

VA Lenders Handbook (VA Pamphlet 26-7), Chapter 7, Topic 5 — What is a Supplemental Loan

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5. What is a Supplemental Loan Change Date March 11, 2019 • This chapter has been revised in its entirety.

a. What is a Supplemental Loan? A supplemental loan is a loan for the alteration, improvement, or repair of a residential property. The residential property must secure an existing VA- guaranteed loan, and be owned and occupied by the Veteran, or the Veteran will reoccupy upon completion of major alterations, repairs, or improvements. The alterations, improvements, or repairs must:

- Be for the purpose of substantially protecting or improving the basic livability, or utility of the property, and
- Be restricted primarily to the maintenance, replacement, improvement or acquisition of real property, including fixtures. Installation of features such as barbecue pits, swimming pools, etc., does not meet this requirement. No more than 30 percent of the loan proceeds may be used for the maintenance, replacement, improvement, repair, or acquisition of non- fixtures or quasi-fixtures such as refrigeration, cooking, washing, and heating equipment. The equipment must be related to or supplement the principal alteration for which the loan is proposed. Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-25

5. What is a Supplemental Loan, continued b. Required Lien and Maximum Loan Term It is the lender's responsibility to obtain an effective lien of the required dignity (lien position). Possible methods to secure a supplemental loan are:

- Through an open-end provision of the instrument securing the existing loan,
- Through an amendment of the existing loan security instrument, By taking a new lien to cover both the existing and the supplemental loans, or
- By taking a separate lien immediately junior to the existing lien. The maximum loan term is:

- 30 years if amortized, or
- 5 years if not amortized.

c. Other Requirements The existing loan must be current with respect to taxes, insurance, and amortized payments, and must not otherwise be in default unless a primary purpose of the supplemental loan is to improve the ability of the borrower to maintain the loan obligation. The making of a supplemental loan can never result in any increase in the rate of interest on the existing loan. A supplemental loan to be written at a higher rate of interest than that payable on the existing loan must be evidenced by a separate note from the existing loan. Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-26

5. What is a Supplemental Loan, continued d. Prior Approval or Automatic Loan Closing A supplemental loan will require the prior approval of VA if the:

- loan is to be made by a lender that does not have authority to close loans on an automatic basis or
- loan is to be made by a lender that does not have authority to close loans on an automatic basis; or
- an obligor liable on the currently outstanding obligation will be released from personal liability by operation of law or otherwise.

e. Procedures Submit a statement describing the alterations, improvements, or repairs made or to be made with the prior approval application (or loan closing package, if closed automatically). In addition, report the amount outstanding on the existing loan as of the date of closing of the supplemental loan in the loan closing package. Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other

Considerations 7-27 5. What is a Supplemental Loan, continued e. Procedures, continued If the cost of the repairs, alterations, or improvements exceeds \$3,500: an NOV and compliance inspections are required. If the cost of the repairs, alterations, or improvements does not exceed \$3,500: an NOV and compliance inspections are not required. Instead, a statement of reasonable value may be submitted. The statement must be completed and signed by a VA-designated appraiser. A VA-designated appraiser is an individual nominated by the lender (who may be an officer, trustee, or employee of the lender or its agent) who has been approved by the local VA office. The statement must specify the: • work done or to be done, • purchase price or cost of the work and material, and • purchase price or cost does not exceed the reasonable value. In lieu of VA compliance inspections, the lender must submit a certification as follows: “The undersigned lender certifies to the Department of Veterans Affairs that the property as repaired, altered, or improved has been inspected by a qualified individual designated by the undersigned, and based on the inspection report, the undersigned has determined that the repairs, alterations, or improvements financed with the proceeds of the loan described in the attached VA Form 26-1820, appear to have been completed in substantial conformance with related contracts.” f. Guaranty and Entitlement If the supplemental loan will not be consolidated with a related outstanding guaranteed loan the: • Veteran must have sufficient entitlement for the new loan, and Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-28 5. What is a Supplemental Loan, continued f. Guaranty and Entitlement, continued • VA will issue a new LGC solely for supplemental loans. If the supplemental loan will be consolidated with a related outstanding guaranteed loan, VA will issue a new modified guaranty certificate. g. Procedure If the Veteran has no available entitlement, VA can still guarantee the supplemental loan provided the lender is the holder of the Veteran’s existing loan and the loans are to be consolidated. The amount of the modified guaranty will be the maximum guaranty effective on the existing loan at the time the supplemental loan is closed. To calculate the percentage of guaranty applicable to the combined indebtedness take the result of Step 1, and divide by the result of Step 3. Follow the steps in the table below to calculate the percentage of guaranty applicable to the combined indebtedness. Step Action 1 Take the balance of the existing loan at the time of closing of the supplemental loan and multiply by the percentage of guaranty for the existing loan, as shown on the guaranty certificate. 2 Calculate the amount of guaranty that would be issued on the supplemental loan as an independent loan (do not exceed the amount of entitlement available to the Veteran). 3 Take the balance of the existing loan and add the amount of the supplemental loan. 4 Take the result of Step 1 above and add the result of Step 2 above. 5 Divide by the result of Step 3 above. VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-29

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