Chapter 9. Legal Instruments, Liens, Escrows and Related Issues

Overview

Introduction

This chapter contains information about legal instruments, liens, escrows, and related issues.

In this Chapter

This chapter contains the following topics.

Topic	Topic Description	See Page
1	Security Instruments	9-2
2	Title Limitations	9-5
3	Land Sale Contracts and Option Contracts	9-8
4	Secondary Borrowing	9-9
5	Purchase of Property with Encumbrances	9-11
6	Liens Covering Community-Type Services and Facilities	9-12
7	Powers of Attorney	9-14
8	Lender Review of Sales Contracts on Proposed Construction	9-17
9	Escrow for Postponed Completion of Improvements	9-20
10	Hazard Insurance	9-24
11	Escrow for Taxes and Insurance	9-27
12	Homebuyer Assistance Programs	9-28

1. Security Instruments

Change Date

April 5, 2012, Change 18
- This section has been updated to make minor grammatical edits.

a. Requirements

Lenders may use any note and mortgage forms they wish for VA loans. VA regulations at 38 CFR 36.4337 provide that security instruments used by a lender which are inconsistent with VA regulations in effect on the date the loan is closed will be considered amended and supplemented to conform to the regulations.

Lenders must ensure that the security instruments they use:

- Establish the required lien
- Comply with the laws and regulations governing VA's home loan program
- Comply with applicable state laws, and
- Contain the following VA clauses:
  - Assumption Approval clause
  - Acceleration clause
  - Funding Fee clause
  - Processing Charge clause, and
  - Indemnity Liability Assumption clause.

If a lender fails to obtain the required lien or otherwise comply with applicable law, VA may reduce or deny liability under its guaranty to the extent that such failure might have prejudiced the rights of the Secretary.

b. Assumption Approval Clause

The instruments evidencing the loan must read substantially as follows:

"THIS LOAN IS NOT ASSUMABLE WITHOUT THE APPROVAL OF THE DEPARTMENT OF VETERANS AFFAIRS OR ITS AUTHORIZED AGENT."

The loan assumption notice must appear conspicuously on at least one of the security instruments for the loan.

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1. Security Instruments, Continued

c. Other Clauses

The mortgage or deed of trust must contain four additional clauses related to the assumption of the loan. VA does not specifically require that these clauses also be included in the note, unless this is required under state law to make them enforceable. Due to variations in local laws, the lender should obtain legal guidance as to any minor changes in these sample clauses which may be necessary to ensure that they have the effect required by the law and regulations; that is, the lender does not have to use the exact language provided for these four clauses.

Acceleration Clause
"This loan may be declared immediately due and payable upon transfer of the property securing such loan to any transferee, unless the acceptability of the assumption of the loan is established pursuant to Section 3714 of Chapter 37, Title 38, United States Code."

Funding Fee Clause
"A fee equal to one-half of 1 percent of the balance of this loan as of the date of transfer of the property shall be payable at the time of transfer to the loan holder or its authorized agent, as trustee for the Department of Veterans Affairs. If the assumer fails to pay this fee at the time of transfer, the fee shall constitute an additional debt to that already secured by this instrument, shall bear interest at the rate herein provided, and at the option of the payee of the indebtedness hereby secured or any transferee thereof, shall be immediately due and payable. This fee is automatically waived if the assumer is exempt under the provisions of 38 U.S.C. 3729(c)."

Processing Charge Clause
"Upon application for approval to allow assumption of this loan, a processing fee may be charged by the loan holder or its authorized agent for determining the creditworthiness of the assumer and subsequently revising the holder's ownership records when an approved transfer is completed. The amount of this charge shall not exceed the maximum established by the Department of Veterans Affairs for a loan to which Section 3714 of Chapter 37, Title 38, United States Code applies."

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1. Security Instruments, Continued

c. Other Clauses (continued)

Indemnity Liability Assumption Clause
"If this obligation is assumed, then the assumer hereby agrees to assume all of the obligations of the veteran under the terms of the instruments creating and securing the loan. The assumer further agrees to indemnify the Department of Veterans Affairs to the extent of any claim payment arising from the guaranty or insurance of the indebtedness created by this instrument."

d. Escape Clause For the Sales Contract

Escape Clause
If the sales contract was signed by the veteran prior to receipt of the Notice of Value (NOV), the contract must include, or be amended to include, the clause below.

"It is expressly agreed that, notwithstanding any other provisions of this contract, the purchaser shall not incur any penalty by forfeiture of earnest money or otherwise or be obligated to complete the purchase of the property described herein, if the contract purchase price or cost exceeds the reasonable value of the property established by the Department of Veterans Affairs. The purchaser shall, however, have the privilege and option of proceeding with the consummation of this contract without regard to the amount of the reasonable value established by the Department of Veterans Affairs. (Authority: 38 U.S.C. 501, 3703(c)(1))"

This clause may be found at 38 CFR 4303(k)(4) in its entirety.

2. Title Limitations

Change Date

April 5, 2012, Change 18
- This section has been updated to make minor grammatical edits.

a. Estate of the Veteran in the Property

VA regulations at 38 CFR 36.4354 provide the parameters for the required estate of a veteran in real property securing a VA-guaranteed loan. The lender is responsible for ensuring the loan conforms to these parameters.

Generally, title to the estate shall be that which is acceptable to informed buyers, title companies, and attorneys in the community in which the property is situated.

b. Title Insurance

VA does **not** require a lender making a VA loan or the veteran-borrower to obtain title insurance. The lender may apply its own title insurance requirements to VA loan transactions. VA requires only that title to the property meet the standards described above in "Estate of the Veteran in the Property."

c. Restrictions on the Purchase or Resale of Properties

Restrictions on the purchase or resale of the property are unacceptable to VA, with certain exceptions. The lender must:

- ensure any restrictions fall within the exceptions provided by VA regulations at 38 CFR 36.4308 and 38 CFR 36.4354
- consult VA where doubt exists
- obtain VA approval where appropriate, and
- fully inform the veteran and obtain his or her consent to the restrictions in writing at the time of loan application.

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2. Title Limitations, Continued

d. Examples of Restrictions that Require VA Approval

A lender may not accelerate a loan based on the sale of the secured property unless the acceptability of the assumption of the loan has not been established pursuant to Section 3714 of Chapter 37, Title 38, U.S.C., except that:

- Under 38 CFR 36.4308(b), VA may guarantee a loan made through a State, Territorial or local government program where restrictions in the legal instruments require acceleration of the loan if it is assumed by a party ineligible for assistance under the program.
- Such acceleration must be mandated by Federal, State, Territorial or local law or regulation.

VA may guarantee a loan made through a state or local government program, designed to assist low- or moderate-income individuals, which imposes resale and price restrictions on purchasers.

Under such a program, if the property is resold within a period established by local law or ordinance, certain restrictions as set forth in 38 CFR 36.4354(b)(5)(iv)(A) on to whom the property may be sold, the resale price, and other restrictions approved by the Secretary may be applied.

VA may guarantee a loan on which a title restriction limits the sale, lease, or occupancy of the dwelling to persons based on age, including a prohibition against the permanent occupancy of the dwelling by children, provided such restriction complies with applicable Federal law.

VA may refuse to approve a property with an age restriction if its operation would work an undue hardship upon the owner in the case of sudden, unforeseen events or be likely to result in an increased risk of loan default.

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2. Title Limitations, Continued

e. Examples of Restrictions That Do Not Require VA Approval

Title to property involving reasonable encroachments, easements, servitudes, and reservations for water, timber, or subsurface rights, generally do not require VA approval. However, they must be taken into consideration in determining reasonable value.

If any of these restrictions impact the basic livability of the property, VA approval is required.

f. Effect of Title Limitations on Reasonable Value

Title conditions or limitations must be shown on the NOV and considered by the appraiser in determining the reasonable value of the property.

If the lender discovers, prior to loan closing, title conditions or limitations not shown on the NOV, the lender must have VA review the conditions and determine whether the value assigned to the property is materially affected.

Without such a determination by VA, the lender risks a later finding that the condition or limitation affects the reasonable value of the property to the extent that:

- the loan will be ineligible for guaranty, or
- a claim on the guaranty will be subject to reduction under 38 CFR 36.4325.

When VA reasonable value is based on the Department of Housing and Urban Development (HUD) Form 92800.5B, Conditional Commitment, Direct Endorsement, Statement of Appraised Value, lenders must contact HUD to process requests for review of title conditions or limitations.

3. Land Sale Contracts and Option Contracts

Change Date

April 5, 2012, Change 18
- This section has been updated to make minor grammatical edits.

a. Eligibility of Land Sale Contracts

VA may guarantee an obligation secured by a land sale contract for the purchase of improved residential property in the same manner as any obligation secured by a mortgage or deed of trust.

- The land sale contract must contain the mandatory clauses provided in section 1 of this chapter.
- The contract must be recorded.

VA may also guarantee a loan to refinance the unpaid balance under a land sale contract for the purchase of improved residential property, provided:

- the veteran will obtain title to the property described in the contract upon closing of the loan, and
- the obligation to be guaranteed is in the form of a note or bond secured by a mortgage or other acceptable form of security instrument other than the existing land sale contract.

b. Eligibility of Option Contracts

Option contracts are not eligible for guaranty, however, VA may guarantee a loan made for the unpaid purchase price of residential property when the option is exercised.

4. Secondary Borrowing

Change Date

April 5, 2012, Change 18
- This section has been updated to make minor grammatical edits.

a. What is Secondary Borrowing?

For purposes of this topic, secondary borrowing refers to the veteran obtaining a second mortgage simultaneously with a VA-guaranteed first mortgage, both secured by the same property.

b. Policy

Secondary borrowing is acceptable as long as:

- the veteran is not placed in a substantially worse position than if the entire amount borrowed had been guaranteed by VA, and
- the requirements detailed below are met.

c. Requirements

The second mortgage must meet the following requirements:

Factor	Requirement
Documentation	The lender must submit documentation disclosing the source, amount, and repayment terms of the second mortgage and agreement to such terms by the veteran and any co-obligors.
Lien Position	The second mortgage must be subordinated to the VA-guaranteed loan, that is, the second mortgage must be in a junior lien position relative to the VA loan.
Allowable Purposes	Proceeds of the second mortgage **may** be used for a variety of purposes, including but not limited to: • closing costs, or • a downpayment to meet secondary market requirements of the lender. But **may not** be used to cover any portion of a downpayment required by VA to cover the excess of the purchase price over VA's reasonable value.

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4. Secondary Borrowing, Continued

c. Requirements (continued)

Factor	Requirement
Cash back	There can be no cash back to the veteran from the VA first mortgage or a second mortgage obtained simultaneously.
Underwriting	The veteran must qualify for the second mortgage which is underwritten as an additional recurring monthly obligation. ***Reference***: See section 5 of chapter 4.
Interest Rate	The rate on the second mortgage may exceed the rate on the VA-guaranteed first, however, it may not exceed industry standards for second mortgages.
Assumability	The second mortgage should not restrict the veteran's ability to sell the property any more than the VA first mortgage. That is, it should be assumable by creditworthy purchasers.
Grace Period	There should be a reasonable grace period before: • a late charge comes due, or • commencement of foreclosure proceedings in the event of default.

d. Unusual Terms

Second mortgages bearing unusual terms, interest rates, etc., are sometimes offered by parties such as:

- Federal, state, or local government agencies
- non-profit organizations
- private individuals
- a builder, or
- the seller.

Consult VA if it is unclear whether the terms of the second mortgage meet VA standards or if there may be a reasonable basis for VA to make an exception to the standards detailed in this topic.

5. Purchase of Property with Encumbrances

Change Date

September 15, 2004, Change 4
This section has been changed to create subsection lettering.

a. Policy

Generally, VA-guaranteed loans must be first liens. Any existing liens on the property must be paid off or subordinated to the VA loan.

A loan to purchase property subject to unpaid delinquent taxes, special assessments, prior mortgage indebtedness, or other obligations secured by effective liens that the veteran agrees to pay or which constitute encumbrances on the property is not eligible for guaranty if the loan amount plus these unpaid obligations exceeds VA's reasonable value of the property.

6. Liens Covering Community-Type Services and Facilities

Change Date

April 5, 2012, Change 18
- This section has been updated to make minor grammatical edits.

a. Policy

Generally, loans for the purchase and construction of homes will be first liens, subject only to taxes, special assessments, and ground rents.

VA will not approve superior liens in favor of private entities unless they:

- are legally or practically necessary, and
- result in no prejudice to veterans or the Government.

b. Requirements

The lender must obtain VA approval of liens held by private parties which are superior to VA home mortgage liens.

Liens held by mandatory membership home associations in planned unit developments are not addressed in this topic.

The lender must demonstrate that:

- it is not legal or practical to subordinate the superior lien to the VA mortgage
- there is a viable rationale for not subordinating the superior lien
- the superior lien will not prejudice veterans or the Government, and
- if periodic charges or assessments are involved, the amounts are reasonable and limits on the amounts have been established.

Always obtain VA approval before the lien is recorded. Builders and developers should be aware that if they plan to market properties through VA financing, covenants creating superior liens should not be recorded without VA approval.

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6. Liens Covering Community-Type Services and Facilities, Continued

c. Examples

VA may find the following types of superior liens acceptable:

- Liens for taxes, assessments, and ground rents.
- Liens by private entities to secure assessments or charges for municipal-type services and facilities which:
  - are clearly governmental in nature
  - a municipality could support out of public tax revenue if it provided the service, **but**
  - the municipality does not provide them.
- Liens to implement or augment a service or facility if the government's provision of such service or facility is inadequate.
- Liens for services or facilities in locations where the services or facilities are adequately supplied by local government generally will **not** be approved by VA.
- Liens created by recorded covenants in favor of private entities to secure the homeowner's share of the costs of the management, operation, maintenance, services or programs for the benefit of a development.
- Liens (on existing properties) previously retained by trustees, improvement associations or other nongovernmental entities for community-type services and facilities in a given area or subdivision, such as maintenance of streets, parkways, playgrounds, water systems, sewage systems, police and fire protection, or street lighting.

7. Powers of Attorney

Change Date

April 5, 2012, Change 18
- This section has been updated to make minor grammatical edits.

a. Policy

VA will allow a veteran to use an attorney-in-fact to execute any documents necessary to obtain a VA-guaranteed loan. This enables active duty servicepersons stationed overseas, and other veterans who cannot be present to execute loan documents, to obtain VA loans.

b. Requirements

The veteran must execute a general or specific power of attorney which is valid and legally adequate. The veteran's attorney-in-fact may use this power of attorney to apply for a Certificate of Eligibility and initiate processing of a loan on behalf of the veteran.

To complete the loan transaction using an attorney-in-fact, ensure that the general or specific power of attorney complies with state law to the extent that:

- the mortgage can be legally enforced in that jurisdiction, and
- clear title can be conveyed in the event of foreclosure.

To complete the loan transaction using an attorney-in-fact, VA also requires the veteran's written consent to the specifics of the transaction. This requirement can be satisfied by either:

- the veteran's signature on both the sales contract and the Uniform Residential Loan Application, as long as the veteran's intention to obtain a VA loan on the particular property is expressed somewhere in those documents, or
- a specific power of attorney or other document(s) signed by the veteran, which encompasses the following elements:
  - Entitlement—A clear intention to use all or a specified amount of entitlement.
  - Purpose—A clear intention to obtain a loan for purchase, construction, repair, alteration, improvement, or refinancing.
  - Property Identification—Identification of the specific property.
  - Price and Terms—The sales price, if applicable, and other relevant terms of the transaction.
  - Occupancy—The veteran's intention to use the property as a home to be occupied by the veteran (or other applicable VA occupancy requirement).

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7. Powers of Attorney, Continued

b. Requirements (continued)

In addition, at the time of loan closing, the lender must:

- verify that the veteran is alive, and, if on active military duty, not missing in action (MIA), and
- make the following certification:

"The undersigned lender certifies that written evidence in the form of correspondence from the veteran or, if on active military duty, statement of his or her commanding officer (including statement of person authorized to act for said officer), affirmatively indicating that the veteran was alive and, if the veteran is on active military duty, not missing in action status on (date), was examined by the undersigned and that the said date is subsequent to the date the note and security instruments were executed on the veteran's behalf by the attorney-in-fact."

c. Veteran's Status as Alive and not MIA

The lender must always verify that the veteran is alive at the time of loan closing, whether or not the veteran is still in the military.

If the lender has difficulty obtaining verification that a service person in a combat area is alive and not in MIA status, the lender may request that VA obtain the necessary information on its behalf.

VA may deny guaranty on a loan if the lender failed to properly verify the veteran's status and the veteran was deceased (or MIA) at the time the loan was closed.

d. Prior Approval Loans

VA will issue a Certificate of Commitment only if the veteran has executed a valid and legally adequate power of attorney and consented to the specific transaction (as described under the "Requirement" heading). If VA has information that the veteran is MIA or deceased, VA will not issue a commitment.

The Certificate of Commitment issued in power of attorney cases contains the condition indicated under "Conditional Commitments" in section 4 of chapter 5.

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7. Powers of Attorney, Continued

e. Hardship Exceptions

VA may relax the requirements in an exceptional case if serious hardship may result due to the time or other pertinent factors involved in obtaining the veteran's consent to the specific transaction.

Submit the facts of the case to VA for a determination.

8. Lender Review of Sales Contracts on Proposed Construction

Change Date

April 5, 2012, Change 18
- This section has been updated to make minor grammatical edits.

a. Procedures

Prior to requesting an appraisal of proposed construction, the lender must review the sales contract or purchase agreement on the property. The lender must determine whether the contract:

- is acceptable, and
- does not contain unfair contractual provisions.

The lender may request revision of an unacceptable contract by the parties to the transaction.

The lender should report unacceptable contract practices by a VA program participant (such as a builder) to VA if:

- the program participant is engaged in practices which seriously prejudice the interests of veterans or the Government, or
- the program participant repeatedly uses unacceptable contracts or contracts containing unfair contractual provisions, and is uncooperative in changing such practices.

The closing of the loan indicates that the lender has determined the contract is acceptable.

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8. Lender Review of Sales Contracts on Proposed Construction, Continued

b. Examples of Unfair Contract Provisions or Features

Unfair contractual provisions or features include, but are not limited to, the information in the table below.

Example	Unfair Contract Provisions or Features
1	Provisions allowing the downpayment or earnest money of the purchaser to be forfeited or retained as liquidated damages if the purchaser cannot obtain VA financing.
2	Inclusion in a lump-sum contract of an "escalator clause" which obligates the purchaser to pay a higher price in the event of increased costs for labor, material, or other items prior to delivery of title unless accompanied by a proviso which gives the purchaser the option of canceling the contract and obtaining a refund of the moneys paid if the increased price is not acceptable to the veteran.
3	Provisions which infringe upon the usual or customary freedom or right of an owner to sell a property, except as allowed under 38 CFR 36.4308(e) and 36.4354(b)(5). For example, a provision that the purchaser will give a stated real estate agency an exclusive listing if he or she resells the property within 2 years after acquisition, or will give the seller or another a first option to buy other than in a cooperative housing project or as provided in 38 CFR 36.4354(b)(5).

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8. Lender Review of Sales Contracts on Proposed Construction, Continued

b. Examples of Unfair Contract Provisions or Features (continued)

Example	Unfair Contract Provisions or Features
4	A requirement that purchasers waive or release any claim or right for nonperformance by the builder under the contract. This does not prevent a builder from obtaining a statement from the purchaser at closing that he or she has inspected the house and has not observed any unsatisfactory construction, nor does it prevent the builder from obtaining a release from the purchaser in settlement of a bona fide dispute.
5	Omission of a description sufficient to identify accurately the property sold.
6	Omission of a provision specifying whether the builder or the veteran is to be charged with any special assessments or improvement bonds. This includes those assessments or bonds which are payable in the future, for improvements included in the plans and specifications or commenced or completed at the time of closing, such as streets, sidewalks, curbs, gutters, and sewers.
7	Omission of a date for completion of proposed construction or failure to give the veteran the option of canceling the contract and obtaining a refund of the deposit if the dwelling is not completed on a specified date or within a reasonable time afterwards.
8	Failure of a contract covering proposed construction to obligate the seller to complete the dwelling in substantial accordance with identified and definite plans and specifications.

9. Escrow for Postponed Completion of Improvements

Change Date

April 5, 2012, Change 18
- This section has been updated to make minor grammatical edits.

a. General

In some instances, it may not be possible to complete certain items before the veteran wishes to move into the property. The escrow of funds can permit the veteran-purchaser to gain occupancy of the dwelling prior to completion of certain items which must be postponed due to weather conditions or other circumstances. Such items include, but are not limited to:

- walkways, driveways, and retaining walls
- exterior painting
- landscaping
- garages

VA may permit the escrow of funds necessary to complete the unfinished work later, and still issue evidence of guaranty.

b. What is an Escrow?

An escrow involves the following:

- withholding 1 1/2 times the dollar amount necessary to complete the postponed items (as estimated by a third party) from the proceeds due the seller at closing
- holding the escrowing funds in a proper, secure manner, and
- releasing the funds once the postponed items have been satisfactorily completed

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9. Escrow for Postponed Completion of Improvements, Continued

c. What is Required to Establish an Escrow?

To establish an escrow, the following must apply:

- construction of the dwelling must be complete and the house must be suitable for immediate occupancy
- postponement of the improvements must be beyond the control of the builder/seller
- the duration of the postponement must not be unreasonable (usually 90 to 120 days)
- the amount escrowed must be at least 1 1/2 times an estimate of the amount needed to complete the work

d. When is an Escrow Not Required?

Lender's are not required to escrow funds when:

- the incomplete work is limited to the installation of landscaping features (lawns, shrubbery, etc.)
- the estimate of the cost to complete the work is not greater than $500, and
- there is adequate assurance that the work will be completed timely and satisfactorily (usually 90 to 120 days).

e. General Procedures

No prior approval of VA is required to escrow funds. Lenders are responsible for establishing escrows in accordance with the guidelines presented in this topic. Lenders are also responsible for assuring that the postponed work is completed. Once the loan closes, VA will randomly monitor cases to ensure completion of escrowed items.

Lenders escrowing funds should follow the procedures below:

Step	Action
1	Close loan and escrow the required funds.
2	Submit closed loan package for issuance of guaranty with: • lender evidence of escrow agreement, or • a completed VA Form 26-1849, Escrow Agreement for Postponed Exterior Onsite Improvements.

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9. Escrow for Postponed Completion of Improvements, Continued

e. General Procedures (continued)

Step	Action
3	Release escrowed funds when work is satisfactorily completed, as evidenced by doing the following: • Complete VA Form 26-1839, Compliance Inspection Report, indicating the postponed work has been satisfactorily completed, or • if the postponed work is minor, uncomplicated, and not involving structural issues, provide written certification from the lender indicating the work has been completed, and a statement from the veteran-purchaser that he or she is satisfied with the work.

Note: In cases involving postponed improvements which affect more than one loan by a lender in a tract development, VA Form 26-1849 will only be required for the initial loan to a veteran in the development.

f. Letters of Credit

A commercial letter of credit may be used in lieu of a cash escrow provided:

- the dollar amount of available credit is at least 1 1/2 times the estimated cost of the postponed work
- a trust agreement describing the duties, obligations, and responsibilities is submitted (VA Form 26-1849 may be used)
- the letter of credit is irrevocable and a valid and binding obligation on the issuing bank **and** extends at least six months beyond the date for completion of improvements
- a copy of the letter of credit and trust agreement is furnished to the appropriate VA office so a control can be maintained on the available credit

Note: A letter of credit acceptable to HUD which conforms to the standards above is also acceptable to VA. In such cases, the escrow agent or trustee must agree to keep VA informed of charges against the letter of credit.

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9. Escrow for Postponed Completion of Improvements, Continued

g. Surety Bonds Cash escrows are not required when the offsite improvements are to be installed by the builder, provided that:

- A surety bond acceptable to the local government authority provides assurance of the builder's obligation to install the offsite improvements.
- The amount of the bond is at least equal to the estimated cost of installing the offsite improvements.
- The local government provides VA evidence:
  - that the offsite improvements will be installed without cost or assessment to the purchasers of the abutting properties, and
  - if the builder does not complete the improvements by a specified date, the local government authority will be responsible for their completion, with no cost or assessment to the purchasers of properties affected by the improvements.
- The local government has provided evidence that it will be responsible for continuous maintenance of the completed offsite improvements.
- The principal law officer of the local authority advises VA that the local authority is legally empowered to assume these obligations.

10. Hazard Insurance

Change Date

April 5, 2012, Change 18
- This section has been updated to make minor grammatical edits.

a. General Requirements

The lender is responsible for ensuring that hazard insurance is obtained prior to loan closing, and maintained for the term of the loan. It must be of a type or types and in an amount sufficient to protect the property against risks or hazards to which it may be subjected in the locality.

Generally, the type(s) and amount of insurance coverage customary in the locality will satisfy this requirement.

Policies must provide that all amounts payable, including unearned premiums, shall be payable to the holder, or to a trustee or other person for the holder. All policy payments received for insured losses must be applied to the restoration of the security or to the loan balance.

b. Flood Insurance Requirements

The lender is responsible for ensuring that flood insurance is obtained and maintained on any building or personal property that secures a VA loan if the property is located in a special flood hazard area (SFHA), as identified by the Federal Emergency Management Agency (FEMA).

- The lender/holder's responsibility extends through the entire term of the loan, and includes insuring any secured property that becomes newly located in a SFHA due to FEMA remapping.
- The VA appraiser's opinion on whether the property is located in a SFHA does not relieve the lender from responsibility for ensuring flood insurance coverage on a property which is in fact located in a SFHA.
- Personal property requiring coverage can include a manufactured home and its appliances, carpet, etc. if they secure the loan.
- The amount of flood insurance must be equal to the lesser of the outstanding principal balance of the loan or the maximum limit of coverage available for the particular type(s) of property under the National Flood Insurance Act.
- Contact local property insurance agents or brokers, or FEMA regional offices, for current information on maximum available coverage.

Note: VA cannot guarantee a loan if the security is located in a SFHA and flood insurance is not available.

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10. Hazard Insurance, Continued

c. Unavailable or Terminated Insurance

If it is not possible to obtain and maintain insurance on the property, contact VA. VA will determine whether to waive the requirement or declare the (existing) loan to be in default.

d. Consequences of Uninsured Losses

VA may reduce a future guaranty claim based on the lender's noncompliance with VA hazard/flood insurance requirements which results in uninsured losses (unless a waiver has been granted).

e. VA Determination of the Amount of Insurance Required

The lender may request VA to determine the minimum insurance coverage needed to meet the requirements of 38 CFR 36.4326 for a specific loan.

If the required amount of coverage is maintained, no future guaranty claim can be reduced due to inadequate coverage provided there has been no change in the nature, value, or use of the security that would require new or additional coverage (based on what is customary in the locality) since VA's determination was made.

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10. Hazard Insurance, Continued

f. Special Considerations with Homeowners Associations

Condominiums and many townhouse homeowners associations (HOAs) maintain blanket or master policies on common areas, including common mechanical and structural elements. The limits of coverage should be described in the policy, and may also be referred to in the organizational documents.

Lenders should be aware that policies maintained by some HOAs may not provide adequate coverage. They may protect only the shell of the structure. These "studs out" policies do not cover:

- interior walls
- flooring
- plumbing or electrical fixtures
- cabinets
- Heating, Ventilation, and Air Conditioning (HVAC) equipment
- appliances, and
- other items considered part of the real property

Carefully review the terms of each blanket policy, or confirm with the HOA that adequate coverage is in effect (and check periodically for any changes in coverage). If coverage is inadequate, the homeowner can be held responsible through the terms of the loan instruments, for maintaining coverage on the portions of the real property not covered by the master policy.

11. Escrow for Taxes and Insurance

Change Date

September 15, 2004, Change 4
This section has been changed to create subsection lettering.

a. Requirements

VA does not require the lender to establish escrow accounts for the collection and payment of property taxes, hazard insurance premiums, and similar items. However, it is the lender's responsibility to ensure that these items are paid timely.

A lender who chooses to escrow for taxes and insurance must comply with applicable laws, including the Real Estate Settlement Procedures Act (RESPA).

12. Homebuyer Assistance Program

Change Date

April 5, 2012, Change 18

- This section has been added to provide homebuyer assistance program information.

a. General Information

VA permits veteran purchasers to utilize homebuyer assistance program services when obtaining a VA home loan. Both government and private entities administer homebuyer assistance programs. Homebuyer assistance programs that are administered by a state, county, or municipal government entity have blanket approval for use with VA loans. Lenders are not required to obtain VA approval of such programs before closing the loan. These state and local programs are not to be confused with the Department of Defense homebuyer assistance program.

b. Requirements

Lenders making VA loans involving homebuyer assistance programs must ensure the following:

- The borrower(s) must meet VA credit standards.
- The lender must obtain a VA appraisal and the property must meet VA minimum property standards.
- If the sale price of the property exceeds the VA reasonable value of the property, VA will only allow homebuyer assistance program assistance in the form of a grant to pay the difference. Otherwise the veteran must pay the difference of price over value from his or her own funds without borrowing.
- Homebuyer assistance programs often require buyers to occupy the property for a specified period of time. The lender must, at closing, obtain the borrower's acknowledgement of this requirement, and provide a copy of the signed acknowledgement if VA requests the loan file for review.

Continued on next page

12. Homebuyer Assistance Program, Continued

c. HAP Fees

Generally, veterans may pay homebuyer assistance program required fees; however, lenders should contact their Regional Loan Center of jurisdiction for approval of any individual HAP fee to the buyer that exceeds $250.

***Note*:** Chapter 8 of the VA Lenders Handbook lists closing charges that veterans are not allowed to pay when a one-percent loan origination fee is charged. Since homebuyer assistance programs are designed to assist low to moderate income buyers, lenders may not charge veteran-borrowers unallowed fees and use homebuyer assistance program funds to offset these charges since this practice dilutes the assistance that the HAP was intended to provide.