be eligible for the program provided they have a demonstrated ability to originate, underwrite, and service single-family home loans.[6]

A bank must demonstrate its ability to originate and underwrite loans by submitting the following documentation:

- A summary of residential mortgage lending activity.
- Written criteria outlining its policies and procedures for originating, underwriting, and closing residential mortgage loans.
- Evidence of an experienced loan underwriter on staff.[7]

[3] See Chapter 7, Section 7.2, of the Single Family Housing Guaranteed Loan Program Technical Handbook ("Lender's Handbook").

[4] 7 CFR 3555.102(h).

[5] 12 CFR 1026.43(e)(4)(ii)(E); see also 80 Fed. Reg. 11950 (March 5, 2015).

[6] 7 CFR 3555.51(a)(8)(v).

[7] See Lender's Handbook, Chapter 3, Section 3.2.B.

A bank must demonstrate its ability to service loans by submitting the following documentation:

- Written servicing policies and procedures.
- A written plan if the bank contracts for escrow services.
- Evidence that the bank has serviced single-family residential mortgage loans in the year before applying to participate in the RHS Guaranteed Loan Program.[8]

A bank that does not intend to service its loans must certify that it will contract with a USDA-approved lender meeting the criteria to participate in the program as a servicer.[9]

How do Borrowers Qualify for an RHS Guaranteed Loan?

Borrowers must certify that they are unable to obtain a traditional conventional mortgage without the RHS guarantee.[10]

Income Limits

A borrower's annual income must not exceed the adjusted annual income limit for the size of the borrower's household, based on the number of people who will occupy the home as their primary residence.

There are three income calculations that the RHS requires of guaranteed loan applicants: annual income, adjusted annual income, and repayment income.

Annual income: Annual income includes all the income of adult household members regardless of whether they are a party to the loan (household income). Annual income includes all current verified income, either part time or full time, received by the borrower and all other adult members of the household—subject to the exclusions in Chapter 9 of the Lender's Handbook.[11] Annual income also includes income of less than 12 months' duration, such as seasonal income, commissions, overtime bonuses, and unemployment income.[12]

Adjusted annual income: Adjusted annual income is used to determine program eligibility. A household's adjusted annual income is calculated as annual income minus eligible deductions listed in Chapter 9 of the Lender's Handbook. The household income must not exceed the adjusted annual income limit based on its household size for the state and county where the property is located. The adjusted annual income limit is 115 percent of the area's median income. Adjusted annual income eligibility can be determined on the USDA Income and Property Eligibility Web site.[13]

Repayment income: Repayment income is the amount of adequate and stable income from all sources that parties to a loan are expected to receive. Repayment income is used to calculate housing and total debt ratios and determine the borrower's ability to repay the loan. The repayment income calculation may differ from the annual income calculation because some household members may not be a party to the note, or because some income sources may not be deemed stable and dependable by the lender.[14] It is common for annual income to be higher than repayment income. Also, repayment income includes some income

[8] Ibid.
[9] Ibid.
[10] Ibid. at Chapter 8, Section 8.B.
[11] Ibid. at Chapter 9.
[12] Income of less than 12 months duration is computed as the estimated annual amount of such income for the upcoming 12 months. Ibid. at Chapter 9, 9.3.
[13] Ibid.at Chapter 9, Section 9.5, Appendix 5.
[14] Ibid. at Chapter 9, Section 9.7-9.10.

sources excluded for the purpose of adjusted income.

Debt Ratios

The RHS uses two ratios to determine repayment ability:

1. **PITI** (principal, interest, real estate taxes, homeowners insurance): Typically, the PITI ratio must not exceed 29 percent of the applicant's gross monthly income. The RHS may allow exceptions when eligible compensating factors are documented.[15]

2. **TD** (total debt): The TD ratio consists of the PITI plus other monthly debt repayments. Typically, the TD must not exceed 41 percent of the applicant's gross monthly income. The RHS may allow exceptions when eligible compensating factors are documented.[16]

Credit History

Borrowers must have a verified credit history that indicates a reasonable ability and willingness to meet debt obligations.[17] If an applicant has a history of "significant derogatory credit" such as a foreclosure or bankruptcy within the past 36 months prior to applying for the loan, the lender may grant a credit waiver upon a finding of mitigating circumstances.[18]

Borrowers who do not have a traditional credit history may still be eligible for loan consideration if they can demonstrate an acceptable non-traditional credit history.[19] When relying on non-traditional credit histories, a lender must develop a borrower's credit profile based on at least four entries, for a period of 12 months or more, from the following sources:

- Rental or housing payment.
- Utility payment records.
- Insurance payments.
- Payments to a retail store.

Non-traditional credit may not be used to offset derogatory references in traditional credit information.[20]

Property Eligibility

A residence to be purchased and financed under the RHS Guaranteed Loan Program must be located in an eligible area as defined by the RHS. The RHS has a nationwide website that lenders can use to determine property eligibility. Guaranteed loans are for single-family primary residences. Properties that include buildings or land specifically used for agricultural business or other income-producing activities are not eligible.

Existing homes must meet the minimum property standards of the current HUD guidance for one-to-four unit dwellings.[21] Condominiums are eligible if the lender can document that the unit has been approved or accepted by HUD, the U.S. Department of Veterans Affairs, Fannie Mae, or Freddie Mac, and meets the requirements stated in Chapter 12 of the Lender's Handbook.[22] New construction also is eligible, and a new program allows the RHS to issue a loan note guarantee before construction begins. Guidelines on new construction are also located at Chapter 12 of the Lender's Handbook.

[15] 7 CFR 3555.151(h).
[16] Ibid.
[17] 7 CFR 3555.151(i).
[18] 7 CFR 3555.151(i)(3), (i)(4).
[19] 7 CFR 3555.151(i)(6).
[20] Lender's Handbook at Chapter 10, Section 10.5.
[21] Ibid. at Chapter 12, Section 12.9 A.
[22] 7 CFR 3555.205.

New manufactured homes are eligible, as well, along with specific existing manufactured homes.[23]

Charges and Fees

The RHS allows a lender to charge reasonable lender fees (such as an origination fee) provided the charges and fees do not exceed those charged to other applicants by the lender for similar types of loan transactions.[24] Lender fees and charges also must meet the points and fees limits under Regulation Z.[25]

Other Considerations

Indemnification

If the RHS determines that a lender did not originate a loan in accordance with RHS requirements, and the RHS pays a loss claim under the loan note guarantee as a result of the originating lender's nonconforming action or failure to act, the RHS may require the originating lender to indemnify the RHS for the loss and may revoke the originating lender's eligibility status.[26]

Federal Home Loan Bank Mortgage-Backed Security Program

The Federal Home Loan Bank (FHLB) of Chicago has begun issuing securities backed by RHS guaranteed loans and other government-insured mortgages originated by FHLB member financial institutions. The secondary market conduit product, Mortgage Partnership Finance government mortgage-backed securities, provides lenders, particularly smaller institutions that lack direct access to the secondary mortgage market, a new source of liquidity. Under the program, the FHLB of Chicago purchases RHS guaranteed loans and other government-insured loans from its member lenders, holds the loans on-balance-sheet, and then pools them into Ginnie Mae-guaranteed securities, which may then be sold to investors. To learn more about this program, see the OCC's Community Developments Fact Sheet, "FHLB Government Mortgage-Backed Security Program: Facilitating Secondary Market Access" (July 2016).

Community Reinvestment Act

The Community Reinvestment Act (CRA) requires the OCC to evaluate a bank's record of helping to meet the credit needs of its entire communities, including low- and moderate-income neighborhoods. Generally, RHS guaranteed loans originated for the purchase of homes located in a bank's assessment area(s) would be considered under the lending tests applicable to large banks or to small and intermediate small banks. In certain circumstances and for certain types of institutions, RHS guaranteed loans originated outside a bank's assessment area(s) may receive consideration under the lending test's borrower distribution and the community development lending criteria.

[23] 7 CFR 3555.208, Lender's Handbook, Chapter 13, Section 13.5 – 13.11.
[24] 7 CFR 3555.101(b)(6)(vii); Lender's Handbook, Chapter 6, Section 6.2 C.
[25] 12 CFR 1026.43(e)(4)(i)(A).
[26] Lender's Handbook, Chapter 4, Section 4.9.