CHAPTER 7: LOANS REQUIRING SPECIAL UNDERWRITING, GUARANTY, AND OTHER CONSIDERATIONS

Overview

Topic 1: Joint Loans

Change Date: March 11, 2019

- This chapter has been revised in its entirety.

a. What is a VA Joint Loan?

"Joint loan" generally refers to a loan for which the:

- Veteran and other person(s) are liable, and
- Veteran and the other obligor(s) own the security.

A joint loan is a loan made to the:

- Veteran and one or more non-Veterans (not spouse),
- Veteran and one or more Veterans (not spouse) who will not be using their entitlement,
- Veteran and the Veteran's spouse who is also a Veteran, and both entitlement will be used; or
- Veteran and one or more other Veterans (not spouse), all of who will use their entitlement.

A loan involving a Veteran and his or her spouse will not be treated as a "joint loan" if the spouse is:

- not a Veteran, or
- a Veteran who will not be using his or her entitlement on the loan.

A loan to a Veteran and fiancé who intend to marry prior to loan closing and take title as Veteran and spouse will be treated as a loan to a Veteran and spouse (conditioned upon their marriage), and not a joint loan.

b. Regulations

The regulations in 38 C.F.R. 36.4307 address joint loans.

c. Terminology Used in This Section

For purposes of applying the principles explained in this section, this term will also be used to represent any other type of joint loan involving at least one Veteran using his or her entitlement, and at least one other person not using entitlement (can be a Veteran or a non-Veteran, but not a spouse).

Examples

- Three Veterans using entitlement and one non-Veteran
- One Veteran using entitlement and four non-Veterans
- Two Veterans using entitlement and two Veterans not using entitlement

Two Veterans Joint Loan: Commonly meaning a loan involving two Veterans who are not married to each other and both are using their entitlement.

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Topic 1: Joint Loans, continued

c. Terminology Used in This Section, continued

For purposes of applying the principles explained in this section, this term will also be used to represent any other type of joint loan involving only Veterans, each of whom uses his or her entitlement.

This may also include loans to the following:

- The Veteran and the Veteran's spouse who is also a Veteran, if both entitlements will be used.
- Entitlement and funding fees are separate. Funding fees are always calculated equally by the number of people on the loan. It is based on each Veteran paying their equal share of the loan.
- On a Veteran/non-Veteran loan, the funding fee is based on half of the base loan amount, downpayment, and sales price for the correct funding fee charge.
- VA will only guarantee the Veteran's portion of the total loan amount.

d. Occupancy

The Veteran using entitlement on a joint loan must certify intent to personally occupy the property as his or her home.

e. How Many Units Can the Property Have?

If a property is to be owned by two or more eligible Veterans, it may consist of four family units and one business unit, plus one additional unity for each Veteran participating in the ownership. Thus, two Veterans may purchase or construct residential property consisting of up to six family units (the basic four units plus one unit for each of the two Veterans), and one business unit.

If the property contains more than four family units plus one family unit for each Veteran participating in the ownership and/or more than one business unit, the loan is not eligible for guaranty.

f. Which Joint Loans Require Prior Approval?

Any joint loan for which the Veteran will hold title to the property and any person other than the Veteran's spouse must be submitted for prior approval.

Any loan for which the Veteran and Veteran's spouse will hold title to the property: whether or not the spouse also uses entitlement, may be closed automatically by the lender with automatic authority. This type of joint loan does not have to be submitted for prior approval.

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Topic 1: Joint Loans, continued

g. How to Underwrite a Joint Loan

The following underwriting considerations apply:

Table 1: Underwriting Considerations for Joint Loans

Type of Joint Loan	Underwriting Considerations Function
Two Veteran Joint Loan	Consider the credit and combined income and assets of both parties. Strengths of one Veteran related to income and/or assets may compensate for income/asset weaknesses of the other. However, satisfactory credit of one Veteran cannot compensate for the other's poor credit.
Veteran/Non-Veteran Joint Loan	Veteran's credit must be satisfactory, and the Veteran's income must be sufficient to repay that portion of the loan allocable to the Veteran. The credit of the non-Veteran must be satisfactory. However, the combined income of both borrowers can be considered in evaluating repayment ability. In other words: • income strength of the Veteran may compensate for income weakness of the non-Veteran, but • income strength of the non-Veteran cannot compensate for income weakness of the Veteran in analyzing the Veteran's ability to repay his or her allocable portion of the loan.

h. How to Calculate Guaranty and Entitlement Use on Veteran/Non-Veteran Joint Loans

Guaranty is limited to that portion of the loan allocable to the Veteran's equal interest in the property.

Percentage of entitlement has no bearing on the amount of the funding fee to be paid. (See Chapter 8).

The lender must satisfy itself that the requirements of its investor or the secondary market can be met with this limited guaranty.

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Topic 1: Joint Loans, continued

i. Procedure

Table 2: Procedure for Calculating Guaranty and Entitlement Use for Veteran/Non-Veteran Joint Loans

Step	Action
1	Divide the total loan amount by the number of borrowers.
2	Multiply the result by the number of Veteran-borrowers who will be using entitlement on the loan. There is usually only one Veteran borrower, in which case the result of this Step is the same as the result of Step 1.
3	Calculate the maximum potential guaranty on the portion of the loan arrived at in Step 2 (as if that portion was the total loan).
4	VA will guarantee the lesser of: • the maximum potential guaranty amount arrived at in Step 3, or • the combined available entitlement of all Veteran-borrowers.
5	VA makes a charge to the Veteran-borrower's available entitlement in the amount of the guaranty. If more than one Veteran is involved, VA divides the entitlement charge equally between them, if possible. If only unequal entitlement is available, unequal charges may be made with the written agreement of the Veterans.

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Topic 1: Joint Loans, continued

j. Examples

Veteran/Non-Veteran Loans

Table 3: Examples of Guaranty and Entitlement Use on Veteran/Non-Veteran Loans

Borrowers and Available Entitlement	Total Loan Amount	Veteran's Portion	Maximum Potential Guaranty on Veteran's Portion	Entitlement Charge T=Total
Veteran $36,000 Non-Veteran $0	$100,000	$50,000	$22,500	$22,500
Veteran $36,000 Non-Veteran $0	$290,000	$145,000	$36,250	$36,250
Veteran $27,500 Veteran $36,000 Non-Veteran $0	$108,000	Total for both Veterans $72,000	Total for both Veterans $28,800	$14,400 $14,400 T=$28,800
Veteran $25,000 Veteran $11,000 Non-Veteran $0	$201,000	Total for both Veterans $134,000	$36,000	$25,000 $11,000 T=$36,000

Note: The last example would require a written agreement from the Veterans to make unequal charges to their entitlement.

Table 4: Quick Reference for Calculation Used

Step	Action
1	Divide the total loan amount by the number of borrowers.
2	Multiply the result by the number of Veterans using entitlement.
3	Calculate the maximum potential guaranty on the portion of the loan arrived at in Step 2, using the maximum guaranty table in Chapter 3 of this handbook.
4	VA will make a charge to entitlement up to the amount arrived at in Step 3. • VA will divide the charge equally between multiple Veterans, if possible. • If Step 2 is greater than $144,000, additional entitlement may be added to each Veteran's entitlement.

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Topic 1: Joint Loans, continued

k. How to Calculate Guaranty and Entitlement Use on Two Veteran Joint Loans?

As with a non-joint loan, the potential maximum guaranty on a joint loan is calculated based on the total loan amount.

l. Procedure

VA Calculates the maximum potential guaranty on the total loan amount.

Table 5 Procedure for Calculating Guaranty and Entitlement Use for Two Veteran Joint Loans

Step	Action
1	Calculate the maximum potential guaranty on the total loan amount. Use the maximum guaranty table in Chapter 3 of this Handbook.
2	VA will guarantee the lesser of: • the maximum potential guaranty amount arrived at in Step 1, or • the combined available entitlement of all Veteran-borrowers. If the loan amount is greater than $144,000, additional entitlement may be added to each Veteran's entitlement. If possible, VA will use this additional entitlement to arrive at equal entitlement charges for the Veterans involved.
3	VA will make charges to the Veterans' available entitlement which total the maximum guaranty arrived at in Step 1, or the total of their available entitlement if less than the maximum potential guaranty. VA will divide the entitlement charge equally between the Veterans if possible, or, if only unequal entitlement is available, unequal charges may be made with the Veterans' written agreement. ***Exception***: VA will make the entitlement charge for husband and wife Veterans according to their preference.

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Topic 1: Joint Loans, continued

m. Examples of Two-Veteran Joint Loans

Table 6: Examples of Two-Veteran Joint Loans

Veterans and Available Entitlement	**Total Loan Amount**	**Maximum Potential Guaranty**	**Entitlement Charge Per Veteran**
Veteran 1 $36,000 Veteran 2 $36,000	$100,000	$36,000	$18,000 $18,000
Veteran 1 $25,500 Veteran 2 $8,500	$80,000	$32,000	$23,500 $8,500
Veteran 1 $36,000 Veteran 2 $36,000	$300,000	$75,000	$37,500 $37,500
Veteran 1 $15,000 Veteran 2 $20,000	$203,000	$50,750	$25,375 $25,375
Veteran 1 $0 Veteran 2 $0 Veteran 3 $6,500	$300,000	$75,000	$25,000 $25,000 $25,000

A written agreement from the Veterans is required whenever there is unequal entitlement usage.

o. Certificate of Commitment

For joint loans involving one or more non-Veterans the:

- loan amount shown on the commitment is limited to the Veteran's portion of the loan, and
- percentage of guaranty is based on the ratio of the amount of entitlement the Veteran has available to the Veteran's portion of the loan.

VA will issue the Certificate of Commitment with a reminder that:

- no part of the guaranty applies to the portion of the loan allocated to the non-Veteran, and
- in the event of the foreclosure where a loss is sustained, the holder must absorb any loss attributable to the non-Veteran's portion of the loan.

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Topic 1: Joint Loans, continued

p. Loan Guaranty Certificate (LGC)

The "Amount of Loan" reflects only the Veteran's portion of the loan.

If more than one Veteran used entitlement on the loan, it will reflect the total of all portions allocable to those Veterans.

The lender must satisfy itself that the requirements of its investor or the secondary market can be met with this limited guaranty.

Whereas the whole loan amount will appear on the mortgage security documents; that is, mortgage note or deed of trust, only the Veteran's portion is shown on the Certificate of Commitment and the LGC.

q. Equal Credit Opportunity Act Considerations (ECOA)

The applicability of the guaranty to only a portion of the loan in the case of a Veteran/non-Veteran joint loan may cause a lender to refuse to accept an application for such loan.

This may appear to conflict with the ECOA prohibition against discrimination based on marital status; however, the lender may refuse the application under these circumstances without violating ECOA.

This is based on an exemption for VA being a special purpose credit program.

r. Calculation of the Funding Fee

Apply the appropriate funding fee percentage to any portion of the loan allocable to a Veteran using his or her entitlement who is not exempt from the funding fee. Determine the appropriate percentage for the type of Veteran involved from the funding fee tables in Chapter 8.

Example. On a no-downpayment loan to two Veterans; on a first-time homebuyer; and on a subsequent user; the funding fee percentages of 2.15 percent and 3.3 percent respectively would each be applied to one-half of the loan amount.

No funding fee will be assessed on any portion of a joint loan allocable to a:

- Non-Veteran
- Veteran who did not use his or her entitlement, or
- Veteran who used his or her entitlement, but is exempt from the funding fee.

Downpayment. The actual loan amount is allocated equally between the borrowers for purposes of calculating the funding fee, whether or not a downpayment is made, and regardless of where the funds for such a downpayment come from.

Example. On a Veteran/non-Veteran loan, the non-Veteran makes a $5,000 (five percent) downpayment out of his cash resources, to purchase a $100,000 property, resulting in a $95,000 loan amount. The Veteran is a first-time homebuyer. The Veteran must pay a funding fee of $712.50, based on 1.5 percent of his/her $47,500 portion.

If situations arise which are not addressed here, contact 1-877-827-3702 for assistance.

Topic 2: Construction/Permanent Loans

Change Date: March 11, 2019

- This chapter has been revised in its entirety.

a. The Basics

VA will guarantee a "construction/permanent home loan," that is, a loan to finance the construction/purchase of a residence. The loan is closed prior to the start of construction with proceeds disbursed to cover the cost of, or balance owed on, the land, and the balance into escrow. The escrowed monies are paid out to the builder during construction.

The lender must obtain written approval from the borrower before each draw payment is provided to the builder. The loan will not be guaranteed until construction is complete and all Notice of Value (NOV) conditions are met.

This section does not address other construction loans guaranteed by VA; that is, those for the purchase of a residence newly constructed for the Veteran by a builder who financed the construction from his or her own resources.

Lenders should have the specialized experience to originate, process, underwrite (borrower, project, and builder), close, service and administer such loans. These types of loans and projects inherently have uncertain elements that require careful examination.

Table 7: Basic Comparison of Construction Loans

Construction to Permanent (One Closing Vehicle)	Construction to Permanent Purchase (Two Part Closing Vehicle)	Refinance Construction Loans
• Once loan vehicle is established it cannot be modified into a different loan vehicle • Can utilize bonus entitlement • See Chapter 10 of this Handbook for appraisal guidance • Loan closed before start of construction • Guarantee cannot be issued until construction is 100% complete	• Once loan vehicle is established, it cannot be modified into a different loan vehicle • Can utilize bonus entitlement • See Chapter 10 of this Handbook for appraisal guidance • Loan closed after the NOV conditions are met	• Can utilize bonus entitlement • VA regular refinance (cash- out) policies apply

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Topic 2: Construction/Permanent Home Loans, continued

b. Amortization

The Veteran begins making payments on a construction/permanent home loan only after construction is complete. Therefore, the initial payment on the principal may be postponed up to 1 year, if necessary. The loan must be amortized to achieve full repayment within its remaining term. The lender must provide evidence of the amortization in the loan file.

Example. If it takes 6 months to complete construction, the payment schedule for the Veteran obtaining a 30-year mortgage must provide for full repayment of the loan in 29 years and 6 months.

Rather than requiring a balloon payment, it may be preferable to set up equal payments (beginning after construction is complete) which are large enough to repay the loan within the original maturity without a balloon payment.

The VA requirement that loans be amortized with approximately equal payments and the principal must be reduced at least once annually, also applies to construction loans. However, the final installment may be for an amount up to five percent of the original principal amount of the loan.

c. What the Builder Must Pay?

On a construction/permanent home loan, the builder is responsible for Interest payments during the construction period, and all fees normally paid by a builder who obtains an interim construction loan including, but not limited to:

- inspection fees,
- title updates,
- title update fees,
- hazard insurance during construction, and
- property taxes.

d. Interest Rate

Lender's may offer a "ceiling-floor" where the Veteran "floats" the interest rate during construction. The agreement must provide that at lock-in, the permanent interest rate will not exceed a specific maximum interest rate and permit the borrower to lock-in at a lower rate based on market fluctuations.

The borrower must qualify for the mortgage at the maximum rate.

e. What Fees the Veteran Can Pay?

Fees the Veteran can pay are described in Chapter 8. The Veteran may not pay any fees that are the builder's responsibility.

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Topic 2: Construction/Permanent Home Loans, continued

f. Funding Fee and Loan Reporting

The funding fee is due and payable to VA within 15 days of loan closing; that is not tied to the commencement or completion of construction. The loan must be guaranteed in WebLGY within 60 days of completion of all NOV requirements.

g. LGC

Although the loan will normally be considered guaranteed upon closing, the LGC on a construction/permanent home loan will not be issued until a clear final compliance inspection report has been received by VA.

h. If Loan Proceeds are Not Fully Disbursed

If the construction is not fully completed and loan proceeds are not fully disbursed, guaranty will apply only to the proper pro rata part of the loan. To calculate the proper pro rata part of the loan:

- take loan proceeds disbursed for construction purposes,
- add any other payments made to the builder by or on behalf of the Veteran,
- take the lesser of the above total or 80 percent of the value of that portion of the construction completed, and
- add any loan disbursements made for the purchase of the land on which the construction is situated.

Topic 3: Energy Efficient Mortgages

Change Date: March 11, 2019

- This chapter has been revised in its entirety.

a. What are EEMs?

Energy Efficient Mortgages (EEMs) are loans to cover the cost of making energy efficiency improvements to a dwelling. They can be made in conjunction with a:

- VA loan for the purchase of an existing dwelling, or
- VA refinancing loan secured by the dwelling.

Acceptable energy efficiency improvements include, but are not limited to:

- solar heating systems, including solar systems for heating water for domestic use;
- solar heating and cooling systems;
- caulking and weather-stripping;
- furnace efficiency modifications limited to replacement burners, boilers, or furnaces designed to reduce the firing rate or to achieve a reduction in the amount of fuel consumed as a result of increased combustion efficiency, devices for modifying flue openings which will increase the efficiency of the heating system, and electrical or mechanical furnace ignition systems which replace standing gas pilot lights;
- clock thermostats;
- new or additional ceiling, attic, wall and floor insulation;
- water heater insulation;
- storm windows and/or doors, including thermal windows and/or doors;
- heat pumps; and
- vapor barriers.

b. Borrower Notice on the NOV

Information on EEMs is provided to a Veteran who applies for a loan which requires an NOV (a loan for a home purchase or regular "cash-out" refinance).

The NOV includes the following notice to the Veteran:

"The buyer may wish to contact a qualified person/firm for a home energy audit to identify needed energy efficiency improvements to the property. In some localities, the utility company may perform this service. The mortgage amount may be increased as a result of making energy efficiency improvements such as: Solar or conventional heating/cooling systems, water heaters, insulation, weather-stripping/caulking, and storm windows/doors. Other energy related improvements may also be considered."

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Topic 3: Energy Efficient Mortgages, continued

b. Borrower Notice on the NOV, continued

The mortgage may be increased by:

- Up to $3,000 based solely on the documented costs,
- Up to $6,000 provided the increase in monthly mortgage payment does not exceed the likely reduction in monthly utility costs, or
- VA does **not** permit EEMs more than $6,000 (38 U.S.C. §3710(d)).

c. Underwriting Considerations

Energy efficiency improvements up to $3,000: The resulting increase in loan payments will normally be offset by a reduction in utility costs.

Energy efficiency improvements more than $3,000, up to $6,000: The lender must make a determination that the increase in monthly mortgage payments does not exceed the likely reduction in monthly utility costs, and must rely on locally available information provided by utility companies, municipalities, state agencies or other reliable sources, and document the determination.

Energy efficiency improvements in conjunction with an Interest Rate Reduction Refinancing Loan (IRRRL). If the monthly payment (Principal, Interest, Taxes, and Insurance (PITI)) for the new loan exceeds the PITI of the loan being refinanced by 20 percent or more, the lender must certify to having determined that the Veteran qualified for the higher payment.

d. Documentation Required with Closed Loan Package

<u>Energy efficiency improvements up to $3,000</u>: Evidence of the cost of improvements such as a copy of the bid(s) or contract itemizing the improvements and their cost.

<u>Improvements more than $3,000, up to $6,000</u>: Evidence of the cost of improvements such as a copy of the bid(s) or contract itemizing the improvements and their cost, and the lender's determination that the increase in monthly mortgage payments does not exceed the likely reduction in monthly utility costs.

<u>IRRRL with significant increase in payments</u>: If the cost of the improvements cause the new loan payment (PITI) to be 20 percent or higher than the old payment (on the loan being refinanced), then include the lender's certification that it has determined that the Veteran qualified for the higher payment.

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Topic 3: Energy Efficient Mortgages, continued

e. How to Calculate Guaranty and Entitlement Use?

Guaranty is calculated on an EEM as described in the following table.

Table 8: How to Calculate Guaranty and Entitlement Use for EEM

Step	Action
1	Calculate guaranty on the loan without the portion attributable to the energy efficiency improvements.
2	Calculate guaranty on the energy efficiency improvements portion by applying the same percentage used in Step 1.
3	Add the results of Steps 1 and 2 to arrive at guaranty on the entire loan.

However, the Veteran's entitlement will **only** be charged the amount arrived at in Step 1; it is based upon the loan amount **before** adding the cost of the energy efficiency improvements.

Example 1: If a Veteran has full entitlement and applies for a loan of $80,000, plus $6,000 in energy efficiency improvements, VA will guarantee 40 percent of the full loan amount of $86,000. Thus, the dollar amount of the guaranty will be $34,400, even though the charge to the Veteran's entitlement is only $32,000.

Example 2: If a Veteran with full entitlement applies for a $144,000 loan to purchase a home, and adds $6,000 in energy efficiency improvements, the 25 percent guaranty on the loan will only require the use of $36,000 entitlement, but the dollar amount of guaranty will be $37,500.

f. How to Calculate the Funding Fee

Calculate the funding fee based on the full loan amount including the cost of the energy efficiency improvements.

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g. Improvements Not Completed Before Closing

If the energy efficiency improvements are not completed before closing, the lender may establish an escrow and close the loan.

- A formal escrow is not required.
- Only the amount needed to complete the improvements must be withheld.

Check the appropriate block in item 23, VA Form 26-1820, Report and Certification of Loan Disbursement.

- No additional documentation concerning the escrowed/earmarked funds must be submitted when reporting the closed loan.

Generally, the improvements should be completed within 6 months from the date of loan closing.

Provide written notification to VA when improvements are completed and the escrow funds are disbursed. Escrow requirements concerning completion of improvements are listed in Chapter 9 of this handbook.

- Assure the funds are properly applied to the costs of improvements.

If, after a reasonable time, the lender determines that the improvements will not be completed:

- Apply the balance of the escrowed/earmarked funds to reduce the principal balance on the loan, and
- Provide written notification to VA that this has been done.

h. Reimbursement to the Veteran out of IRRRL Proceeds

The Veteran generally may not obtain cash proceeds from an IRRRL.

There is **one** exception. Up to $6,000 of IRRRL loan proceeds may be used to reimburse the Veteran for the cost of energy efficiency improvements completed within the 90 days immediately preceding the date of the loan.

Topic 4: Loans for Alteration and Repairs

Change Date: March 11, 2019

- This chapter has been revised in its entirety.

a. Description

VA may guarantee a loan for alteration and repair:

- Of a residence already owned by the Veteran and occupied as a home, or
- Made in conjunction with a purchase loan on the property.

The alterations and repairs must be those ordinarily found on similar property of comparable value in the community.

b. Value Considerations

The cost of alterations and repairs to structures may be included in a loan for the purchase or regular "Cash-Out" refinance of improved property to the extent that their value supports the loan amount.

Topic 5: What is a Supplemental Loan

Change Date: March 11, 2019

- This chapter has been revised in its entirety.

a. What is a Supplemental Loan?

A supplemental loan is a loan for the alteration, improvement, or repair of a residential property. The residential property must secure an existing VA- guaranteed loan, and be owned and occupied by the Veteran, or the Veteran will reoccupy upon completion of major alterations, repairs, or improvements.

The alterations, improvements, or repairs must:

- Be for the purpose of substantially protecting or improving the basic livability, or utility of the property, and
- Be restricted primarily to the maintenance, replacement, improvement or acquisition of real property, including fixtures.

Installation of features such as barbecue pits, swimming pools, etc., does not meet this requirement.

No more than 30 percent of the loan proceeds may be used for the maintenance, replacement, improvement, repair, or acquisition of non- fixtures or quasi-fixtures such as refrigeration, cooking, washing, and heating equipment. The equipment must be related to or supplement the principal alteration for which the loan is proposed.

b. Required Lien and Maximum Loan Term

It is the lender's responsibility to obtain an effective lien of the required dignity (lien position).

Possible methods to secure a supplemental loan are:

- Through an open-end provision of the instrument securing the existing loan,
- Through an amendment of the existing loan security instrument,
- By taking a new lien to cover both the existing and the supplemental loans, or
- By taking a separate lien immediately junior to the existing lien.

The maximum loan term is:

- 30 years if amortized, or
- 5 years if not amortized.

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Topic 5: What is a Supplemental Loan, continued

c. Other Requirements

The existing loan must be current with respect to taxes, insurance, and amortized payments, and must not otherwise be in default unless a primary purpose of the supplemental loan is to improve the ability of the borrower to maintain the loan obligation.

The making of a supplemental loan can never result in any increase in the rate of interest on the existing loan.

A supplemental loan to be written at a higher rate of interest than that payable on the existing loan must be evidenced by a separate note from the existing loan.

d. Prior Approval or Automatic Loan Closing

A supplemental loan will require the prior approval of VA if the:

- loan is to be made by a lender that does not have authority to close loans on an automatic basis or
- loan is to be made by a lender that does not have authority to close loans on an automatic basis; or
- an obligor liable on the currently outstanding obligation will be released from personal liability by operation of law or otherwise.

e. Procedures

Submit a statement describing the alterations, improvements, or repairs made or to be made with the prior approval application (or loan closing package, if closed automatically). In addition, report the amount outstanding on the existing loan as of the date of closing of the supplemental loan in the loan closing package.

If the cost of the repairs, alterations, or improvements exceeds $3,500: an NOV and compliance inspections are required.

If the cost of the repairs, alterations, or improvements does not exceed $3,500: an NOV and compliance inspections are not required. Instead, a statement of reasonable value may be submitted. The statement must be completed and signed by a VA-designated appraiser. A VA-designated appraiser is an individual nominated by the lender (who may be an officer, trustee, or employee of the lender or its agent) who has been approved by the local VA office.

The statement must specify the:

- work done or to be done,
- purchase price or cost of the work and material, and
- purchase price or cost does not exceed the reasonable value.

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Topic 5: What is a Supplemental Loan, continued

e. Procedures, continued

In lieu of VA compliance inspections, the lender must submit a certification as follows:

"The undersigned lender certifies to the Department of Veterans Affairs that the property as repaired, altered, or improved has been inspected by a qualified individual designated by the undersigned, and based on the inspection report, the undersigned has determined that the repairs, alterations, or improvements financed with the proceeds of the loan described in the attached VA Form 26-1820, appear to have been completed in substantial conformance with related contracts."

f. Guaranty and Entitlement

If the supplemental loan will not be consolidated with a related outstanding guaranteed loan the:

- Veteran must have sufficient entitlement for the new loan, and
- VA will issue a new LGC solely for supplemental loans.

If the supplemental loan will be consolidated with a related outstanding guaranteed loan, VA will issue a new modified guaranty certificate.

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Topic 5: What is a Supplemental Loan, continued

g. Procedure

If the Veteran has no available entitlement, VA can still guarantee the supplemental loan provided the lender is the holder of the Veteran's existing loan and the loans are to be consolidated.

The amount of the modified guaranty will be the maximum guaranty effective on the existing loan at the time the supplemental loan is closed.

To calculate the percentage of guaranty applicable to the combined indebtedness take the result of Step 1, and divide by the result of Step 3.

Follow the steps in the table below to calculate the percentage of guaranty applicable to the combined indebtedness.

Table 9: Supplemental Loan Procedure

Step	Action
1	Take the balance of the existing loan at the time of closing of the supplemental loan and multiply by the percentage of guaranty for the existing loan, as shown on the guaranty certificate.
2	Calculate the amount of guaranty that would be issued on the supplemental loan as an independent loan (do not exceed the amount of entitlement available to the Veteran).
3	Take the balance of the existing loan and add the amount of the supplemental loan.
4	Take the result of Step 1 above and add the result of Step 2 above.
5	Divide by the result of Step 3 above.

Topic 6: Adjustable-Rate Mortgages

Change Date: March 11, 2019

- This chapter has been revised in its entirety.

a. General Information Concerning ARMs

An ARM loan offers adjustable interest rates based on negotiated initial fixed interest rates coupled with periodic adjustments to the interest rate over time. Hybrid ARMs have longer initial fixed rates of 3, 5, 7, or 10 years, while a “traditional” ARM allows for an annual adjustment after 1 year.

b. Interest Rate Adjustments

Traditional ARMs: Interest rate adjustments occur on an annual basis. The annual interest rate adjustments are limited to a maximum increase or decrease of one percentage point. Additionally, interest rate increases are limited to a maximum of five percentage points over the life of the loan.

Hybrid ARMs: If the initial contract interest rate remains fixed for less than 5 years, the initial adjustment is limited to a maximum increase, or decrease of one percentage point and the interest rate increase over the life of the loan is limited to five percentage points.

If the initial contract interest rate remains fixed for 5 years or more, the initial adjustment will be limited to a maximum increase or decrease of two percentage points and the interest rate increase over the life of the loan will be limited to six percentage points.

c. Underwriting an ARM

ARM loans that may adjust after 1 year must be underwritten at one percentage point above the initial rate.

Hybrid ARMs with a fixed period of 3 or more years may be underwritten at the initial interest rate

Topic 7: Loans Involving Temporary Interest Buydowns

Change Date: July 27, 2023

- Subsection b. has been updated to clarify when a temporary buydown may be used in conjunction with a VA-guaranteed loan and how escrowed funds are to be held.
- Subsection c. has been updated to clarify buydown payment schedules.
- Subsection d. has been updated to clarify how to underwrite loans involving a temporary buydown.
- Subsection e. has been added to include information on when a temporary buydown is considered a seller concession.

a. Description

VA generally allows two types of temporary interest rate buydowns. One is a marketing tool, where builders, sellers, or lenders establish and fund escrows to temporarily reduce a borrower's loan payments during the initial years of the loan. A second is where a borrower funds an escrow account for herself/himself as a financial management tool. Lenders may not fund or establish a temporary buydown by charging an above market interest rate.

VA can guaranty loans involving temporary interest rate buydowns, provided that the loan meets all other applicable requirements.[1]

In VA's home loan programs, temporary interest rate buydowns can only be used in conjunction with fixed rate loans.

b. Escrow Agreement

Funds must be held in a segregated escrow account. The lender is responsible for ensuring that the escrowed funds are legally protected and used only for payments due under the note. The funds may not be used to pay past due monthly loan payments, or for any other purpose. If the loan is foreclosed or prepaid, the funds must be credited against the Veteran's indebtedness. The funds may not revert to the party that established the escrow. If the property is sold subject to, or on an assumption of the loan, the escrow must continue to pay out on behalf of the new borrower.

It is the lender's responsibility to review and determine the acceptability of the buydown and ensure that it complies with all applicable federal and state laws. Lenders must provide the Veteran with a clear, written explanation of the buydown agreement. A copy of the buydown and escrow agreements, signed by the Veteran, must be maintained in the lender's loan file.[2] Lenders must submit such agreements to VA if the loan is selected for review.

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[1] See 38 U.S. Code § 3703(c) (authorizing guaranteed loans with interest rates agreed upon by the Veteran and lender).
[2] 38 C.F.R. 36.4333.

c. Buydown Payment Schedule

The monthly buydown payments must run for a minimum of 1 year and cannot exceed a maximum of 3 years. Common frameworks for temporary buydowns are 3-2-1 (3 years) and 2-1 (2 years). Reductions in the buydown payments must be scheduled to occur annually, i.e., on the anniversary date of the first loan payment due date. A reduction in the buydown payment means the Veteran's monthly loan payment will increase. To avoid serious financial disruption, VA limits the increase in the Veteran's payment to an amount that corresponds to a one-percent interest rate increase (effective interest rate).

Annual increases can be rate-based or payment-based. If rate-based, the Veteran's payment increase can correspond to equal annual increases in the effective interest rate. If payment-based, the Veteran's monthly loan payments must increase in equal or approximately equal dollar amounts, year over year. Please see the examples below.

Example of equal interest rate increase: A Veteran obtains a $300,000, 30-year home loan, at an interest rate of 5%, with a two-year, 2-1 temporary buydown. The total monthly amount due under the note is $1,610. In year one, the Veteran's effective interest rate will be 3%, and in year two the Veteran's effective interest rate will be 4%. In year three, the buydown period is over and the Veteran will start making payments at the full interest rate of 5%. The Veteran's effective interest rate increased by the same amount, i.e., 1 percentage point, for each annual adjustment.

Table 10: Example of an Equal Interest Rate Increase

Year	Effective Interest Rate	Veteran Payment	Monthly Buydown Contribution	Total Payment
1	3%	$1,265	$345	$1,610
2	4%	$1,432	$178	$1,610
3-30	5%	$1,610	$0	$1,610

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Topic 7: Loans Involving Temporary Interest Buydowns, continued

c. Buydown Payment Schedule, continued

Example of equal monthly payment increase: A Veteran obtains the same loan described in the example above. In year one, the Veteran's monthly payment is $1,305 per month with $305 per month coming from the buydown escrow. In year two, the Veteran's monthly payment is $1,457 per month with $153 per month coming from the buydown escrow. In year three, the buydown period is over and the Veteran's monthly payment is $1,610. The Veteran's monthly payment increased by approximately the same amount, i.e., $153 per month, for each annual adjustment.

Table 11: Example of an Equal Monthly Payment Increase

Year	Effective Interest Rate	Veteran Payment	Monthly Buydown Contribution	Total Payment
1	3.25%	$1,305	$305	$1,610
2	4.14%	$1,457	$153	$1,610
3-30	5%	$1,610	$0	$1,610

d. Underwriting Considerations

The lender must underwrite the loan and determine that the Veteran can afford the full payment amount under the note, without considering the monthly buydown contributions being applied from escrow.

Nevertheless, the buydown arrangement can be considered a compensating factor for residual income and/or debt-to-income calculations. If these calculations produce marginal results, the buydown plan (which could be used, for example, to offset a short-term debt), along with other compensating factors, may support approval of the loan. See "Compensating Factors" in Chapter 4 of this Handbook.

A statement with the reasons for approval, signed by the underwriter, must be maintained in the lender's loan file. Lenders must submit the statement to VA if the loan is selected for review.

e. Seller Concessions

Temporary interest rate buydown funds provided by the builder or seller are considered seller concessions. See Chapter 8, Topic 5 of this handbook for more information.

Topic 8: Farm Residence Loans

Change Date: March 11, 2019

- This chapter has been revised in its entirety.

a. Eligibility

A loan for the purchase, construction, repair, alteration, or improvement of a farm residence which is occupied or will be occupied by the Veteran/borrower as a home is eligible for guaranty.

The loan cannot cover the:

- nonresidential value of farm land in excess of the home site,
- barn, silo, or other outbuildings necessary to the operation of the farm, or
- Farm equipment or livestock.

A portion of the proceeds of a loan to construct a farm residence on encumbered land owned by the Veteran may be used to pay off the lien, or liens on the land **only if** the reasonable value of the land is at least equal to the amount of the lien(s).

b. Underwriting

If some or all of the income necessary to support the loan payments comes from farming operations, the Veteran's ability and experience as a farm operator must be established. The procedures and analysis provided under "Self-Employment Income" in Chapter 4 apply generally. In addition, apply the following:

For new farmer or new farm operation, the lender must obtain the following:

- Veteran's proposed plan of operation of the farm, showing the number of acres for each crop, amount of livestock, etc., upon which an estimate of income and expenses may be made.
- Veteran's statement that he or she owns, or proposes purchasing the farm equipment required to operate the farm. If additional indebtedness is to be incurred in the purchase of this equipment, the statement should contain full details as to repayment terms, etc.

An estimate of farm income and expenses by a local farm appraiser designated by VA or another qualified person, or the estimate used by a lender that has agreed to carry an operating line of credit for the Veteran. The estimate should be based on the Veteran's proposed plan of operation, his or her ability and experience, and the nature and condition of the farm to be sold, including livestock and livestock products. The expense estimate must detail labor, seed, fertilizer, taxes and insurance, repairs, machinery, fuel, etc.

- A copy of a commitment from a lender for an operating line of credit or evidence of the resources to be used to cover operating expenses.
- Experienced farmer continuing the same farm operation. If the Veteran finances operations out of an operating line of credit, obtain records of advances from, payments to, and carryover balances on the operating line of credit for the last 3 years (or additional periods if needed to demonstrate stability of Veteran's operation). Analyze the reasons for any build-up of operating debt.

Topic 9: Loans for Manufactured Homes Classified as Real Estate

Change Date: February 22, 2019

- This chapter has been revised in its entirety.

a. How to Begin

This section only addresses manufactured homes which are, or will be, permanently affixed to a lot and considered real estate under state law.

Lenders considering making a loan involving a manufactured home that is **not** permanently affixed should contact 1-877-827-3702 and follow the instructions.

b. Allowable Loan Purposes and Calculation of the Maximum Loan Amount

Table 12: Table of Loan Purposes and Maximum Loan Amount Calculations

Allowable Loan Purpose	Maximum Loan
To purchase a manufactured home to be affixed to a lot already owned by the Veteran.	The lesser of: • the sum of the purchase price plus the cost of all other real property improvements, and the VA funding fee, or • the VA NOV for the property, plus the VA funding fee.
To purchase a manufactured home and a lot to which it will be affixed.	The lesser of: • the total purchase price of the manufactured home unit and the lot, plus the cost of all other real property improvements, plus the VA funding fee, or • the purchase price of the manufactured home unit, plus the cost of all other real property improvements, plus the balance owed by the Veteran on a deferred purchase money mortgage or contract given for the purchase of the lot, plus the VA funding fee.
To obtain a regular "Cash-Out" refinance for an existing loan on a manufactured home and purchase the lot to which the home will be affixed.	The lesser of: • the sum of the balance of the loan being refinanced, plus the purchase price of the lot, not to exceed its reasonable value, plus the costs of the necessary site preparation as determined by VA, plus a reasonable discount on that portion of the loan used to refinance the existing loan on the manufactured home, plus authorized closing costs plus the VA funding fee, or • the total reasonable value of the unit, lot, and real property improvements, plus VA. funding fee.

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Topic 9: Loans for Manufactured Homes Classified as Real Estate, continued

b. Allowable Loan Purposes and Calculation of the Maximum Loan Amount, continued

Table 12: Table of Loan Purposes and Maximum Loan Amount Calculations, continued

Allowable Loan Purpose	Maximum Loan
An IRRRL to refinance an existing VA loan on a permanently affixed manufactured home and lot	The sum of: • the balance of the VA loan being refinanced, plus • allowable closing costs, plus • up to two discount points, plus • the VA funding fee. **Note**: The provisions applicable to IRRRLs apply (See Chapter 6 of this handbook).

Topic 10: Loans to Native American Veterans on Trust Lands

Change Date: March 11, 2019

- This chapter has been revised in its entirety.

a. General

VA does underwrite direct loans to Native American Veterans on trust land.

Native American Direct Loan information can be found at http://www.benefits.va.gov/HOMELOANS/nadl.asp. Lenders should advise interested Native American Veterans to contact the VA RLC that has jurisdiction over the state that the property is located for information on the direct loan.