

Homeownership Direct 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 multistate 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**
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U.S. Dept of Housing & Urban Development
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PROGRAM BASICS

Section 502 loans are used primarily to help low-income households purchase homes. They can be used to build, repair, renovate, or relocate homes, or to purchase and prepare sites, including providing water and sewage facilities. They may also be used to refinance debts when necessary to avoid losing a home or when required to make necessary rehabilitation of a house affordable. At least 40 percent of appropriated funds must be used to assist families with incomes less than 50 percent of area median income (AMI).

ELIGIBLE ACTIVITIES

Applicants must have very low or low incomes. Very low income is defined as below 50 percent of AMI; low income is between 50 and 80 percent of AMI. Families must be without adequate housing, but be able to afford the mortgage payments, including taxes and insurance. In addition, applicants must be unable to obtain credit elsewhere, yet have reasonable credit histories. Priority is given to loan servicing, especially servicing for participation loans; applicants living in deficient housing; and people participating in mutual self-help housing.

PROJECT REQUIREMENTS

Loans are for up to 33 years (38 for those with incomes below 60 percent of AMI and who cannot afford 33-year terms). The term is 30 years for manufactured homes. There is no required down payment. The promissory note interest rate is set by RHS and was 6.75 percent in August 2002. That interest rate is not initially meaningful, however, since it is modified by payment assistance subsidy. The interest rate and amount of subsidy are determined by family income as a percentage of AMI. Families without leveraged loans pay from 22 to 26 percent of their income for principal, interest, taxes, and insurance (PITI), but not more than the payment amount calculated using the promissory note rate. Eligibility is also affected by repayment feasibility, determined using ratios of repayment (gross) income to PITI and to total family debt.

Standards

Under the Section 502 program, housing must be modest in size, design, and cost. Modest housing is defined as housing costing less than the dollar cap set by the Federal Housing Administration 203(b) program as of 1997, which was \$86,317, with adjustments for high cost areas. As of September 2002, RHS is developing a final rule that will provide a new definition for modest housing.

Houses constructed, purchased, or rehabilitated must meet the voluntary national model building code adopted by the state, the CABO Model Energy Code (MEC), and RHS site standards. Manufactured housing must be permanently installed and meet the HUD Manufactured Housing Construction and Safety Standards, MEC, and RHS site standards.

Variations

There are several variations of the basic Section 502 direct loan program. These include mutual self-help housing, condominium housing, community land trusts, manufactured housing, and the rural housing disaster loan program. A separate Section 502 guaranteed loan program provides government guarantees of loans made by banks or others.¹

Approval

RD Local Managers have the authority to approve most Section 502 loan requests. If no backlog exists, decisions on applications should be made within 30 to 60 days of the RD office's receipt of the application.

Basic Instruction

7 CFR Part 3550 subparts A, B, D, and E, HB-1-3550, and HB-2-3550

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://rdinit.usda.gov/regs>.

¹ For more information, see the Funding Summary on the Section 502 guaranteed program.