VA Home Loan Centers

http://www.vahomeloancenters.org/va-refinance/loan-modification-administrative-law-update/

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SUPPLEMENTARY INFORMATION:

Statutory Background

Under 38 U.S.C. chapter 37, VA guarantees loans made by private lenders to veterans for the purchase, construction, and refinancing of homes owned and occupied by veterans.

Regulatory Background

On February 1, 2008, VA published in the Federal Register (73 FR 6294) a final rule that extensively revised 38 CFR part 36 to modernize procedures for servicing VA-guaranteed home loans. A new subpart F was added to include § 36.4815, which provided detailed parameters for private loan servicers to modify delinquent loans without seeking prior approval from VA, thereby enabling servicers to quickly assist veteran borrowers in avoiding foreclosure.

On June 15, 2010, VA published in the Federal Register (75 FR 33704) a final rule that redesignated subpart F (the 36.4800 series) to replace obsolete subpart B (the 36.4300 series) in its entirety.

On February 7, 2011, VA published in the Federal Register (76 FR 6555) an interim final rule that (1) restructured § 36.4315 to clarify that holders may seek VA approval for a loan modification if the proposed modification does not otherwise meet the conditions prescribed in § 36.4315(a), (2) revised the methodology for determining the maximum interest rate on a modified loan, and (3) allowed foreclosure costs actually incurred to be capitalized into the modified loan balance.

Discussion of Public Comments

The public comment period on the interim final rule closed on April 8, 2011. VA received comments from six entities about the rule. One comment was from a mortgage industry trade association, three were from mortgage servicers, and two were from nonprofit law firms writing on behalf of veteran borrowers.

The final rule has been revised to incorporate changes that VA agrees are necessary in light of, or as the logical outgrowth of the comments provided. The following paragraphs discuss the comments VA received on the interim final rule. The comments are presented in order by the paragraph to which the comments apply, and similar comments are grouped together.

Section 36.4315(a)(8) Interest Rate Restrictions

Comment: VA should change the establishment of the maximum interest rate from the date the modification is executed to the date the modification is approved. *VA Response:* VA concurs. As indicated in the interim final rule, VA based its revision to the establishment of the maximum interest rate allowable on a loan modification to a large extent on a Department of Housing and Urban Development (HUD) Mortgagee Letter (2009–35), which stated that the maximum rate would be computed as of the date of execution of the Modification Agreement. However, several comments mentioned that a subsequent Loan Modification Frequently Asked Questions (FAQ) document posted by HUD on its Web site (at *http://www.hud.gov/offices/hsg/sfh/nsc/faqlm.cfm*) stated that the maximum interest rate on a loan modification should actually be calculated as of the date the Mortgagee approves the modification. This is a more beneficial position for a veteran borrower, as it allows the maximum rate to be calculated when the servicer is underwriting the modification, without the possibility of an interest rate increase occurring before execution of the modification that might result in an increase in the interest rate. In addition, it is more feasible from a processing standpoint for the servicer, because it allows the rate to be fixed without concern that documents may be sent to the borrower to be signed, but the Modification Agreement may be in violation of the regulation if rates decrease before the modification is executed. Therefore, § 36.4315(a)(8)(i) is changed by replacing the word ''executed'' with the word ''approved''.

Comment: VA should require that the interest rate on a modified loan be lower than the existing rate, or that any interest rate increase on a modified loan be submitted to VA for approval. *VA Response:* VA does not concur. As discussed in the preamble to the interim final rule, a modification typically allows capitalization of past due amounts over a very long repayment term, sometimes as long as 10 years past the original maturity date of the loan (or even longer if the original term was less than 30 years), which is easier to maintain than a short term repayment arrangement, but will likely increase the monthly payments by a small amount.

This benefits the veteran by eliminating the delinquency and granting a ''fresh start'' on payment of the loan. The servicer is required to determine that the borrower is a reasonable credit risk based on income, expenses and other obligations, so even though the interest rate may be increasing on a modification, future payments will still be affordable. Requiring VA to review every case with a small interest rate increase would place an undue burden on limited staff, while providing no tangible benefit to veterans. Allowing modification at a market interest rate, which may be lower or higher than the existing interest rate, serves as an incentive for the servicer to complete the modification at a rate that will allow it to re-pool the modified loan without taking a loss to do so. However, if the proposed interest rate for the modification is more than one percent above the existing rate, then VA believes it is appropriate to review the case to determine if the increased rate, in addition to the capitalization of the delinquency, could raise serious questions about the veteran's ability to repay the modified loan. That would give VA the opportunity to consider refunding the loan at a lower rate in order to make the modification even more affordable for the veteran borrower. If the servicer decides that a veteran is not a reasonable credit risk for a loan modification, then VA has the opportunity through its oversight to consider refunding the loan at a rate that will make the loan affordable, if that is possible. This is the position that VA believes best balances the goals of the VA home loan program to provide a benefit to our nation's veterans, while also exercising appropriate judgment in the use of taxpayer funds to acquire loans that will yield much lower than market rates.

Comment: VA should mandate lower payments on a modified loan. For circumstances in which: (1) The interest rate will be the same or higher, (2) even a reduced interest rate will not result in a lower payment, or (3) the interest rate cannot be reduced (such as on a loan held by a state housing-finance authority), VA should require reduction in the principal balance so that the payment will be reduced.

VA Response: VA does not concur. As stated above, the purpose of a loan modification is to give a borrower a fresh start by resetting the terms of the loan to make payments affordable. Reducing a loan payment does not necessarily guarantee that future payments will be affordable for a borrower, as that requires an analysis of income and other expenses. If a borrower can afford future payments that are slightly higher than existing payments, but cannot afford to pay the accrued delinquency, then there is no need to require that payments on a modified loan be lower than the existing payments, only that the delinquency be eliminated via the modification. As far as requiring that a servicer waive a portion of the principal balance in order to reduce payments, VA does not have any specific authority to do so. VA does have the option to assist a veteran borrower in need of lower payments by refunding a loan and reducing the interest rate well below the market rate to make payments affordable. However, that authority to refund must be balanced against the fact that taxpayer funds will be used to acquire a loan that will be modified to yield much less than market interest rates.

Section 36.4315(a)(10) Fees Allowed in

Modified Amount

Comment: VA should ensure that veterans are not overcharged for foreclosure expenses, perhaps by setting a limit of $1,000 on legal fees that may be capitalized when a loan is modified.

VA Response: VA partially agrees. This subparagraph presently limits the amount that may be included in the modified indebtedness to ‘‘actual legal fees and foreclosure costs related to the cancelled foreclosure.’’ Existing § 36.4314 limits the amount of legal fees for foreclosure that may be included in the computation of a guaranty claim, based on the reasonable and customary amounts the Secretary has determined appropriate in each state. In order to ensure that veterans are not charged in excess of the maximum amount allowable for a completed foreclosure, § 36.4315(a)(10) is amended to limit the amount of legal fees and costs that may be included in the modified indebtedness to the maximum amounts prescribed in § 36.4314 by inserting after ‘‘canceled foreclosure’’ the phrase ‘‘(subject to the maximum amounts prescribed in § 36.4314).’’ VA does not believe it is appropriate to set a maximum $1,000 for the limit on cancelled foreclosure costs and fees that may be included in the modified loan balance, as costs vary from state to state, and the amount of work completed on a foreclosure will also [vary] from case to case. The language limiting costs to ‘‘actual’’ fees and costs clearly indicates that the maximum allowable charge should not be made unless those fees and costs have actually been incurred.

Loss Mitigation Requirements

Comment: VA should promulgate new regulations requiring that loan holders engage in mandatory loss mitigation efforts prior to initiation of foreclosure.

VA Response: VA does not concur. VA believes its existing regulations both require and encourage loss mitigation efforts by loan holders and their mortgage servicers prior to the initiation of foreclosure. In § 36.4350, VA requires establishment of a system for servicing delinquent loans and prescribes collection actions designed to determine reasons for loan defaults and to explore loss mitigation options. In § 36.4319, VA provides an incentive structure to encourage successful loss mitigation efforts by loan servicers. This final rule (§ 36.4315) allows servicers wide latitude in modifying delinquent loans without the prior approval of VA in order to resolve defaults. VA also authorizes servicers to pursue short sale and deeds in lieu of foreclosure (§ 36.4322) when home retention is not possible and the servicing requirements in VA's regulations are satisfied. Furthermore, in order to ensure that a servicer has sufficient time to explore all possible loss mitigation options, in calculating the guaranty claim payable on a terminated loan, VA allows inclusion of interest for 210 days from the due date of the last paid installment, plus the reasonable period that VA has established for completion of termination in the jurisdiction where the loan is located. We believe all these existing requirements, plus the oversight efforts of dedicated VA Loan Technicians, has resulted in ensuring that veterans receive excellent opportunities to retain their homes when feasible, or to avoid foreclosure when retention is not possible. As a demonstration of this point, for the past 2 years the Mortgage Bankers Association quarterly National Delinquency Survey has reported that VA-guaranteed loans have the lowest foreclosure starts and foreclosure inventory of any loan type.

Paperwork Reduction Act of 1995

This document contains no provisions constituting a collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3521).

Unfunded Mandates

The Unfunded Mandates Reform Act of 1995 requires, at 2 U.S.C. 1532, that agencies prepare an assessment of anticipated costs and benefits before issuing any rule that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any given year. This rule will have no such effect on State, local, and tribal governments, or on the private sector.

Executive Orders 12866 and 13563

Executive Orders 12866 and 13563 direct agencies to assess the costs and benefits of available regulatory alternatives and, when regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, and other advantages; distributive impacts; and equity).

Executive Order 13563 (Improving Regulation and Regulatory Review) emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility.

Executive Order 12866 (Regulatory Planning and Review) defines a ''significant regulatory action,'' which requires review by the Office of Management and Budget (OMB), as ''any regulatory action that is likely to result in a rule that may: (1) Have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; (2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive Order.'' The economic, interagency, budgetary, legal, and policy implications of this regulatory action have been examined and it has been determined not to be a significant regulatory action under Executive Order 12866.

Regulatory Flexibility Act

The Secretary hereby certifies that this final rule would not have a significant economic impact on a substantial number of small entities as they are defined in the Regulatory Flexibility Act, 5 U.S.C. 601–612. The vast majority of VA loans are serviced by very large financial companies. Only a handful of small entities service VA loans and they service only a very small number of loans. This final rule, which only impacts veterans, other individual obligors with guaranteed loans, and companies that service VA loans, will have very minor economic impact on a very small number of small entities servicing such loans. Therefore, pursuant to 5 U.S.C. 605(b), this rule is exempt from the initial and final regulatory flexibility analysis requirements of sections 603 and 604.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance number and title for the program affected by this document is 64.114, Veterans Housing—Guaranteed and Insured Loans.

Signing Authority

The Secretary of Veterans Affairs, or designee, approved this document and authorized the undersigned to sign and submit the document to the Office of the Federal Register for publication electronically as an official document of the Department of Veterans Affairs. John R. Gingrich, Chief of Staff, Department of Veterans Affairs, approved this document on October 24, 2011, for publication.

List of Subjects in 38 CFR Part 36

Condominiums, Handicapped, Housing, Indians, Individuals with disabilities, Loan programs—housing and community development, Loan programs—Indians, Loan programs—veterans, Manufactured homes, Mortgage insurance, Reporting and recordkeeping requirements, Veterans.

Dated: December 15, 2011.

Robert C. McFetridge,

Director of Regulation Policy and Management, Office of the General Counsel, Department of Veterans Affairs.

For the reasons stated in the preamble, VA amends 38 CFR part 36 as follows:

PART 36—LOAN GUARANTY

■ 1. The authority citation for part 36 continues to read as follows:

Authority: 38 U.S.C. 501 and as otherwise noted.

■ 2. Amend § 36.4315 by:

■ a. In paragraph (a)(8)(i) removing ‘‘executed’’ and adding, in its place, ‘‘approved’’.

■ b. In paragraph (a)(10) removing ‘‘canceled foreclosure;’’ and adding, in its place, ‘‘canceled foreclosure; (subject to the maximum amounts prescribed in § 36.4314)’’.

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