

**PRINCIPAL REDUCTION ALTERNATIVE (PRA) FOR DEPARTMENT OF  
VETERANS AFFAIRS (VA) LOANS**

1. Purpose. This circular clarifies the ability of servicers and loan holders to utilize principal reductions in connection with the modification of VA-guaranteed home loans.
2. Background. Under section 36.4315 of Title 38 of the Code of Federal Regulations (38 CFR 36.4315), VA authorizes loan holders to modify VA-guaranteed home loans without VA prior approval, as long as all conditions listed in the regulation are satisfied. When the Department of Treasury established the Home Affordable Modification Program (HAMP), VA issued Circular 26-10-6 to authorize modifications of loans in accordance with the HAMP guidelines, including principal deferment, even when the terms of modification differed from those allowed for traditional modifications under 38 CFR 36.4315. As the Department of Treasury modified HAMP to include a PRA, the fact that VA had authorized HAMP-style modifications meant that a loan holder could complete a PRA on a VA loan modification without seeking VA prior approval. VA considers the PRA as a partial prepayment of the loan (albeit by the holder), which is authorized by 38 CFR 36.4311.
3. Action. VA encourages all holders and servicers of VA-guaranteed home loans to consider the possibility of a PRA when reviewing loans for possible modifications. VA is not able to reimburse for any principal reduction, as a VA claim is payable only upon termination of a loan, and any forgiven amount is no longer part of the eligible indebtedness. However, review of a PRA in connection with a loan modification may produce a higher expected return for a servicer than termination of the loan, especially when the sum of the net property value plus VA's maximum claim liability is less than the total indebtedness on the loan. In addition, the 25% guaranty on a modified loan may result in a higher dollar amount of guaranty for any future claim. Since most VA-guaranteed loans are placed in pools guaranteed by Ginnie Mae, servicers should ensure compliance with all requirements for loan buy-outs and re-pooling.
4. Rescission: This circular is rescinded January 1, 2016.

By Direction of the Under Secretary for Benefits

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Director, Loan Guaranty Service

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