

Section 502 Direct Loan

Packaging loans for rural borrowers made affordable with payment assistance to reduce the interest rate

BACKGROUND AND PURPOSE

This program helps low-income borrowers obtain housing in eligible rural areas by providing payment assistance, a type of subsidy that reduces the mortgage payment to increase an applicant's repayment ability. The U.S. Department of Agriculture (USDA) provides an eligibility map on its website to determine if a property is in a qualified rural area (see resources).

Section 502 Direct loans are underwritten and serviced by the USDA at market interest rates, but payment assistance brings the interest rate down to as low as 1 percent. Funds can be used to build, repair, renovate, or relocate a home, or to purchase and prepare sites, including providing water and sewage facilities.

Community banks may only package applications, not originate loans, but they can earn a fee for doing this. Any costs above fixed limits will not be reimbursed by USDA. Packaging fees that are not charged by a

nonprofit or government entity cannot be folded into the loan.

BORROWER CRITERIA

Income limits: Applicants must have very-low or low incomes (as defined by USDA), and at least 40 percent of the funding appropriated each year must go to very low-income families. Very-low income is defined as below 50 percent of area median income (AMI); low income is between 50 and 80 percent of AMI.

Credit: Beneficiaries must be unable to obtain a loan from other sources on reasonable terms and conditions; that is, they would not otherwise have access to affordable, non-predatory credit. However, borrowers must have reasonable credit histories as determined by USDA's loan officers. For applicants who do not use traditional credit or have a limited credit history, the

PROGRAM NAME	Section 502 Direct Loan
AGENCY	U.S. Department of Agriculture's Rural Housing Service
EXPIRATION DATE	Not Applicable
APPLICATIONS	No specific application is required. Contact your local RD office: http://www.rd.usda.gov/contact-us/state-offices
WEB LINK	http://www.rd.usda.gov/programs-services/single-family-housing-direct-home-loans
CONTACT INFORMATION	Contact your local RD office (http://www.rd.usda.gov/contact-us/state-offices)
APPLICATION PERIOD	Continuous
GEOGRAPHIC SCOPE	Rural areas as determined by http://eligibility.sc.egov.usda.gov

loan originator must develop a credit history from at least three nontraditional credit sources such as rent payments, utility payment records, automobile insurance payments, or other means of direct access from the credit provider.

First-time homebuyers: This program is exclusively for first-time mortgage holders. Housing counseling is mandatory.

Occupancy and ownership of other properties: Prospective borrowers must be without safe, decent, and sanitary housing. Only owner occupancy is supported through this program, not income producing activities. Properties must be 1,800 square feet or less and not have a market value in excess of the applicable area loan limits.

Special populations: USDA offers variations on the Section 502 Direct loan for mutual self-help housing, condominium housing, community land trusts, manufactured housing, and the Rural Housing Disaster Loan Program.

Special assistance for persons with disabilities: Special design features or permanently installed equipment to accommodate a household member who has a physical disability may be financed using this loan.

Other: Borrowers must meet citizenship or eligible noncitizen requirements.

LOAN CRITERIA

Loan limits: USDA has its own area loan limits that vary by county.

Loan-to-value limits: The loan-to-value ratio may be 100 percent or more to cover closing costs.

Adjustable-rate mortgages: Not allowed. A fixed interest rate is based on current market rates at loan approval or loan closing, whichever is lower. Up to a 33-year payback period or a 38-year payback period for very low-income applicants who cannot afford the 33-year loan term. For manufactured homes, the term is 30 years.

Down payment sources: No down payment is typically required. Applicants are required to use assets in excess of the asset limits of \$15,000 for non-elderly applicants and \$20,000 for elderly applicants as a down payment.

Homeownership counseling: Required for first-time homebuyers. The Rural Housing Service attempts to connect prospective buyers with free or reasonably priced counseling in the appropriate geographic area, and makes exceptions where counseling is not reasonably available.

Mortgage insurance: No mortgage insurance is required. "Insurance" in documentation refers to homeowner's insurance.

Debt-to-income ratio: The borrower's payment for principal, interest, taxes, and insurance (PITI) is the lower of 24 percent of the borrower's income or principal and interest calculated at a 1 percent interest rate

POTENTIAL BENEFITS

Lenders can earn a fee by helping borrowers package their applications.

No preapproval or training is required by the USDA.

POTENTIAL CHALLENGES

Community banks may only package applications, not originate loans.

It may be necessary to partner with mission-oriented organizations to develop a pipeline of prospective borrowers.

on the loan, plus taxes and insurance. Eligibility is also affected by repayment feasibility, which is determined by using ratios of repayment (gross) income to PITI and to total family debt.

Temporary interest rate buy downs: Not applicable.

Refinance: Not applicable.

Interest rate: Market rate. Payment assistance can reduce the interest rate to as low as 1 percent.

Subsidy recapture: The payment assistance subsidy that reduces the effective interest rate must be repaid to USDA when the property is sold, transferred, or no longer occupied by the customer. This works based on the assumption that the home increases in value and the borrower improves his or her circumstances through access to stable, decent, and affordable housing. If the loan is being paid off, but the customer continues to live in the property, there are two payment options: (1) the borrower pays the subsidy recapture when the loan is paid off (the subsidy recapture is discounted by 25 percent if this option is chosen); or (2) defer the payment of the subsidy recapture until the property is sold, transferred, or no longer occupied by the customer. The subsidy recapture will not be discounted when the loan is paid off, nor will the discount apply in the future if this option is chosen.

Leverage: Applicants who demonstrate the ability to obtain a portion of the needed funds from outside sources should do so. Loans leveraged with other funding sources receive processing priority.

ADDITIONAL INFORMATION

Loan packager: Community banks may charge a fee to act as a loan packager for interested borrowers, though the service is optional for borrowers. USDA supports partnerships with loan application packagers since packagers can promote the program in underserved areas, prescreen, and educate potential applicants to save USDA staff time, counsel potential applicants on how to improve their ability to qualify, and ensure that applications are complete. Processing times vary depending on funding availability and program demand in the area in which an applicant is interested in buying and completeness of the application package. Typically, applicant eligibility, loan approval, and loan closing may be accomplished

within approximately 90 days of filing of the written application. However, depending on the availability of government funding, this time frame may be extended. The applicant is periodically advised regarding the status of his or her application when there is lack of funding.

Funding: The Section 502 Direct Loan program is subject to appropriations. Typically, about \$900 million is available annually.

Potential Benefits

- Lenders can earn a fee by helping borrowers package their applications.
- No preapproval or training is required by USDA.
- Favorable consideration under the Community Reinvestment Act for serving low-income borrowers and communities with credit-related activities is available even when banks do not originate the loans, if the role as packager is explained and numbers and characteristics of borrowers assisted is documented (it is helpful to include income and census tract information).

Potential Challenges

- Community banks may only package applications, not originate loans.
- It may be necessary to partner with mission-oriented organizations to develop a pipeline of prospective borrowers.
- Depending on the needs in a bank's service area, funding may not be adequate to the need.
- Only available in rural areas, which may not correspond to a bank's service area.

RESOURCES

Property rural status and eligibility

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

Requirements for loan packagers (page 460)

<http://www.rd.usda.gov/files/hb-1-3550.pdf>

Area and county loan limits

http://www.rd.usda.gov/files/RD-SFHAreaLoanLimitMap_0.pdf