

Clarification and Updates to Policy Guidance for VA Interest Rate Reduction Refinance Loans (IRRRLs)

1. Purpose. The purpose of this Circular is to consolidate and clarify guidance regarding how section 309 of Public Law 115-174, the Economic Growth, Regulatory Relief, and Consumer Protection Act (the Act), affects IRRRLs. This Circular discusses how the standards imposed by the Act, i.e. fee recoupment, net tangible benefit, loan seasoning, and disclosure standards, affect whether the Department of Veterans Affairs (VA) can guarantee such refinance loans. Section 309 of the Act, in relevant part, is codified at 38 U.S.C. § 3709. This Circular also updates guidance regarding loan seasoning based on the recently enacted Public Law 116-33, Protecting Affordable Mortgages for Veterans Act of 2019 (formerly S.1749).

2. Background.

a. Department of Veterans Affairs (VA) previously issued policy guidance (VA Circular 26-18-13) regarding compliance with section 309 (Protecting Veterans from predatory lending) of the Act. This guidance applied to all VA refinance loans (e.g. IRRRLs and cash-outs). VA has not yet issued new regulations implementing section 309 changes for IRRRLs. It is important for lenders to not confuse cash-out refinance regulatory and policy guidance with IRRRL policy guidance. Previously, VA had issued VA Circular 26-18-1 (and Change 1 and Exhibit A) and VA Circular 26-18-13 (and Exhibit A) to ensure compliance with the Act. This Circular consolidates policy guidance for IRRRLs into one document and, per paragraph 5 below, will supersede the previous policy.

b. Generally, in addition to this Circular, lenders should continue to follow all applicable VA regulations. However, as discussed above, VA has not yet updated its IRRRL regulations. Therefore, until VA publishes a final rule updating its IRRRL regulations, in instances where regulatory provisions unequivocally conflict with this Circular, this Circular constitutes VA's interpretation of current policy.

3. Action. To receive and retain the full amount of VA's guaranty, an IRRRL must meet the requirements of the Act. See generally 38 U.S.C. § 3709. In cases of IRRRLs where the application was initiated on or after May 25, 2018, and before the date of this Circular, and such loans did not meet the recoupment or net tangible benefit standards recited below, lenders may take steps to cure the noncompliance without VA's prior approval, *provided that such action results in no costs to the Veteran*. In such cases, lenders should keep detailed records of these actions, allowing for VA's examination, e.g. in cases where VA conducts loan reviews or lender site inspections. VA has identified certain IRRRLs that did not meet the statutory standards and will be contacting the relevant lenders to inquire about their efforts to cure the noncompliance. VA is also considering whether other actions are appropriate, e.g. withdrawal of authority to close loans on the automatic basis. Due to the nature of the loan seasoning requirement, remedial action is not possible in cases where the loan that was refinanced was not properly seasoned. The authority for lenders to take the remedial action described above

without VA's prior approval does not apply in cases of loans for which applications were initiated on or after the date of this Circular.

a. Fee Recoupment. Recoupment describes the length of time it takes for a Veteran to pay for certain fees, closing costs, and expenses that were necessitated by the refinance loan. The recoupment standard applies to all IRRRLs. This includes, but is not limited to, IRRRLs where the principal balance is increasing, the term of the loan is decreasing, or where the loan being refinanced is an adjustable-rate mortgage (ARM).

(1) The lender, any broker or agent of the lender, and any servicer or issuer of an IRRRL, must ensure, and certify to VA, that:

(a) For an IRRRL that results in a lower monthly principal and interest (PI) payment, the recoupment period of fees, closing costs, and expenses (other than taxes, amounts held in escrow, and fees paid under chapter 37 (e.g., VA funding fee collected under 38 U.S.C. § 3729)), incurred by the Veteran, does not exceed 36 months from the date of the loan closing.

(b) For an IRRRL that results in the same or higher monthly PI payment, the Veteran has incurred no fees, closing costs, or expenses (other than taxes, amounts held in escrow, and fees paid under chapter 37 (e.g., VA funding fee collected under 38 U.S.C. § 3729)).

(2) Lenders must upload the following documentation during the Loan Guaranty Certificate (LGC) process to certify that fee recoupment has been met:

(a) If the recoupment period shown on the final loan disclosure outlined below in paragraph 3.d.(2) is 36 months or less, the lender may upload this disclosure.

(b) If the recoupment period shown on the final loan disclosure outlined below in paragraph 3.d.(2) is more than 36 months, the lender must provide documentation showing the recoupment calculation outlined in paragraph 3.a.(3).

(c) For an IRRRL that results in the same or higher monthly PI payment, the lender should submit to VA evidence that the Veteran has incurred no fees, closing costs, or expenses (other than taxes, amounts held in escrow, and fees paid under chapter 37).

(3) *Calculating Recoupment*. Recoupment is calculated by dividing all fees, expenses, and closing costs, whether included in the loan or paid outside of closing (i.e., an appraisal fee), by the reduction of the monthly PI payment. The VA funding fee, escrow, and prepaid expenses, such as, insurance, taxes, special assessments, and homeowners' association (HOA) fees, are excluded from the recoupment calculations. See Exhibit B for more specific instructions and examples including IRRRLs with Energy Efficient Mortgage (EEM) improvements.

b. Net Tangible Benefit. A loan that provides a net tangible benefit (NTB) means that it is in the financial interest of the Veteran. The following NTB standards are required under 38 U.S.C. 3709:

(1) *Fixed Rate to Fixed Rate IRRRLs*. In cases where the loan being refinanced has a fixed interest rate and the refinance loan will also have a fixed interest rate, the refinance loan's

interest rate must be not less than 0.50 percent (50 basis points) lower than the interest rate of the loan being refinanced. For example, if the interest rate of the loan being refinanced is 3.75 percent (fixed), then the interest rate of the refinance loan may not be greater than 3.25 percent (fixed).

(2) *Fixed Rate to Adjustable Rate (Fixed-to-ARM) IRRRLs*. In cases where the loan being refinanced has a fixed interest rate and the refinance loan will have an adjustable interest rate, the refinance loan's interest rate must be not less than 2 percent (200 basis points) lower than the interest rate of the loan being refinanced. For example, if the interest rate of the loan being refinanced is 3.75 percent (fixed), then the initial interest rate of the refinance loan may not be greater than 1.75 percent (adjustable).

(a) In Fixed-to-ARM cases, discount points may be added to the principal loan amount of a Fixed-to-ARM refinancing loan **only** if one of the following circumstances exist:

(i) The lower interest rate is **not** produced solely from discount points. In other words, the interest rate environment is such that some portion of the lower interest rate on the refinancing loan is the result of favorable changes in the market as compared to the Veteran's current rate.

(ii) The lower interest rate is produced solely from discount points (i.e., the interest rate environment is such that a lower interest rate cannot be achieved without charging discount points); discount points equal to or less than one discount point are added to the loan amount, and; the resulting loan balance after any fees and expenses maintains a loan-to-value (LTV) ratio of 100 percent or less.

(iii) The lower interest rate is produced solely from discount points (i.e., the interest rate environment is such that a lower interest rate cannot be achieved without charging discount points); more than one discount point is added to the loan amount, and; the resulting loan balance after any fees and expenses maintains an LTV ratio of 90 percent or less. As a reminder, while the Veteran may pay any reasonable amount of discount points in cash, no more than two discount points can be included in the loan amount of an IRRRL. See 38 C.F.R. § 36.4307(a)(4)(i).

(b) *Valuation for Fixed-to-ARM IRRRLs*. A new appraisal will enable lenders to determine the LTV for Fixed-to-ARM IRRRLs. It is VA's interpretation that such appraisals need not be ordered through VA's appraisal system. Lenders can use their appraisal management and assignment process to complete a property value determination. As a reminder, the Veteran may only be charged a reasonable and customary amount, and only charged for one appraisal. For VA audit purposes, any appraisal report and invoice should be included in the loan file. Loan-to-value is calculated by dividing the total loan amount by the value determined in one of the methods listed below. Acceptable appraisal reports to determine property value include:

- (i) Exterior-Only Inspection Residential Appraisal Report (Fannie Mae 2055)
- (ii) Uniform Residential Appraisal Report (Fannie Mae 1004)
- (iii) Exterior-Only Inspection Individual Condominium Unit Appraisal Report (Fannie Mae 1075)
- (iv) Individual Condominium Unit Appraisal Report (Fannie Mae 1073)
- (v) Industry accepted appraisal reports for manufactured and multi-unit homes

c. Loan Seasoning. Loan seasoning refers to the age of the loan being refinanced. If the loan being refinanced is not seasoned on or before the date that the refinance loan closes, VA cannot guarantee the refinance loan.

(1) *Calculating Loan Seasoning*. The due date of the first payment is used to determine loan seasoning. A loan is considered seasoned if both of the following conditions are met as of the date of loan closing:

(a) The due date of the first monthly payment of the loan being refinanced is 210 days or more prior to the closing date of the refinance loan; and

(b) Six consecutive monthly payments have been made on the loan being refinanced.

(2) Example: The loan being refinanced closed on March 8, 2019. The first payment is due May 1, 2019. If the Veteran makes six consecutive monthly payments, the loan being refinanced will be seasoned on November 27, 2019.

(3) *Audit Process*. During VA's audit process, VA will look for evidence confirming that the loan being refinanced was properly seasoned. Such evidence could include, for example, a payment history/ledger documenting all payments, or a credit bureau supplement that clearly identifies all payments made in that timeframe.

d. Disclosure. VA interprets the Act as requiring that lenders make certain disclosures when originating IRRRLs. Lenders should twice present the Veteran with a comparison of the refinance loan to the loan being refinanced. The loan comparison statement will provide the Veteran with up-front information about the overall cost of the refinance, thereby helping the Veteran make an informed decision about whether to proceed with the refinance. See Exhibit C for a sample comparison statement.

(1) *Timing of Disclosures*. The lender should present the Veteran with the comparison statement within 3 business days from the initial date of the loan application and again at loan closing. For example, the Veteran completed/submitted the loan application to the lender on August 5, 2019. The lender must present the comparison statement to the Veteran no later than August 8, 2019.

(2) *Content*. Please refer to Exhibit C for a sample comparison statement. The loan statement must include the following information relating to the loan being refinanced and the refinance loan, i.e. the IRRRL: VA Loan Identification Number (LIN); Loan Amount; Loan Term; Monthly Payment; Interest Rate; and Borrower Name(s). The statement must also show the recoupment period (in months) for all fees, expenses, and closing costs, (including taxes, amounts held in escrow, and fees paid under chapter 37 such as the VA funding fee), whether included in the loan or paid outside of closing.

Note: The recoupment calculation for the purposes of the comparison statement differs from the recoupment calculation required under 38 U.S.C. § 3709(a) and discussed above. Namely, the comparison statement will gauge how the Veteran's payment of taxes, amounts held in escrow, and fees paid under chapter 37 affect the cost of the new refinance loan. As discussed

above, the Act excludes such items from the 36-month recoupment calculation that affects whether VA can guarantee a refinance loan. To complete the recoupment calculation for the purposes of the comparison statements:

(a) Add the following items from the Loan Estimate (initial disclosure) or Closing Disclosure (final disclosure): origination charges, services you cannot shop for, services you can shop for, taxes, other government fees, and the VA funding fee.

(b) Subtract any lender credits.

(c) Divide that amount by the decrease in monthly PI payment. Please note that the monthly PI payment is calculated using the total loan amount, including any financed VA funding fee and EEM improvements.

Note: If the IRRRL results in the same or increased monthly PI payment, the lender should still complete paragraphs (a) and (b) and present the Veteran with the total costs associated with the IRRRL.

(3) *Veteran Certification*. The Veteran must communicate to the lender that he/she received the comparison statements, e.g. via written letter, e-signature, email from the Veteran certifying receipt, system time/date stamp where the Veteran certified receipt, etc. For example, on September 1, 2019, a Veteran could communicate to the lender that he/she received the comparison statements on both occasions, e.g. on August 1, 2019 (one day after submitting the loan application) and August 20, 2019 (date of closing). Lenders should retain evidence of such communications in the loan file.

4. Questions: Contact your VA Regional Loan Center (RLC) with Loan Guaranty operations by calling 1-877-827-3702, Option 2 with hours of operation between 8am to 6pm EST. Your call will be placed in the national queue and responded too at the earliest convenience.

5. Rescission: The following is rescinded effective immediately: Circular 26-18-1, Policy Guidance for VA Interest Rate Reduction Refinance Loans (IRRRL); Circular 26-18-1, Change 1; Circular 26-18-1, Change 1 Exhibit A, Frequently Asked Questions (FAQ); Circular 26-18-13, Policy Guidance Update: VA Refinance Loans and the Economic Growth, Regulatory Relief and Consumer Protection Act; Circular 26-18-13, Exhibit A, Lender Instructions When Determining Value for IRRRLs.

By Direction of the Under Secretary for Benefits

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