

VA Lenders Handbook (VA Pamphlet 26-7), Chapter 7, Topic 2 — Construction/Permanent Home Loans

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2. Construction/Permanent Home Loans Change Date March 11, 2019 • This chapter has been revised in its entirety a. The Basics VA will guarantee a “construction/permanent home loan,” that is, a loan to finance the construction/purchase of a residence. The loan is closed prior to the start of construction with proceeds disbursed to cover the cost of, or balance owed on, the land, and the balance into escrow. The escrowed monies are paid out to the builder during construction. The lender must obtain written approval from the borrower before each draw payment is provided to the builder. The loan will not be guaranteed until construction is complete and all Notice of Value (NOV) conditions are met. This section does not address other construction loans guaranteed by VA; that is, those for the purchase of a residence newly constructed for the Veteran by a builder who financed the construction from his or her own resources. Lenders should have the specialized experience to originate, process, underwrite (borrower, project, and builder), close, service and administer such loans. These types of loans and projects inherently have uncertain elements that require careful examination. Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-14 2. Construction/Permanent Home Loans, continued a. The Basics, continued Construction to Permanent (One Closing Vehicle) Construction to Permanent Purchase (Two Part Closing Vehicle) Refinance Construction Loans • Once loan vehicle is established it cannot be modified into a different loan vehicle • Can utilize bonus entitlement • See Chapter 10 of this Handbook for appraisal guidance • Loan closed before start of construction • Guarantee cannot be issued until construction is 100% complete • Once loan vehicle is established, it cannot be modified into a different loan vehicle • Can utilize bonus entitlement • See Chapter 10 of this Handbook for appraisal guidance • Loan closed after the NOV conditions are met • Can utilize bonus entitlement • VA regular refinance (cash-out) policies apply b. Amortization The Veteran begins making payments on a construction/permanent home loan only after construction is complete. Therefore, the initial payment on the principal may be postponed up to 1 year, if necessary. The loan must be amortized to achieve full repayment within its remaining term. The lender must provide evidence of the amortization in the loan file. Example. If it takes 6 months to complete construction, the payment schedule for the Veteran obtaining a 30-year mortgage must provide for full repayment of the loan in 29 years and 6 months. Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-15 2. Construction/Permanent Home Loans, continued b. Amortization, continued Rather than requiring a balloon payment, it may be preferable to set up equal payments (beginning after construction is complete) which are large enough to repay the loan within the original maturity without a balloon payment. The VA requirement that loans be amortized with approximately equal payments and the principal must be reduced at least once annually, also applies to construction loans. However, the final installment may be for an amount up to five

percent of the original principal amount of the loan. c. What the Builder Must Pay? On a construction/permanent home loan, the builder is responsible for Interest payments during the construction period, and all fees normally paid by a builder who obtains an interim construction loan including, but not limited to: • inspection fees, • title updates, • title update fees, • hazard insurance during construction, and • property taxes. d. Interest Rate Lender's may offer a "ceiling-floor" where the Veteran "floats" the interest rate during construction. The agreement must provide that at lock-in, the permanent interest rate will not exceed a specific maximum interest rate and permit the borrower to lock-in at a lower rate based on market fluctuations. The borrower must qualify for the mortgage at the maximum rate. Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-16 2. Construction/Permanent Home Loans, continued e. What Fees the Veteran Can Pay? Fees the Veteran can pay are described in Chapter 8. The Veteran may not pay any fees that are the builder's responsibility. f. Funding Fee and Loan Reporting The funding fee is due and payable to VA within 15 days of loan closing; that is not tied to the commencement or completion of construction. The loan must be guaranteed in WebLGY within 60 days of completion of all NOV requirements. g. LGC Although the loan will normally be considered guaranteed upon closing, the LGC on a construction/permanent home loan will not be issued until a clear final compliance inspection report has been received by VA. h. If Loan Proceeds are Not Fully Disbursed If the construction is not fully completed and loan proceeds are not fully disbursed, guaranty will apply only to the proper pro rata part of the loan. To calculate the proper pro rata part of the loan: • take loan proceeds disbursed for construction purposes, • add any other payments made to the builder by or on behalf of the Veteran, • take the lesser of the above total or 80 percent of the value of that portion of the construction completed, and • add any loan disbursements made for the purchase of the land on which the construction is situated. VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-17

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