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Attachment: Exhibit A

REAL PROPERTY INSURANCE

I General.

A Authority. This subpart sets forth the policies and procedures regarding insurance requirements on real property which serves as security for a debt under the Farm Credit Programs of the Farm Service Agency (FSA) or the Multi-Family Housing Programs of the Rural Housing Service (RHS), herein referred to as the "Agency". (Revised 12-23-96, SPECIAL PN.)

B Borrower to furnish insurance. The real estate mortgage executed by the borrower provides that he will furnish and continually maintain and pay for insurance on buildings situated or constructed on the property with companies, in amounts, and on terms and conditions satisfactory to the Agency until the loan is repaid.

C Borrower's selection of company. The borrower may select the insurance company provided that the company and insurance policy comply with all the requirements set forth in this Instruction.

D Responsibility. The field staff is responsible for taking all actions in connection with insurance as may be necessary to protect the security interest of the Agency. Any unusual situation that may arise with respect to obtaining or servicing insurance should be referred to the State Director or State Executive Director, as appropriate. The Director will refer any questions of a legal nature to the Office of the General Counsel (OGC). (Revised 12-23-96, SPECIAL PN.)

E Use of Form RD 426-1, "Valuation of Buildings." The minimum insurance required will be indicated in the appraisal report by the employee who makes the appraisal of property that includes insurable buildings. In the case where no real estate appraisal is required or the appraisal report does not indicate the minimum insurance coverage, Form RD 426-1 will be prepared by the Agency employee. Reevaluation of the buildings will not be done on appraisal reports; however, when new buildings are constructed or values increase or decrease materially and reevaluation is necessary to properly reflect the buildings' security interest of the Agency, the Agency employee will prepare or revise Form RD 426-1 as appropriate. Changes made on an existing Form RD 426-1 will be dated and initialed. The reason for any deletion will be noted on the Form. (Revised 12-23-96, SPECIAL PN.)

DISTRIBUTION: WSDC

Program Operations
Real Property
Property Insurance

Sheet 1
(Revision 1)

(8-11-76) SPECIAL PN

II COMPANIES AND POLICIES: Property insurance policies or other evidence of insurance will be accepted from borrowers when the requirements outlined herein are complied with fully.

A Companies. It is desirable that companies be licensed to do business in the particular State or other jurisdiction where the property is located, or that they be otherwise authorized by law to transact business within such State or other jurisdiction (hereinafter called "State"). If the required insurance is not available locally at comparable rates from an insurance company licensed or otherwise authorized to do business in the State, insurance may be accepted from another company if (1) the OGC advises that policies issued by such company will not be rendered unenforceable by virtue of the company's failure to be licensed or otherwise authorized to transact business in the State and that the company is a legal entity which may be sued in the State where the insured property is located, and (2) the State Director determines that the company is reputable and financially sound. In making the above determinations, the State Director will consider all relevant available information such as that which may be obtained from financial statements, Best's Insurance Reports, State insurance authorities, and other lending institutions.

B Insurance Policies.

1 STANDARD POLICIES. If a standard fire insurance policy has been adopted for the State, it should be used unless State statutes exempt the company from the regulations requiring its use. The standard policy is one containing substantially the same standard provisions adopted or recommended by legislative action or by order of the supervisory insurance authorities of the State in which the security is located.

2 OTHER POLICIES. To be acceptable, any other insurance policies, must conform to the requirements of this Instruction.

a "Homeowner's" policies, "All Physical Loss" policies, "Broad Form" policies, and other such all-inclusive policies are acceptable if they otherwise meet the requirements of this Instruction.

b A builder's risk policy naming the borrower as the insured or a builder's risk endorsement for a policy issued to the borrower may be accepted during the period a building is under construction if the policy otherwise meets the requirements of this Instruction. If such a policy or endorsement does not automatically convert to full coverage when the building is completed, acceptable

insurance must be obtained simultaneously with the expiration of the builder's risk provisions of the policy.

c A builder's risk insurance policy issued to a contractor only may not be substituted for the property insurance the borrower is required to provide.

d Borrowers eligible for insurance under the National Flood Insurance Act of 1968, as amended by the Flood Disaster Act of 1973, will be serviced in accordance with RD Instruction 426.2.

3 STATE INSTRUCTIONS. If the State Director and the OGC consider it advisable, a State Instruction may be issued to help County Supervisors identify standard insurance policies adopted for the State. The Instruction should also furnish a guide to assist in identifying other acceptable insurance policy forms that are commonly used by insurance companies in the State, recognizing that such information is not all inclusive.

4 BINDERS. Whenever there is a justifiable reason for not issuing a policy or endorsement, as required, a written binder will be acceptable for a period not to exceed 60 days from the effective date of the insurance. The written binder must have attached thereto the approved form of mortgage clause. Such a binder will be submitted to the County Supervisor in lieu of an insurance policy or endorsement and the insurance policy or endorsement will be submitted on or before the expiration date of the binder. The State Director, with the advice of the OGC and subject to prior approval of the National Office, may issue a State Instruction authorizing such binders to be accepted for periods longer than 60 days.

(Revised 8-30-89, PN 116.)

5 SUBMISSION OF POLICIES. (Revised 03-25-91, SPECIAL PN.)

a For Farmer Program (FP) loans secured by a first lien, the original policy or declaration page must be delivered to the County Supervisor. The original policy or declaration page will be returned to the borrower after one year using Form RD 426-4, "Notice of Expiration of Insurance."

b For Single Family Housing (SFH) loans secured by a first lien, the original policy or declaration page must be delivered to the closing agent.

c In cases where an FP or SFH loan is secured by other than a first lien and the mortgage clauses include the names of the prior mortgagees, a certificate of insurance, copy of the policy, or other evidence of insurance is acceptable.

d The County Supervisor will process an advance to pay for insurance only in strict compliance with provisions of paragraph VI of this Instruction.

6 MASTER SETS. If the master sets meet all of the requirements of this Instruction they may be accepted in lieu of an original policy for each The Agency borrower.

a One complete master set of the different insurance fees for policies issued by the insurance company must be on file in each County Office where the company insures property of The Agency borrowers.

b The "Declaration Page" furnished by the insurance company for each borrower insured, in lieu of a complete policy, will be filed in the borrower's case folder. When a "Declaration Page" in the form of a computer printout is used by an insurance company an endorsement on every policy issued by that company or a letter from that company will be obtained and attached to the printout. However, a letter signed by an authorized official of the company and addressed to the State Director may cover all policies issued by that company in the State. Any such endorsements or letters should clearly state that the company considers the printout to be an original "Declaration Page." Such endorsements or letters are not necessary if the printout itself clearly states that it is an original "Declaration Page."

C Name and Location. The policy should contain the names of all of the borrowers who are owners of the property being insured, and it will be returned for correction if it does not do so. The location of the property should be so described in the policy that the property can easily be identified. The complete legal description of the property by metes and bounds is not required. Any deviation from the requirements of this paragraph must first be cleared with the National Office.
(Revised 11-29-78, PN 650.)

D Loss or Damage Covered. Buildings must be insured against loss or damage by fire, lightning, windstorm, hail, explosion, riot, civil commotion, aircraft, vehicles, and smoke.

E Effective Date of Insurance. If there are insurable buildings located on the property, the borrower will arrange with his agent or company to have adequate insurance in force at the time the loan, assumption, or credit sale is closed so that the policy will properly insure the borrower and the mortgagees. When new buildings are erected or major improvements are made to existing buildings, such insurance will be made effective as of the date materials are delivered to the property. The County Supervisor will make no payments from loan funds for labor or materials until the borrower has furnished adequate insurance to protect the interest of the Agency in the buildings being erected or improved.

F Term. The borrower will be required to furnish insurance for a term of at least one year with evidence that a full year's premium is paid. The term "premium" as used herein includes any assessments which may be charged to the borrower. If the assessments are of the type imposed only after a loss occurs involving property insured by the insurance company, then the borrower must present evidence (such as a letter from the company) that he currently does not owe any such assessments. The borrower may receive a discount for insuring for a longer period such as three years or five years and with an annual premium. If the insurance contains an automatic renewal clause, its provision should be substantially the following to be acceptable to The Agency:

"This policy will be automatically extended for successive terms at expiration of the original term and of each extension thereof, upon payment of renewal premiums. It is a condition of this policy that if the policy expires or is canceled for nonpayment of premium, or for any other reason, the mortgagee will be given 10 days notice."

G Mortgage Clause. The standard mortgage clause adopted by the State must be attached to or printed in the policy, or Form RD 426-2, "Property Insurance Mortgage Clause (Without Contribution)," must be attached to or the provisions thereof printed in the policy. A letter signed by an authorized official of an insurance company to the State Director, stating that all insurance policies the company issues in the State and in which the Agency has a mortgage interest incorporates all of the provisions of Form RD 426-2 may be accepted in lieu of attaching Form RD 426-2 to each policy. If such a blanket letter is used, the Agency will be named in the loss payable clause and a State Instruction will be issued, after prior approval is obtained from the National Office, authorizing the use of such method.

1 If the use of a mortgage clause, other than the standard mortgage clause (without contribution), has been made mandatory by State laws or insurance regulations, a State Instruction will be issued, after prior approval is obtained from the National Office, authorizing the use of such a form.

2 When an approved mortgage clause is printed in the policy a "Loss Payable Clause" is acceptable provided the Agency, as mortgagee, would receive payment in case of loss even though the company would not be liable to the borrower. A "Loss Payable Clause" which contains the statement that the mortgagee is "subject to all terms and conditions of the policy" is not acceptable.

3 Whenever a new mortgage clause including the interest of the Agency is issued after the policy has been in force, the new mortgage clause must be signed by an authorized agent or officer of the company that issued the policy. Form RD 426-6, "Transmittal of Property Insurance Mortgage Clause," may be used to transmit the mortgage clause to the insurance official.

4 The Agency and all other mortgagees whose interests are insured by the policy will be shown either in the mortgage clause or in the "Declaration Page" in the order of priority of their mortgages.

a "UNITED STATES OF AMERICA (Rural Development or Farm Service Agency)" will be named in the mortgage clause for direct and insured loan mortgages naming The Agency as mortgagee, whether in its own right or as trustee under a 2(f) or other agreement with a State Rural Rehabilitation Corporation.

b "UNITED STATES OF AMERICA (Rural Development or Farm Service Agency), AS FIRST MORTGAGEE OR AS STATUTORY AGENT AND INSURER OF SUCH MORTGAGEE," will be named in the mortgage clause for insured FO mortgages naming the lender as mortgagee, whether the mortgage is held by the original or a subsequent lender or by the insurance fund or by The Agency under a trust agreement or declaration of trust.

c If the designation is not identical to that set forth in paragraph II G 4 a or b, whichever is applicable, it will be sufficient if the mortgagee is readily identifiable as Rural Development or Farm Service Agency.

H Evidence of Premium Payment.

1 When Form RD 426-2 is attached to or the provisions thereof are printed in the policy, or a blanket letter from an insurance company incorporating the provisions of Form RD 426-2 in all policies in which the Agency has a mortgagee interest is in effect in accordance with paragraph II G, no evidence of premium or assessment payment is required except for the first year of the loan. When a subsequent FP or Section 502 RH loan is made to build, buy, or rehabilitate essential buildings, an endorsement to the existing policy, including coverage for the property improved will be sufficient. (Revised 6-29-77 PN 576)

2 When a mortgage clause requires the mortgagee to pay the premium if the insured does not, the borrower will be required to furnish, with the policy, proper evidence that the premium has been paid for the full term of the policy, unless a State Instruction has been issued in accordance with paragraph II H 3 or an exception is otherwise authorized by the National Office. The evidence of a premium payment may be (a) a receipt (b) the policy or bill for the premium stamped "Premium Paid," (c) the endorsement renewing or continuing the policy stamped "Premium Paid," or (d) a letter or statement signed by the agent or company stating that the premium has been paid. In case the policy is written by an assessment mutual insurance company on an annual assessment basis, proper evidence will accompany the policy to show that the most recent annual assessment has been paid.

3 In those States in which laws or regulations do not permit the use of Form RD 426-2, the State Director may issue a State Instruction which sets forth the manner in which premium payment will be handled.

I Policy Restrictions.

1 Any insurance on essential buildings as defined in paragraph III having restrictions which limit the amount of collectable insurance must meet the Agency requirements set forth below (except for the clause described in subparagraph (d) which is never acceptable); otherwise, such restrictions must be eliminated or modified to afford the required protection.

a Coinsurance Clause. This clause generally provides that in consideration of a reduced rate, the borrower agrees to maintain insurance on his buildings up to a specified percentage (usually 80 percent) of their value and that the company will not be liable for a greater proportion of any partial loss than the amount of the insurance bears to the specified percentage of either the undepreciated replacement value or the depreciated replacement value (actual cash value) of the buildings at the time of the loss. When the buildings are insured for the specified percentage of their value, the company, in the event of a partial loss, will be liable for the full amount of the loss not to exceed the amount of insurance. A coinsurance clause can be accepted only where the amount of insurance is at least equal to the specified percentage of either the undepreciated replacement value or the depreciated replacement value (actual cash value). For example, an 80 percent coinsurance clause can be accepted only where the amount of insurance on each insured building is at least equal to 80 percent of the appropriate replacement value of the insured building.

b Three-Fourths' Value Clause. This clause provides that the liability of the company shall be limited to three-fourths of the depreciated replacement value of the buildings covered at the time of the loss, not to exceed the amount of insurance. This clause may be accepted if the unpaid balance of the loan is not greater than three-fourths of the depreciated replacement value of the building and the amount of insurance is at least equal to the unpaid balance of the loan and any prior liens and no building is insured for more than three-fourths of its depreciated replacement value.

c Loss Deductible Clause.

(1) For all loans other than RRH, RCH, and LH organizations this clause generally provides that loss to each building to the extent of the limitation is not recoverable. The company is liable only for loss to each building in excess of such limitation stated in the clause. This clause may be accepted where the limitation does not exceed \$150, or one percent of the insurance coverage which is greater. In no case, however, may the limitation on any one building exceed \$500.00.

(Revised 6-25-86, PN 14.)

(2) For RRH, RCH, and LH organization loans this clause generally provides that loss to each project to the extent of the limitation is not recoverable. The company is liable only for loss to each project in excess of such limitations stated in the clause. This clause may be accepted where the limitation does not exceed the option shown below that is chosen by the borrower and agreed to by the Loan Approving Official and properly annotated in the borrower file. The borrower and The Agency Official should consider the economic impact to the project when selecting the appropriate option.

(i) Option 1 - Up to one-fourth of one percent (0.0025) of the insurable value. Maximum deductible \$5,000.

(ii) Option 2 - Up to a maximum deductible of \$500 on any project with an insurable value not exceeding \$200,000.

(iii) Option 3 - Option 1 may be chosen and increased above the maximum deductible by an amount equivalent to funds specifically escrowed in the project replacement reserve account as an offset to the increased deductible.

(iv) Option 4 - Option 2 may be chosen and increased above the maximum deductible by an amount equivalent to funds specifically escrowed in the project replacement reserve account as an offset to the increased deductible.

(v) The funds used to increase the deductible in Option 3 or Option 4 may be from project funds if it does not create an unsecured financial situation for the project. Also, non-project funds may be used for Option 3 or 4 and then repaid by withdrawal from the project at the rate of 75 percent of the annual insurance premium savings earned by the amount of escrow deposit, up to the amount deposited.

(vi) The funds escrowed to increase the authorized deductible will be placed in the project reserve account as an increased amount in and above the amount required by the Loan Agreement/Resolution and so annotated in the borrower's accounting system.

d Three-Fourths' Loss Clause. This clause provides that the company will not pay more than three-fourths of any loss, no more than three-fourths of the amount of insurance in force. This clause is never acceptable and must be eliminated.

e Deferred Loss Payable Clause. This clause provides that, if the amount payable under the policy for any loss to any building insured shall be in excess of a specified portion, (usually 60 percent) of the amount of insurance on such building, the company will withhold from its initial loss payment any sum in excess of the specified portion of the amount of insurance on such building. If the building sustaining such loss is repaired or replaced within six months from the date of the fire and at or within 300 feet of the original location, as described in the policy, the company upon receipt of evidence to that effect from the insured will pay the full balance withheld from the initial payment, provided the amount expended in repairing or replacing the building as determined under the terms of the policy. Failure to repair or replace any insured building within the time and manner provided will constitute acceptance of the initial payment as full and final settlement under the policy with respect to the loss. This clause may be accepted if the amount of insurance is for the full depreciated replacement value (actual cash value) of the building and the unpaid balance of the loan and any prior lien(s) is not greater than the initial loss payment made by the company.

f Construction Specification and Use Conditions. If the insurance policy contains clauses which specify certain standards of construction or prescribes certain uses of the property for the insurance to be valid, the policy is acceptable only if the property meets such specifications or conditions at the time of acceptance. For example, if the policy provides that the chimney be constructed of a certain type of material, the County Supervisor should be assured that the required material has been used, or if the policy provides that farming operations are not carried out on the premises he should be assured that this condition is met.

2 Policies generally will not be accepted if, under the terms of the policies or local laws, contributions or assessments may be made against the The Agency; however, policies which impose assessments on the borrower may be accepted only if the Agency mortgage will be recorded prior to any failure of the borrower to pay any such assessments. Policies also will not be accepted if, by their terms or other conditions, loss payments are contingent upon collective action by the Board of Directors, or the stockholders, or the members.

II (Cont.)

J. Buildings on Leaseholds. The policy will indicate that the insured is the lessee or tenant and not the owner of the buildings securing the Agency loan; or, if he is the owner of the building on the leased land, the policy will indicate that the insured is the owner of the building, but not of the land. State Directors, with the advice of the OGC will issue State Instructions to meet any other special requirements needed to conform with the insurance requirements of the State to enable leaseholders to obtain property insurance for buildings which are security for The Agency loans.

III COVERAGE REQUIREMENTS: The County Supervisor should encourage the borrower for his own protection to insure for their depreciated replacement value (actual cash value) all essential buildings. Essential buildings include the dwelling and any other buildings that are necessary for the operation of the property or that provide income to assure orderly repayment of the loan. If insurance is for less than the depreciated replacement value of all essential buildings, the County Supervisor will see that the coverage is obtained on one or more of the most essential buildings. The minimum amount of coverage will be furnished as prescribed below:

A Loans Secured by a First Lien.

1 When the unpaid balance of the Agency loan secured by a first lien is equal to or greater than the depreciated replacement value of the essential buildings, or the cost of adequate essential buildings which can be constructed for amounts less than the depreciated replacement value of the existing buildings, the essential buildings will be insured, to the nearest multiple of insurance that is available, for the lesser of (a) their depreciated replacement value, or (b) the cost of constructing adequate essential buildings. For example, if insurance is available in only multiples of \$1,000, the minimum insurance required on an essential building valued at \$6,600 would be \$7,000, and that required on an essential building valued at \$6,400 would be \$6,000.

2 When the unpaid balance of the loan is less than the sum of the depreciated replacement value of the essential buildings to be insured, the total amount of insurance must be at least equal to the lesser of (a) the unpaid balance of the loan, or (b) the cost of adequate essential buildings which can be constructed for amounts less than the depreciated replacement value of the existing buildings to be insured.

3 When, by the use of loan funds or otherwise, buildings are erected or substantial improvements are made to essential buildings, the amount of insurance will be adjusted in accordance with paragraph III A 1 or 2, whichever is applicable.

B Loans Secured by Other Than First Liens. The amount of insurance on buildings in the case of The Agency loans secured by other than a first lien will be the same as required in paragraph III A, with the understanding that the unpaid balance of the loan will be deemed for this purpose to be the amount of the total real estate mortgage indebtedness owed all prior mortgagees named in the mortgage clause, plus the debt to the Agency which is secured by real estate mortgage.

C Exception of Buildings from Insurance.

1 Insurance will not be required on a building:

- a That is not essential.
- b In such a state of disrepair that the cost of insurance would be prohibitive.
- c Which has a depreciated replacement value of \$2,500 or less.
- d Which is being or has been repaired with a Section 504 loan of \$7,500 or less. Families receiving Section 504 loans should be encouraged but not required to carry insurance on their home.
(Revised 03-25-91, SPECIAL PN.)
- e On LH security property which was not built or repaired with The Agency loan funds provided that the State Director determines that the land and other structures adequately secure the The Agency loan and any prior liens.
- f On which the hazards are so slight because of the character and construction of the building, or the cost of the insurance is so high in comparison with the value of the building that, according to common standards of judgment, it should not be insured, including but not limited to windmills, silos, and fire-cured tobacco barns.

2 In cases where the unpaid balance of the Agency loans and any prior liens have been reduced to \$2,500 or less, property insurance need not be required if the borrower wants to discontinue it, provided the County Supervisor determines that the value of the land security itself is sufficient to protect the Agency in its collection of the amount of the outstanding indebtedness.

III C (Con.)

3 If insurance for windstorm and hail to meet all The Agency requirements is not available in a hurricane area, the County Supervisor may accept from the borrower or applicant the windstorm and hail insurance policy that most nearly conforms to The Agency requirements. If such an exception is made, the situation should be fully documented in the borrower's case file. However, if the best insurance policy a borrower or applicant can obtain at the time he receives a loan contains a loss deductible clause for windstorm and hail damage exceeding \$250 or 10 percent of the actual cash value of the buildings, whichever amount is greater, the insurance policy, with an explanation of the reasons why more adequate insurance is not available will be submitted to the State Office for prior approval.

IV EXAMINING AND GENERAL SERVICING OF INSURANCE:

A Examination by County Office of Policies, Endorsements, Binders, and Other Evidence of Insurance. Upon receipt in the County Office of a policy, endorsement, binder, or other evidence of insurance, submitted by a borrower, it will be examined promptly for compliance with the requirements of this Instruction. If the evidence of insurance is found to be acceptable, it will be placed in the borrower's case folder.

1 UNACCEPTABLE POLICIES.

a When the borrower furnishes any policy or other evidence of insurance which does not meet the requirements of this Instruction, such policy or other evidence of insurance will be returned to the borrower with the reasons why it is not acceptable.

b If the borrower does not furnish acceptable insurance by the date the previous policy expired or was cancelled, the County Supervisor will proceed as provided in paragraph VI.

2 EXPIRATION RECORDS AND NOTICES. After the insurance has been accepted, the expiration date will be inserted on Form RD 1905-1, "Management System Card - Individual," or Form 1905-5, "Management System Card - Individual (Rural Housing Only)," or Form RD 1905-10, "Management System Card - Association or Organization," or Form RD 1905-12, "Monthly Expirations," as provided in RD Instruction 1905-A for servicing the renewal of the insurance. (Revised 8-30-89, PN 116)

a In cases other than those involving FP or Section 502 RH borrowers, the County Supervisor will notify the borrower of the expiration of his insurance at least 30 days in advance of such expiration unless he has received written evidence that the insurance has been renewed.
(Revised 8-30-89, PN 116)

b FP and Section 502 RH borrowers will be informed, during the tenth month after the date of loan closing of their responsibility to carry insurance. Form RD 426-4 will be sent to those borrowers, regardless of whether there is evidence that the insurance has been renewed. Thereafter the County Supervisor will not be required to further determine whether the borrower has adequately maintained insurance; however, if a further notice of expiration is received in the County Office, the County Supervisor will again notify the borrower by using Form RD 426-4 of his responsibility. (Revised 6-29-77 - PN 576.)

3 RELEASE OF MORTGAGE INTEREST. When the borrower's loan has been paid in full and the satisfaction or release of the

mortgage has been executed, the County Supervisor or his delegate will execute the following Release of Mortgage Interest on the mortgage clause attached to the policy or other evidence of insurance and transmit it with the policy or other evidence of insurance, the paid-in-full note, and the satisfaction to the borrower:

"It is understood and agreed that the interest of the United States of America in the property insured hereunder ceased as of (Date of Final Payment), and that the Government shall have no interest in any loss or damage to such property occurring thereafter."

4 LOST OR MISPLACED POLICIES. When an unexpired insurance policy or other evidence of insurance is lost or misplaced, it will be necessary to obtain a replacement policy or other evidence of insurance. The County Supervisor is authorized to sign a lost Policy Receipt on behalf of the Agency. For FP and Sec. 502 RH loans, this paragraph applies only during the period the policy is retained in the County Office.

5 DISPOSITION OF EXPIRED AND CANCELLED POLICIES. An expired or cancelled policy or other evidence of insurance will be returned to the borrower, unless (1) there is a loss settlement pending.

B Special Servicing of Insurance.

1 VACANCY OR UNOCCUPANCY - TENANT OCCUPANCY - INCREASED HAZARD. If the County Supervisor has knowledge that insured property is vacant or unoccupied or that the hazards otherwise are increased, he will examine the policy to determine whether the policy permits such conditions. Unless the insurance permits such conditions, the County Supervisor will immediately notify the company or agent in writing. In any case where there is an additional premium due because of vacancy, unoccupancy, tenant occupancy, or other increased hazard, and upon demand to The Agency from the company or agent because the borrower cannot, or will not, pay the additional premium, it may be paid in accordance with RD Instruction 2024-A, to the company or agent. For FP and Section 502 RH borrowers, property insurance will not be obtained except in cases where an unusual and severe hazard exists and insurance is necessary to protect the interests of the Government. (Revised 08-13-92, SPECIAL PN.)

2 TRANSFER OF PROPERTY.

a When a borrower or transferee requests the consent of The Agency to a transfer the security property which already has been made, or when the County Supervisor learns that any such transfer has been made, he will immediately inform, the transferee that the mortgage requires the owner to provide and maintain adequate insurance acceptable to, and with loss payable to, The Agency as mortgagee. The transferee may obtain a new insurance policy or the transferor may have the insurance company or agent issue an endorsement to the current insurance policy changing the name of the assured to that of the transferee. If a new insurance policy is obtained, the old

policy or other evidence of insurance will be returned to the transferor unless there is an unsettled loss. If there is an unsettled loss, the policy or other evidence of insurance will not be returned until the claim has been settled. The County Supervisor, with the concurrence of the State Director and the OGC, will notify the borrower and transferee that acceptance of the new policy or endorsement will not constitute consent by the Government to the transfer even though the Government is protected by a loss payable clause in such an insurance policy.

b In a transfer with assumption, insurance will be required in the same amount and according to the same provisions as for an initial loan of the same type. (Revised 10-30-85, SPECIAL PN.)

3 VOLUNTARY CONVEYANCE OF PROPERTY TO THE GOVERNMENT AND FORECLOSURE. Insurance will not be carried on buildings which the Government has acquired. After a foreclosure sale has been held, or after a deed of conveyance to the Government in lieu of foreclosure has been filed for record, insurance will not be maintained by the Government (whether or not subject to redemption).

V Losses.

A Protecting Property. It is the responsibility of the borrower to immediately notify the County Supervisor and insurance company or agents of any loss or damage to insured property and collect the amount of the loss. When the County Supervisor learns of a loss to property which secures an The Agency loan, he will:

1 Check the borrower's casefile for an insurance policy or other evidence of insurance. When a policy or other evidence of insurance has not been retained by the Agency, such as for FP and Section 502 RH borrowers, the County Supervisor will determine whether the property was insured and whether The Agency was named as mortgagee in the insurance policy.

2 Determine that the borrower has taken such steps as are necessary to protect the interest of the Agency in the security property against further damage. When serious problems arise with respect to protecting the property from further damage, the borrower cannot or will not arrange adequate protection for the property, or when legal action appears to be necessary, the County Supervisor will arrange for emergency protection and immediately refer the case with complete information to the State Director.

B Loss Covered by Insurance.

1 If the Agency is listed as mortgagee in the insurance policy, the County Supervisor will collect the amount of the loss and may consent to the borrower using the funds to repair or replace damaged or destroyed property or to apply the loss proceeds to his loan account or to any prior liens that might exist in the order of their priority.

2 If the The Agency is not listed as mortgagee in the insurance policy, the County Supervisor will contact the borrower to determine whether he has received the loss proceeds. If the borrower has received the loss proceeds but not yet paid for improvements to repair or replace the property, or has not received the loss proceeds the County Supervisor will:

a Notify the insurance company in writing of the Agency's interest in the security property and request that the loss proceeds be made payable jointly to the Agency and the borrower.

b Inform the borrower of his responsibility for repairing or replacing the damaged or destroyed property or for authorized disposition of the loss proceeds as outlined in paragraph V B 1.

3 Loss Drafts - When Loan is Secured by a First Mortgage.

a A loss draft which in the opinion of the County Supervisor represents a satisfactory adjustment of the loss will be endorsed immediately without recourse (see RD Instruction 1951-B) and deposited in a supervised bank account to be used in repairing or replacing the damaged building, except: (Revised 6-20-79, PN 679)

(1) When the amount of the loss is \$1,000 or less and the borrower will use the funds for repairing or replacing an essential building, the loss draft may be endorsed without recourse and given to the borrower upon satisfactory proof that the repairs or replacements have been made, or upon satisfactory assurance that the work will be performed.

(2) When (1) the essential buildings are not to be repaired or replaced and other suitable buildings are not to be erected, or (2) a balance remains after all repairs, replacements, and other authorized disbursements have been made, such insurance funds will be applied on prior liens or as an extra payment to the borrower's loan accounts secured by the real estate or disposed of in accordance with the general principles applicable to the use of proceeds from the sale of a part of the security contained in applicable security servicing regulations for the type loan involved. (Revised 10-30-85, SPECIAL PN.)

(3) An insurance payment for loss or damage to a nonessential building the borrower voluntarily insured will be (1) applied on prior liens, or to current delinquencies to The Agency or as an extra payment on the borrower's loan accounts secured by real estate, (2) disposed of as authorized by the State Director in accordance with the general principles applicable to the use of proceeds from the sale of a part of the security contained in applicable security servicing regulations for the type loan involved; or (3) used for other purposes as authorized by the State Director if the loan is adequately secured and the loan account is current. (Revised 10-30-85, SPECIAL PN.)

(4) When the indebtedness secured by the insured property has been paid in full or the draft is in Payment for loss of property on which the Agency has no claim, a loss draft which includes the Agency as a joint payee may be endorsed without recourse and delivered to the borrower.

4 Loss Drafts - When Loan is Secured by Other than First Mortgage.

a When the loss draft does not include the interest of a prior mortgagee, it will be processed as provided in paragraph V B 3.

b When the loss draft includes the interest of a prior mortgagee, the County Supervisor is authorized to endorse and process the draft as follows:

(1) When the prior mortgagee will permit the use of such loss funds to repair or replace the damaged building, the draft may be endorsed without recourse upon satisfactory proof that the repairs or replacements have been made or upon satisfactory assurance that the work will be performed.

(2) When the amount of the draft does not exceed the amount of the indebtedness then secured by the prior mortgage as stated in writing by the holder of the prior mortgage, and the holder of the prior mortgage has agreed in a written statement to the County Supervisor that he will apply such funds as a payment on the borrower's prior mortgage indebtedness, the draft may be endorsed without recourse.

(3) When the amount of the draft exceeds the amount of the indebtedness then secured by the prior mortgage, as stated in writing by the holder, and he has agreed in writing to pay such indebtedness from the loss funds, the draft will be endorsed without recourse only after all parties named as payees in the draft have signed an agreement to deliver the draft "in escrow" to a bank acceptable to the named parties. The agreement will specify the manner in which the funds will be disbursed by the bank, as escrow agent, to the several

mortgagees named in the draft. After the loss funds have been collected by the bank, it will issue cashier's checks in the manner prescribed in the escrow agreement (see Exhibit A for suggested form). If this procedure is found to be impractical in an individual instance, the State Director may authorize an alternative method for disbursing the loss funds to protect the Government's financial interest.

(4) Drafts which have been endorsed by all other payees will be endorsed immediately without recourse. Such drafts or other loss funds will be processed in accordance with the methods described in paragraph V B 3.

5 Servicing Insurance Losses Under Special Circumstances.

a FORECLOSURES AND VOLUNTARY CONVEYANCES. Losses on properties in process of foreclosure or voluntary conveyance will be handled with the advice of the OGC. If the necessary cooperation of the borrower cannot be obtained, the State Director, with the advice of the OGC, will determine the proper action to be taken. To the extent feasible from a legal and practical standpoint, all loss payments should be received for a damaged or destroyed building and applied on the borrower's real estate indebtedness before title to the property is taken by the Government through foreclosure sale, voluntary conveyance, or otherwise, unless absolute assignment has been made by the borrower to the Government of all loss funds due from the insurance company.

b SUBROGATION AGREEMENTS. When a company claims nonliability to the borrower and subrogation to the rights of the Agency, the County Supervisor will forward a full report of the facts in the case to the State Director. The State Director will, upon advice from OGC, instruct the County Supervisor regarding further action to be taken.

6 Repairs and Replacements. When any loss payments have been deposited in a supervised bank account, all repairs and replacements done by or under the direction of the borrower, or by contract, will be planned, performed, inspected, and paid for in the same manner as improvements financed with loan funds.

7 Completing Adjustment. The borrower must complete the adjustment of the loss with the company or its authorized representatives. The County Supervisor, upon request of the borrower may consult with the borrower regarding the loss adjustment, but will not enter into negotiations with insurance adjusters or company representatives relative to the adjustment or settlement of losses on borrower property, or make any commitments, or sign any forms in connection with the adjustment of the loss. The Agency will not waive any rights which it may have against the company except when the borrower's account or the Agency claim has been paid-in-full.

V B 7 (Cont.)

a The County Supervisor will maintain a proper followup on all losses until satisfactory settlement has been made by the company.

b When the County Supervisor has evidence that the adjustment agreed to by the borrower is significantly less than the amount of damage to which the borrower is entitled under the terms of the policy, the loss draft accompanied by a report will be sent to the State Director so that he/she may reopen the adjustment, if he/she considers it is in the interest of the Rural Development to do so.

c When it appears evident that the amount of the loss is \$1,000 or less, the County Supervisor may rely on estimates of contractors, building supply firms, reliable carpenters, or other evidence rather than personal inspection in determining whether the adjustment is equitable and the Government's interest is protected.

8 Reinstatement After Loss. In cases where insurance in the amount of the loss is not reinstated automatically by the provisions of the policy, it will be the responsibility of the County Supervisor to have the borrower reinstate as much of the insurance as may be necessary to fulfill the requirements of the Rural Development.

C Losses not Covered by Insurance. When a loss occurs and insurance is not in force, the County Supervisor will:

1 Inform the borrower that he has violated the security instrument by not providing insurance coverage and that it is his responsibility to make the needed replacements or repairs.

2 If the borrower is unable or unwilling to make needed repairs or replacements from his own resources, the County Supervisor will submit complete information to the Rural Development official authorized to determine whether Rural Development will or will not continue with the loan. The County Supervisor's report will include recommendations on the following items:

a The advisability and possibility of making a subsequent loan to pay for needed repairs.

b Subordination of the Rural Development real estate lien to permit the borrower to obtain funds for needed repairs from another source.

RD Instruction 426.1
V C (Cont.)

c The possibility of the borrower obtaining funds secured by a junior lien from another source.

d Whether an advance is needed to protect the Government's interest in the property.

3 If the loan will not be continued with the borrower, it must be serviced in accordance with the applicable Instructions.

4 If the borrower has improperly disposed of loss proceeds, the County Supervisor will refer the case with complete information and recommendations to the State Director. The State Director will consult the Regional Attorney when necessary and advise the County Supervisor as to appropriate servicing actions.

VI FAILURE OF BORROWER TO PROVIDE INSURANCE: When a borrower fails to provide and maintain property insurance which meets the requirements set forth in paragraph II of this Instruction, every effort will be made to have the borrower provide coverage acceptable to Rural Development. It will be emphasized that under the terms of the security instrument, it is the borrower's responsibility to provide and maintain proper insurance coverage. Existing borrowers required to escrow will be notified by letter at least 90 days prior to initiating escrowing for insurance. Failure to provide insurance is a nonmonetary default and will be a consideration in determining if the loan is to be continued. For FP or SFH borrowers not required to escrow, the County Supervisor will obtain insurance coverage and voucher for the insurance premium only in cases where: (1) an unusual and severe hazard, such as recurring fires or unstable ground conditions, exists, or (2) an SFH borrower on a moratorium is unable to pay the insurance premium and the borrower requests that Rural Development pay the premium. For SFH borrowers required to escrow, force placed insurance will be obtained if the borrower fails to provide acceptable insurance. Borrowers being phased into escrow will be given at least 30 days to obtain coverage, after which force placed insurance will be obtained. If the escrow account contains insufficient funds to pay the insurance when due, the County Supervisor will request the borrower to pay an amount equal to the difference between the premium due and the escrow balance in a lump sum within 30 days after notification. If the borrower fails to remit the amount requested, the amount will be advanced and charged to the borrower's account as a recoverable cost. The amortization period for an advance due to an escrow shortage will be one year. Insurance coverage shall be provided continuously unless the property is acquired by Rural Development. The cost of obtaining such a policy shall be advanced and charged to the borrower's account as a recoverable cost. Amortization of the charge will be handled in accordance with 7 CFR part 3550. If a borrower indebted for other than an FP or SFH loan fails to provide acceptable insurance, the Servicing Official will take the following action: (Revised 01-23-03, SPECIAL PN.)

A Expired Policies.

1 The County Supervisor will request the insurance agency or broker who issued the expired policy to issue a new policy which is acceptable to the Rural Development.

a The new policy will be effective as of the date of the County Supervisor's contact with the insurance agency or broker or as soon thereafter as possible, and will be for a term of one year. If State insurance regulations require a longer term, the State Director will issue a State Instruction authorizing County Supervisors to obtain policies for the minimum period permitted by State insurance regulations.

b The Rural Development will be shown in the loss payable clause and in the mortgage clause in the proper order of priority.

c Insurance coverage on each building usually will be the same as shown on the expired policy if it meets or exceeds Rural Development requirements. If the coverage shown on the expired policy does not meet Rural Development requirements, proper coverage will be obtained.

d The County Supervisor will, if possible, have an automatic renewal provision included in the policy.

VI A (Cont.)

2 If the borrower refuses to pay the insurance premium with his own funds or arrange with the agent for subsequent payment by premium note or otherwise, the County Supervisor will pay the amount of the insurance premium in accordance with RD Instruction 2024-A. The amount of the premium payment will be charged to the borrower's The Agency account with the highest lien priority as a recoverable cost item. (Revised 08-13-92, SPECIAL PN.)

3 If the insurance agency or broker who issued the expired policy refuses to issue a new policy, the County Supervisor will have the borrower designate in writing another insurance agency or broker from whom the insurance can be obtained.

4 After the County Supervisor and the borrower exhaust all efforts to obtain acceptable insurance, the County Supervisor will request advice from the State Office as to companies issuing acceptable policies in the State and from which the borrower might be able to obtain an acceptable policy. If the borrower still cannot obtain an acceptable policy from any such company, and the determination has been made to continue with the borrower, the County Supervisor will temporarily accept from the borrower the available insurance policy The Agency determines most nearly conforms to the requirements of paragraph II. (Revised 10-30-85, SPECIAL PN.)

a In making this determination, the following deficiencies become more objectionable in the order from (1) to (5) below.

(1) A policy written for an initial term of less than one year.

(2) A policy which will insure the most essential buildings but will not cover all essential buildings.

(3) A policy which covers major risks such as fire and lightning, but does not include one or more of the other risks specified in paragraph II D.

(4) A policy for a lesser amount of insurance than is required by paragraph III.

(5) A policy that is issued by a company which is not licensed to do business in the State or otherwise does not meet the requirements of paragraph III.

b Whenever adequate insurance becomes available, the County Supervisor will require the borrower to deliver to the County Office an acceptable insurance policy. The temporary policy will be returned to the borrower for Cancellation after all losses claimed under the policy have been settled.

Sheet 10
(Revision 2)

c If the borrower is unable to furnish a property insurance policy of any kind, he is still responsible for the debt in the event of loss.

d If the County Supervisor accepts an inadequate insurance policy under these conditions or the borrower fails to furnish any insurance policy, the County Supervisor will include in his report to the State Director an explanation of the efforts he and the borrower made to obtain acceptable insurance and his justification for accepting an inadequate policy, or for not obtaining an insurance policy of any kind.

B Insurance Canceled for Reasons Other Than Nonpayment of Insurance Premium.

1 The County Supervisor, immediately upon receipt of a 10-day notice of cancellation for a policy, will urge the borrower to provide acceptable insurance.

2 If the borrower fails to provide acceptable insurance before the cancellation is effective, the County Supervisor will contact the insurance agency or broker who issued the insurance policy to determine the reasons for cancellation and, if possible, have the policy reinstated.

3 If the insurance company will not reinstate the policy, the County Supervisor will attempt to obtain an acceptable insurance policy from another agency or broker in accordance with the provisions of paragraph VI A.

C Insurance Canceled for Nonpayment of Premium.

1 The County Supervisor, immediately upon receiving a 10-day cancellation notice for a policy, will, if possible, contact the borrower in an effort to have him pay the insurance premium from his own funds or arrange with the agent for subsequent payment by premium note, or otherwise.

2 If the borrower does not pay or arrange to pay the premium before the policy cancellation is effective, the County Supervisor will, before the cancellation becomes effective, notify the insurance company or broker by certified mail, (return receipt requested), that the The Agency as mortgagee (or trustee) will pay the premium for one year to continue the policy in effect for that period. The County Supervisor will, in accordance with RD Instruction 2024-A, pay the amount of the premium for a period of one year. The amount of the premium will be charged to the borrower's loan account as a recoverable cost item.
(Revised 08-13-92, SPECIAL PN.)

RD Instruction 426.1
VI C (Cont.)

3 If a property insurance mortgage clause other than Form RD 42602 is used in connection with the policy and the insurance company or broker refuses to accept payment from the Agency in this manner to reinstate or continue the policy, the County Supervisor will attempt to obtain an acceptable insurance policy from another insurance company or broker in accordance with the provisions of paragraph VI A.

Attachment: Exhibit A.

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Sheet 11
(Revision 3)

(8-11-76) SPECIAL PN

ESCROW AGREEMENT
REAL PROPERTY INSURANCE

Date _____

(Name of Bank)

(City or Town)

(State)

Gentlemen:

Attached is Draft No. _____, for \$ _____, issued by the _____
_____ Insurance Company in payment of
_____ loss which damaged the buildings on the farm of _____,
of _____ County, State of _____.

This draft has been endorsed by the undersigned payees who request that you
collect these funds and issue cashier's checks to the following payees for the
following amounts:

_____, First Mortgagee \$ _____
_____, Second Mortgagee \$ _____
_____, Third Mortgagee \$ _____

The balance only, if any, will be paid to _____, the
owner of the property.

First Mortgagee

Second Mortgagee

Third Mortgagee

Owner

o O o