RD AN No. 4687 (1980-D)
October 2, 2012

TO: State Directors
Rural Development

ATTENTION: Housing Program Directors,
Guaranteed Loan Coordinators,
Area Directors and Area Specialists

FROM: Tammye Treviño *(Signed by Tammye Treviño)*
Administrator
Housing and Community Facilities Programs

SUBJECT: Single Family Housing Guaranteed Loan Program
Definition of Conventional Credit

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to clarify the meaning of "conventional credit" as it applies to the Single Family Housing Guaranteed Loan Program (SFHGLP) and RD Instruction 1980-D, 1980.346(b).

COMPARISON WITH PREVIOUS AN:

This AN replaces AN 4594 (1980-D), dated July 26, 2011, which expired on July 31, 2012.

BACKGROUND:

Section 1980.346(b), of Title 7, of the Code of Federal Regulations (also found at RD Instruction 1980-D, Section 1980.346(b)) requires that eligible guaranteed loan applicants be unable to secure conventional credit without a SFHGLP guarantee. Since this policy was adopted in the early 1990's, a number of new non-traditional loan vehicles have emerged that have been marketed as "conventional." Many of these new non-traditional loans have incorporated features with the potential of additional risk to applicants. Some of the loan vehicles have been recognized as subprime loans, yet, they were purchased and securitized by conventional loan organizations such as Fannie Mae and Freddie Mac.

EXPIRATION DATE:
August 31, 2013

FILING INSTRUCTIONS:
Preceding RD Instruction 1980-D

This AN clarifies the definition of conventional credit only for purposes of the SFHGLP. A distinction will be drawn between "traditional" conventional credit and newer, non-traditional mortgage products that have surfaced under the term "conventional." The latter will be referred to as "non-traditional" conventional credit in this AN.

Traditional Conventional Credit

Conventional credit has long referred to loans not guaranteed or insured by the Federal Housing Administration (FHA), the Veterans Administration (VA), or the Rural Housing Service (RHS). When 7 CFR Part 1980, Subpart D (and the corresponding RD Instruction 1980-D) was promulgated in the early 1990's, a conventional loan was universally recognized in the housing industry as one where:

- the applicant was able to make a 20 percent down payment; and
- the applicant was able to pay all closing costs out of pocket; and
- the applicant's total debt ratio was 36 percent or less; and
- the applicant's debt ratio for principal, interest, taxes and insurance (PITI) was 28 percent or less; and
- the applicant had a good credit history consisting of at least two credit bureau trade lines open and paid as agreed for at least a 24- month period, to include that:
    - the applicant was not currently 30 days or more past due on any trade line; and
    - the applicant had not been 60 days or more past due on any trade line over the past 24 month period; and
    - the applicant did not have a foreclosure or bankruptcy in their credit history over the past 36-month period; and
- the conventional mortgage loan term was for a 30-year fixed rate loan term without a condition to obtain private mortgage insurance (PMI).

Liquid assets for conventional credit down payment purposes typically consisted of cash or cash equivalents. Cash or cash equivalents included funds in the applicant's checking or savings accounts, or investments in stocks, bonds, mutual funds, certificates of deposit, and money market funds, unless they were encumbered (pledged as collateral) or otherwise inaccessible without substantial penalty. Cash equivalents typically did not include funds in Individual Retirement Accounts, 401(k) accounts, Keogh accounts, or other retirement accounts that were restricted and may not be accessed without incurring substantial monetary penalties.

Non-Traditional Conventional Credit

A number of non-traditional lending vehicles have emerged over time and have been marketed as "conventional" but which allow lower down payments and higher debt ratios than traditional conventional loans. PMI is typically required under these new programs. The actual terms for these loans vary widely and include interest-only payment loans, graduated payment loans, negative amortization loans, balloon payment loans, and hybrid adjustable rate loans which include one or more of the preceding loan terms. Some of these loans were recognized as subprime loans but were purchased and securitized along with traditional conventional loans.

<u>IMPLEMENTATION RESPONSIBILITIES</u>:

In keeping with the original intent of 7 CFR Part 1980, Subpart D, conventional credit is defined in the traditional sense for Agency purposes. A borrower is able to secure conventional credit under reasonable terms when they can meet the requirements of a traditional conventional credit loan as described above. Approved participating lenders should make the determination of whether the applicant is capable of meeting all of the criteria defined as a traditional conventional credit loan.

Form RD 1980-21, "Request for Single Family Housing Loan Guarantee," requires both the lender and the applicant to certify that the applicant is unable to secure credit from other sources upon terms and conditions which the applicant can reasonably fulfill. The certification can be made if the applicant does not meet the requirements to obtain a traditional conventional credit loan. To ensure delays are not experienced in the Rural Development review process, underwriters are encouraged to document their underwriting analysis indicating they have considered the six criterion of the traditional conventional credit loan when determining SFHGLP eligibility.

Should there be any questions concerning this AN, please contact Debbie Terrell, Senior Loan Specialist, at (918) 534-3254.