

VA-Guaranteed Cash-Out Refinancing Home Loans (AQ42)

1. **Purpose.** This Circular clarifies the Department of Veterans Affairs' (VA) new policies regarding VA-guaranteed cash-out refinancing loans, including refinancing of construction loans (construction-to-perm).

2. **Background.** Public Law 115-174, *The Economic Growth, Regulatory Relief, and Consumer Protection Act* (the Act), was signed into law by President Donald Trump on May 24, 2018. Section 309 of the Act provides new statutory criteria to determine when VA may guarantee a refinancing loan. The Act required VA to promulgate regulations for cash-out refinancing loans, specifically refinancing loans in which the loan amount will exceed the payoff amount of the loan being refinanced.

a. On December 17, 2018, VA published interim final rule (AQ42) in the federal register setting forth requirements relating to cash-out refinance loans. See <https://www.federalregister.gov/documents/2018/12/17/2018-27263/loan-guaranty-revisions-to-va-guaranteed-or-insured-cash-out-home-refinance-loans>. This includes the Regulatory Impact Analysis (RIA) that provides details concerning VA's analysis in developing this rule. AQ42 amends VA regulations pertaining to all cash-out refinancing loans (38 CFR 36.4306). This includes refinancing of construction loans (construction-to-perm loans), regardless of whether there is a change in the principal loan amount. However, AQ42 does not implement rules pertaining to interest rate reduction refinance loans (IRRRLs).

b. VA will update IRRRL regulations in an upcoming rulemaking.

3. **Effective date.** The rule is effective on February 15, 2019, and will apply to VA cash-out refinance loan applications taken on, or after, this date. Loan applications taken prior to the effective date that were submitted to an Automated Underwriting System (AUS) either before or after the effective date, where subsequent and/or final AUS submissions result in a Refer recommendation, require manual underwriting.

4. **Action.** All-VA guaranteed cash-out refinancing loans must comply with the Act and AQ42. All refinancing loan applications taken on or after the effective date that do not meet the following requirements may be subject to indemnification or the removal of the guaranty. Failure to provide initial disclosures to the Veteran within 3 business days from the initial application date and at closing may result in indemnification of the loan up to 5 years. There are three categories of refinance loans; Interest Rate Reduction Refinancing Loans (IRRRL), TYPE I Cash-Out Refinance, and TYPE II Cash-Out Refinance.

(LOCAL REPRODUCTION AUTHORIZED)

a. Definitions.

(1) An Interest Rate Reduction Refinancing Loan (IRRRL) is a refinancing loan made to refinance an existing VA-guaranteed home loan at a lower interest rate.

(2) TYPE I Cash-Out Refinance is a refinancing loan in which the loan amount (including VA funding fee) does not exceed the payoff amount of the loan being refinanced.

(3) TYPE II Cash-Out Refinance is a refinancing loan in which the loan amount (including VA funding fee) exceeds the payoff amount of the loan being refinanced.

b. Loan-to-Value (LTV). VA will no longer guaranty refinancing loans when the LTV exceeds 100 percent. Inclusion of any funding fee that is financed, in part or whole, cannot cause the loan to exceed the reasonable value of the property.

(1) LTV Calculation. Divide the total loan amount (including VA funding fee, if any) by the reasonable value of the property determined by the appraiser.

c. Net Tangible Benefit (NTB). NTB standards apply to all cash-out refinancing loans. It consists of the NTB test, Loan Comparison, and Home Equity Disclosure

(1) NTB Test. All cash-out refinancing loans must pass the NTB test. This requirement is met if the refinancing loan satisfies at least one of the following:

- (a) The new loan eliminates monthly mortgage insurance; or
- (b) Loan term of the new loan is less than the loan term of the loan being refinanced; or
- (c) Interest rate of the new loan is less than the interest rate of the loan being refinanced. (Note: If the loan being refinanced had an adjustable interest rate or was modified, the current interest rate must be used when determining if this requirement has been met.); or
- (d) The monthly (principal and interest) payment of the new loan is less than the monthly (principal and interest) payment of the loan being refinanced; or
- (e) The Veteran's monthly residual income is higher as a result of the new loan. (residual income, including refinancing monthly PITI (principal, interest, taxes, and insurance) payment vs. current residual income, including monthly PITI payment of the loan being refinanced.) In cases where TI amounts are changing between the application date and the closing date of the refinance transaction, the new TI amount will be used in determining residual income for both the current and refinanced loan); or
- (f) The new loan is used to payoff the Veteran's interim construction loan; or
- (g) The new loan LTV is equal to or less than 90 percent of the reasonable value of the home, i.e. $LTV \leq 90\%$; or
- (h) Refinance of an adjustable-rate mortgage to a fixed-rate mortgage.

(2) Loan Comparison Disclosure. The lender must provide the Veteran a comparison of the new loan to the existing loan being refinanced. VA requires lenders to generate two loan comparison disclosures, one within 3 business days from the initial date of the loan

application and at loan closing. The borrower must certify receipt of both disclosures (i.e. signature, e-signature, email from borrower certifying receipt, email read receipts, system time/date stamp where a borrow certified receipt, etc).

(a) Initial 3-Day Disclosure. Lender's shall provide a reasonable estimate within 3 business days of loan application. Reasonably accurate estimates, may involve the use of borrower documentation, such as their mortgage statement, closing documents, their own estimation of the existing loan terms, online property valuation tools, and manual calculations. Lenders are encouraged, but not required, to continually update the disclosure as additional, and more accurate, information becomes available throughout the origination process.

(b) Final Loan Closing Disclosure. The final loan comparison disclosure provided at loan closing shall be accurate with respect to the new loan information, while the initial loan information may be a generally accurate representation of the existing loan, given that payments may be in transit, tax and insurance amounts may be pending, and payoffs may fluctuate when the final closing date has not been determined.

(c) Contents of the Initial 3-Day Disclosure and the Final Loan Closing Disclosure. VA has provided a sample disclosure in Exhibit A that includes both the loan comparison and home equity provisions stated in this Circular. The following information will be provided in the disclosures:

1. Refinancing loan amount (including VA funding fee, if financed into the loan) vs. the payoff amount (including fees, escrow shortages, and prorated interest) of the loan being refinanced.

2. Interest Rate

3. Mortgage Loan Type (i.e., fixed, adjustable)

4. Loan term of the refinancing loan vs. the remaining term of the loan being refinanced. The term may be expressed in months or years and months.

5. The total payments the Veteran will have paid after making all payments (principal and interest) as scheduled on the refinancing loan vs. the total remaining payments the Veteran will have paid after making all remaining payments of principal, interest, and mortgage insurance (if applicable) as scheduled on the loan being refinanced.

6. LTV of the refinancing loan vs. loan payoff (including fees, escrow shortages, and prorated interest) to current value of the loan being refinanced.

(3) Home Equity Disclosure. The lender must disclose the amount of home equity being removed from the home as a result of the new loan to the Veteran within 3 business days from the initial date of the loan application and at loan closing. The disclosure must also explain to the Veteran how the removal of home equity may affect the sale or refinance of the home in the future. Similar to the Loan Comparison Disclosure, the borrower must certify receipt of the Home Equity Disclosure (i.e. signature, e-signature, email from borrower certifying receipt, email read receipts, system time/date stamp where a borrow certified receipt, etc.). VA has provided a sample disclosure in Exhibit A that includes both the loan comparison and home equity provisions stated in this Circular.

(a) For the initial home equity disclosure, lenders may use estimated loan payoff or unpaid principal balance and estimated current property value to determine the home equity being removed from the home. However, the lender must use the final payoff amount (including fees, escrow shortages, and prorated interest) and the reasonable value shown on the Notice of Value (NOV) to determine the home equity being removed from the home on the home equity disclosure provided to the Veteran at loan closing.

d. Loan Seasoning. Loan seasoning applies to all cash-out refinancing loans made to refinance a VA-guaranteed home loan (VA-to-VA). A cash-out refinancing loan, Type I nor Type II, is not eligible for guaranty by VA, if the VA-guaranteed loan being refinanced has not been seasoned as of the date of closing. A loan is considered seasoned if both of the following conditions are met as of the date of loan closing:

(1) The first monthly payment of the loan being refinanced was made 210 days or more prior to the closing date of the refinancing loan; **and**

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

(3) For loans being refinanced within 1 year from the date of closing, lenders must obtain a payment history/ledger from the servicing lender documenting all payments. If the loan is selected for audit by VA, the lender must include the payment ledger/history of the loan being refinanced in the loan file for VA review.

e. Fee Recoupment. Fee recoupment applies to TYPE I cash-out refinancing loans made to refinance a VA-guaranteed home loan (VA-to-VA). To obtain a Loan Guaranty Certificate (LGC) the lender must certify that the recoupment period of fees, expenses, and closing costs (included in the loan and paid outside of closing), do not exceed 36 months from the date of the loan closing.

(1) Recoupment Calculation: The recoupment period is calculated by dividing all fees (not including VA funding fee per), expenses, and closing costs included in the loan and paid outside of closing by the reduction of monthly principal and interest (PI).

(a) Example:

PI (VA loan being refinanced):	\$654.00
PI (new VA refinancing loan):	<u>- \$604.00</u>
Reduction of monthly PI:	= \$ 50.00

If the loan being refinanced loan has been modified, the reduction of monthly PI should be computed using the modified monthly PI of the loan being refinanced.

(b) Example:

Fees/expenses/closing cost:	\$1,436.49
Reduction of monthly PI:	<u>÷ \$ 50.00</u>
Fee Recoupment Period:	= 29 months (28.72 months rounded)

(c) Escrow and prepaid expenses, such as, insurance, taxes, special assessments, and

homeowners' association (HOA) fees shall be excluded from the recoupment calculations.

(d) VA allowable fee as established in 38 C.F.R. § 36.4313 offset by lender credits and/or premium pricing may also be excluded from the recoupment calculation.

4. Rescission: This Circular is rescinded April 1, 2021.

By Direction of the Under Secretary for Benefits

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