

U.S. Department of Veterans Affairs Home Loan Guaranty Program

Introduction

The Home Loan Guaranty Program of the U.S. Department of Veterans Affairs (VA) had its genesis in the Servicemen's Readjustment Act.¹ This Act was adopted in 1944 with the goal of putting veterans who had served during World War II on a path to financial stability, since they may have missed the opportunity to build favorable credit while serving their country in the armed services. The legislation has been updated since its enactment to reflect the changing needs of the nation's veterans.

The VA Home Loan Guaranty Program helps eligible veterans, current service members, and their survivors obtain, retain, and modify their homes. A key product offered by the program is the VA-guaranteed home loan benefit. Private lenders, such as banks, savings associations and credit unions, originate the mortgages, and VA guarantees a portion of the loan. With VA's guaranty, private lenders are able to provide borrowers with more favorable terms, such as no down payments and consideration of the adequacy of residual

income in underwriting. The program features flexible, yet prudent, requirements that open the door of homeownership to veterans and service members, including those who might otherwise struggle to secure financing.²

How Can Banks Participate in the VA Home Loan Guaranty Program?

National banks and federal savings associations (collectively "banks") interested in participating in the VA Home Loan Guaranty Program must send the following information to the VA regional office with jurisdiction over the bank's home office (a list of VA regional offices may be found in appendix A of the [VA Lender's Handbook](#)):

- Specimen signatures of all officers, underwriters, or other personnel authorized to sign documents related to VA-guaranteed loan activities;
- VA Form 26-8812, "VA Equal Opportunity Lender Certification;" and
- A letter identifying

periodically, and lenders are advised to consult VA's Pamphlet [26-7](#) (commonly referred to as the *VA Lender's Handbook*), pertinent regulations, and [VA circulars](#) for the most current information concerning the program.

¹ Public Law 78-346, 58 Stat. 284 (1944) (commonly known as the G.I. Bill of Rights). VA-guaranteed home loans are currently authorized by 38 USC 3701 and its implementing regulations, 38 CFR 36.4201 *et seq.*

² This fact sheet reflects information that was available as of January 2017. VA's policies change

- the bank’s corporate address,
- the bank’s owners,
- any lending personnel or officers whom the VA or the U.S. Department of Housing and Urban Development ever debarred or took other adverse action against, and
- a list of all the bank’s branch offices involved in VA mortgage lending.³

“Supervised Lenders” – that is, lenders subject to periodic examination by a state or federal agency – are granted automatic underwriting authority from the VA and may begin making VA loans without the prior approval of the VA as soon as they become familiar with the laws, regulations, and procedures pertaining to VA-guaranteed loans.⁴ Banks are considered supervised lenders because they are subject to mandatory periodic examination and supervision by the Office of the Comptroller of the Currency (OCC).⁵

What Are the Benefits for Borrowers?

One of the major advantages of the VA Home Loan Guaranty Program for borrowers is that, generally, no down payment is required. A borrower can finance up to 100 percent of the purchase price of the home. Additional benefits include:

- No mortgage insurance is required.
- Subject to lender approval, VA-guaranteed loans are assumable by subsequent purchasers, regardless of whether the subsequent purchaser is

a veteran.

- A veteran’s home loan benefit never expires, and there is no limit to the number of times a veteran can use the benefit.⁶

What Are the Benefits for Banks?

The VA Home Loan Guaranty Program is an important program for community banks, allowing them to provide their veteran customers with another financing option for purchasing a home. Additionally, VA-guaranteed loans are eligible to be placed in highly liquid Ginnie Mae securities, thus providing secondary market fee income.

Furthermore, a bank can receive a conclusive presumption of compliance, or safe harbor, under the ability-to-repay standard for covered mortgages included in the Truth in Lending Act if the bank originates the mortgage under the VA Home Loan Guaranty Program and otherwise complies with the rule.⁷ These mortgages are “qualified mortgages” under the Truth in Lending Act.

Risk Mitigation and Regulatory Capital Requirements

The VA Home Loan Guaranty Program guarantees a portion of a mortgage to a qualified borrower against default, and that guaranty is backed by the full faith and credit of the federal government. This government guaranty reduces the credit risk that banks face in originating and holding or servicing VA-guaranteed loans.

³ *VA Lender’s Handbook*, chapter 1, topic 2, subsection a.

⁴ 38 CFR 36.4352

⁵ *VA Lender’s Handbook*, chapter 1, topic 3, subsection a.

⁶ For limitations on the use of the home loan benefit eligibility, see 38 CFR 36.4302. See also, M26-1 Guaranteed Loan Processing Manual, chapter 2 - [\(linked here\)](#).

⁷ 38 CFR 36.4300; see also 79 Fed. Reg. 26620 (May 9, 2014); 15 USC 1639c(b)(3)(B)(ii).

Under the regulatory agencies' current risk-based capital requirements, the portion of loans guaranteed by the federal government through the VA generally should be risk-weighted at 20 percent.⁸

What Risks Do Banks Face?

Indemnification Risk: The bank must agree to indemnify the VA if the VA finds fraud or other material defects in a loan.⁹ Indemnification means that if the originating bank holds a fraudulent or materially defective loan in its portfolio, the bank cannot submit a claim against the guaranty if the bank suffers a loss.¹⁰ If the loan is sold, the originating bank must agree to indemnify the VA if the new holder of the loan submits a claim.

Cancellation/Withdrawal of Guaranty: The loan guaranty may be cancelled or withdrawn in instances of fraud or misrepresentation or in cases when the veteran, property, or purpose of the loan is clearly ineligible. Examples of such instances are when

- loans are made to purchase a nonresidential business property,
- loan amounts exceed the reasonable value of the property,
- notice-of-value conditions affecting the basic livability of the property cannot be satisfied, or
- the loan has a term that exceeds the lesser of the remaining economic life of the property or 30 years, 32 days.

Operational Risk: A bank should have appropriate risk management systems to

comply with its own origination requirements as well as with the VA's origination requirements to guard against errors, omissions, and fraud and ensure timely and appropriate corrective action.¹¹ The OCC expects lenders to properly train risk management and compliance staffs and provide them access to current guidelines relating to the operations that they review. More information regarding the VA's required quality control plan can be found in the [VA Lenders Handbook](#), chapter 1, topic 15, "Elements of a Quality Control Plan." More information regarding the VA's servicing requirements can be found in the [VA Servicer Handbook \(M26-4\)](#).

Special Considerations

Borrower Eligibility

Before processing and closing a loan for an applicant, the lender must ensure the applicant is an eligible veteran, spouse of an eligible veteran, or otherwise qualified beneficiary.¹² Eligibility means the veteran meets the basic criteria of appropriate length and character of service to use the home loan benefit. An eligible veteran must still meet credit and income standards in order to qualify for a VA-guaranteed loan. A certificate of eligibility issued by the VA is the only reliable proof of eligibility for the lender.

The [VA Lender's Handbook](#) provides a quick reference table outlining some of the different categories of eligible veterans.¹³ This table is not exhaustive. A veteran's eligibility for home loan benefits may be determined only by the VA.

⁸ 12 CFR 3.32(a)(1)(ii).

⁹ [VA Lender's Handbook](#), chapter 3, topic 11.

¹⁰ [VA Lender's Handbook](#), chapter 3, topic 11.

¹¹ [VA Lender's Handbook](#), chapter 1, topic 15.

¹² [VA Lender's Handbook](#), chapter 3, topic 11.

¹³ [VA Lender's Handbook](#), chapter 2, topic 9.

*Loan Limits*¹⁴

The VA does not set a cap on how much a borrower can finance to purchase a home. However, the VA does limit the amount of liability it will assume, as far as the loan guaranty is concerned. The VA's maximum loan guaranty amount varies based on the loan amount and the location of the home. Typically, for no-down-payment loans greater than \$417,000, the maximum guaranty is 25 percent of the Fannie Mae and Freddie Mac "loan limit" for the county in which the property is located. Again banks may make loans greater than the "limit" if the borrower makes a down payment; typically, that down payment equals 25 percent of the difference between the loan amount and the Fannie Mae and Freddie Mac loan limit. The VA's [Loan Limits](#) webpage contains a listing of these limits and helpful explanatory scenarios.

Residual Income Analysis

The VA's underwriting requirements stipulate that borrowers maintain a certain amount of income left over each month after all major expenses are paid. The excess is meant to cover typical family needs, such as food, transportation, and so forth, and is referred to as residual income. In conducting this residual income analysis, lenders are required to compare the borrower's residual income with a table of residual incomes by region, family size, and loan amount, which is found in chapter 4 of the [VA Lender's Handbook](#).¹⁵

¹⁴ *VA Lender's Handbook*, chapter 3, topic 3, subsection a.

¹⁵ *VA Lender's Handbook*, chapter 4, topic 9.

¹⁶ *VA Lender's Handbook*, chapter 7, topic 1, subsection a.

VA Loans with Co-Signors

VA guidelines recognize legally married spouses of qualified veterans as co-signors on VA loans and can include their income on the loan application. These loans can be fully guaranteed by the VA.¹⁶

The VA guidelines allow for more than one eligible veteran to co-sign for a loan. If more than one eligible veteran is involved, the VA guarantee is divided equally between the eligible veteran co-signors. The VA can fully guarantee these loans.

While VA guidelines may allow for a non-veteran, who is not the veteran's spouse, to co-sign for a mortgage loan, VA will not fully guarantee the loan. The VA guarantee is limited to that portion of the loan allocated to the veteran's interest in the property. For more information on co-signers, see chapter 7 of the [VA Lender's Handbook](#).

Fees and Closing Costs

The VA is required by law to collect a funding fee from borrowers to help defray costs of the VA Home Loan Guaranty Program.¹⁷ The funding fee may be financed into the loan amount. The funding fee varies based on the circumstances and can be determined by reviewing the VA's funding fee chart.¹⁸ The law allows the fee to be waived for veterans receiving (or who would be entitled to receive) VA compensation for service-connected disabilities, surviving spouses of veterans who died in service or from service-connected disabilities.

¹⁷ 38 USC 3729.

¹⁸ *VA Lender's Handbook*, chapter 8, topic 8, subsection h.

Generally, closing costs payable by the veteran are limited by regulation to a specific list of items plus a flat fee charged by the lender equal to one percent of the loan amount.¹⁹ Any other party, including the seller, can pay any costs on behalf of the veteran. Closing costs cannot be financed in purchase or construction loans.²⁰ Chapter 8 of the [VA Lender's Handbook](#) has complete information on the funding fee and closing costs.

Underwriting Requirements

The VA's regulations implement flexible, yet prudent, statutorily prescribed [underwriting standards](#) that banks must follow to ensure the borrower is a satisfactory credit risk and has present and anticipated income that bears a proper relation to the contemplated terms of repayment.²¹ For example, the VA's regulations call for greater scrutiny of loans when the borrower's debt-to-income ratio is greater than 41 percent.²² Chapter 4 of the [VA Lender's Handbook](#) details the method required by the VA to identify and verify a borrower's income, assets, debts and credit history.

Adjustable Rate Mortgages

The VA is authorized statutorily to guarantee "traditional" and so-called "hybrid" adjustable rate mortgages (ARMs).²³

Traditional ARMs

Traditional ARM interest rate adjustments occur annually. The annual interest rate adjustment is 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. Traditional ARMs must be underwritten at one percentage point above the initial rate.²⁴

Hybrid ARMs

Hybrid ARMs have longer initial fixed rates of three, five, seven, or 10 years before they adjust. If the initial contract interest rate remains fixed for less than five years, the initial adjustment in the interest rate 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 five 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. After the initial interest rate adjustment, annual adjustments may be up to two percentage points. Hybrid ARMs with a fixed period of three or more years may be underwritten at the initial interest rate.

Appraisal Requirements

The VA is required by law to maintain a list of eligible appraisers based on qualifications the VA prescribes.²⁵ The VA is also required to select the appraiser from this list. The appraisers are selected by rotation. Chapter 10 of the [VA Lender's Handbook](#) provides instructions for how lenders are to obtain an appraisal.

¹⁹ 38 CFR 36.4313.

²⁰ *VA Lender's Handbook*, chapter 8, topic 7, subsection a.

²¹ *VA Lender's Handbook*, chapter 4.

²² 38 CFR 36.4340.

²³ 38 USC 3707, 3707A.

²⁴ 38 USC 3707.

²⁵ 38 USC 3731.

Loss Mitigation²⁶

The VA's goal is to ensure each veteran receives every possible opportunity to retain his or her home and avoid foreclosure. Loss mitigation is an option available to help veterans avoid foreclosure on delinquent loans and reduce possible loss to the government. The VA delegates the primary responsibility for loss mitigation to loan servicers. The VA recognizes five loss mitigation options and pays an incentive to the servicer when any of these options are successfully completed. The loss mitigation options are divided into either home retention options or alternatives to foreclosure. Home retention options include repayment plans, special forbearances, and loan modifications. Alternatives to foreclosure include compromise sales and deed-in-lieu of foreclosure.

The VA encourages servicers to consider loss mitigation options that allow the veteran to retain his or her home. If circumstances show that the borrower is unable to retain the home, however, or that home retention options are not feasible, the servicer should proceed with reviewing alternatives to foreclosure. Even though the VA encourages servicers to consider loss mitigation as a retention option, VA regulations do not require such review if the borrower is unable or unwilling to retain his or her home. Servicers must select the best option for all parties involved as early in the delinquency process as possible.²⁷

Federal Home Loan Bank of Chicago MPF Government MBS Program

The Federal Home Loan Bank (FHLB) of Chicago has begun issuing securities backed

by VA-guaranteed loans and other government-insured mortgages originated by FHLB member financial institutions. The new secondary market conduit product, [Mortgage Partnership Finance Government Mortgage-Backed Securities](#), provides banks, particularly smaller institutions that lack direct access to the secondary mortgage market, a new source of liquidity. Under the program, the FHLB of Chicago purchases VA-guaranteed loans and other government-insured loans from its member banks, holds the loans on its balance sheet and then pools them into Ginnie Mae-guaranteed securities, which may then be sold to investors. To learn more about this program see the OCC's *Community Developments Fact Sheet*, "[FHLB Government Mortgage-Backed Securities Program: Facilitating Secondary Market Access](#)" (July 2016).

For More Information

[VA Lender's Handbook \(VA Pamphlet 26-7\)](#)

[VA Circulars](#)

[OCC's District Community Affairs Officers contact information](#)

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²⁶ *VA Servicer Handbook*, chapter 5.

²⁷ *VA Servicer Handbook*, chapter 5.