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: June 5, 2024

- This topic has been revised in its entirety.

a. The Basics

VA may guarantee a loan for the construction[1] of a home to be owned and occupied by the Veteran. VA permits one-time and two-time construction loans. Construction loans (one-time or two-time) may also be refinanced under VA's cash-out refinance guidelines. This section specifically addresses construction loans and does not apply to the purchase of a newly built home financed by a builder (such as those commonly found in Planned Unit Development communities) or cash-out refinances.

All construction and cash-out refinancing loans are subject to VA's underwriting requirements[2] outlined in Chapter 4.

Once the VA construction loan type, one-time or two-time, is closed it cannot be modified into another loan type. **That is, a one-time close cannot be turned into (converted) a two-time close or vice versa.**

One-time and two-time construction loans may be considered purchases in VA's systems regardless of the category stated on the loan application, closing disclosure, or whether or not the borrower already owns the land. Note this is for VA purposes and may not match Real Estate Settlement Procedures Act requirements (RESPA).

One-Time Close Construction or VA Construction to Permanent Loans. These types of loans are used to close the construction financing and permanent financing at the same time. The permanent financing is established prior to construction, and the final terms are modified to the permanent terms at the conclusion of construction.

Two-Time Close Construction Loans. These types of loans involve an initial non-VA interim construction loan that closes prior to the commencement of construction and a second loan closing, where a VA-guaranteed loan is used to establish permanent financing by refinancing the interim construction loan.

Interim construction financing does not include Home Equity Lines of Credit (HELOCs) or loan vehicles that already provided for permanent financing such as a one-time construction loan.

Cash-Out Refinance Loans. These types of loans involve the refinancing of any existing lien indebtedness. Unlike the one-time or two-time construction loan, the Veteran may obtain cash-out through the transaction. These loans are subject to VA's Cash-Out Refinance Requirements[3] and may not exceed 100% of the VA reasonable value. Note that satisfaction of an interim construction loan is considered a net tangible benefit for the purpose of a cash-out refinance.

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[1] 38 USC § 3710(a)(1)(3)
[2] 38 CFR § 36.4340
[3] 38 CFR § 36.4309

Topic 2: Construction/Permanent Home Loans, continued

b. Builder Identification (ID) Number

The Veteran may choose their own builder and a VA Builder ID must be obtained prior to the issuance of the Notice of Value (NOV). The Veteran may act as their own contractor or builder, and VA Builder ID is not required in these cases.

Refer to Chapter 10 for additional information.

A list of registered VA builders is available for lenders in the VA LGY HUB https://lgy.va.gov/lgyhub/.

Information on obtaining a VA Builder ID number is available on our website: https://www.benefits.va.gov/HOMELOANS/appraiser_cv_builder_info.asp.

c. Property Eligibility and Appraisals

One-time construction loans: appraisals should be ordered before the completion of the foundation as a purchase, specifying the loan use as "Construction to Permanent" and building status as "Proposed". Construction exhibits, permitting, and materials specifications, should be provided to the appraiser at the time of the appraisal order for preparation of the appraisal report for valuation purposes. Appraisers will hold appraisal assignments until the appropriate exhibits are received.

Two-time construction loans:

(1) Appraisals should be ordered when the dwelling is 100% complete. The appraisal should be ordered as a purchase, specifying the building status as "New Construction".

(2) While VA prefers for the appraisal to be ordered after the dwelling is 100% complete, if the appraisal is being ordered prior to completion, the lender will need to order the appraisal as a purchase, specifying the loan use as "Construction to Permanent" and the building status as "Proposed." Construction exhibits, permitting, and materials specifications, should be provided to the appraiser at the time of the appraisal order to be utilized in the preparation of the appraisal report for valuation purposes. Appraisers will hold appraisal assignments until the appropriate exhibits are received.

Cash-Out Refinances: Transactions in which construction was completed and at least one year has passed, as evidenced by a Certificate of Occupancy (CO) or other evidence by the taxing authority, are treated as cash-out refinances if the Veteran already owns the property. The appraisal should be ordered as a "VA Cash-Out Refinance" in WebLGY. Construction exhibits such as plans, specifications, and contracts are not required.

d. Maximum Loan Amount

The maximum loan amount for construction (one-time and two-time) loans is limited to:

(1) the lesser of the VA reasonable value or the acquisition costs (described in section e), plus,

(2) the applicable VA funding fee.

Cash-Out Refinance Loans may not exceed the VA reasonable value.

See Chapter 3 for additional details on maximum loan amounts.

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Topic 2: Construction/Permanent Home Loans, continued

e. Acquisition Costs

One-Time Close:

Acquisition costs on a one-time construction loan include the following, provided documentation is submitted to support the associated amount:

(1) the contract to build
(2) balance owed on the land
(3) interest reserve, if not included in the contract to build
(4) contingency reserve
(5) permits, if not included in the contract to build

If the Veteran acts as their own contractor, all labor and material costs must be documented by receipts, work orders, and/or contractual agreements to establish the contract price.

If no balance is owed on the land neither the original cost nor current value may be included in the acquisition cost.

Two-Time Close:

Acquisition costs on a two-time construction loan include the following, provided documentation is submitted to support the associated amount:

(1) balance of the interim construction loan, and
(2) balance owed on the land

If no balance is owed on the land neither the original cost nor current value may be included in the acquisition cost.

f. Loan Guaranty Certificate and Maximum Guaranty Amount

Although the loan will normally be considered guaranteed upon closing, the Loan Guaranty Certificate (LGC) on a construction/permanent home loan will not be issued until a clear post construction inspection report has been received by VA.

All NOV requirements, including the Post Construction Inspection by the appraiser must be met prior to the issuance of the LGC.

VA construction loans are eligible to receive the same guaranty amount and percentage as VA purchase loans.[4] See Chapter 3 for additional information.

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[4] 38 CFR 36.4302(a)

Topic 2: Construction/Permanent Home Loans, continued

g. Funding Fee and Loan Reporting

The funding fee is due and payable to VA within 15 days of loan closing[5]; this requirement is **not** tied to the commencement or completion of construction.

Although evidence of guaranty is not issued until construction is complete, VA will not approve a funding fee refund if the lender fails to obtain evidence of guaranty or for the fact that the Veteran sold the property before the completion of construction.

The loan must be guaranteed in WebLGY within 60 days[6] of receipt of the clear post construction inspection report and completion of all NOV requirements.

<u>For one-time and two-time construction loans</u>: In some instances, equity in the subject property may be considered as a downpayment for the purpose of reducing the funding fee.

(1) Equity in the secured property may be used as a down payment for calculating the funding fee, or

(2) In cases where the Veteran purchased the land within one year of VA loan closing, the greater of the amount paid to acquire the land or the value of the land (if the appraiser assigned value to the land on the appraisal) may be considered as a downpayment for the purpose of calculating the funding fee, or (Section u, Table 8)

(3) In cases where the Veteran purchased the land more than one year prior to the VA loan closing, the value of the land may be considered for the purpose of calculating the funding fee if the appraiser assigns value to the land on the appraisal. If the appraiser does not assign value to the land on the appraisal, equity in the subject property may be considered as a down payment for the purpose of calculating the funding fee, or (Section u, Table 9)

(4) In cases where the Veteran obtained the land as a gift, only equity in the subject property may be counted as a downpayment for the purpose of calculating the funding fee. (Section u, Table 10)

Detailed examples are provided in Section u.

Simple equity example: A borrower is using a VA (one-or two-time) construction loan to construct a dwelling on land owned for more than one year prior to the VA loan closing. The VA financing will close on March 15, 2023. The reasonable value is $400,000, and the loan amount is $350,000. The purchase price in the Funding Fee Payment System (FFPS) should be entered as $400,000 and the equity in the secured property, $50,000 ($400,000 - $350,000), should be entered as the down payment. FFPS will automatically calculate the required funding fee of $4,900 (1.40%).

Note: Equity in the secured property **cannot** be used as a down payment for VA cash-out refinance transactions.

See Chapter 8 for additional details on the VA Funding Fee.

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[5] 38 C.F.R. § 36.4313(e)(2)
[6] 38 C.F.R. §36.4303(a)(2)

h. Fees and Charges the Veteran Can Pay

Fees and charges the Veteran can pay are described in Chapter 8. Note that permissible fees differ for one-time and two-time construction loans, and that an increased flat fee may be charged on one-time construction loans where the lender supervised the progress of construction and/or makes advances to the Veteran during construction.

On one-time close construction loans, the Veteran may not pay any fees or charges that are the builder's responsibility.

The Veteran **may** pay for interest not included in the interest reserve, and/or interest due after the initial interest reserve is depleted to prevent loan default.

i. One-Time Construction Loan Process

This loan type may also be called a construction to permanent loan and closes prior to the start of construction simultaneously providing both the construction loan and permanent financing. Loan proceeds may be disbursed to cover the cost of, or balance owed on the land, with the remaining balance deposited into an escrow account, commonly referred to as a Draw or Loan in Process (LIP) account. Escrowed funds are then 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 lender must also retain this in the loan file and provide to VA upon request.

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

The following provides a general guide for lenders to follow when processing a VA one-time construction loan.

(1) Verify the Veteran's eligibility and entitlement. (Chapter 2)
(2) Order the appraisal as a purchase, specify the loan use as "Construction to Permanent" and the building status as "Proposed" and provide all necessary documentation. (Chapter 10)
(3) Issue the NOV. (Chapter 13)
(4) Underwrite the loan using VA's underwriting guidelines. (Chapter 4)
(5) Close the loan, disburse monies to cover the cost of the land and fund the construction escrow (LIP or Draw) account.
(6) Pay the VA Funding Fee within 15 days of loan closing. (Chapter 8)
(7) Construction takes place, disburse funds in accordance with any established draw schedule after obtaining the Veteran's written approval before making such a payment.
(8) The final inspection report signifies the end of the project.
(9) Modify the loan in accordance with the terms of the loan.
(10) Issue the Loan Guaranty Certificate after all NOV requirements are met. (Chapter 5).

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Topic 2: Construction/Permanent Home Loans, continued

j. Account Management and Contingency Reserve (one-time close)

Contingency reserve funds will be negotiated between the borrower and builder.

The lender is responsible for all aspects of establishing the account containing the construction funds. The lender should ensure that funds are accounted for and disbursed according to the progress completed. Escrowed funds will be used for their stated purpose.

Any funds remaining in the LIP account upon completion of construction should be disbursed according to the contract. Excess construction or reserve funds may be returned to the borrower up to the verified amount that has been paid in advance, otherwise, the funds should be applied to the loan balance.

Note: The application of excess funds to the loan balance does not impact calculation of the funding fee or final guaranty amount. The lender should retain evidence of the principal balance reduction in the loan file.

k. Amortization (one-time close)

The Veteran begins making payments on a one-time construction loan when construction is complete. Therefore, the initial payment on the principal may be postponed up to one year, if necessary. If construction cannot be completed within 12 months[7], payments may be delayed, on a monthly basis for up to an additional six months. 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.

The maximum term on a VA-guaranteed loan is 30 years and 32 days[8].

Example. If it takes six 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 six months.

VA requires amortization with approximately equal payments and the principal must be reduced at least once annually, this includes construction loans. However, the final installment may be for an amount up to five percent of the original principal amount of the loan[9].

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.

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[7] 38 CFR § 36.4300(b)(3)
[8] 38 USC § 3704(d)(1)
[9] 38 CFR § 36.4310(a)

Topic 2: Construction/Permanent Home Loans, continued

l. Change Orders (one-time close)

Change orders should be reviewed in advance by the appraiser to ensure no loss in value.

Change orders/upgrades made after the appraisal cannot be mortgaged into the loan unless an updated appraisal is obtained. The additional appraisal fee may come out of available contingency reserve funds, or borrowers are permitted to pay for upgrades out of pocket.

If an updated appraisal is required, the lender is responsible for contacting VA Construction and Valuation for assistance and for providing the documented change order(s). Requests should be made through the ServiceNow portal accessible at https://www.benefits.va.gov/HOMELOANS/contact.asp.

Note: lenders must maintain change orders and appraisal invoices in the loan file.

m. Inspections (one-time close)

NOV requirements for both Post Construction Inspections and Proposed Construction Inspections and Warranties must be met if conditioned on the NOV.

Proposed Construction Inspections: Construction should be completed according to local building codes. There are three options allowable to satisfy the proposed construction inspection requirement for cases ordered as "Proposed."

(1) If the local authority performs the required foundation, framing, and final inspections and issues a Certificate of Occupancy (CO) or equivalent, VA will accept the CO for the property as evidence of local authority inspections and satisfactory completion of construction. Please note that framing inspection is not required on manufactured or modular homes.
(2) If the local authority performs the required foundation, framing, and final inspections but does not issue a CO or equivalent, VA will accept copies of the inspection reports, which verify full compliance with local building codes, or a written statement from the local authority confirming that the required inspections were performed satisfactorily.
(3) If the local authority does not perform the required inspections, the property should be covered by a 10-year insured protection plan that is acceptable to the Department of Housing and Urban Development (HUD) and a 1-year VA builder's warranty.

Post-Construction Inspection. When the property is 100 percent complete, the lender will contact the original VA fee appraiser to complete the VA final inspection. If the original VA fee appraiser is not available, the lender must contact VA Construction and Valuation by submitting a request through the VA ServiceNow portal (link available in Appendix A) for another VA fee appraiser to complete the VA final inspection.

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Topic 2: Construction/Permanent Home Loans, continued

m. Inspections (one-time close), *continued*

The VA final inspection is to certify that all VA Minimum Property Requirements (MPR) are met, and the house was built to the original plans, specifications, and approved change orders, and that the as-completed value from the appraisal was maintained[10].

It is the lender's responsibility to negotiate an inspection schedule with the general contractor, and it is the lender's responsibility to ensure the schedule is followed.

Refer to Chapter 10 for additional information on post-construction inspection reports.

n. Interest Rate (one-time close)

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. Lock-in agreements should be maintained in the loan file and provided to VA upon request.

The borrower(s) must qualify for the mortgage at the maximum rate.

o. Project Management (one-time close)

The lender is responsible for evaluating, monitoring, and managing the project.

It is the lender’s responsibility to ensure that the project is completed per the plans, specifications, and /or contract documents, so that the value of the home is preserved.

p. Fees the Veteran Cannot Pay (one-time close)

On a one-time construction home loan, the builder is responsible for all fees normally paid by a builder who obtains an interim construction loan including, but not limited to:

(1) inspection fees
(2) title updates, and
(3) hazard insurance during construction.

Note: In the case of a two-time construction loan, the VA loan is not established prior to the commencement of construction, therefore the terms of the initial construction loan, and the fees to be paid by the builder, are subject to negotiation.

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[10] 38 U.S.C. § 3705(a)

Topic 2: Construction/Permanent Home Loans, continued

q. What if Construction Is Not Fully Completed and Loan Proceeds are not Fully Disbursed? (one-time close)

If the construction is not fully completed and loan proceeds are not fully disbursed, the guaranty[11] will apply **only** to the proper pro rata part of the loan. To calculate the proper pro rata part of the loan:

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

The lender must also certify that any amounts advanced for land is protected by title or lien and that no enforceable liens, for any work done or material furnished for that part of the construction completed and for which payment has been made out of proceeds of the loan exists or can come into exitance.

In the event circumstances make it impracticable to complete construction and fully disburse funds, the lender should contact VA for additional information on obtaining a partial guaranty.

r. Two-Time Construction Loan Process

This loan type involves the refinance of a non-VA interim construction loan with a VA-guaranteed loan. Interim construction loans are construction loans that do not provide for permanent financing.

The following provides a **general** guide for lenders to follow when processing a VA two-time construction loan. As VA prefers for the appraisal on a two-time construction loan to be ordered after the dwelling is 100% complete, this general guide does not address instances where the lender orders the appraisal prior to completion of the dwelling.

(1) Verify the Veteran's eligibility and entitlement. (Chapter 2)
(2) Close the non-VA interim construction loan.
(3) The construction takes place.
(4) Order the VA appraisal after construction is complete as "New Construction." (Chapter 10)
(5) Issue the NOV. (Chapter 13)
(6) Underwrite the loan using VA's underwriting guidelines. (Chapter 4)
(7) Close the loan after all NOV requirements are met. (Chapter 5)
(8) Pay the VA Funding Fee within 15 days of loan closing. (Chapter 8)
(9) Issue the Loan Guaranty Certificate. (Chapter 5)

Continued on next page

[11] 38 CFR 36.4305

Topic 2: Construction/Permanent Home Loans, continued

s. Construction Complaint Process

VA assistance with construction complaints will be limited to defects in equipment, material, and workmanship reported during the required 1-year VA builder's warranty period.

t. Construction Loan Comparison

Table 7: Comparison of VA Construction Loan Types and Cash-Out Refinance Loans

Loan Feature	One-Time Close	Two-Time Close	Cash-Out Refinance
Appraisal Timing	Prior to Commencement of Construction	Preferred: After Dwelling is 100% Complete	Preferred: After Dwelling is 100% Complete
Purchase or Refinance for VA Purposes	Purchase	Purchase	Refinance
Appraisal Type	Proposed – Per Plans and Specs	Preferred: Built Less than One Year and Never Occupied	Refer to Chapter 10
Maximum Loan Amount	Lesser of: a. Acquisition Cost, or b. VA Reasonable Value. Plus, the applicable VA Funding Fee	Lesser of: a. Acquisition Cost, or b. VA Reasonable Value. Plus, the applicable VA Funding Fee	100% of the Reasonable Value
Cash to Veteran Acceptable?	No	No	Yes, the Veteran may receive proceeds from the loan and/or satisfy other debts
Can Equity be Considered for VA Funding Fee Rate Reduction?	Yes	Yes	No
Do VA's refinancing NTBs apply?	No	No	Yes (The refinance of an interim construction loan is an NTB.)

Continued on next page

Topic 2: Construction/Permanent Home Loans, continued

u. Funding Fee Downpayment Examples

This section provides examples of construction loan downpayment scenarios and the appropriate amount to enter into FFPS as the Purchase Price and the Downpayment amount.

Table 8: Construction Loans – Veteran Purchased the Land **Within One Year** of Close

Lenders should use this table in cases where the Veteran purchased the land within one year of closing of the VA-loan.

Item	Description	Example 1	Example 2	Example 3
A	Cost to Acquire Land	$100,000	$30,000	$100,000
B	Balance Owed on Land	$0	$20,000	$60,000
C	Contract to Construct + Permits and Reserves (if applicable)	$300,000	$300,000	$300,000
D	Acquisition Cost (B+C)	$300,000	$320,000	$360,000
E	Reasonable Value (Per NOV)	$350,000	$375,000	$500,000
F	Land Value (if given)	n/a	$80,000	n/a
G	Max Loan Amount (Lesser of D or E)	$300,000 + applicable FF	$320,000 + applicable FF	$360,000 + applicable FF
H	Purchase Price in FFPS (Greater of: E., (A+C), or (C+F))	$400,000	$380,000	$500,000
I	Downpayment in FFPS (H-G)	$100,000	$60,000	$140,000

Continued on next page

Topic 2: Construction/Permanent Home Loans, continued

u. Funding Fee Downpayment Examples, continued

Table 9: Construction Loans – Land Purchased **More than One Year** Before Close

Lenders should use this table in cases where the Veteran purchased the land more than one year prior to the closing of the VA-loan.

Item	Description	Example 1	Example 2	Example 3
A	Cost to Acquire Land	n/a	n/a	n/a
B	Balance Owed on Land	$0	$60,000	$0
C	Contract to Construct + Permits and Reserves (if applicable)	$300,000	$300,000	$300,000
D	Acquisition Cost (B+C)	$300,000	$360,000	$300,000
E	Reasonable Value (Per NOV)	$350,000	$350,000	$350,000
F	Land Value (if given)	Not Given	Not Given	$75,000
G	Max Loan Amount (Lesser of D or E)	$300,000 + applicable FF	$350,000 + applicable FF	$300,000 + applicable FF
H	Purchase Price in FFPS (Greater of D, E, or (C+F))	$350,000	$360,000	$375,000
I	Downpayment in FFPS (H-G)	$50,000	$10,000	$75,000

Table 10: Construction Loans – Land was Gifted

Lenders should use this table in cases where the land was gifted or inherited by the Veteran free of encumbrance.

Item	Description	Example 1	Example 2
A	Cost to Acquire Land	n/a	n/a
B	Balance Owed on Land	$0	$0
C	Contract to Construct + Permits and Reserves (if applicable)	$300,000	$300,000
D	Acquisition Cost (B+C)	$300,000	$300,000
E	Reasonable Value (Per NOV)	$350,000	$290,000
F	Land Value (if given)	Not Given	Not Given
G	Max Loan Amount (Lesser of D or E)	$300,000 + applicable FF	$290,000 + applicable FF
H	Purchase Price in FFPS (Greater of D or E)	$350,000	$300,000
I	Downpayment in FFPS (H-G)	$50,000	$10,000

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."

Continued on next page

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

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

Improvements more than $3,000, up to $6,000: 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.

IRRRL with significant increase in payments: 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.

Continued on next page

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.

Continued on next page

Topic 3: Energy Efficient Mortgages, continued

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.

Continued on next page

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.

Continued on next page

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.

Continued on next page

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.[12]

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.[13] Lenders must submit such agreements to VA if the loan is selected for review.

Continued on next page

[12] See 38 U.S. Code § 3703(c) (authorizing guaranteed loans with interest rates agreed upon by the Veteran and lender).
[13] 38 C.F.R. 36.4333.

Topic 7: Loans Involving Temporary Interest Buydowns, continued

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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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.

Continued on next page

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.