

LOAN MODIFICATIONS UNDER VALERI

1. Purpose. The purpose of this circular is to clarify the applicable maximum interest rate and new requirements when modifying a loan under the new VA Loan Electronic Reporting Interface (VALERI) environment.

2. Background. Under the existing VA regulation in Title 38, Code of Federal Regulations (CFR), section 36.4314, loan holders are not allowed to increase the interest rate on a loan that is being modified. Section 36.4311(c) specifically states that interest in excess of the rate reported by the lender when requesting evidence of guaranty shall not be payable. Furthermore, the guaranty amount does not increase when the modified loan amount is greater than the original loan amount. In contrast, the new regulation relating to loan modifications in the VALERI environment, 38 CFR 36.4815, provides for an increase to the guaranty amount on a modified loan. It also allows for an increase or decrease in the interest rate on a loan being modified when market conditions dictate (with an appropriate exception in 38 CFR 36.4812(c) to allow the increased interest rate).

3. Modification Requirements. Section 36.4815 of title 38, CFR, specifies that any guaranteed loan may be modified by written agreement between the holder and the borrower, without prior approval from VA, provided **all** of the following conditions are met:

- a. The loan is in default;
- b. The event or circumstances that caused the default has been or will be resolved and is not expected to re-occur;
- c. The holder has determined the debtor is a reasonable credit risk based on review of the debtor's financial information to include a current credit report;
- d. The borrower has made at least 12 monthly payments since the closing date of the loan;
- e. All current owners are obligated to repay the loan and are party to the loan modification agreement;
- f. The loan will be restored to performing status by virtue of the loan modification; and
- g. The loan has not been modified more than once within a 3-year period, and no more than three times within the life of the loan.

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4. Prior VA Approval. Loans meeting the requirement in paragraph 3 may be modified without VA prior approval. However, in situations that do not conform (e.g., a modification less than three years after a previous modification), holders should contact VA for prior approval to execute a loan modification. Unusual cases that do not conform to the general criteria established in the regulation require VA's review and concurrence.

5. Maximum Interest Rate. In all cases, modified loans must bear a fixed-rate of interest, which may be higher or lower than that of the defaulted loan. The interest rate may not exceed the GNMA current month coupon rate that is closest to par (100) plus 50 basis points. The rate shall be determined as of the close of business on the last business day of the month prior to the date the holder approved the loan modification. For example, if the loan modification was approved on April 15, 2008, the applicable GNMA coupon rate as of March 31, 2008, was 5.0 percent. Adding 50 basis points means the maximum interest rate the modified loan may have is 5.5 percent. For a current list of maximum allowable interest rates on loan modifications, refer to the VALERI website <http://www.homeloans.va.gov/valeri.htm>.

6. Modified Loan Term and Amount. The unpaid principal balance may be re-amortized over the remaining life of the loan to extend the maturity date to the shorter of 360 months from the due date of the first installment required under the terms of the modification, or 120 months after the original maturity date of the loan. The modified loan amount may include the unpaid principal balance; accrued interest; shortages in the tax and insurance escrow accounts; and advances to maintain the first lien position such as special assessments, homeowner association fees, utility liens, etc. Loan holders shall not charge a processing fee to complete a loan modification; however, late fees and other legally chargeable and actually incurred costs may be collected directly from the borrower as part of the modification process. Under no circumstances shall the borrower receive any cash back from the modification.

7. Guaranty Amount. Section 36.4815 of title 38, CFR, allows for an increase in the guaranty amount, subject to the limitations specified in 38 U.S.C 3703 (a)(1)(B). The guaranty dollar amount may increase, but it cannot exceed the greater of:

a. The original guaranty dollar amount of the loan being modified. However, if the modified loan amount is less than the original loan amount, the amount of dollar guaranty on the modified loan will be equal to the original guaranty percentage multiplied by the modified loan balance; or

b. Twenty-five percent of the modified loan amount, if the modified loan amount is greater than the original loan amount.

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8. Additional Information. This circular will be posted to the VA Loan Guaranty website www.homeloans.va.gov. Questions concerning this circular may be directed to Mary Ann Mills at mary.mills@va.gov.

9. RESCISSION. This circular is rescinded April 1, 2010.

By Direction of the Under Secretary for Benefits

Judith A. Caden
Director, Loan Guaranty Service

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