



USDA Guaranteed Rural Rental Housing Program (Section 538)

Housing Assistance Council

June 2008

Under the Section 538 program, the U.S. Department of Agriculture's Rural Development Housing and Community Facilities Programs office (RD) guarantees loans made by private lenders for the development of affordable rental housing in rural places.

Purpose

The Section 538 Guaranteed Rural Rental Housing Program enables RD to guarantee loans made by private lenders – generally banks and savings and loans institutions – for the development of affordable rural rental housing. The program can be used to guarantee permanent financing, or a combination construction and permanent loan. It cannot be used for a loan that covers only construction.

A Section 538 guaranteed loan can be combined with other financing sources such as Low Income Housing Tax Credits, a HOME grant or loan, state or local assistance (including tax-exempt bond financing), or a second bank loan.

Eligibility

Lender: Eligible lenders fall into two categories. First, a lender is eligible for Section 538 if it is approved by Fannie Mae, Freddie Mac, or the Federal Housing Administration and currently active in the multifamily housing guaranteed lending program(s) of the approving entity(ies). Second, state or local housing finance agencies, members of the Federal Home Loan Bank System, or other lenders can be eligible if they demonstrate to RD that they have knowledge and experience with multifamily lending. Lender eligibility must be verified every year.

Borrower: Eligible borrowers include individuals, nonprofit or for-profit corporations, partnerships, state or local public agencies, limited liability companies, trusts, or Indian tribes. The borrower must contribute initial operating capital equal to at least 2 percent of the loan amount.

Tenant: Tenants must have incomes at or under 115 percent of area median income at the time of initial occupancy.

Terms

The lender may set the term of the loan, up to a maximum of 40 years. The interest rate must be fixed; the maximum allowable interest rate is included in RD's annual Notice of Funding Availability. RD must provide interest credit to reduce the interest to the Treasury rate for at least 20 percent of the loans made.

Loan amounts are capped at maximum costs per unit established by HUD and available from HUD offices. Nonprofit borrowers and Indian tribes can borrow up to 97 percent of the total development cost or property value; others can borrow up to 90 percent of cost or value. The Section 538 program will guarantee a maximum of 90 percent of the unpaid principal and interest of the loan. RD will guarantee construction contracts to 90 percent of work in place if there are protective credit enhancements.

Rent, including utilities paid by the tenants, cannot exceed 30 percent of 115 percent of the area median income.

Standards

The program permits varying housing types. Each project must contain at least five units, be in a rural area (as defined by Rural Development), and be under one management.

Application and Approval

RD publishes a Notice of Fund Availability (NOFA) in the *Federal Register* each year. It provides information on the amount of funds available, preliminary submission requirements, selection criteria, and deadlines for submission, usually 60 to 90 days after publication. Lenders (not borrowers) submit guarantee requests summarizing proposed projects.

Comments

Priority is given to applications for projects located in smaller rural communities, those located in the most needy communities with the highest percentage of leveraged funds, those with the highest ratio of three- to five-bedroom units, those located in Empowerment Zones or Enterprise Communities, or those on tribal land.

Section 538, which was created by Congress in 1996, differs in some important ways from USDA's longstanding Section 515 Rural Rental Housing Program. Section 538 focuses on partnerships between USDA and qualified lenders, whereas Section 515 makes loans directly to nonprofit or for-profit rural housing developers. Section 538 is intended to provide decent, affordable rental housing for low- and moderate-income rural households with incomes up to 115 percent of area median income, higher than those served by Section 515. Income calculations for Section 538 tenants do not take into account the deductions permitted under Section 515. Units developed with Section 538 loans can be larger than those financed by Section 515.

Regulations

Regulations for the Section 538 guaranteed loan program are compiled in 7 CFR part 3565. A handbook, HB-1-3565, provides additional details from the perspective of RD staff.

Additional Information

For additional information on Section 538 direct and RD, contact the National Office, 1400 Independence Avenue, S.W., Washington, D.C. 20250; 202-690-1533, or your Rural Development State Office, which can be identified at http://www.rurdev.usda.gov/recd_map.html or contacted by telephone through 202-720-4323. RD regulations and handbooks are available online at <http://rurdev.usda.gov/regs>. The regulation at 7 CFR part 3565 is included in the handbook as Appendix 1.

Housing Assistance Council

Founded in 1971, HAC is a national nonprofit corporation headquartered in Washington, D.C. that helps local organizations build affordable homes in rural America by providing below-market financing, technical assistance, research, training, and information services. HAC's programs focus on local solutions, empowerment of the poor, reduced dependency, and self-help strategies. HAC is an equal opportunity lender.

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