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Multi-Family Housing Programs
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"538" PROGRAM OVERVIEW
Section 538 Guaranteed Rural Rental Housing ("538") Loan Program

Program Goal

Encourage commercial financing of rural rental housing, providing affordable housing for low & moderate income people.

+ **The 538 program is lender-driven**. *USDA guarantees the loan rather than lending directly.*
A commercial lender requests the 538 guarantee, and, if approved, it makes (and services) the loan.

Type of Assistance

Federal guarantee of 90% (maximum) on loans on loans for affordable rural rental housing

Lender Benefits

There is a secondary market for 538 guarantees (e.g., Freddie Mac, Fannie Mae & Ginnie Mae)
The guaranteed portion of the loan is protected against loss by a Federal guarantee.
The guaranteed portion of the loan does not count against lending limits.
538 guarantees help lenders satisfy Community Reinvestment Act (CRA) requirements.
Lenders use their own forms, loan documents, and security instruments.

Authorized Loan Purposes

Construction of new rental housing, including land, on-site & off-site improvements, office & maintenance buildings, community & recreation facilities, parking, landscaping, fencing, appliances
Acquisition and rehabilitation of existing rural rental housing when there is at least $6,500/unit of rehab also involved.
Loan fees & costs (including USDA fees), professional services, market study costs, developer fees, construction interest.
Debt refinancing may be authorized on land acquisition and other incurred charges that are integral to the development.
Includes Rehab/acquisition of existing 515 projects.

Program Features

+ **Tax-exempt financing** is a permitted a source of capital for the loan being guaranteed.
Construction projects: The guarantee can be issued on a combined construction/permanent loan or simply on the permanent, take-out loan. (Interest credit is not provided on construction loans.)
Leveraging with other financing sources is encouraged, including with 9% Low Income Housing Tax Credits & HOME.
Davis-Bacon wage requirements **are not activated** by the use of 538 financing.

Size of Loans

No minimum. Maximum loan size is set only by *the lesser of*:
For-profit borrowers: 90% of project's appraised value *or* 90% of total development cost
Nonprofit & public borrowers: 97% of project's appraised value *or* 97% of total development cost
Maximum loan per dwelling unit may not exceed the dollar limits in §207(c)(3) of the National Housing Act as adjusted by HUD for California localities.

Affordability Criteria

Eligible tenants. Tenancy is restricted to those with incomes ≤115% of the area's Adjusted Median Income. Once a tenant is admitted, there is no further income restriction or any requirement for tenant income verifications or certifications.
Average rent. The project's average monthly rent + utility allowance must be ≤30% of area's Adjusted Median Income
Maximum rent. Maximum monthly rent + utility allowance must be ≤30% of 115% of area's Adjusted Median Income
These affordability requirements must be established in a deed restriction and remain in effect for the full term of the 538 loan, even if the loan is prepaid.

Interest Rate, Term, Payment Structure, and Fees

Rate: Negotiated by lender & applicant
A fixed rate is required.
Term: Minimum – 25 years. Maximum – 40 years, not to exceed useful life of the collateral.

(*Note: The term of the loan also fixes the length of affordability restrictions*.)
Structure: Amortized over up to 40 years. Balloons are permitted.
Fees: Lender's reasonable and customary fees are permitted -- negotiated by lender & applicant
USDA charges a $2,500 application fee. In addition, there is a one-time guarantee fee equal to 1% of the guaranteed amount due at guarantee closing, plus an annual servicing fee of ½% on the loan balance owing as of each 12/31.

Federal subsidy

No direct tenant subsidy or Rental Assistance is provided by USDA for the 538 program.
A limited amount of interest credit is available from USDA to reduce the effective note rate by 1-2% to the Applicable Federal Rate. This is limited to only 20% of loans per year, not to exceed $1.5 million per loan. Interest credit is not available for combination construction/permanent loans.
On rehabs of existing 515 projects using the 538, existing RA is not lost!

Borrower Eligibility

Typically will be a single-asset entity.
Individuals, general & limited partnerships, corporations, LLC's, trusts, nonprofits, tribes, public bodies (inc. housing authorities)
All ownership must be held by US citizens or permanent residents.
The applicant must have sufficient qualifications and experience to develop and operate the project.
The applicant and its owners must have a satisfactory established credit history, no delinquent Federal debt, & no Federal housing violations.

Project Eligibility

Attached or detached, semi-detached, row houses, modular or manufactured structures are permitted.
Project must be in a rural area – typically in unincorporated areas and cities of less that 10,000-20,000 population. (1990 census)
The applicant must have site control at the time of preapplication. Upon closing, normally the borrower must have fee simple title. Secure, long-term leasehold may be allowed. A single contiguous site is preferred.
Projects must consist of at least 5 rental units.
Adequate public facilities and community services must be available, including water & sewer connection.
Features & amenities must be reasonable and customary for similar housing in the market area.
Project must be designed & managed in accordance with ADA and Fair Housing Act. If USDA provides interest credit, Section 504 of the Rehabilitation Act of 1973 must be followed.
Assisted living facilities are eligible. (Facilities licensed to provide medical care are *not* eligible.)

Underwriting and Security Requirements

The operation must have realistic repayment ability – typically ≥115% debt coverage ratio.
A market study should be obtained to analyze the supply & demand for rental housing and local rents. This may be included in the appraisal.
An equity commitment of ≥10% of total development cost (TDC) is required on for-profits; ≥3% of TDC on nonprofits.
An initial operating capital commitment of 2% of the loan amount is required of the applicant – either in cash account or as an irrevocable letter of credit.
A construction contingency commitment must also be made – 2% of construction contract is recommended.
The lender must assure the borrower makes adequate O&M reserve and long-term management provisions.
There must be adequate collateral based on the project's appraised value (FIRREA, USPAP appraisal):
1st deed of trust on the real estate
LTV of ≤ 90% (on for-profits); ≤ 97% (on nonprofits)
Insurance – hazard, fidelity, errors & omission, and liability insurance that meet FannieMae/FreddieMac requirements
Non-recourse. Any personal/corporate guaranties are negotiated between lender and borrower. (*Not* required by USDA.)
Inability to get credit elsewhere is *not* a requirement.

Ownership & Operational Issues

Prepayment is permitted by affordability must be maintained to the full term of the original loan via a deed restriction.
Return to owner is *not* fixed. All such distributions must be monitored and approved by the lender.
Replacement reserves must be established and supervised by the lender.
No tenant income verifications or certifications are required after tenant admission.
Grievance rights must be afforded to all tenants.
Annual audited financial statements are required.
Transfer & assumption of an existing 538 loan is permitted with USDA's prior approval.

Application Process

USDA makes 538 funds available on an ongoing basis via NOFA (Notice of Funding Availability) published annually.
An interested lender submits a preapplication to USDA's National Office briefly describing the project – including evidence of site control.
The exact contents of a NOFA preapplication are set forth each year in the *Federal Register*. The current NOFA is available online at: http://www.rurdev.usda.gov/rd/nofas/index.html
Normally within 30 days, the USDA National Office selects the project for funding, and the USDA State Office takes over processing, requesting a complete application.
Complete application must be submitted within 90 days of selection. A complete application includes lender underwriting analysis, appraisal, market study, plans & specifications.
From receipt of complete application, approval takes less than 60-90 days (depending on environmental issues).
USDA issues a Conditional Commitment, authorizing the guarantee subject to conditions.
The California State Office has the authority to approve 538 loans regardless of amount.
The lender closes its loan and, after meeting USDA's conditions, requests the guarantee.
USDA issues a Loan Note Guarantee after verifying that all conditions have been met.

Lender Eligibility

Lenders must be approved by USDA to participate in the 538 program (though lenders need not wait for eligible status approval before submitting 538 preapplication proposals).
Requests for eligible lender status are submitted to the USDA State Office and approved by USDA's National Office.
Eligible lenders are typically already-approved HUD/FHA, Fannie Mae, or Freddie Mac multifamily lenders.
Other lenders with demonstrated multifamily lending experience and financial strength may also be approved.
Lender must have made at least 1 multifamily loan in the last 2 years.
Lender's officers/directors/owners may not have a substantial financial interest in the borrower.

538 Regulations & Forms

Regulations are available online at: http://www.rurdev.usda.gov/regs/hblist.html#hbw6
Forms are available online at: http://www.rurdev.usda.gov/regs/formstoc.html

For more information
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