



## **DEPARTMENT OF AGRICULTURE**

### **Rural Housing Service**

#### **7 CFR Part 3555**

**[Docket No. RHS-26-SFH-0100]**

**RIN 0575-AD45**

### **Single Family Housing Guaranteed Loan Program - Income Producing Accessory Dwelling Unit (ADU) Provisions**

**AGENCY:** Rural Housing Service, Agriculture Department (USDA).

**ACTION:** Proposed rule.

**SUMMARY:** The Rural Housing Service (RHS or the Agency), an agency of the Rural Development mission area within the United States Department of Agriculture (USDA), is issuing a proposed rule to amend the current Single Family Housing Guaranteed Loan Program (SFHGLP) regulation. These proposed changes are intended to allow the Agency to finance a single family home with a single or multiple income producing Accessory Dwelling Units (ADU). Additionally, we propose to clarify that borrowers can finance properties with features designed to accommodate home-based operations with non-commercial real estate features. The plain language summary of the proposal is available on Regulations.gov in the docket for rulemaking.

**DATES:** Comments must be submitted on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

**ADDRESSES:** Comments may be submitted by going to the Federal eRulemaking Portal, [regulations.gov/](https://www.regulations.gov/). In the “Search for dockets and documents on agency actions” box, enter the docket number, RHS-26-SFH-0100, and click “Search” button. From the search results: click on or locate the document title: “Single Family Housing Guaranteed

Loan Program - Income Producing Accessory Dwelling Unit (ADU) Provisions” and select the “Comment” button. Before inputting comments, commenters may review the “Commenter’s Checklist” (optional). To submit a comment: Insert comments under the “Comment” title, click “Browse” to attach files (if available), input email address, select box to opt to receive email confirmation of submission and tracking (optional), select the box “I’m not a robot,” and then select “Submit Comment”. Information on using Regulations.gov, including instructions for accessing documents, submitting comments, and viewing the docket after the close of the comment period, is available under the site’s “FAQ” link. All comments will be available for public inspection online at the Federal eRulemaking Portal ([regulations.gov](https://www.regulations.gov)).

Other Information: Additional information about Rural Development and its programs is available on the internet at <https://www.rd.usda.gov>.

**FOR FURTHER INFORMATION CONTACT:** Stephanie Freeman, Finance and Loan Analyst, Single Family Housing Guaranteed Loan Division, Rural Development, U.S. Department of Agriculture, STOP 0784, Room 2250, South Agriculture Building, 1400 Independence Avenue SW., Washington, DC 20250-0784. Telephone: (314) 457-6413; or email: [stephanie.freeman@usda.gov](mailto:stephanie.freeman@usda.gov).

**SUPPLEMENTARY INFORMATION:**

**Abbreviations**

ADU	Accessory Dwelling Unit
CFR	Code of Federal Regulations
FNMA	Fannie Mae
FHA	Federal Housing Administration
FR	Federal Register
FHLMC	Freddie Mac
HUD	Department of Housing and Urban Development

RHS	Rural Housing Service
§	Section
SEQ.	Sequentes
SFHGLP	Single Family Housing Guaranteed Loan Program
U.S.C.	United States Code
USPAP	Uniform Standards of Professional Appraisal Practice
VA	The Department of Veterans Affairs

## **I. Statutory Authority**

The SFHGLP is authorized by Section 502(h) of the Housing Act of 1949 (42 U.S.C. §1472(h)), as amended, and implemented by 7 CFR part 3555.

## **II. Background**

The RHS offers an array of programs to develop and enhance housing and critical community infrastructure in rural areas. The Agency offers loans, grants, and loan guarantees for single and multi-family housing, childcare centers, emergency services facilities, hospitals, libraries, nursing homes, schools, and housing for agricultural workers, among other essential projects. Additionally, the RHS collaborates with non-profits, tribal governments, and state/federal agencies to offer technical assistance and supplementary financing to local communities.

Under the authority of the Housing Act of 1949, (42 U.S.C. §1471 *et seq.*), as amended, the SFHGLP makes loan guarantees to provide low and moderate income persons in rural areas an opportunity to own decent, safe, and sanitary dwellings and related facilities. Approved lenders make the initial eligibility determinations, and the Agency reviews those determinations to make a final eligibility decision.

In an effort to boost homeownership, the federal government has introduced new

initiatives that provide prospective buyers with greater flexibilities for financing properties with ADUs. There is a growing demand for affordable housing, coupled with a limited amount of land available for development in many rural communities, which has made it necessary to consider the financing of properties with an ADU. ADUs offer numerous community benefits, including increasing overall housing supply and providing affordable living options for low- and moderate-income families. It can be created within or added to the primary dwelling through the conversion of existing space, such as an attic or basement; constructed as separate structures over an existing accessory building, such as a garage; or built independently from the primary residential structure as a residential unit.

Homeownership options are limited for many Americans. The Agency has recognized that ADUs can offer a variety of benefits, including increasing a community's housing supply by adding or introducing new and innovative housing typologies of smaller scale, providing a more affordable housing option for many low- and moderate-income residents. It provides a means to generate additional income for borrowers. These additional benefits support the goal of increasing the stock of affordable housing while creating innovative solutions and expanding opportunities for homeownership stability.

### **III. Discussion of the Proposed Rule**

#### *A. Agency Definitions of an Accessory Dwelling Unit (ADU) and Living Unit*

ADUs, also known as in-law apartments, casitas, carriage houses, second units, or granny flats, became a common feature in single-family homes in the early 1900s. The post-WWII housing boom and suburbanization further increased demand for these supplementary living spaces. Regardless of the terminology used, ADUs are self-contained living spaces with kitchens or kitchenettes and bathrooms, or comparable space, in an open floor plan that are built on the same lot as a single-family home. These separate

living quarters can be attached to, or detached from, the primary dwelling. Today, they are widely recognized as a valuable housing option in communities across the country.

The Agency currently considers an ADU as a habitable living unit, within or detached from a single-family dwelling, which together with the single-family dwelling constitutes a single interest in real estate. Neither the definition of an ADU or a living unit is currently defined in program regulations. The Agency is proposing to formally codify the definition of an ADU in 7 CFR § 3555.10 as a habitable living unit, either within or detached from a single family dwelling. The ADU must be a private space that is subordinate in size, has means of separate ingress and egress that meets HUD's minimum requirements for a living unit, and together with the single-family dwelling constitutes a single interest in real estate. Furthermore, the Agency proposes to add the definition of a living unit in 7 CFR § 3555.10 to provide the minimum requirements for a unit to be considered a living unit for this purpose. The other major federal housing agencies, such as the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA), as well as government-sponsored enterprises (GSE) Fannie Mae (FNMA) and Freddie Mac (FHLMC), use comparable definitions.

#### *B. Accessory Dwelling Unit Changes*

Under 7 CFR § 3555.102(b), the purchase or improvement of land or buildings that are typically used principally for income-producing purposes is prohibited. Additionally, 7 CFR 3555.201(b)(2) states that a site must not include income-producing land or buildings to be used principally for income-producing purposes. A qualified property must be predominantly residential in use, character, and appearance. The Agency currently prohibits financing a property that includes an income-producing building, such as a freestanding ADU, to be used for income-generating purposes. However, ADUs on the subject property that do not produce income, but are used to support multigenerational

households, are consistent with program requirements. In an effort to continue delivering meaningful solutions that increase the affordable housing supply and promote homeowner financial stability, the Agency proposes to amend 7 CFR §§ 3555.102(b) and 3555.201(b)(2), to clarify that properties that include, or will include, a single or multiple ADUs constitute an eligible loan purpose.

### *C. Financing homes with home-based business operations*

The Agency's current program regulations do not provide guidance on whether properties with features allowing for home-based operations such as childcare, product sales, or craft production, are accepted or excluded. The presence of such features may provide an opportunity for an additional income stream for the borrower, however the property remains a residential home, consistent with the intent of the SFHGLP. Therefore, the Agency is proposing to amend 7 CFR § 3555.102(c), to provide clarity regarding features designed to accommodate home-based business operations, making it eligible for the SFHGLP.

## **IV. Request for Comment**

Stakeholder input is vital to ensure the proposed changes in the proposed rule would support the Agency's mission, while ensuring that new regulations and policies are reasonable and do not overly burden the Agency's lenders and their customers. Comments must be submitted on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]** and may be submitted electronically by going to the Federal eRulemaking Portal: <http://www.regulations.gov>. Details on how to submit comments to the Federal eRulemaking Portal are in the **ADDRESSES** section of this proposed rule.

## **V. Summary of Changes**

RHS is proposing to make the following changes to 7 CFR part 3555:

- (1) Add the definitions of an *Accessory Dwelling Unit (ADU)* and a *Living Unit* in 7 CFR § 3555.10 which would clarify the understanding of these terms.
- (2) Update section 7 CFR § 3555.102(b) to allow the Agency to issue a guarantee if loan funds are used for a single or multiple income producing ADUs.
- (3) Update section 7 CFR § 3555.102(c) to allow the Agency to issue a guarantee if loan funds are used to finance a property which accommodates a home-based operation.
- (4) Update section 7 CFR § 3555.201(b)(2) to clarify that borrowers are allowed to finance sites that include an income producing ADU.

## **VI. Executive Orders and Statutory Regulatory Review Requirements**

### **Executive Order 12372, Intergovernmental Review of Federal Programs**

This program is not subject to the requirements of Executive Order 12372, “Intergovernmental Review of Federal Programs,” as implemented under USDA's regulations .

### **Executive Order 12866, Regulatory Planning and Review**

This rule has been determined to be significant under section 3(f) of Executive Order 12866 and was reviewed by the Office of Management and Budget. In accordance with Executive Order 12866, an Economic Impact Analysis was completed, outlining the costs and benefits of implementing this program in rural America. The complete analysis is available from Regulations.gov by searching for the Docket number [RHS-26-SFH-0100].

### **Executive Order 12988, Civil Justice Reform**

This proposed rulemaking has been reviewed under Executive Order 12988. In accordance with this rule: (1) unless otherwise specifically provided, all State and local laws that conflict with this rule will be preempted; (2) no retroactive effect will be given to this rule except as specifically prescribed in the rule; and (3) administrative proceedings of the National Appeals Division of the Department of Agriculture (7 CFR part 11) must be exhausted before bringing suit in court that challenges action taken under this rule.

### **Executive Order 13132, Federalism**

The policies contained in this proposed rulemaking do not have any substantial direct effect on states, on the relationship between the national government and states, or on the distribution of power and responsibilities among the various levels of government. This proposed rule does not impose substantial direct compliance costs on state and local governments. Therefore, consultation with the states is not required.

### **Executive Order 13175, Consultation and Coordination with Indian Tribal Governments**

This proposed rule has been reviewed in accordance with the requirements of Executive Order 13175, "Consultation and Coordination with Indian Tribal Governments." Executive Order 13175 requires Federal agencies to consult and coordinate with tribes on a government-to-government basis on policies that have tribal implications, including regulations, legislative comments or proposed legislation, and other policy statements or actions that have substantial direct effects on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes or on the distribution of power and responsibilities between the Federal Government and Indian tribes. Consultation is also required for any regulation that preempts tribal law or that

imposes substantial direct compliance costs on Indian tribal governments and that is not required by statute. The Agency has determined that this proposed rule does not, to our knowledge, have tribal implications that require formal tribal consultation under Executive Order 13175. If a Tribe requests consultation, the Rural Housing Service will work with the Office of Tribal Relations to ensure meaningful consultation is provided where changes, additions and modifications identified herein are not expressly mandated by Congress.

### **Unfunded Mandates Reform Act**

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), Public Law 104-4, establishes requirements for federal agencies to assess the effect of their regulatory actions on state, local, and tribal governments, and the private sector. Under section 202 of the UMRA, the Agency generally must prepare a written statement, including a cost-benefit analysis, for proposed and final rules with "federal mandates" that may result in expenditures to state, local, or tribal governments, in the aggregate, or to the private sector, of \$100 million, or more in any one year. When such a statement is needed for a rule, section 205 of the UMRA generally requires the Agency to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, most cost-effective, or least burdensome alternative that achieves the objectives of the rule.

This proposed rule contains no federal mandates (under the regulatory provisions of Title II of the UMRA) for state, local, and tribal governments, or the private sector. Therefore, this proposed rule is not subject to the requirements of sections 202 and 205 of the UMRA.

### **National Environmental Policy Act**

In accordance with the National Environmental Policy Act of 1969, Public Law 91-190, this proposed rule has been reviewed in accordance with 7 CFR part 1b (“National Environmental Policy Act”). The Agency has determined that i) this action meets the criteria established in 7 CFR § 1b.4(c)(31); ii) no extraordinary circumstances exist; and iii) the action is not “connected” to other actions with potentially significant impacts, is not considered a “cumulative action”. Therefore, the Agency has determined that the action does not have a significant effect on the human environment, and therefore neither an Environmental Assessment nor an Environmental Impact Statement is required.

### **Regulatory Flexibility Act**

This proposed rule has been reviewed with regard to the requirements of the Regulatory Flexibility Act (5 U.S.C. §§ 601-612). The undersigned has determined and certified by signature on this document that this rule will not have a significant economic impact on a substantial number of small entities since this rulemaking action does not involve a new or expanded program nor does it require any more action on the part of a small business than required of a large entity.

### **Civil Rights Impact Analysis**

RD has reviewed this proposed rule in accordance with USDA Regulation 4300-4, "Civil Rights Impact Analysis," to identify any major civil rights impacts the rule might have on program participants on the basis of age, race, color, national origin, sex, disability, political beliefs, marital status, familial status, parental status, veteran status, religion, reprisal and/or resulting from all or a part of an individual's income being derived from any public assistance program. This proposed rule is within a Guarantee-based program. Guarantees are not covered under Title VI of the Civil Rights Act of 1964, Section 504 of the Rehabilitation Act of 1973, and Title IX of the Education Amendments

Act of 1972, as amended, when the Federal assistance does not include insurance or interest credit loans. Lenders must comply with other applicable Federal laws, including Equal Employment Opportunities, the Equal Credit Opportunity Act, the Fair Housing Act, and the Civil Rights Act of 1964. Guaranteed loans that involve the construction of or addition to facilities that accommodate the public must comply with the Architectural Barriers Act Accessibility Standard. The borrower and lender are responsible for ensuring compliance with these requirements.

### **Assistance Listing Number**

The program affected by this proposed rule is listed in the Assistance Listing (AL) Number 10.410, Very Low to Moderate Income Housing Loans (Section 502 Rural Housing Loans).

### **Paperwork Reduction Act**

This proposed rule contains no new reporting or recordkeeping burdens under OMB control number 0575-0179 that would require approval under the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35).

### **E-Government Act Compliance**

Rural Development is committed to the E-Government Act, which requires Government agencies in general to provide the public the option of submitting information or transacting business electronically to the maximum extent possible and to promote the use of the Internet and other information technologies to provide increased opportunities for citizen access to Government information and services, and for other purposes.

### **Non-Discrimination Policy**

In accordance with Federal civil rights law and U.S. Department of Agriculture (USDA) civil rights regulations and policies, the USDA, its Agencies, offices, and employees, and institutions participating in or administering USDA programs are prohibited from discriminating based on race, color, national origin, religion, sex, disability, age, marital status, family/parental status, income derived from a public assistance program, political beliefs, or reprisal or retaliation for prior civil rights activity, in any program or activity conducted or funded by USDA (not all bases apply to all programs). Remedies and complaint filing deadlines vary by program or incident.

Persons with disabilities who require alternative means of communication for program information (e.g., Braille, large print, audiotape, American Sign Language, etc.) should contact the State or local Agency that administers the program or contact USDA through the Telecommunications Relay Service at 711 (voice and TTY). Additionally, program information may be made available in languages other than English.

To file a program discrimination complaint, complete the USDA Program Discrimination Complaint Form, AD-3027, found online at How to File a Program Discrimination Complaint and at any USDA office or write a letter addressed to USDA and provide in the letter all of the information requested in the form. To request a copy of the complaint form, call (866) 632-9992. Submit your completed form or letter to USDA by: (1) mail: U.S. Department of Agriculture, Office of the Assistant Secretary for Civil Rights, 1400 Independence Avenue, SW, Mail Stop 9410, Washington, D.C. 20250-9410; (2) fax: (202) 690-7442; or (3) email: [program.intake@usda.gov](mailto:program.intake@usda.gov).

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#### **List of Subjects in 7 CFR Part 3555**

Administrative practice and procedure, Business and industry, Conflicts of interest, Credit, Environmental impact statements, Fair housing, Flood insurance, Grant programs-

housing and community development, Home improvement, Housing, Loan programs-housing and community development, Low and moderate income housing, Manufactured homes, Mortgage insurance, Mortgages, Reporting and recordkeeping requirements, Rural areas.

For the reasons set forth in the preamble, chapter XXXV of the title 7, Code of Federal Regulations is proposed to be amended as follows:

## **PART 3555 – GUARANTEED RURAL HOUSING PROGRAM**

1. The authority citation for Part 3555 continues to read as follows:

**Authority:** 5 U.S.C. 301; 42 U.S.C. 1471 *et seq.*

### **Subpart A – General**

2. Amend § 3555.10 by adding the definitions of an *Accessory Dwelling Unit* and a *Living Unit* to read as follows:

#### **§ 3555.10 Definitions and abbreviations.**

\* \* \* \* \*

*Accessory Dwelling Unit.* A habitable living unit, within or detached from a single family dwelling, that is a private space that is subordinate in size, has means of separate ingress and egress that meets the minimum requirements for a living unit, which together constitutes a single interest in real estate.

*Living Unit.* To constitute a living unit, the unit must contain a continuous and sufficient supply of safe and potable water, sanitary facilities and a safe method of sewage disposal, heating adequate for healthful and comfortable living conditions, domestic hot water, electricity adequate for lighting and mechanical equipment, and kitchen facilities adequate for the preparation and cooking of food. The unit must contain at least one bathroom, or similar space, which includes a water closet, lavatory, and bathtub or

shower; and kitchen or kitchenette facilities which include a sink with potable running water and a stove utility hookup, or similar cooking instrument.

\* \* \* \* \*

### **Subpart C – Loan Requirements**

3. Amend § 3555.102 by revising paragraph (b) and (c) to read as follows:

#### **§ 3555.102 Loan Restrictions.**

\* \* \* \* \*

(a) \* \* \*

(b) *Income producing land or buildings.* Purchase or improvement of land or buildings that are typically used principally for income-producing purposes, except this restriction shall not apply where loan funds are to be used for the financing of an otherwise qualifying property that contains or will contain a single or multiple accessory dwelling units;

(c) *Business or income-producing enterprise.* Purchase or the construction of buildings which are largely or in part specifically designed to accommodate a business or income-producing enterprise. This restriction shall not apply where loan funds are to be used for the financing of an otherwise qualifying property with design features that accommodate a home-based business or businesses; such as childcare, product sales, or craft production; that do not require specific commercial real estate features;

\* \* \* \* \*

### **Subpart E – Underwriting the Property**

4. Amend § 3555.201 by revising paragraph (b)(2) to read as follows:

#### **§ 3555.201 Site Requirements.**

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(2) The site must not include income-producing land or buildings to be used principally for income-producing purposes, except this limitation shall not apply where the site is otherwise qualified and contains or will contain a single or multiple accessory dwelling units. Vacant land without eligible residential improvements, or property used primarily for agriculture, farming or commercial enterprise is ineligible for a loan guarantee.

\* \* \* \* \*

**Anthony Priest,**

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[FR Doc. 2026-06173 Filed: 3/30/2026 8:45 am; Publication Date: 3/31/2026]