

## VA Lenders Handbook (VA Pamphlet 26-7), Chapter 7, Topic 7 — Loans Involving Temporary Interest Bydowns

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7. Loans Involving Temporary Interest Bydowns Change Date March 11, 2019 • This chapter has been revised in its entirety. a. Description As a marketing tool, builders, sellers, or lenders will sometimes establish and fund escrows to temporarily reduce a borrower's loan payments during the initial years of the mortgage. The borrower may also fund such an escrow for herself/himself as a financial management tool. VA will guaranty loans involving temporary interest rate buydowns, if otherwise eligible. A temporary interest rate buydown can be used in conjunction with any type of VA-guaranteed loan. b. Escrow Agreements Funds must be safely escrowed with an independent third-party escrow agent beyond the reach of prospective creditors of the builder, seller, lender, and the borrower. Exception. If the Federal National Mortgage Association is the holder, it may take custody of the funds. The escrow agent must make payments directly to the lender or servicer. The funds may be used only for payments due on the note. The funds may not be used to pay past due monthly loan payments. If the loan is foreclosed or prepaid, the funds must be credited against the Veteran's indebtedness. Escrowed funds may not revert to the party that established the escrow. If the property is sold subject to, or on an assumption of the loan, the escrow must continue to pay out on behalf of the new owner. c. If Borrowers Income is Expected to Keep Pace with Payment Increases The loan application may be underwritten based on the first year's payment amount if there are strong indications that the income used to support the application will increase to cover the yearly increases in loan payments. Routine cost of living increases cannot be used for this purpose. Increases resulting from confirmed future promotions or wage percentage increases guaranteed by labor contracts (for example, teachers, and auto workers) may be given favorable consideration. Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-31 7. Loans Involving Temporary Interest Bydowns, continued c. If Borrowers Income is Expected to Keep Pace with Payment Increases, continued The assistance payments must run for a minimum of 1 year. Scheduled reductions in the assistance payments must occur annually on the anniversary of the first mortgage payment. The reduction in the assistance payments may be accomplished through annual payment increases in equal or approximately equal amounts, or equal annual increases in the interest rate. d. If it is Unclear Whether the Borrower's Income Can Keep Pace with Increases The loan application must be underwritten based on the full payment amount if there are no strong indications that the income used to support the application can reasonably be expected to keep pace with the increases in loan payments. The buydown arrangement can be considered a compensating factor. If the residual income and/or debt-to-income ratio is marginal, the buydown plan (used to offset a short-term debts), along with other compensating factors, may support approval of the loan. See "Compensating Factors" in Chapter 4 of this Handbook. Provide a statement signed by the underwriter giving reasons for approval. The terms of the buydown arrangement are not limited to specific criteria such as a

minimum or maximum number of years for application of the assistance payments. It is the lender's responsibility to review and determine the acceptability of the buydown. Lenders must provide the Veteran-borrower with a clear, written explanation of the buydown agreement. A copy of the buydown and escrow agreements must accompany the loan submission. VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-32

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