

Guaranteed Rural Housing Loans (Section 502)

January 2004

The Rural Housing Service (RHS) is a part of Rural Development (RD) in the U.S. Department of Agriculture (USDA). It operates a broad range of programs that were formerly administered by the Farmers Home Administration to support affordable housing and community development in rural areas. RHS both provides direct loans (made and serviced by USDA staff) and also guarantees loans for mortgages extended and serviced by others.

The RHS National Office is located in Washington, D.C., and is responsible for setting policy, developing regulations, and performing oversight. RHS employs a central collection and servicing center in St. Louis, Mo. and a computerized system called DLOS for Section 502 direct and Section 504 loans. In the field, RHS operations are carried out through the USDA's RD offices. Each RD State Office administers programs in a state or multi-state area. The organization of Rural Development offices within a state varies, but typically Area or District Offices supervise Local Offices (also termed county or community development offices) and do the processing and servicing of organizational loans and grants. Local Offices process single family housing applications, assist District Offices with organizational applications and servicing, and provide counseling to applicant families and backup servicing as needed.

**Rural Housing and
Economic Development Gateway**
U.S. Dept of Housing & Urban Development
451 7th Street, S.W., Room 7137
Washington, DC 20410
1-877-RURAL26 (1-877-787-2526)
www.hud.gov/ruralgateway/

PROGRAM BASICS

The Section 502 Guaranteed Rural Housing Loan Program is designed to serve rural residents who have a steady, low or modest income, and yet are unable to obtain adequate housing through conventional financing. These loans enable low- and moderate-income rural residents to acquire modestly priced housing for their own use as a residence through the purchase of a new or existing dwelling or the purchase of a new manufactured home. In this variation of the Section 502 program, RHS does not make a loan directly to an eligible borrower, but guarantees a loan made by a commercial lender. This guarantee substantially reduces the risk for lenders, thus encouraging them to make loans to rural residents who have only modest incomes and little collateral.

ELIGIBLE ACTIVITIES

An eligible applicant must have an adequate and dependable income (up to 115 percent of adjusted area median income [AMI]) and a decent credit history, and be unable to qualify for conventional mortgage credit. RHS uses two formulas to determine a family's ability to undertake the responsibility of a mortgage. First, the burden of principal, interest, taxes, and insurance (PITI) must be 29 percent or less of gross monthly income. Second, the total of monthly debts must be 41 percent or less of gross monthly income.

PROJECT REQUIREMENTS

Loans must be from lending institutions that have been approved by RHS. Loans have 30-year terms and fixed rates at market interest rates. Loans may be for up to 100 percent of market value or for acquisition cost, whichever is less. The maximum loan amount is based on what the homeowner can afford. Loans may include closing costs, legal fees, title services, the cost of establishing an escrow account, and other prepaid items as long as the appraised value is higher than the sales price. In addition, RHS charges the lender a one-time guarantee fee of 2 percent of the loan amount. The lending institution may choose to pass this charge along to the borrower. No private mortgage insurance is required, and the loans have Fannie Mae and Ginnie Mae acceptability on the secondary market. RHS guarantees the loan at 100 percent of the loss for the first 35 percent of the original loan and the remaining 65 percent at 85 percent of loss.

The maximum loss payable by RHS cannot exceed 90 percent of the original loan amount.

Standards

The residence to be purchased with the guaranteed loan must conform to the CABO Model Energy Code and to the structure, facility, and termite standards established by the U.S. Department of Housing and Urban Development.

There are no restrictions on size or design. Typical amenities, except in-ground swimming pools, are allowed. Manufactured homes must be new and permanently installed.

Approval

Interested borrowers should contact their local Rural Development office for more information on the program and a list of approved lenders. The loan application itself is made to the approved lender, and is subject to their schedule for loan approval. Approximately 30 percent of guaranteed 502 loans are made to families with incomes below 80 percent of AMI.

Basic Instruction

Instruction 1980-D

DIFFERENCES BETWEEN THE SECTION 502 GUARANTEED AND DIRECT LOAN PROGRAMS

There are several other Section 502 loan programs, but the only one that approaches the guaranteed program in number of loans made is the Homeownership Direct Loan Program.¹ This program once accounted for almost all the Section 502 loans, but the number of guaranteed loans has greatly increased in the last few years. In Fiscal Year 2001, the guaranteed program obligated approximately \$2.3 billion for 29,326 loans, while the direct program obligated approximately \$1.07 billion for a total of 14,789 loans. The important differences between the Section 502 guaranteed and direct loan programs are as follows:

- *The lender* for Section 502 guaranteed loans is a private savings and loan institution, bank, or mortgage company which also handles all the loan servicing. The lender for the direct program is the Rural Housing Service; Rural Development handles the servicing.

- *Income levels* for Section 502 guaranteed borrowers are capped at 115 percent of the area median income. Income levels for the direct program must be no more than 80 percent of the AMI.
- *Payment assistance subsidy* is not available through the guaranteed program. Payment assistance, which can reduce the interest paid on the mortgage to as low as 1 percent, is available for borrowers in the direct program and is based on the borrower's income as a percent of AMI.
- *Borrower protections* differ between the programs. Applicants for guaranteed loans do not have the rights of moratorium or of appeal that accompany the direct program. Also, in the case of default, Section 502 guaranteed loans are liquidated by the commercial lender, while direct loans are liquidated by the government.

ADDITIONAL INFORMATION

For additional information on Section 502 and RHS, contact the RHS National Office, 1400 Independence Avenue, S.W., Room 5037S, Washington, D.C. 20250; 202-720-4323. Contact your Rural Development State Office to find out the location of the Local Office closest to you, or visit www.rurdev.usda.gov/recd_map.html. Copies of RHS regulations are available online at <http://www.rurdev.usda.gov/regs/>.

¹ For more information on the Homeownership Direct Loan Program see the Funding Summary on that topic or the HAC publication *Rural Housing Service's Section 502 Rural Homeownership Direct Loan Program: A Guide for Applicants*.