

§ 36.4337

a rate not in excess of 2.5 percent per year, but in no event may the projected value of the property exceed 115 percent of the initially established reasonable value, and

(Authority: 38 U.S.C. 3703(d)(2))

(3) The veteran has certified, in such form as the Secretary may prescribe, that the veteran has paid in cash from his or her own resources on account of such purchase, construction, alteration, repair, or improvement a sum equal to the difference, if any, between the purchase price or cost of the property and its reasonable value.

(4) A loan guaranteed under 38 U.S.C. 3710(d) which includes the cost of energy efficient improvements may exceed the reasonable value of the property. The cost of the energy efficient improvements that may be financed may not exceed \$3,000; provided, however, that up to \$6,000 in energy efficient improvements may be financed if the increase in the monthly payment for principal and interest does not exceed the likely reduction in monthly utility costs resulting from the energy efficient improvements.

(Authority: 38 U.S.C. 3710)

(b) Notwithstanding that the aggregate of the loan amount in the case of loans for the purposes specified in paragraph (a) of this section, and the amount remaining unpaid on taxes, special assessments, prior mortgage indebtedness, or other obligations of any character secured by enforceable superior liens or a right to such lien existing as of the date the loan is closed exceeds the reasonable value of such property as of said date and that evidence of guaranty or insurance credit is issued in respect thereof, as between the holder and Secretary (for the purpose of computing the claim on the guaranty or insurance and for the purposes of § 36.4320, and all accountings), the indebtedness which is the subject of the guaranty or insurance shall be deemed to have been reduced as of the date of the loan by a sum equal to such excess, less any amounts secured by liens released or paid on the obligations secured by such superior liens or rights by a holder or others without expense to or obligation on the debtor re-

38 CFR Ch. I (7-1-03 Edition)

sulting from such payment, or release of lien or right; and all payments made on the loan shall be applied to the indebtedness as so reduced. Nothing in this paragraph affects any right or liability resulting from fraud or willful misrepresentation.

(Authority: 38 U.S.C. 501, 3703(c)(1); 38 U.S.C. 501, 3710, 3712)

[33 FR 6975, May 9, 1968, as amended at 35 FR 17180, Nov. 7, 1970; 40 FR 34592, Aug. 18, 1975; 46 FR 43673, Aug. 31, 1981; 47 FR 15139, Apr. 8, 1982; 50 FR 3335, Jan. 24, 1985; 60 FR 38262, July 26, 1995]

UNDERWRITING STANDARDS, PROCESSING PROCEDURES, AND LENDER RESPONSIBILITY AND CERTIFICATION**§ 36.4337 Underwriting standards, processing procedures, lender responsibility, and lender certification.**

(a) *Use of standards.* The standards contained in paragraphs (c) through (j) of this section will be used to determine whether the veteran's present and anticipated income and expenses, and credit history are satisfactory. These standards do not apply to loans guaranteed pursuant to 38 U.S.C. 3710(a)(8) except for cases where the Secretary is required to approve the loan in advance under § 36.4306a.

(Authority: 38 U.S.C. 3703, 3710)

(b) *Waiver of standards.* Use of the standards in paragraphs (c) through (j) of this section for underwriting home loans will be waived only in extraordinary circumstances when the Secretary determines, considering the totality of circumstances, that the veteran is a satisfactory credit risk.

(c) *Methods.* The two primary underwriting tools that will be used in determining the adequacy of the veteran's present and anticipated income are debt-to-income ratio and residual income analysis. They are described in paragraphs (d) through (f) of this section. Ordinarily, to qualify for a loan, the veteran must meet both standards. Failure to meet one standard, however, will not automatically disqualify a veteran. The following shall apply to cases where a veteran does not meet both standards:

Department of Veterans Affairs**§ 36.4337**

(1) If the debt-to-income ratio is 41 percent or less, and the veteran does not meet the residual income standard, the loan may be approved with justification, by the underwriter's supervisor, as set out in paragraph (c)(4) of this section.

(2) If the debt-to-income ratio is greater than 41 percent (unless it is larger due solely to the existence of tax-free income which should be noted in the loan file), the loan may be approved with justification, by the underwriter's supervisor, as set out in paragraph (c)(4) of this section.

(3) If the ratio is greater than 41 percent and the residual income exceeds the guidelines by at least 20 percent, the second level review and statement of justification are not required.

(4) In any case described by paragraphs (c)(1) and (c)(2) of this section, the lender must fully justify the decision to approve the loan or submit the loan to the Secretary for prior approval in writing. The lender's statement must not be perfunctory, but should address the specific compensating factors, as set forth in paragraph (c)(5) of this section, justifying the approval of the loan. The statement must be signed by the underwriter's supervisor. It must be stressed that the statute requires not only consideration of a veteran's present and anticipated income and expenses, but also that the veteran be a satisfactory credit risk. Therefore, meeting both the debt-to-income ratio and residual income standards does not mean that the loan is automatically approved. It is the lender's responsibility to base the loan approval or disapproval on all the factors present for any individual veteran. The veteran's credit must be evaluated based on the criteria set forth in paragraph (g) of this section as well as a variety of compensating factors that should be evaluated.

(5) The following are examples of acceptable compensating factors to be considered in the course of underwriting a loan:

- (i) Excellent long-term credit;
- (ii) Conservative use of consumer credit;
- (iii) Minimal consumer debt;
- (iv) Long-term employment;
- (v) Significant liquid assets;

(vi) Downpayment or the existence of equity in refinancing loans;

(vii) Little or no increase in shelter expense;

(viii) Military benefits;

(ix) Satisfactory homeownership experience;

(x) High residual income;

(xi) Low debt-to-income ratio;

(xii) Tax credits of a continuing nature, such as tax credits for child care; and

(xiii) Tax benefits of home ownership.

(6) The list in paragraph (c)(5) of this section is not exhaustive and the items are not in any priority order. Valid compensating factors should represent unusual strengths rather than mere satisfaction of basic program requirements. Compensating factors must be relevant to the marginality or weakness.

(d) *Debt-to-income ratio.* A debt-to-income ratio that compares the veteran's anticipated monthly housing expense and total monthly obligations to his or her stable monthly income will be computed to assist in the assessment of the potential risk of the loan. The ratio will be determined by taking the sum of the monthly Principal, Interest, Taxes and Insurance (PITI) of the loan being applied for, homeowners and other assessments such as special assessments, condominium fees, homeowners association fees, etc., and any long-term obligations divided by the total of gross salary or earnings and other compensation or income. The ratio should be rounded to the nearest two digits; e.g., 35.6 percent would be rounded to 36 percent. The standard is 41 percent or less. If the ratio is greater than 41 percent, the steps cited in paragraphs (c)(1) through (c)(6) of this section apply.

(e) *Residual income guidelines.* The guidelines provided in this paragraph for residual income will be used to determine whether the veteran's monthly residual income will be adequate to meet living expenses after estimated monthly shelter expenses have been paid and other monthly obligations have been met. All members of the household must be included in determining if the residual income is sufficient. They must be counted even if the

§ 36.4337

veteran's spouse is not joining in title or on the note, or if there are any other individuals depending on the veteran for support, such as children from a spouse's prior marriage who are not the veteran's legal dependents. It is appropriate, however, to reduce the number of members of a household to be counted for residual income purposes if there is sufficient verified income not otherwise included in the loan analysis, such as child support being regularly received as discussed in paragraph (e)(4) of this section. In the case of a spouse not to be obligated on the note, verification that he/she has stable and reliable employment as discussed in paragraph (f)(3) of this section would allow not counting the spouse in determining the sufficiency of the residual income. The guidelines for residual income are based on data supplied in the Consumer Expenditure Survey (CES) published by the Department of Labor's Bureau of Labor Statistics. Regional minimum incomes have been developed for loan amounts up to \$79,999 and for loan amounts of \$80,000 and above. It is recognized that the purchase price of the property may affect family expenditure levels in individual cases. This factor may be given consideration in the final determination in individual loan analyses. For example, a family purchasing in a higher-priced neighborhood may feel a need to incur higher-than-average expenses to support a lifestyle comparable to that in their environment, whereas a substantially lower-priced home purchase may not compel such expenditures. It should also be clearly understood from this information that no single factor is a final determinant in any applicant's qualification for a VA-guaranteed loan. Once the residual income has been established, other important factors must be examined. One such consideration is the amount being paid currently for rental or housing expenses. If the proposed shelter expense is materially in excess of what is currently being paid, the case may require closer scrutiny. In such cases, consideration should be given to the ability of the borrower and spouse to accumulate liquid assets, such as cash and bonds, and to the amount of debts incurred while paying a lesser amount for shel-

38 CFR Ch. I (7-1-03 Edition)

ter. For example, if an application indicates little or no capital reserves and excessive obligations, it may not be reasonable to conclude that a substantial increase in shelter expenses can be absorbed. Another factor of prime importance is the applicant's manner of meeting obligations. A poor credit history alone is a basis for disapproving a loan, as is an obviously inadequate income. When one or the other is marginal, however, the remaining aspect must be closely examined to assure that the loan applied for will not exceed the applicant's ability or capacity to repay. Therefore, it is important to remember that the figures provided below for residual income are to be used as a guide and should be used in conjunction with the steps outlined in paragraphs (c) through (j) of this section. The residual income guidelines are as follows:

- (1) Table of residual incomes by region (for loan amounts of \$79,999 and below):

TABLE OF RESIDUAL INCOMES BY REGION
[For loan amounts of \$79,999 and below]

Family size*	North-east	Mid-west	South	West
1	390	382	382	425
2	654	641	641	713
3	788	772	772	859
4	888	868	868	967
5	921	902	902	1,004

* For families with more than five members, add \$75 for each additional member up to a family of seven. "Family" includes all members of the household.

- (2) Table of residual incomes by region (for loan amounts of \$80,000 and above):

TABLE OF RESIDUAL INCOMES BY REGION
[For loan amounts of \$80,000 and above]

Family size*	North-east	Mid-west	South	West
1	450	441	441	491
2	755	738	738	823
3	909	889	889	990
4	1,025	1,003	1,003	1,117
5	1,062	1,039	1,039	1,158

* For families with more than five members, add \$80 for each additional member up to a family of seven. "Family" includes all members of the household.

- (3) *Geographic regions for residual income guidelines:* Northeast—Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island and

Vermont; Midwest—Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota and Wisconsin; South—Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, Puerto Rico, South Carolina, Tennessee, Texas, Virginia, West Virginia; West—Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington and Wyoming.

(4) *Military adjustments.* For loan applications involving an active-duty servicemember or military retiree, the residual income figures will be reduced by a minimum of 5 percent if there is a clear indication that the borrower or spouse will continue to receive the benefits resulting from the use of facilities on a nearby military base. (This reduction applies to tables in paragraph (e) of this section.)

(f) *Stability and reliability of income.* Only stable and reliable income of the veteran and spouse can be considered in determining ability to meet mortgage payments. Income can be considered stable and reliable if it can be concluded that it will continue during the foreseeable future.

(1) *Verification.* Income of the borrower and spouse which is derived from employment and which is considered in determining the family's ability to meet the mortgage payments, payments on debts and other obligations, and other expenses must be verified. If the spouse is employed and will be contractually obligated on the loan, the combined income of both the veteran and spouse is considered when the income of the veteran alone is not sufficient to qualify for the amount of the loan sought. In other than community property states, if the spouse will not be contractually obligated on the loan, Regulation B (12 CFR part 202), promulgated by the Federal Reserve Board pursuant to the Equal Credit Opportunity Act, prohibits any request for, or consideration of, information concerning the spouse (including income, employment, assets, or liabilities), except that if the applicant is relying on alimony, child support, or maintenance payments from a spouse or former

spouse as a basis for repayment of the loan, information concerning such spouse or former spouse may be requested and considered (see paragraph (f)(4) of this section). In community property states, information concerning a spouse may be requested and considered in the same manner as that for the applicant. The standards applied to income of the veteran are also applicable to that of the spouse. There can be no discounting of income on account of sex, marital status, or any other basis prohibited by the Equal Credit Opportunity Act. Income claimed by an applicant that is not or cannot be verified cannot be considered when analyzing the loan. If the veteran or spouse has been employed by a present employer for less than 2 years, a 2-year history covering prior employment, schooling, or other training must be secured. Any periods of unemployment must be explained. Employment verifications and pay stubs must be no more than 120 days (180 days for new construction) old to be considered valid. For loans closed automatically, this requirement will be considered satisfied if the date of the employment verification is within 120 days (180 days for new construction) of the date the note is signed. For prior approval loans, this requirement will be considered satisfied if the verification of employment is dated within 120 days of the date the application is received by VA.

(2) *Active-duty, Reserve, or National Guard applicants.* (i) In the case of an active-duty applicant, a military Leave & Earnings Statement is required and will be used instead of an employment verification. The statement must be no more than 120 days old (180 days for new construction) and must be the original or a lender-certified copy of the original. For loans closed automatically, this requirement is satisfied if the date of the Leave & Earnings Statement is within 120 days (180 days for new construction) of the date the note is signed. For prior approval loans, this requirement will be considered satisfied if the verification of employment is dated within 120 days of the date the application is received by VA.

§ 36.4337**38 CFR Ch. I (7-1-03 Edition)**

(ii) For servicemembers within 12 months of release from active duty, or members of the Reserves or National Guard within 12 months of release, one of the following is also required:

(A) Documentation that the servicemember has in fact already re-enlisted or extended his/her period of active duty or Reserve or National Guard service to a date beyond the 12-month period following the projected closing of the loan.

(B) Verification of a valid offer of local civilian employment following release from active duty. All data pertinent to sound underwriting procedures (date employment will begin, earnings, etc.) must be included.

(C) A statement from the servicemember that he/she intends to reenlist or extend his/her period of active duty or Reserve or National Guard service to a date beyond the 12 month period following the projected loan closing date, and a statement from the servicemember's commanding officer confirming that the servicemember is eligible to reenlist or extend his/her active duty or Reserve or National Guard service as indicated and that the commanding officer has no reason to believe that such reenlistment or extension will not be granted.

(D) Other unusually strong positive underwriting factors, such as a downpayment of at least 10 percent, significant cash reserves, or clear evidence of strong ties to the community coupled with a nonmilitary spouse's income so high that only minimal income from the active duty servicemember or member of the Reserves or National Guard is needed to qualify.

(iii) Each active-duty member who applies for a loan must be counseled through the use of VA Form 26-0592, Counseling Checklist for Military Homebuyers. Lenders must submit a signed and dated VA Form 26-0592 with each prior approval loan application or automatic loan report involving a borrower on active duty.

(3) *Income reliability.* Income received by the borrower and spouse is to be used only if it can be concluded that the income will continue during the foreseeable future and, thus, should be properly considered in determining ability to meet the mortgage pay-

ments. If an employer puts N/A or otherwise declines to complete a verification of employment statement regarding the probability of continued employment, no further action is required of the lender. Reliability will be determined based on the duration of the borrower's current employment together with his or her overall documented employment history. There can be no discounting of income solely because it is derived from an annuity, pension or other retirement benefit, or from part-time employment. However, unless income from overtime work and part-time or second jobs can be accorded a reasonable likelihood that it is continuous and will continue in the foreseeable future, such income should not be used. Generally, the reliability of such income cannot be demonstrated unless the income has continued for 2 years. The hours of duty and other work conditions of the applicant's primary job, and the period of time in which the applicant was employed under such arrangement, must be such as to permit a clear conclusion as to a good probability that overtime or part-time or secondary employment can and will continue. Income from overtime work and part-time jobs not eligible for inclusion as primary income may, if properly verified for at least 12 months, be used to offset the payments due on debts and obligations of an intermediate term, i.e., 6 to 24 months. Such income must be described in the loan file. The amount of any pension or compensation and other income, such as dividends from stocks, interest from bonds, savings accounts, or other deposits, rents, royalties, etc., will be used as primary income if it is reasonable to conclude that such income will continue in the foreseeable future. Otherwise, it may be used only to offset intermediate-term debts, as described in this paragraph. Also, the likely duration of certain military allowances cannot be determined and, therefore, will be used only to offset intermediate-term debts, as described in this paragraph. Such allowances are: Pro-pay, flight or hazard pay, and overseas or combat pay, all of which are

subject to periodic review and/or testing of the recipient to ascertain whether eligibility for such pay will continue. Only if it can be shown that such pay has continued for a prolonged period and can be expected to continue because of the nature of the recipient's assigned duties, will such income be considered as primary income. For instance, flight pay verified for a pilot can be regarded as probably continuous and, thus, should be added to the base pay. Income derived from service in the Reserves or National Guard may be used if the applicant has served in such capacity for a period of time sufficient to evidence good probability that such income will continue beyond 12 months. The total period of active and reserve service may be helpful in this regard. Otherwise, such income may be used to offset intermediate-term debts. There are a number of additional income sources whose contingent nature precludes their being considered as available for repayment of a long-term mortgage obligation. Temporary income items such as VA educational allowances and unemployment compensation do not represent stable and reliable income and will not be taken into consideration in determining the ability of the veteran to meet the income requirement of the governing law. As required by the Equal Opportunity Act Amendments of 1976, Public Law 94-239, income from public assistance programs is used to qualify for a loan if it can be determined that the income will probably continue for 3 years or more.

(4) *Tax-exempt income.* Special consideration can be given to verified non-taxable income once it has been established that such income is likely to continue (and remain untaxed) into the foreseeable future. Such income includes certain military allowances, child support payments, workers' compensation benefits, disability retirement payments and certain types of public assistance payments. In such cases, current income tax tables may be used to determine an amount which can be prudently employed to adjust the borrower's actual income. This adjusted or "grossed up" income may be used to calculate the monthly debt-to-income ratio, provided the analysis is

documented. Only the borrower's actual income may be used to calculate the residual income. Care should be exercised to ensure that the income is in fact tax-exempt.

(5) *Alimony, child support, maintenance, workers' compensation, foster care payments.* (i) If an applicant chooses to reveal income from alimony, child support or maintenance payments (after first having been informed that any such disclosure is voluntary pursuant to the Federal Reserve Board's Regulation B), such payments are considered as income to the extent that the payments are likely to be consistently made. Factors to be considered in determining the likelihood of consistent payments include, but are not limited to: Whether the payments are received pursuant to a written agreement or court decree; the length of time the payments have been received; the regularity of receipt; the availability of procedures to compel payment; and the creditworthiness of the payor, including the credit history of the payor when available under the Fair Credit Reporting Act or other applicable laws. However, the Fair Credit Reporting Act (15 U.S.C. 1681(b)) limits the permissible purposes for which credit reports may be ordered, in the absence of written instructions of the consumer to whom the report relates, to business transactions involving the subject of the credit report or extensions of credit to the subject of the credit report.

(ii) If the applicant chooses to reveal income related to workers' compensation, it will be considered as income to the extent it can be determined such income will continue.

(iii) Income received specifically for the care of any foster child(ren) may be counted as income if documented. Generally, however, such foster care income is to be used only to balance the expenses of caring for the foster child(ren) against any increased residual income requirements.

(6) *Military quarters allowance.* With respect to off-base housing (quarters) allowances for service personnel on active duty, it is the policy of the Department of Defense to utilize available on-base housing when possible. In order for a quarters allowance to be considered as continuing income, it is

§ 36.4337

necessary that the applicant furnish written authorization from his or her commanding officer for off-base housing. This authorization should verify that quarters will not be made available and that the individual should make permanent arrangements for nonmilitary housing. A Department of Defense form, DD Form 1747, Status of Housing Availability, is used by the Family Housing Office to advise personnel regarding family housing. The applicant's quarters allowance cannot be considered unless item b (Permanent) or d is completed on DD Form 1747, dated October 1990. Of course, if the applicant's income less quarters allowance is sufficient, there is no need for assurance that the applicant has permission to occupy nonmilitary housing provided that a determination can be made that the occupancy requirements of the law will be met. Also, authorization to obtain off-base housing will not be required when certain duty assignments would clearly qualify service personnel with families for quarters allowance. For instance, off-base housing authorizations need not be obtained for service personnel stationed overseas who are not accompanied by their families, recruiters on detached duty, or military personnel stationed in areas where no on-base housing exists. In any case in which no off-base housing authorization is obtained, an explanation of the circumstances justifying its omission must be included with the loan application except when it has been established by the VA facility of jurisdiction that the waiting lists for on-base housing are so long that it is improbable that individuals desiring to purchase off-base housing would be precluded from doing so in the foreseeable future. If stations make such a determination, a release shall be issued to inform lenders.

(7) *Automobile (or similar) allowance.* Generally, automobile allowances are paid to cover specific expenses related to an applicant's employment, and it is appropriate to use such income to offset a corresponding car payment. However, in some instances, such an allowance may exceed the car payment. With proper documentation, income from a car allowance which exceeds the

38 CFR Ch. I (7-1-03 Edition)

car payment can be counted as effective income. Likewise, any other similar type of allowance which exceeds the specific expense involved may be added to gross income to the extent it is documented to exceed the actual expense.

(8) *Commissions.* When all or a major portion of the veteran's income is derived from commissions, it will be necessary to establish the stability of such income if it is to be considered in the loan analysis for the repayment of the mortgage debt and/or short-term obligations. In order to assess the value of such income, lenders should obtain written verification of the actual amount of commissions paid to date, the basis for the payment of such commissions and when commissions are paid; i.e., monthly, quarterly, semi-annually, or annually. Lenders should also obtain signed and dated individual income tax returns, plus applicable schedules, for the previous 2 years, or for whatever additional period is deemed necessary to properly demonstrate a satisfactory earnings record. The length of the veteran's employment in the type of occupation for which commissions are paid is also an important factor in the assessment of the stability of the income. If the veteran has been employed for a relatively short time, the income should not normally be considered stable unless the product or service was the same or closely related to the product or service sold in an immediate prior position. Generally, income from commissions is considered stable when the applicant has been receiving such income for at least 2 years. Less than 2 years of income from commissions cannot usually be considered stable. When an applicant has received income from commissions for less than 1 year, it will rarely be possible to demonstrate that the income is stable for qualifying purposes; such cases would require in-depth development.

(9) *Self-employment.* Generally, income from self-employment is considered stable when the applicant has been in business for at least 2 years. Less than 2 years of income from self-employment cannot usually be considered stable unless the applicant has had previous related employment and/or extensive specialized training. When

an applicant has been self-employed less than 1 year, it will rarely be possible to demonstrate that the income is stable for qualifying purposes; such cases would require in-depth development. The following documentation is required for all self-employed borrowers:

(i) A profit-and-loss statement for the prior fiscal year (12-month accounting cycle), plus the period year to date since the end of the last fiscal year (or for whatever shorter period records may be available), and balance sheet based on the financial records. The financial statement must be sufficient for a loan underwriter to determine the necessary information for loan approval and an independent audit (on the veteran and/or the business) by a Certified Public Accountant will be required if necessary for such determination; and

(ii) Copies of signed individual income tax returns, plus all applicable schedules for the previous 2 years, or for whatever additional period is deemed necessary to properly demonstrate a satisfactory earnings record, must be obtained. If the business is a corporation or partnership, copies of signed Federal business income tax returns for the previous two years plus all applicable schedules for the corporation or partnership must be obtained; and

(iii) If the business is a corporation or partnership, a list of all stockholders or partners showing the interest each holds in the business will be required. Some cases may justify a written credit report on the business as well as the applicant. When the business is of an unusual type and it is difficult to determine the probability of its continued operation, explanation as to the function and purpose of the business may be needed from the applicant and/or any other qualified party with the acknowledged expertise to express a valid opinion.

(10) *Recently discharged veterans.* Loan applications received from recently discharged veterans who have little or no employment experience other than their military occupation and from veterans seeking VA-guaranteed loans who have retired after 20 years of active military duty require special at-

tention. The retirement income of the latter veterans in many cases may not be sufficient to meet the statutory income requirements for the loan amount sought. Many have obtained full-time employment and have been employed in their new jobs for a very short time.

(i) It is essential in determining whether veterans in these categories qualify from the income standpoint for the amount of the loan sought, that the facts in respect to their present employment and retirement income be fully developed, and that each case be considered on its individual merits.

(ii) In most cases the veteran's current income or current income plus his or her retirement income is sufficient. The problem lies in determining whether it can be properly concluded that such income level will continue for the foreseeable future. If the veteran's employment status is that of a trainee or an apprentice, this will, of course, be a factor. In cases of the self-employed, the question to be resolved is whether there are reasonable prospects that the business enterprise will be successful and produce the required income. Unless a favorable conclusion can be made, the income from such source should not be considered in the loan analysis.

(iii) If a recently discharged veteran has no prior employment history and the veteran's verification of employment shows he or she has not been on the job a sufficient time in which to become established, consideration should be given to the duties the veteran performed in the military service. When it can be determined that the duties a veteran performed in the service are similar or are in direct relation to the duties of the applicant's present position, such duties may be construed as adding weight to his or her present employment experience and the income from the veteran's present employment thus may be considered available for qualifying the loan, notwithstanding the fact that the applicant has been on the present job only a short time. This same principle may be applied to veterans recently retired from the service. In addition, when the veteran's income from retirement, in relation to the total of the estimated shelter expense,

§ 36.4337

38 CFR Ch. I (7-1-03 Edition)

long-term debts and amount available for family support, is such that only minimal income from employment is necessary to qualify from the income standpoint, it would be proper to resolve the doubt in favor of the veteran. It would be erroneous, however, to give consideration to a veteran's income from employment for a short duration in a job requiring skills for which the applicant has had no training or experience.

(iv) To illustrate the provisions of paragraph (f)(10), it would be proper to use short-term employment income in qualifying a veteran who had experience as an airplane mechanic in the military service and the individual's employment after discharge or retirement from the service is in the same or allied fields; e.g., auto mechanic or machinist. This presumes, however, that the verification of employment included a statement that the veteran was performing the duties of the job satisfactorily, the possibility of continued employment was favorable and that the loan application is eligible in all other respects. An example of non-qualifying experience is that of a veteran who was an Air Force pilot and has been employed in insurance sales on commission for a short time. Most cases, of course, fall somewhere between those extremes. It is for this reason that the facts of each case must be fully developed prior to closing the loan automatically or submitting the case to VA for prior approval.

(11) *Employment of short duration.* The provisions of paragraph (f)(7) of this section are similarly applicable to applicants whose employment is of short duration. Such cases will entail careful consideration of the employer's confirmation of employment, probability of permanency, past employment record, the applicant's qualifications for the position, and previous training, including that received in the military service. In the event that such considerations do not enable a determination that the income from the veteran's current position has a reasonable likelihood of continuance, such income should not be considered in the analysis. Applications received from persons employed in the building trades, or in other occupations affected by cli-

matic conditions, should be supported by documentation evidencing the applicant's total earnings to date and covering a period of not less than 1 year as well as signed and dated copies of complete income tax returns, including all schedules for the past 2 years or for whatever additional period is deemed necessary to properly demonstrate a satisfactory earnings record. If the applicant works out of a union, evidence of the previous year's earnings should be obtained together with a verification of employment from the current employer.

(12) *Rental income*—(i) *Multi-unit subject property.* When the loan pertains to a structure with more than a one-family dwelling unit, the prospective rental income will not be considered unless the veteran can demonstrate a reasonable likelihood of success as a landlord, and sufficient cash reserves are verified to enable the veteran to carry the mortgage loan payments (principal, interest, taxes, and insurance) without assistance from the rental income for a period of at least 6 months. The determination of the veteran's likelihood of success as a landlord will be based on documentation of any prior experience in managing rental units or other collection activities. The amount of rental income to be used in the loan analysis will be based on 75 percent of the amount indicated on the lease or rental agreement, unless a greater percentage can be documented.

(ii) *Rental of existing home.* Proposed rental of a veteran's existing property may be used to offset the mortgage payment on that property, provided there is no indication that the property will be difficult to rent. If available, a copy of the rental agreement should be obtained. It is the responsibility of the loan underwriter to be aware of the condition of the local rental market. For instance, in areas where the rental market is very strong the absence of a lease should not automatically prohibit the offset of the mortgage by the proposed rental income.

(iii) *Other rental property.* If income from rental property will be used to qualify for the new loan, the documentation required of a self-employed applicant should be obtained together with evidence of cash reserves equaling

3 months PITI on the rental property. As for any self-employed earnings (see paragraph (f)(7) of this section), depreciation claimed may be added back in as income. In the case of a veteran who has no experience as a landlord, it is unlikely that the income from a rental property may be used to qualify for the new loan.

(13) *Taxes and other deductions.* Deductions to be applied for Federal income taxes and Social Security may be obtained from the Employer's Tax Guide (Circular E) issued by the Internal Revenue Service (IRS). (For veterans receiving a mortgage credit certificate (MCC), see paragraph (f)(14) of this section.) Any State or local taxes should be estimated or obtained from charts similar to those provided by IRS which may be available in those states with withholding taxes. A determination of the amount paid or withheld for retirement purposes should be made and used when calculating deductions from gross income. In determining whether a veteran-applicant meets the income criteria for a loan, some consideration may be given to the potential tax benefits the veteran will realize if the loan is approved. This can be done by using the instructions and worksheet portion of IRS Form W-4, Employee's Withholding Allowance Certificate, to compute the total number of permissible withholding allowances. That number can then be used when referring to IRS Circular E and any appropriate similar State withholding charts to arrive at the amount of Federal and State income tax to be deducted from gross income.

(14) *Mortgage credit certificates.* (i) The Internal Revenue Code (26 U.S.C.) as amended by the Tax Reform Act of 1984, allows states and other political subdivisions to trade in all or part of their authority to issue mortgage revenue bonds for authority to issue MCCs. Veterans who are recipients of MCCs may realize a significant reduction in their income tax liability by receiving a Federal tax credit for a percentage of their mortgage interest payment on debt incurred on or after January 1, 1985.

(ii) Lenders must provide a copy of the MCC to VA with the home loan application. The MCC will specify the

rate of credit allowed and the amount of certified indebtedness; i.e., the indebtedness incurred by the veteran to acquire a principal residence or as a qualified home improvement or rehabilitation loan.

(iii) For credit underwriting purposes, the amount of tax credit allowed to a veteran under an MCC will be treated as a reduction in the monthly Federal income tax. For example, a veteran having a \$600 monthly interest payment and an MCC providing a 30-percent tax credit would receive a \$180 ($30\% \times \600) tax credit each month. However, because the annual tax credit, which amounts to \$2,160 ($12 \times \180), exceeds \$2,000 and is based on a 30-percent credit rate, the maximum tax credit the veteran can receive is limited to \$2,000 per year (Pub. L. 98-369) or \$167 per month (\$2,000/12). As a consequence of the tax credit, the interest on which a deduction can be taken will be reduced by the amount of the tax credit to \$433 (\$600 - \$167). This reduction should also be reflected when calculating Federal income tax.

(iv) For underwriting purposes, the amount of the tax credit is limited to the amount of the veteran's maximum tax liability. If, in the example in paragraph (f)(14)(iii) of this section, the veteran's tax liability for the year were only \$1,500, the monthly tax credit would be limited to \$125 (\$1,500/12).

(g) *Credit.* The conclusion reached as to whether or not the veteran and spouse are satisfactory credit risks must also be based on a careful analysis of the available credit data. Regulation B (12 CFR part 202), promulgated by the Federal Reserve Board pursuant to the Equal Credit Opportunity Act, requires that lenders, in evaluating creditworthiness, shall consider, on the applicant's request, the credit history, when available, of any account reported in the name of the applicant's spouse or former spouse which the applicant can demonstrate accurately reflects the applicant's creditworthiness. In other than community property states, if the spouse will not be contractually obligated on the loan, Regulation B prohibits any request for or consideration of information about the

§ 36.4337

38 CFR Ch. I (7-1-03 Edition)

spouse concerning income, employment, assets or liabilities. In community property states, information concerning a spouse may be requested and considered in the same manner as that for the applicant.

(1) *Adverse data.* If the analysis develops any derogatory credit information and, despite such facts, it is determined that the veteran and spouse are satisfactory credit risks, the basis for the decision must be explained. If a veteran and spouse have debts outstanding which have not been paid timely, or which they have refused to pay, the fact that the outstanding debts are paid after the acceptability of the credit is questioned or in anticipation of applying for new credit does not, of course, alter the fact that the record for paying debts has been unsatisfactory. With respect to unpaid debts, lenders may take into consideration a veteran's claim of bona fide or legal defenses. Such defenses are not applicable when the debt has been reduced to judgment. Where a collection account has been established, if it is determined that the borrower is a satisfactory credit risk, it is not mandatory that such an account be paid off in order for a loan to be approved. Court-ordered judgments, however, must be paid off before a new loan is approved.

(2) *Bankruptcy.* When the credit information shows that the borrower or spouse has been discharged in bankruptcy under the "straight" liquidation and discharge provisions of the bankruptcy law, this would not in itself disqualify the loan. However, in such cases it is necessary to develop complete information as to the facts and circumstances concerning the bankruptcy. Generally speaking, when the borrower or spouse, as the case may be, has been regularly employed (not self-employed) and has been discharged in bankruptcy within the last one to two years, it probably would not be possible to determine that the borrower or spouse is a satisfactory credit risk unless both of the following requirements are satisfied:

(i) The borrower or spouse has obtained credit subsequent to the bankruptcy and has met the credit payments in a satisfactory manner over a continued period; and

(ii) The bankruptcy was caused by circumstances beyond the control of the borrower or spouse, e.g., unemployment, prolonged strikes, medical bills not covered by insurance. Divorce is not generally viewed as beyond the control of the borrower and/or spouse. The circumstances alleged must be verified. If a borrower or spouse is self-employed, has been adjudicated bankrupt, and subsequently obtains a permanent position, a finding as to satisfactory credit risk may be made provided there is no derogatory credit information prior to self-employment, there is no derogatory credit information subsequent to the bankruptcy, and the failure of the business was not due to misconduct. If a borrower or spouse has been discharged in bankruptcy within the past 12 months, it will not generally be possible to determine that the borrower or spouse is a satisfactory credit risk.

(3) *Petition under chapter 13 of Bankruptcy Code.* A petition under chapter 13 of the Bankruptcy Code (11 U.S.C.) filed by the borrower or spouse is indicative of an effort to pay their creditors. Some plans may provide for full payment of debts while others arrange for payment of scaled-down debts. Regular payments are made to a court-appointed trustee over a 2- to 3-year period (or up to 5 years in some cases). When the borrowers have made all payments in a satisfactory manner, they may be considered as having reestablished satisfactory credit. When they apply for a home loan before completion of the payout period, favorable consideration may nevertheless be given if at least 12 months' worth of payments have been made satisfactorily and the Trustee or Bankruptcy Judge approves of the new credit.

(4) *Foreclosures.* (i) When the credit information shows that the veteran or spouse has had a foreclosure on a prior mortgage; e.g., a VA-guaranteed or HUD-insured mortgage, this will not in itself disqualify the borrower from obtaining the loan. Lenders and field station personnel should refer to the preceding guidelines on bankruptcies for cases involving foreclosures. As with a borrower who has been adjudicated bankrupt, it is necessary to develop

complete information as to the facts and circumstances of the foreclosure.

(ii) When VA pays a claim on a VA-guaranteed loan as a result of a foreclosure, the original veteran may be required to repay any loss to the Government. In some instances VA may waive the veteran's debt, in part or totally, based on the facts and circumstances of the case. However, guaranty entitlement cannot be restored unless the Government's loss has been repaid in full, regardless of whether or not the debt has been waived, compromised, or discharged in bankruptcy. Therefore, a veteran who is seeking a new VA loan after having experienced a foreclosure on a prior VA loan will in most cases have only remaining entitlement to apply to the new loan. The lender should assure that the veteran has sufficient entitlement for its secondary marketing purposes.

(5) *Federal debts.* An applicant for a Federally-assisted loan will not be considered a satisfactory credit risk for such loan if the applicant is presently delinquent or in default on any debt to the Federal Government, e.g., a Small Business Administration loan, a U.S. Guaranteed Student loan, a debt to the Public Health Service, or where there is a judgment lien against the applicant's property for a debt owed to the Government. The applicant may not be approved for the loan until the delinquent account has been brought current or satisfactory arrangements have been made between the borrower and the Federal agency owed, or the judgment is paid or otherwise satisfied. Of course, the applicant must also be able to otherwise qualify for the loan from an income and remaining credit standpoint. Refinancing under VA's interest rate reduction refinancing provisions, however, is allowed even if the borrower is delinquent on the VA guaranteed mortgage being refinanced. Prior approval processing is required in such cases.

(6) *Absence of credit history.* The fact that recently discharged veterans may have had no opportunity to develop a credit history will not preclude a determination of satisfactory credit. Similarly, other loan applicants may not have established credit histories as a result of a preference for purchasing

consumer items with cash rather than credit. There are also cases in which individuals may be genuinely wary of acquiring new obligations following bankruptcy, consumer credit counseling (debt proration), or other disruptive credit occurrence. The absence of the credit history in these cases will not generally be viewed as an adverse factor in credit underwriting. However, before a favorable decision is made for cases involving bankruptcies or other derogatory credit factors, efforts should be made to develop evidence of timely payment of non-installment debts such as rent and utilities. It is anticipated that this special consideration in the absence of a credit history following bankruptcy would be the rare case and generally confined to bankruptcies that occurred over 3 years ago.

(7) *Consumer credit counseling plan.* If a veteran, or veteran and spouse, have prior adverse credit and are participating in a Consumer Credit Counseling plan, they may be determined to be a satisfactory credit risk if they demonstrate 12 months' satisfactory payments and the counseling agency approves the new credit. If a veteran, or veteran and spouse, have good prior credit and are participating in a Consumer Credit Counseling plan, such participation is to be considered a neutral factor, or even a positive factor, in determining creditworthiness.

(8) *Re-establishment of satisfactory credit.* In circumstances not involving bankruptcy, satisfactory credit is generally considered to be reestablished after the veteran, or veteran and spouse, have made satisfactory payments for 12 months after the date of the last derogatory credit item.

(9) *Long-term v. short-term debts.* All known debts and obligations including any alimony and/or child support payments of the borrower and spouse must be documented. Significant liabilities, to be deducted from the total income in determining ability to meet the mortgage payments are accounts that, generally, are of a relatively long term, i.e., 10 months or over. Other accounts for terms of less than 10 months must, of course, be considered in determining ability to meet family expenses. Certainly, any severe impact on the family's resources for any period of

§ 36.4337

time must be considered in the loan analysis. For example, monthly payments of \$300 on an auto loan with a remaining balance of \$1,500 would be included in those obligations to be deducted from the total income regardless of the fact that the account can be expected to pay out in 5 months. It is clear that the applicant will, in this case, continue to carry the burden of those \$300 payments for the first, most critical months of the home loan.

(10) *Requirements for verification.* If the credit investigation reveals debts or obligations of a material nature which were not divulged by the applicant, lenders must be certain to obtain clarification as to the status of such debts from the borrower. A proper analysis is obviously not possible unless there is total correlation between the obligations claimed by the borrower and those revealed by a credit report or deposit verification. Conversely, significant debts and obligations reported by the borrower must be dated. If the credit report fails to provide necessary information on such accounts, lenders will be expected to obtain their own verifications of those debts directly from the creditors. Credit reports and verifications must be no more than 120 days old (180 days for new construction) to be considered valid. For loans closed automatically, this requirement will be considered satisfied if the date of the credit report or verification is within 120 days (180 days for new construction) of the date the note is signed. For prior approval loans, this requirement will be considered satisfied if the date of the credit report or verification is within 120 days of the date of the application is received by VA. Of major significance are the applicant's rental history and outstanding or recently retired mortgages, if any, particularly prior VA loans. Lenders should be sure ratings on such accounts are obtained; a written explanation is required when ratings are not available. A determination is necessary as to whether alimony and/or child support payments are required. Verification of the amount of such obligations should be obtained, although documentation concerning an applicant's divorce should not be obtained automatically unless it is necessary to

38 CFR Ch. I (7-1-03 Edition)

verify the amount of any alimony or child support liability indicated by the applicant. If in the routine course of processing the loan application, however, direct evidence is received (e.g., from the credit report) that an obligation to pay alimony or child support exists (as opposed to mere evidence that the veteran was previously divorced), the discrepancy between the loan application and credit report can and should be fully resolved in the same manner as any other such discrepancy would be handled. When a pay stub or leave-and-earnings statement indicates an allotment, the lender must investigate the nature of the allotment(s) to determine whether the allotment is related to a debt. Debts assigned to an ex-spouse by a divorce decree will not generally be charged against a veteran-borrower.

(11) *Job-related expenses.* Known job-related expenses should be documented. This will include costs for any dependent care, significant commuting costs, etc. When a family's circumstances are such that dependent care arrangements would probably be necessary, it is important to determine the cost of such services in order to arrive at an accurate total of deductions.

(12) *Credit reports.* Credit reports obtained by lenders on VA-guaranteed loan applications must be either a three-file Merged Credit Report (MCR) or a Residential Mortgage Credit Report (RMCR). If used, the RMCR must meet the standards formulated jointly by the Department of Veterans Affairs, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Federal Housing Administration, Farmers Home Administration, credit repositories, repository affiliated consumer reporting agencies and independent consumer reporting agencies. All credit reports obtained by the lender must be submitted to VA.

(h) *Borrower's personal and financial status.* The number and ages of dependents have an important bearing on whether income after deduction of fixed charges is sufficient to support the family. Type and duration of employment of both the borrower and spouse are important as an indication of stability of their employment. The amount of liquid assets owned by the

borrower or spouse, or both, is an important factor in determining that they have sufficient funds to close the loan, as well as being significant in analyzing the overall qualifications for the loan. (It is imperative that adequate cash assets from the veteran's own resources are verified to allow the payment (see § 36.4336(a)(3)) of any difference between the sales price of the property and the loan amount, in addition to that necessary to cover closing costs, if the sales price exceeds the reasonable value established by VA.) Verifications must be no more than 120 days old (180 days for new construction) to be considered valid. For loans closed on the automatic basis, this requirement will be considered satisfied if the date of the deposit verification is within 120 days (180 days for new construction) of the date of the veteran's application to the lender. For prior approval loans, this requirement will be considered satisfied if the verification of employment is dated within 120 days of the date the application is received by VA. Current monthly rental or other housing expense is an important consideration when compared to that to be undertaken in connection with the contemplated housing purchase.

(i) *Estimated monthly shelter expenses.* It is important that monthly expenses such as taxes, insurance, assessments and maintenance and utilities be estimated accurately based on property location and type of house; e.g., old or new, large or small, rather than using or applying a "rule of thumb" to all properties alike. Maintenance and utility amounts for various types of property should be realistically estimated. Local utility companies should be consulted for current rates. The age and type of construction of a house may well affect these expenses. In the case of condominiums or houses in a planned unit development (PUD), the monthly amount of the maintenance assessment payable to a homeowners association should be added. If the amount currently assessed is less than the maximum provided in the covenants or master deed, and it appears likely that the amount will be insufficient for operation of the condominium or PUD, the amount used will be the maximum the veteran could be

charged. If it is expected that real estate taxes will be raised, or if any special assessments are expected, the increased or additional amounts should be used. In special flood hazard areas, include the premium for any required flood insurance.

(j) *Lender responsibility.* (1) Lenders are fully responsible for developing all credit information; i.e., for obtaining verifications of employment and deposit, credit reports, and for the accuracy of the information contained in the loan application.

(2) Verifications of employment and deposits, and requests for credit reports and/or credit information must be initiated and received by the lender.

(3) In cases where the real estate broker/agent or any other party requests any of this information, the report(s) must be returned directly to the lender. This fact must be disclosed by appropriately completing the required certification on the loan application or report and the parties must be identified as agents of the lender.

(4) Where the lender relies on other parties to secure any of the credit or employment information or otherwise accepts such information obtained by any other party, such parties shall be construed for purposes of the submission of the loan documents to VA to be authorized agents of the lender, regardless of the actual relationship between such parties and the lender, even if disclosure is not provided to VA under paragraph (j)(3) of this section. Any negligent or willful misrepresentation by such parties shall be imputed to the lender as if the lender had processed those documents and the lender shall remain responsible for the quality and accuracy of the information provided to VA.

(5) All credit reports secured by the lender or other parties as identified in paragraphs (j)(3) and (j)(4) of this section shall be provided to VA. If updated credit reports reflect materially different information than that in other reports, such discrepancies must be explained by the lender and the ultimate decision as to the effects of the discrepancy upon the loan application fully addressed by the underwriter.

§ 36.4337

38 CFR Ch. I (7-1-03 Edition)

(k) *Lender certification.* Lenders originating loans are responsible for determining and certifying to VA on the appropriate application or closing form that the loan meets all statutory and regulatory requirements. Lenders will affirmatively certify that loans were made in full compliance with the law and loan guaranty regulations as prescribed in this section.

(1) *Definitions.* The definitions contained in part 42 of this title and the following definitions are applicable in this section.

(i) *Another appropriate amount.* In determining the appropriate amount of a lender's civil penalty in cases where the Secretary has not sustained a loss or where two times the amount of the Secretary's loss on the loan involved does not exceed \$10,000, the Secretary shall consider:

(A) The materiality and importance of the false certification to the determination to issue the guaranty or to approve the assumption;

(B) The frequency and past pattern of such false certifications by the lender; and

(C) Any exculpatory or mitigating circumstances.

(ii) *Complaint* includes the assessment of liability served pursuant to this section.

(iii) *Defendant* means a lender named in the complaint.

(iv) *Lender* includes the holder approving loan assumptions pursuant to 38 U.S.C. 3714.

(2) *Procedures for certification.* (i) As a condition to VA issuance of a loan guaranty on all loans closed on or after October 27, 1994, and as a prerequisite to an effective loan assumption on all loans assumed pursuant to 38 U.S.C. 3714 on or after November 17, 1997, the following certification shall accompany each loan closing or assumption package:

The undersigned lender certifies that the (loan) (assumption) application, all verifications of employment, deposit, and other income and credit verification documents have been processed in compliance with 38 CFR part 36; that all credit reports obtained or generated in connection with the processing of this borrower's (loan) (assumption) application have been provided to VA; that, to the best of the undersigned lender's knowledge and belief the (loan) (assumption)

meets the underwriting standards recited in chapter 37 of title 38 United States Code and 38 CFR part 36; and that all information provided in support of this (loan) (assumption) is true, complete and accurate to the best of the undersigned lender's knowledge and belief.

(ii) The certification shall be executed by an officer of the lender authorized to execute documents and act on behalf of the lender.

(3) Any lender who knowingly and willfully makes a false certification required pursuant to § 36.4337(k)(2) shall be liable to the United States Government for a civil penalty equal to two times the amount of the Secretary's loss on the loan involved or to another appropriate amount, not to exceed \$10,000, whichever is greater.

(1) *Assessment of liability.* (i) Upon an assessment confirmed by the Under Secretary for Benefits, in consultation with the Investigating Official, that a certification, as required in this section, is false, a report of findings of the Under Secretary for Benefits shall be submitted to the Reviewing Official setting forth:

(i) The evidence that supports the allegations of a false certification and of liability;

(ii) A description of the claims or statements upon which the allegations of liability are based;

(iii) The amount of the VA demand to be made; and

(iv) Any exculpatory or mitigating circumstances that may relate to the certification.

(2) The Reviewing Official shall review all of the information provided and will either inform the Under Secretary for Benefits and the Investigating Official that there is not adequate evidence, that the lender is liable, or serve a complaint on the lender stating:

(i) The allegations of a false certification and of liability;

(ii) The amount being assessed by the Secretary and the basis for the amount assessed;

(iii) Instructions on how to satisfy the assessment and how to file an answer to request a hearing, including a specific statement of the lender's right to request a hearing by filing an answer and to be represented by counsel; and

Department of Veterans Affairs**§ 36.4339**

(iv) That failure to file an answer within 30 days of the complaint will result in the imposition of the assessment without right to appeal the assessment to the Secretary.

(m) *Hearing procedures.* A lender hearing on an assessment established pursuant to this section shall be governed by the procedures recited at 38 CFR 42.8 through 42.47.

(n) *Additional remedies.* Any assessment under this section may be in addition to other remedies available to VA, such as debarment and suspension pursuant to 38 U.S.C. 3704 and part 44 of this title or loss of automatic processing authority pursuant to 38 U.S.C. 3702, or other actions by the Government under any other law including but not limited to title 18 U.S.C. and 31 U.S.C. 3732.

(Authority: 38 U.S.C. 3703, 3710)

(Approved by the Office of Management and Budget under control number 2900-0521)

[59 FR 49200, Sept. 27, 1994, as amended at 61 FR 56449, Nov. 1, 1996; 62 FR 53965, Oct. 17, 1997; 62 FR 63454, Dec. 1, 1997; 64 FR 19910, Apr. 23, 1999]

§ 36.4338 Death or insolvency of holder.

(a) Immediately upon the death of the holder and without the necessity of request or other action by the debtor or the Secretary, all sums then standing as a credit balance in a trust, or deposit, or other account to cover taxes, insurance accruals, or other items in connection with the loan secured by the encumbered property, whether stated to be such or otherwise designated, and which have not been credited on the note shall, nevertheless, be treated as a setoff and shall be deemed to have been credited thereon as of the date of the last debit to such account, so that the unpaid balance of the note as of that date will be reduced by the amount of such credit balance:

Provided, That any unpaid taxes, insurance premiums, ground rents, or advances may be paid by the holder of the indebtedness, at the holder's option, and the amount which otherwise would have been deemed to have been credited on the note reduced accordingly.

This paragraph shall be applicable whether the estate of the deceased holder is solvent or insolvent.

(b) The provisions of paragraph (a) of this section shall also be applicable in the event of:

(1) Insolvency of holder;

(2) Initiation of any bankruptcy or reorganization, or liquidation proceedings as to the holder, whether voluntary or involuntary;

(3) Appointment of a general or ancillary receiver for the holder's property; or in any case

(4) Upon the written request of the debtor if all secured and due insurance premiums, taxes, and ground rents have been paid, and appropriate provisions made for future accruals.

(c) Upon the occurrence of any of the events enumerated in paragraph (a) or (b) of this section, interest on the note and on the credit balance of the deposits mentioned in paragraph (a) shall be set off against each other at the rate payable on the principal of the note, as of the date of last debit to the deposit account. Any excess credit of interest shall be treated as a set-off against the unpaid advances, if any, and the unpaid balance of the note.

(d) The provisions of paragraphs (a), (b) and (c) of this section shall apply also to corporations. The dissolution thereof by expiration of charter, by forfeiture, or otherwise shall be treated as is the death of an individual as provided in paragraph (a) of this section.

[13 FR 7279, Nov. 27, 1948, as amended at 40 FR 34593, Aug. 18, 1975]

§ 36.4339 Qualification for designated fee appraisers.

To qualify for approval as a designated fee appraiser, an applicant must show to the satisfaction of the Secretary that his or her character, experience, and the type of work in which he or she has had experience for at least 5 years qualifies the applicant to competently appraise and value within a prescribed area the type of property to which the approval relates.

[40 FR 34593, Aug. 18, 1975]

§ 36.4340

§ 36.4340 Restriction on designated fee appraisers.

(a) A designated fee appraiser shall not make an appraisal, excepting of alterations, improvements, or repairs to real property entailing a cost of not more than \$3,500, if such appraiser is an officer, director, trustee, employer, or employee of the lender, contractor, or vendor.

(b) An appraisal made by a designated fee appraiser shall be subject to review and adjustment by the Secretary. The amount determined to be proper upon any such review or adjustment shall constitute the "reasonable value" for the purpose of determining the eligibility of the related loan.

[15 FR 4398, July 12, 1950, as amended at 24 FR 2655, Apr. 7, 1959; 43 FR 51016, Nov. 2, 1978]

§ 36.4342 Delegation of authority.

(a) Except as hereinafter provided, each employee of the Department of Veterans Affairs heretofore or hereafter appointed to, or lawfully filling, any position designated in paragraph (b) of this section is hereby delegated authority, within the limitations and conditions prescribed by law, to exercise the powers and functions of the Secretary with respect to the guaranty or insurance of loans and the rights and liabilities arising therefrom, including but not limited to the adjudication and allowance, disallowance, and compromise of claims; the collection or compromise of amounts due, in money or other property; the extension, rearrangement, or acquisition of loans; the management and disposition of secured and unsecured notes and other property; and those functions expressly or impliedly embraced within paragraphs (2) to (6), inclusive, of 38 U.S.C. 3720(a). Incidental to the exercise and performance of the powers and functions hereby delegated, each such employee is authorized to execute and deliver (with or without acknowledgement) for, and on behalf of, the Secretary, evidence of guaranty or of insurance credits and such certificates, forms, conveyances, and other instruments as may be appropriate in connection with the acquisition, ownership, management, sale, transfer, assignment, encumbrance, rental, or

38 CFR Ch. I (7-1-03 Edition)

other disposition of real or personal property, or, of any right, title, or interest therein, including, but not limited to, contracts of sale, installment contracts, deeds, leases, bills of sale, assignments, and releases; and to approve disbursements to be made for any purpose authorized by 38 U.S.C. chapter 37.

(b) Designated positions:

Under Secretary for Benefits
Director, Loan Guaranty Service
Director, Medical and Regional Office Center
Director, VA Regional Office and Insurance Center
Director, Regional Office
Loan Guaranty Officer
Assistant Loan Guaranty Officer

The authority hereby delegated to employees of the positions designated in this paragraph may, with the approval of the Under Secretary for Benefits, be redelegated.

(c) Nothing in this section shall be construed (1) to authorize any such employee to exercise the authority vested in the Secretary under 38 U.S.C. 501 or 3703(a)(2) or to sue, or enter appearance for and on behalf of the Secretary, or confess judgment against the Secretary in any court without the Secretary's prior authorization; or (2) to include the authority to exercise those powers delegated to the Under Secretary for Benefits, or the Director, Loan Guaranty Service, under §§36.4320(j), 36.4335 or 36.4343:

Provided, That, anything in the regulations concerning guaranty or insurance of loans to veterans to the contrary notwithstanding, any evidence of guaranty or insurance issued on or after July 1, 1948, by any of the employees designated in paragraph (b) of this section or by any employee designated an authorized agent or a loan guaranty agent shall be deemed to have been issued by the Secretary, subject to the defenses reserved in 38 U.S.C. 3721.

(d) Each Regional Office, regional office and insurance center, and Medical and Regional Office Center shall maintain and keep current a cumulative list of all employees of that Office or Center who, since May 1, 1980, have occupied the positions of Director, Loan Guaranty Officer, and Assistant Loan Guaranty Officer. This list will include each employee's name, title, date the

Department of Veterans Affairs**§ 36.4343**

employee assumed the position, and the termination date, if applicable, of the employee's tenure in such position. The list shall be available for public inspection and copying at the Regional Office, or Center, during normal business hours.

(e)(1) Authority is hereby delegated to the officers, designated in paragraph (e)(2) of this section, of the entity performing loan servicing functions under a contract with the Secretary to execute on behalf of the Secretary all documents necessary for the servicing and termination of a loan made or acquired by the Secretary pursuant to 38 U.S.C. chapter 37 (other than under subchapter vi of that chapter). Documents executed under this paragraph include but are not limited to: loan modification agreements, notices of default and other documents necessary for loan foreclosure or termination, notices of appointment or substitution of trustees under mortgages or deeds of trust, releases or satisfactions of mortgages or deeds of trust, acceptance of deeds-in-lieu of foreclosure, loan assumption agreements, loan assignments, deeds tendered upon satisfaction or conversion of an installment land sales contract, and documents related to filing, pursuing and settling claims with insurance companies relating to hazard coverage on properties securing loans being serviced.

(2) The designated officers are: Vice President, Assistant Vice President, and Assistant Secretary.

(3) The Director, Loan Guaranty Service, Washington, DC, shall maintain a log listing all persons authorized to execute documents pursuant to paragraph (e) of this section and the dates such persons held such authority, together with certified copies of resolutions of the board of directors of the entity authorizing such individuals to perform the functions specified in paragraph (e)(1) of this section. These records shall be available for public inspection and copying at the Office of

the Director of VA Loan Guaranty Service, Washington, DC 20420.

(Authority: 38 U.S.C. 501, 3720(a)(5))

(Authority: 38 U.S.C. 501, 1820(a)(5))

[23 FR 2217, Apr. 4, 1958, and 24 FR 2655, Apr. 7, 1959, as amended at 40 FR 34593, Aug. 18, 1975; 43 FR 60460, Dec. 28, 1978; 45 FR 21243, Apr. 1, 1980; 46 FR 43673, Aug. 31, 1981; 54 FR 34988, Aug. 23, 1989; 61 FR 28058, June 4, 1996; 66 FR 32231, June 14, 2001]

§ 36.4343 Cooperative loans.

(a) Any loan, which is (1) related to an enterprise in which more than 10 individuals will participate; or (2) to be made for the purchase or construction of residential units in any housing development, cooperative or otherwise, the title to which development or to the individual units therein is not to be held directly by the veteran-participants, or which contemplates the ownership or maintenance of more than three units or of their major appurtenances in common, to be eligible for guaranty or insurance shall require prior approval of the Under Secretary for Benefits, or the Director, Loan Guaranty Service, who may issue such approval upon such conditions and limitations deemed appropriate, not inconsistent with the provisions of 38 U.S.C. chapter 37 and the regulations concerning guaranty or insurance of loans to veterans.

(b) The issuance of such approval with respect to a residential development under paragraph (a)(2) of this section also shall be subject to such conditions and stipulation as in the judgment of the approving officer are possible and proper to (1) afford reasonable and feasible protection to the rights of the Government as guarantor or insurer, and as subrogee, and to each veteran-participant against loss of his or her respective equity consequent upon the failure of other participants to discharge their obligations; (2) provide for a reasonable and workable plan for the operation and management of the project; (3) limit the personal liability of each veteran-participant to those

§ 36.4344**38 CFR Ch. I (7-1-03 Edition)**

sums allocable on a proper ratable basis to the purchase, cost, and maintenance of his or her individual unit or participating interest; (4) limit commercial features to those reasonably calculated to promote the economic soundness of the project and the living convenience of the participants, retaining the essential character of a residential project.

(c) No such project, development, or enterprise may be approved which involves an initial grouping of more than 500 veterans, or a cost of more than five million dollars, unless it is conclusively shown to the satisfaction of the approving officer that a greater number of veterans or dollar amount will assure substantial advantages to the veteran-participants which could not be achieved in a smaller project.

(d) When approved as in this section provided, and upon performance of the conditions indicated in the prior approval, proper guaranty certificate or certificates may be issued in connection with the loan or loans to be guaranteed on behalf of eligible veterans participating in the project, development or enterprise not to exceed in total amount the sum of the guaranties applied for by the individual participants and for which guaranty each participant is then eligible.

(e) In lieu of guaranty as authorized in paragraph (d) of this section, insurance shall be available on application by the lender and all veterans concerned. In such case the insurance credit shall be limited to 15 percent of the obligation of the veteran applicant (subject to available eligibility) and the total insurance credit in respect to the veterans' loans involved in the project shall not exceed 15 percent of the aggregate of the principal sums of the individual indebtedness incurred by the veterans participating in the project for the purpose of acquiring their respective interests therein.

[13 FR 7280, Nov. 27, 1948, as amended at 20 FR 9180, Dec. 10, 1955; 24 FR 2656, Apr. 7, 1959; 40 FR 34593, Aug. 18, 1975; 46 FR 43673, Aug. 31, 1981; 61 FR 28058, June 4, 1996]

§ 36.4344 Lender Appraisal Processing Program.

(a) *Delegation of authority to lenders to review appraisals and determine reasonable value.*

(1) To be eligible for delegation of authority to review VA appraisals and determine the reasonable value of properties to be purchased with VA guaranteed loans, a lender must (i) have automatic processing authority under 38 U.S.C. 3702(d), and (ii) employ one or more staff appraisal reviewers acceptable to the Secretary.

(2) To qualify as a lender's staff appraisal reviewer an applicant must be a full-time member of the lender's permanent staff and may not be employed by, or perform services for, any other mortgagee. The individual must not engage in any private pursuits in which there will be, or appear to be, any conflict of interest between those pursuits and his/her duties, responsibilities, and performance as a Lender Appraisal Processing Program (LAPP) staff appraisal reviewer. Three years of experience is necessary to qualify as a lender's staff appraisal reviewer. That experience must demonstrate a knowledge of, and the ability to apply industry-accepted principles, methods, practices and techniques of appraising, and the ability to competently determine the value of property within a prescribed geographical area. The individual must demonstrate the ability to review the work of others and to recognize deviations from accepted appraisal principles, practices, and techniques, errors in computations, and unjustifiable and unsupportable conclusions.

(3) Lenders that meet the requirements of 38 U.S.C. 3702(d), and have a staff appraisal reviewer determined acceptable by VA, will be authorized to review appraisals and make reasonable value determinations on properties that will be security for VA guaranteed loans. The lender's authorization will be subject to a one-year probationary period. Additionally, lenders must satisfy initial and subsequent VA office case review requirements prior to being allowed to determine reasonable value without VA involvement. The initial office case review requirement must be satisfied in the VA regional office in whose jurisdiction the lender's staff appraisal reviewer is located before the LAPP authority may be utilized by that lender in any other VA office's jurisdiction. To satisfy the initial office case review requirement, the first five

Department of Veterans Affairs**§ 36.4344**

cases of each lender staff appraisal reviewer involving properties in the regional office location where the staff appraisal reviewer is located will be processed by him or her up to the point where he or she has made a reasonable value determination and fully drafted, but not issued, the lender's notification of reasonable value letter to the veteran. At that point, and prior to loan closing, each of the five cases will be submitted to the local VA office. After a staff review of each case, VA will issue a Certificate of Reasonable Value, which the lender may use in closing the loan automatically if it meets all other requirements of the VA. If these five cases are found to be acceptable by VA, the lender's staff appraisal reviewer will be allowed to fully process subsequent appraisals for properties located in that VA office's jurisdiction without prior submission to VA and issuance by VA of a Certificate of Reasonable Value. Lenders must also satisfy a subsequent VA office case review requirement in each additional VA office location in which they desire to extend and utilize this authority. Under this requirement, the lender must have first satisfied the initial office case review requirement and then must submit to the additional VA office(s) the first case each staff appraisal reviewer processes in the jurisdiction of that office. As provided under the initial office case review requirement, VA office personnel will issue a Certificate of Reasonable value for this case and subsequently determine the acceptability of the lender's staff appraisal reviewer's processing. If VA finds this first case to be acceptable, the lender's staff appraisal reviewer will be allowed to fully process subsequent cases in that additional VA office's jurisdiction without prior submission to VA. The initial and subsequent office case review requirements may be expanded by VA if acceptable performance has not been demonstrated. After satisfaction of the initial and subsequent office case review requirements, routine reviews of LAPP cases will be made by VA staff based upon quality control procedures established by the Under Secretary for Benefits. Such review will be made on a random sampling or performance related

basis. During the probationary period a high percentage of reviews will be made by VA staff.

(4) The following certification by the lender's nominated staff appraisal reviewer must be provided with the lender's application for delegation of LAPP authority:

I hereby acknowledge and represent that by signing the Uniform Residential Appraisal Report (URAR), FHLMC (Federal Home Loan Mortgage Corporation) Form 70/ FNMA (Federal Notice Mortgage Association) Form 1004, I am certifying, in all cases, that I have personally reviewed the appraisal report. In doing so I have considered and utilized recognized professional appraisal techniques, have found the appraisal report to have been prepared in compliance with applicable VA requirements, and concur with the recommendations of the fee appraiser, who was assigned by VA to the case. Furthermore, in those cases where clarifications or corrections have been requested from the VA fee appraiser there has been no pressure or influence exerted on that appraiser to remove or change information that might be considered detrimental to the subject property, or VA's interests, or to reach a pre-determined value for that property. *Signature of Staff Appraisal Reviewer.*

(5) Other certifications required from the lender will be specified with particularity in the separate instructions issued by the Secretary, as noted in § 36.4344(b).

(b) *Instructions for LAPP Procedures.* The Secretary will publish separate instructions for processing appraisals under the Lenders Appraisal Processing Program. Compliance with these regulations and the separate instructions issued by the Secretary is deemed by VA to be the minimum exercise of due diligence in processing LAPP cases. Due diligence is considered by VA to represent that care, as is to be properly expected from, and ordinarily exercised by, reasonable and prudent lenders who would be dependent on the property as security to protect its investment.

(c) *VA minimum property requirements.* Lenders are responsible for determining that the property meets VA minimum property requirements. The separate instructions issued by the Secretary will set forth the lender's ability to adjust, remove, or alter the fee appraiser's or fee compliance inspector's recommendations concerning

§ 36.4344

VA minimum property requirements. Condominiums, planned-unit developments and leasehold estates must have been determined acceptable by VA. A condominium or planned-unit development which is acceptable to the Department of Housing and Urban Development or the Department of Agriculture may also be acceptable to VA.

(d) *Adjustment of value recommendations.* The amount of authority to upwardly adjust the fee appraiser's estimated market value during the lender staff appraisal reviewer's initial review of the appraisal report or to subsequently process an appeal of the lender's established reasonable value will be specified in the separate instructions issued by VA as noted in § 36.4344(b). The amount specified must not in any way be considered an administrative adjustment figure which may be applied indiscriminately and without valid basis or justification with the sole purpose of reaching an amount necessary to complete the sale or mortgage transaction.

(1) *Adjustment during initial review.* Any adjustment during the staff appraisal reviewer's initial review of the appraisal report must be fully and clearly justified in writing on the appraisal report form or, if necessary, on an addendum. The basis for the adjustment must be adequate and reasonable by professional appraisal standards. If real estate market or other valid data was utilized in arriving at the decision to make the adjustment, such data must be attached to the appraisal report. All adjustments, comments, corrections, justifications, etc., to the appraisal report must be made in a contrasting color, be clearly legible, and signed and dated by the staff appraisal reviewer.

(2) *Processing appeals.* The authority provided under 38 U.S.C. 3731(d) which permits a lender to obtain a VA fee panel appraiser's report which VA is obligated to consider in an appeal of the established reasonable value shall not apply to cases processed under the authority provided by this section. All appeals of VA fee appraisers' estimated market values or lenders' reasonable value determinations above the amount specified in the separate instructions issued by VA must be sub-

38 CFR Ch. I (7-1-03 Edition)

mitted, along with the lender's recommendations, if any, to VA for processing and final determination. Unless otherwise authorized in the separate instructions lenders must also submit appeals, regardless of the amount, to VA in all cases where the staff appraisal reviewer has made an adjustment during their initial review of the appraisal report to the fee appraiser's market value estimate. The fee appraiser's estimated market value or lender's reasonable value determination may be increased only when such increase is clearly warranted and fully supported by real estate market or other valid data considered adequate and reasonable by professional appraisal standards and the lender's staff appraisal reviewer clearly and fully justifies the reasoning and basis for the increase in writing on the appraisal report form or an addendum. The staff appraisal reviewer must date and sign the written justification and must cite within it the data used in arriving at the decision to make the increase. All such data shall be attached to the appraisal report form and any addendum.

(e) *Notification.* It will be the responsibility of the lender to notify the veteran borrower in writing of the determination of reasonable value and related conditions specific to the property and to provide the veteran with a copy of the appraisal report. Any delay in processing the notification of value must be documented. Any delay of more than five work days between the date of the lender's receipt of the fee appraiser's report and date of the notification of value to the veteran, without reasonable and documented extenuating circumstances, will not be acceptable. A copy of the lender notification letter to the veteran and the appraisal report must be forwarded to the VA office of jurisdiction at the same time the veteran is notified. In addition, the original appraisal report, related appraisal documentation, and a copy of the reasonable value determination notification to the veteran must be submitted to the VA with the request for loan guaranty.

(f) *Indemnification.* When the Secretary has incurred a loss as a result of a payment of claim under guaranty and in which the Secretary determines an

increase made by the lender under § 36.4344(d) or (f) was unwarranted, or arbitrary and capricious, the lender shall indemnify the Secretary to the extent the Secretary determines such loss was caused, or increased, by the increase in value.

(g) *Affiliations.* A lender affiliated with a real estate firm builder, land developer or escrow agent as a subsidiary division, investment or any other entity in which it has a financial interest or which it owns may not use this authority for any cases involving the affiliate unless the lender demonstrates to the Secretary's satisfaction that the lender and its affiliate(s) are essentially separate entities that operate independently of each other, free of all cross-influences (e.g., a formal corporate agreement exists which specifically sets forth this fact).

(h) *Quality Control Plans.* The lender must have an effective self-policing or quality control system to ensure the adequacy and quality of their LAPP staff appraisal reviewer's processing and, that its activities do not deviate from high standards of integrity. The quality control system must include frequent, periodic audits that specifically address the appraisal review activity. These audits may be performed by an independent party, or by the lender's independent internal audit division which reports directly to the firm's chief executive officer. The lender must agree to furnish findings and information under this system to VA on demand. While the quality control personnel need not be appraisers, they should have basic familiarity with appraisal theory and techniques and the ability to prescribe appropriate corrective action(s) in the appraisal review process when discrepancies or problems are identified. The basic elements of the system will be described in separate instructions issued by the Secretary. Copies of the lender's quality control plan or self-policing system evidencing appraisal related matters must be provided to the VA office of jurisdiction with the lender's application for LAPP authority.

(i) *Fees.* The Secretary may require mortgagees to pay an application fee and/or annual fees, including additional fees for each branch office authorized

to process cases under the authority delegated under this section, in such amounts and at such times as the Secretary may require.

(j) *Withdrawal of lender authority.* The authority for a lender to determine reasonable value may be withdrawn by the Loan Guaranty Officer when proper cause exists. A lender's authority to make reasonable value determinations shall be withdrawn when the lender no longer meets the basic requirements for delegating the authority, or when it can be shown that the lender's reasonable value determinations have not been made in accordance with VA regulations, requirements, guidelines, instructions or applicable laws, or when there is adequate evidence to support reasonable belief by VA that a particular unacceptable act, practice, or performance by the lender or the lender's staff has occurred. Such acts, practices or performance include, but are not limited to: Demonstrated technical incompetence (i.e., conduct which demonstrates an insufficient knowledge of industry accepted appraisal principles, techniques and practices; or the lack of technical competence to review appraisal reports and make value determinations in accordance with those requirements); substantive or repetitive errors (i.e., any error(s) of a nature that would materially or significantly affect the determination of reasonable value or condition of the property; or a number or series of errors that, considered individually, may not significantly impact the determination of reasonable value or property condition, but which when considered in the aggregate would establish that appraisal reviews or LAPP case processing are being performed in a careless or negligent manner), or continued instances of disregard for VA requirements after they have been called to the lender's attention.

(l) Withdrawal of authority by the Loan Guaranty Officer may be either for an indefinite or a specified period of time. For any withdrawal longer than 90 days a reapplication for lender authority to process appraisals under these regulations will be required. Written notice will be provided at least 30 days in advance of withdrawal unless the Government's interests are exposed

§ 36.4345

to immediate risk from the lender's activities in which case the withdrawal will be effected immediately. The notice will clearly and specifically set forth the basis and grounds for the action. There is no right to a formal hearing to contest the withdrawal of LAPP processing privileges. However, if within 15 days after receiving notice the lender requests an opportunity to contest the withdrawal, the lender may submit, in person, in writing, or through a representative, information and argument to the Loan Guaranty Officer in opposition to the withdrawal. The Loan Guaranty Officer will make a recommendation to the Regional Office Director who shall make the determination as to whether the action should be sustained, modified or rescinded. The lender will be informed in writing of the decision.

(2) The lender has the right to appeal the Regional Office Director's decision to the Under Secretary for Benefits. In the event of such an appeal, the Under Secretary for Benefits will review all relevant material concerning the matter and make a determination that shall constitute final agency action. If the lender's submission of opposition raises a genuine dispute over facts material to the withdrawal of LAPP authority, the lender will be afforded an opportunity to appear with a representative, submit documentary evidence, present witnesses and confront any witness the Veterans Benefits Administration presents. The Under Secretary for Benefits will appoint a hearing officer or panel to conduct the hearing. When such additional proceedings are necessary, the Under Secretary for Benefits shall base the determination on the facts as found, together with any information and argument submitted by the lender.

(3) In actions based upon a conviction or civil judgment, or in which there is no genuine dispute over material facts, the Under Secretary for Benefits shall make a decision on the basis of all the information in the administrative record, including any submission made by the lender.

(4) Withdrawal of the LAPP authority will require that VA make subsequent determinations of reasonable value for the lender. Consequently, VA

38 CFR Ch. I (7-1-03 Edition)

staff will review each appraisal report and issue a Certificate of Reasonable Value which can then be used by the lender to close loans on either the prior VA approval or automatic basis.

(5) Withdrawal by VA of the lender's LAPP authority does not prevent VA from also withdrawing automatic processing authority or taking debarment or suspension action based upon the same conduct by the lender.

(Authority: 38 U.S.C. 3731)

(Approved by the Office of Management and Budget under control number 2900-0513)

[55 FR 21019, May 22, 1990]

§ 36.4345 Waivers, consents, and approvals; when effective.

No waiver, consent, or approval required or authorized by the regulations concerning guaranty or insurance of loans to veterans shall be valid unless in writing signed by the Secretary or the subordinate officer to whom authority has been delegated by the Secretary.

[13 FR 7281, Nov. 27, 1948]

§ 36.4346 Servicing procedures for holders.

(a) *Establishment of loan servicing program.* The holder of a loan guaranteed or insured by the Secretary shall develop and maintain a loan servicing program which follows accepted industry standards for servicing of similar type conventional loans. The loan servicing program established pursuant to this section may employ different servicing approaches to fit individual borrower circumstances and avoid establishing a fixed routine. However, it must incorporate each of the provisions specified in paragraphs (b) through (l) of this section.

(b) *Procedures for providing information.* (1) Loan holders shall establish procedures to provide loan information to borrowers, arrange for individual loan consultations upon request and maintain controls to assure prompt responses to inquiries. One or more of the following means of making information readily available to borrowers is required.

(i) An office staffed with trained servicing personnel with access to loan

Department of Veterans Affairs**§ 36.4346**

account information located within 200 miles of the property.

(ii) Toll-free telephone service or acceptance of collect telephone calls at an office capable of providing needed information.

(2) All borrowers must be informed of the system available for obtaining answers to loan inquiries, the office from which the needed information may be obtained, and reminded of the system at least annually.

(c) *Statement for income tax purposes.* Within 60 days after the end of each calendar year, the holder shall furnish to the borrower a statement of the interest paid and, if applicable, a statement of the taxes disbursed from the escrow account during the preceding year. At the borrower's request, the holder shall furnish a statement of the escrow account sufficient to enable the borrower to reconcile the account.

(d) *Change of servicing.* Whenever servicing of a loan guaranteed or insured by the Secretary is transferred from one holder to another, notice of such transfer by both the transferor and transferee, the form and content of such notice, the timing of such notice, the treatment of payments during the period of such transfer, and damages and costs for failure to comply with these requirements shall be governed by the pertinent provisions of the Real Estate Settlement Procedures Act as administered by the Department of Housing and Urban Development.

(e) *Escrow accounts.* A holder of a loan guaranteed or insured by the Secretary may collect periodic deposits from the borrower for taxes and/or insurance on the security and maintain a tax and insurance escrow account provided such a requirement is authorized under the terms of the security instruments. In maintaining such accounts, the holder shall comply with the pertinent provisions of the Real Estate Settlement Procedures Act.

(f) *System for servicing delinquent loans.* In addition to the requirements of the Real Estate Settlement Procedures Act, concerning the duties of the loan servicer to respond to borrower inquiries, to protect the borrower's credit rating during a payment dispute period, and to pay damages and costs for noncompliance, holders shall establish

a system for servicing delinquent loans which ensures that prompt action is taken to collect amounts due from borrowers and minimize the number of loans in a default status. The holder's servicing system must include the following:

(1) An accounting system which promptly alerts servicing personnel when a loan becomes delinquent;

(2) A collection staff which is trained in techniques of loan servicing and counseling delinquent borrowers to advise borrowers how to cure delinquencies, protect their equity and credit rating and, if the default is insoluble, pursue alternatives to foreclosure;

(3) Procedural guidelines for individual analysis of each delinquency;

(4) Instructions and appropriate controls for sending delinquent notices, assessing late charges, handling partial payments, maintaining servicing histories and evaluating repayment proposals;

(5) Management review procedures for evaluating efforts made to collect the delinquency and the response from the borrower before a decision is made to initiate action to liquidate a loan;

(6) Procedures for reporting delinquencies of 90 days or more and loan terminations to major consumer credit bureaus as specified by the Secretary and for informing borrowers that such action will be taken; and

(7) Controls to ensure that all notices required to be given to the Secretary on delinquent loans are provided timely and in such form as the Secretary shall require.

(g) *Collection actions.* (1) Holders shall employ collection techniques which provide flexibility to adapt to the individual needs and circumstances of each borrower. A variety of collection techniques may be used based on the holder's determination of the most effective means of contact with borrowers during various stages of delinquency. However, at a minimum the holder's collection procedures must include the following actions:

(i) A written delinquency notice to the borrower(s) requesting immediate payment if a loan installment has not been received within 17 days after the due date. This notice must be mailed

§ 36.4346

no later than the 20th day of the delinquency and state the amount of the payment and of any late charges that are due.

(ii) An effort, concurrent with the written delinquency notice to establish contact with the borrower(s) by telephone. When talking with the borrower(s), the holder should attempt to determine why payment was not made and emphasize the importance of remitting loan installments as they come due.

(iii) A letter to the borrower(s) if payment has not been received within 30 days after it is due and telephone contact could not be made. This letter should emphasize the seriousness of the delinquency and the importance of taking prompt action to resolve the default. It should also notify the borrower(s) that the loan is in default, state the total amount due and advise the borrower(s) how to contact the holder to make arrangements for curing the default.

(iv) In the event the holder has not established contact with the borrower(s) and has not determined the financial circumstances of the borrower(s) or established a reason for the default or obtained agreement to a repayment plan from the borrower(s), then a face-to-face interview with the borrower(s) or a reasonable effort to arrange such a meeting is required.

(2) The holder must provide a valid explanation of any failure to perform these collection actions when reporting loan defaults to the Secretary. A pattern of such failure may be a basis for sanctions under 38 CFR 44.205 and 44.305.

(h) *Conducting interviews with delinquent borrowers.* When personal contact with the borrower(s) is established, the holder shall solicit sufficient information to properly evaluate the prospects for curing the default and whether the granting of forbearance or other relief assistance would be appropriate. At a minimum, the holder must make a reasonable effort to establish the following:

(1) The reason for the default and whether the reason is a temporary or permanent condition;

(2) The present income and employment of the borrower(s);

38 CFR Ch. I (7-1-03 Edition)

(3) The current monthly expenses of the borrower(s) including household and debt obligations;

(4) The current mailing address and telephone number of the borrower(s); and

(5) A realistic and mutually satisfactory arrangement for curing the default.

(i) *Property inspections.* (1) The holder shall make an inspection of the property securing the loan whenever it becomes aware that the physical condition of the security may be in jeopardy. Unless a repayment agreement is in effect, a property inspection shall also be made at the following times:

(i) Before the 60th day of delinquency or before initiating action to liquidate a loan, whichever is earlier; and,

(ii) At least once each month after liquidation proceedings have been started unless servicing information shows the property remains owner-occupied.

(2) Whenever a holder obtains information which indicates that the property securing the loan is abandoned, it shall make appropriate arrangements to protect the property from vandalism and the elements. Thereafter, the holder shall schedule inspections at least monthly to prevent unnecessary deterioration due to vandalism, or neglect. With respect to any loan more than 30 days delinquent, a property abandonment must be reported to the Secretary and appropriate action initiated under § 36.4317(a) within 15 days after the holder confirms the property is abandoned.

(j) *Collection records.* The holder shall maintain individual file records of collection action on delinquent loans and make such records available to the Secretary for inspection on request. Such collection records shall show:

(1) The dates and content of letters and notices which were mailed to the borrower(s);

(2) Dated summaries of each personal servicing contact and the result of same;

(3) The indicated reason(s) for default; and,

(4) The date and result of each property inspection.

Department of Veterans Affairs**§ 36.4348**

(k) *Reporting to the Secretary.* A summary of collection efforts, the information obtained through such efforts and the holder's evaluation of the reason for the default and prospects for resolution of the default must be included in any notice provided to the Secretary pursuant to §§ 36.4315 and 36.4317.

(l) *Quality control procedures.* No later than 180 days after the effective date of this regulation, each loan holder shall establish internal controls to periodically assess the quality of the servicing performed on loans guaranteed by the Secretary and assure that all requirements of this section are being met. Those procedures must provide for a review of the holder's servicing activities at least annually and include an evaluation of delinquency and foreclosure rates on loans in its portfolio which are guaranteed by the Secretary. As part of its evaluation of delinquency and foreclosure rates, the holder shall:

(1) Collect and maintain appropriate data on delinquency and foreclosure rates to enable the holder to evaluate effectiveness of its collection efforts;

(2) Determine how its VA delinquency and foreclosure rates compare with rates in reports published by the industry, investors and others; and,

(3) Analyze significant variances between its foreclosure and delinquency rates and those found in available reports and publications and take appropriate corrective action.

(m) Holders shall provide available statistical data on delinquency and foreclosure rates and their analysis of such data to the Secretary upon request.

(Approved by the Office of Management and Budget under Control Number 2900-0530)

[58 FR 29117, May 19, 1993, as amended at 61 FR 28058, June 4, 1996]

§ 36.4347 Minimum property and construction requirements.

No loan for the purchase or construction of residential property shall be eligible for guaranty or insurance unless such property complies or conforms with those standards of planning, construction, and general acceptability that may be applicable thereto and pre-

scribed by the Secretary pursuant to 38 U.S.C. 3704(a).

[24 FR 2656, Apr. 7, 1959]

§ 36.4348 Authority to close loans on the automatic basis.

(a) Supervised lenders of the classes described in 38 U.S.C. 3702(d) (1) and (2) are authorized by statute to process VA guaranteed home loans on the automatic basis. This category of lenders includes any Federal land bank, national bank, State bank, private bank, building and loan association, insurance company, credit union or mortgage and loan company that is subject to examination and supervision by an agency of the United States or of any State or by any State.

(b) Non-supervised lenders of the class described in 38 U.S.C. 3702(d)(3) must apply to the Secretary for authority to process loans on the automatic basis. Each of the minimum requirements listed below must be met by applicant lenders.

(1) *Experience.* The firm must meet one of the following experience requirements:

(i) The firm must have been actively engaged in originating VA loans for at least two years, have a VA Lender ID number and have originated and closed a minimum of ten VA loans within the past two years, excluding interest rate reduction refinance loans (IRRRLs), that have been properly documented and submitted in compliance with VA requirements and procedures; or

(ii) The firm must have a VA ID number and, if active for less than two years, have originated and closed at least 25 VA loans, excluding IRRRLs, that have been properly documented and submitted in compliance with VA requirements and procedures; or

(iii) Each principal officer of the firm, who is actively involved in managing origination functions, must have a minimum of two recent years' management experience in the origination of VA loans. This experience may be with the current or prior employer. For the purposes of this requirement, principal officer is defined as president or vice president; or

(iv) If the firm has been operating as an agent for a non-supervised automatic lender (sponsoring lender), the

§ 36.4348

38 CFR Ch. I (7-1-03 Edition)

firm must submit documentation confirming that it has a VA Lender ID number and has originated a minimum of ten VA loans, excluding IRRRLs, over the past two years. If active for less than two years, the agent must have originated at least 25 VA loans. The required documentation is a copy of the VA letter approving the firm as an agent for the sponsoring lender; a copy of the corporate resolution, describing the functions the agent was to perform, submitted to VA by the sponsoring lender; and a letter from a senior officer of the sponsoring lender indicating the number of VA loans submitted by the agent each year and that the loans have been properly documented and submitted in compliance with VA requirements and procedures.

(2) *Underwriter.* A senior officer of the firm must nominate a full-time qualified employee(s) to act in the firm's behalf as underwriter(s) to personally review and make underwriting decisions on VA loans to be closed on the automatic basis.

(i) Nominees for underwriter must have a minimum of three years experience in processing, pre-underwriting or underwriting mortgage loans. At least one recent year of this experience must have included making underwriting decisions on VA loans. (Recent is defined as within the past three years.) A VA nomination and current resume, outlining the underwriter's specific experience with VA loans, must be submitted for each underwriter nominee.

(ii) Alternatively, if an underwriter does not have the experience outlined above, the underwriter must submit documentation verifying that he or she is a current Accredited Residential Underwriter (ARU) as designated by the Mortgage Bankers Association (MBA).

(iii) If an underwriter is not located in the lender's corporate office, then a senior officer must certify that the underwriter reports to and is supervised by an individual who is not a branch manager or other person with production responsibilities.

(iv) All VA-approved underwriters must attend a 1-day (eight-hour) training course on underwriter responsibilities, VA underwriting requirements, and VA administrative requirements, including the usage of VA forms, with

in 90 days of approval (if VA is unable to make such training available within 90 days, the underwriter must attend the first available training). Immediately upon approval of a VA underwriter, the office of jurisdiction will contact the underwriter to schedule this training at a VA regional office (VARO) of the underwriter's choice. This training is required for all newly approved VA underwriters, including those who qualified for approval based on an ARU designation, as well as VA-approved underwriters who have not underwritten VA-guaranteed loans in the past 24 months. Furthermore, and at the discretion of any VARO in whose jurisdiction the lender is originating VA loans, VA-approved underwriters who consistently approve loans that do not meet VA credit standards may be required to retake this training.

(3) *Underwriter certification.* The lender must certify that all underwriting decisions as to whether to accept or reject a VA loan will be made by a VA-approved underwriter. In addition each VA-approved underwriter will be required to certify on each VA loan that he or she approves that the loan has been personally reviewed and approved by the underwriter.

(4) *Financial requirements.* Each application must include the most recent annual financial statement audited and certified by a certified public accountant (CPA). If the date of the annual financial statement precedes that of the application by more than six months, the lender must also attach a copy of its latest internal financial statement. Lenders are required to meet either the working capital or the minimum net worth financial requirement as defined below.

(i) *Working capital.* A minimum of \$50,000 in working capital must be demonstrated.

(A) Working capital is a measure of a firm's liquidity, or the ability to pay its short-term debts. Working capital is defined as the excess of current assets over current liabilities. Current assets are defined as cash or other liquid assets convertible into cash within a 1-year period. Current liabilities are defined as debts that must be paid within the same 1-year time frame.

Department of Veterans Affairs**§ 36.4348**

(B) The VA determination of whether a lender has the required minimum working capital is based on the balance sheet of the lender's annual audited financial statement. Therefore, either the balance sheet must be classified to distinguish between current and fixed assets and between current and long-term liabilities or the information must be provided in a footnote to the statement.

(ii) *Net worth.* Lenders must show evidence of a minimum of \$250,000 in adjusted net worth. Net worth is a measure of a firm's solvency, or its ability to exist in the long run, quantified by the payment of long-term debts. Net worth as defined by generally accepted accounting principles (GAAP) is total assets minus total liabilities. Adjusted net worth for VA purposes is the same as the adjusted net worth required by the Department of Housing and Urban Development (HUD), net worth less certain unacceptable assets including:

(A) Any assets of the lender pledged to secure obligations of another person or entity.

(B) Any asset due from either officers or stockholders of the lender or related entities, in which the lender's officers or stockholders have a personal interest, unrelated to their position as an officer or stockholder.

(C) Any investment in related entities in which the lender's officers or stockholders have a personal interest unrelated to their position as an officer or stockholder.

(D) That portion of an investment in joint ventures, subsidiaries, affiliates and/or other related entities which is carried at a value greater than equity, as adjusted. "Equity as adjusted" means the book value of the related entity reduced by the amount of unacceptable assets carried by the related entity.

(E) All intangibles, such as goodwill, covenants not to compete, franchisee fees, organization costs, etc., except unamortized servicing costs carried at a value established by an arm's-length transaction and presented in accordance with generally accepted accounting principles.

(F) That portion of an asset not readily marketable and for which appraised values are very subjective, carried at a

value in excess of a substantially discounted appraised value. Assets such as antiques, art work and gemstones are subject to this provision and should be carried at the lower of cost or market.

(G) Any asset that is principally used for the personal enjoyment of an officer or stockholder and not for normal business purposes. Adjusted net worth must be calculated by a CPA using an audited and certified balance sheet from the lender's latest financial statements. "Personal interest" as used in this section indicates a relationship between the lender and a person or entity in which that specified person (e.g., spouse, parent, grandparent, child, brother, sister, aunt, uncle or in-law) has a financial interest in or is employed in a management position by the lender.

(5) *Lines of credit.* The lender applicant must have one or more lines of credit aggregating at least \$1 million. The identity of the source(s) of warehouse lines of credit must be submitted to VA and the applicant must agree that VA may contact the named source(s) for the purpose of verifying the information. A line of credit must be unrestricted, that is, funds are available upon demand to close loans and are not dependent on prior investor approval. A letter from the company(ies) verifying the unrestricted line(s) of credit must be submitted with the application for automatic authority.

(6) *Permanent investors.* If the lender customarily sells loans it originates, it must have a minimum of two permanent investors. The names, addresses and telephone numbers of the permanent investors must be submitted with the application.

(7) *Liaison.* The lender applicant must designate an employee and an alternate to be the primary liaison with VA. The liaison officers should be thoroughly familiar with the lender's entire operation and be able to respond to any query from VA concerning a particular VA loan or the firm's automatic authority.

(8) *Other considerations.* All applications will also be reviewed in light of the following considerations:

(i) There must be no factors that indicate that the firm would not exercise

§ 36.4348

38 CFR Ch. I (7-1-03 Edition)

the care and diligence required of a lender originating and closing VA loans on the automatic basis; and

(ii) In the event the firm, any member of the board of directors, or any principal officer has ever been debarred or suspended by any Federal agency or department, or any of its directors or officers has been a director or officer of any other lender or corporation that was so debarred or suspended, or if the lender applicant ever had a servicing contract with an investor terminated for cause, a statement of the facts must be submitted with the application for automatic authority.

(9) *Quality control system.* In order to be approved as a non-supervised lender for automatic-processing authority, the lender must implement a written quality control system which ensures compliance with VA requirements. The lender must agree to furnish findings under its systems to VA on demand. The elements of the quality control system must include the following:

(i) *Underwriting policies.* Each office of the lender shall maintain copies of VA credit standards and all available VA underwriting guidelines.

(ii) *Corrective measures.* The system should ensure that effective corrective measures are taken promptly when deficiencies in loan origination's are identified by either the lender or VA. Any cases involving major discrepancies which are discovered under the system must be reported to VA.

(iii) *System integrity.* The quality control system should be independent of the mortgage loan production function.

(iv) *Scope.* The review of underwriting decisions and certifications must include compliance with VA underwriting requirements, sufficiency of documentation and soundness of underwriting judgments.

(v) *Appraisal quality.* For lenders approved for the Lender Appraisal Processing Program (LAPP), the quality control system must specifically contain provisions concerning the adequacy and quality of real property appraisals. While the lender's quality control personnel need not be appraisers, they should have basic familiarity with appraisal theory and techniques so that they can select appropriate cases for review if discretionary sam-

pling is used, and prescribe appropriate corrective action(s) in the appraisal review process when discrepancies or problems are identified. Copies of the lender's quality control plan or self-policing system evidencing appraisal related matters must be provided to the VA office of jurisdiction.

(10) *Courtesy closing.* The lender-applicant must certify to VA that it will not close loans on an automatic basis as a courtesy or accommodation for other mortgage lenders, whether or not such lenders are themselves approved to close on an automatic basis without the express approval of VA. However, a lender with automatic authority may close loans for which information and supporting credit data have been developed on its behalf by a duly authorized agent.

(11) *Probation.* Lenders meeting these requirements will be approved to close VA loans on an automatic basis for a 1-year period. At the end of this period, the lender's quality of underwriting, the completeness of loan submissions, compliance with VA requirements and procedures, and the delinquency and foreclosure rates will be reviewed.

(12) *Extensions of automatic authority.* When a lender wants its automatic authority extended to another State, the request must be submitted, with the fee designated in paragraph (e)(5) of this section, to the VA regional office having jurisdiction in the State where the lender's corporate office is located.

(i) When a lender wants its automatic authority to include loans involving a real estate brokerage and/or a residential builder or developer in which it has a financial interest, owns, is owned by, or with which it is affiliated, the following documentation must be submitted:

(A) A corporate resolution from the lender and each affiliate indicating that they are separate entities operating independently of each other. The lender's corporate resolution must indicate that it will not give more favorable underwriting consideration to its affiliate's loans, and the affiliate's corporate resolution must indicate that it will not seek to influence the lender to give their loans more favorable underwriting consideration.

Department of Veterans Affairs**§ 36.4348**

(B) Letters from permanent investors indicating the percentage of all VA loans based on the affiliate's production originated by the lender over a 1-year period that are past due 90 days or more. This delinquency ratio must be no higher than the national average for the same period for all mortgage loans.

(ii) When a lender wants its automatic authority extended to additional States, the lender must indicate how it plans to originate VA loans in those States. Unless a lender proposes a telemarketing plan, VA requires that a lender have a presence in the State, that is, a branch office, an agent relationship, or that it is a reasonable distance from one of its offices in an adjacent State, i.e., 50 miles. If the request is based on an agency relationship, the documentation outlined in paragraph (b)(13) must be submitted with the request for extension.

(13) *Use of agents.* A lender using an agent to perform a portion of the work involved in originating and closing a VA-guaranteed loan on an automatic basis must take full responsibility by certification for all acts, errors and omissions of the agent or other entity and its employees for the work performed. Any such acts, errors or omissions will be treated as those of the lender and appropriate sanctions may be imposed against the lender and its agent. Lenders requesting an agent must submit the following documentation to the VA regional office having jurisdiction for the lender's corporate office:

(i) A corporate resolution certifying that the lender takes full responsibility for all acts, errors and omissions of the agent that it is requesting. The corporate resolution must also identify the agent's name and address, and the geographic area in which the agent will be originating and/or closing VA loans; whether the agent is authorized to issue interest rate lock-in agreements on behalf of the lender; and outline the functions the agent is to perform. Alternatively, the lender may submit a blanket corporate resolution which sets forth the functions of any and all agents and identifies individual agents by name, address, and geographic area in separate letters which refer to the blanket resolution.

(ii) When the VA regional office having jurisdiction for the lender's corporate office acknowledges receipt of the lender's request in writing, the agent is thereby authorized to originate VA loans on the lender's behalf.

(Authority: 38 U.S.C. 501(a), 3702(d))

(c) A lender approved to close loans on the automatic basis who subsequently fails to meet the requirements of this section must report to VA the circumstances surrounding the deficiency and the remedial action to be taken to cure it. Failure to advise VA in a timely manner could result in a lender's loss of its approval to close VA loans on the automatic basis.

(Authority: 38 U.S.C. 501(a), 3702(d))

(d) *Annual recertification.* Non-supervised lenders of the class described in 38 U.S.C. 3702(d)(3) must be recertified annually for authority to process loans on the automatic basis. The following minimum annual recertification requirements must be met by each lender approved for automatic authority:

(1) *Financial requirements.* A lender must submit, within 120 days following the end of its fiscal year, an audited and certified financial statement with a classified balance sheet or a separate footnote for adjusted net worth to VA Central Office (264) for review. The same minimum financial requirements described in § 36.4348(b)(5) must be maintained and verified annually in order to be recertified for automatic authority.

(2) *Processing annual lender data.* The VA regional office having jurisdiction for the lender's corporate office will mail an annual notice to the lender requesting current information on the lender's personnel and operation. The lender is required to complete the form and return it with the appropriate annual renewal fees to the VA regional office.

(Authority: 38 U.S.C. 501(a), 3702(d))

(e) *Lender fees.* To participate as a VA automatic lender, non-supervised lenders of the class described in 38 U.S.C. 3702(d)(3) shall pay fees as follows:

(1) \$500 for new applications;

§ 36.4349

- (2) \$200 for reinstatement of lapsed or terminated automatic authority;
 - (3) \$100 for each underwriter approval;
 - (4) \$100 for each agent approval;
 - (5) A minimum fee of \$100 for any other VA administrative action pertaining to a lender's status as an automatic lender;
 - (6) \$200 annually for certification of home offices; and
 - (7) \$100 annually for each agent renewal.
- (f) Supervised lenders of the classes described in paragraphs (d)(1) and (d)(2) of 38 U.S.C. 3702 participating in VA's Loan Guaranty Program shall pay fees as follows:
- (1) \$100 fee for each agent approval; and
 - (2) \$100 annually for each agent renewal.

(Authority: 38 U.S.C. 501(a) and 3703(c)(1))

(g) Lenders participating in VA's Lender Appraisal Processing Program shall pay a fee of \$100 for approval of each staff appraisal reviewer.

[56 FR 40561, Aug. 15, 1991, as amended at 57 FR 829, Jan. 9, 1992; 57 FR 40616, Sept. 4, 1992; 63 FR 12004, Mar. 12, 1998]

§ 36.4349 Withdrawal of authority to close loans on the automatic basis.

(a)(1) As provided in 38 U.S.C. 3702(e), the authority of any lender to close loans on the automatic basis may be withdrawn by the Secretary at any time upon 30 days notice. The automatic processing authority of both supervised and nonsupervised lenders may be withdrawn for engaging in practices which are imprudent from a lending standpoint or which are prejudicial to the interests of veterans or the Government but are of a lesser degree than would warrant complete suspension or debarment of the lender from participation in the program.

(2) Automatic-processing authority may be withdrawn at any time for failure to meet basic qualifying and/or annual recertification criteria.

(i) *Non-supervised lenders.* (A) Automatic authority may be withdrawn for lack of a VA-approved underwriter, failure to maintain \$50,000 in working capital or \$250,000 in adjusted net

38 CFR Ch. I (7-1-03 Edition)

worth, or failure to file required financial information.

(B) During the 1-year probationary period for newly approved lenders, automatic authority may be temporarily or permanently withdrawn for any of the reasons set forth in this section regardless of whether deficiencies previously have been brought to the attention of the probationary lender.

(ii) *Supervised lenders.* Automatic authority will be withdrawn for loss of status as an entity subject to examination and supervision by a Federal or State supervisory agency as required by 38 U.S.C. 3702(d).

(Authority: 38 U.S.C. 501(a), 3702(d))

(3) Automatic processing authority may also be withdrawn for any of the causes for debarment set forth at § 44.305 of this title.

(b) Authority to close loans on the automatic basis may also be temporarily withdrawn for a period of time under the following schedule.

(1) Withdrawal for 60 days:

(i) Automatic loan submissions show deficiencies in credit underwriting, such as use of unstable sources of income to qualify the borrower, ignoring significant adverse credit items affecting the applicant's creditworthiness, etc., after such deficiencies have been repeatedly called to the lender's attention;

(ii) Employment or deposit verifications are handcarried by applicants or otherwise improperly permitted to pass through the hands of a third party;

(iii) Automatic loan submissions are consistently incomplete after such deficiencies have been repeatedly called to the lender's attention by VA; or

(iv) There are continued instances of disregard of VA requirements after they have been called to the lender's attention.

(2) Withdrawal for 180 days:

(i) Loans are closed automatically which conflict with VA credit standards and which would not have been made by a lender acting prudently;

(ii) The lender fails to disclose to VA significant obligations or other information so material to the veteran's ability to repay the loan that undue risk to the Government results;

Department of Veterans Affairs**§ 36.4349**

(iii) Employment or deposit verifications are allowed to be handcarried by applicant or otherwise mishandled, resulting in the submission of significant misinformation to VA;

(iv) Substantiated complaints are received that the lender misrepresented VA requirements to veterans to the detriment of their interests (e.g., veteran was dissuaded from seeking a lower interest rate based on lender's incorrect advice that such options were precluded by VA requirements);

(v) Closing documentation shows instances of improper charges to the veteran after the impropriety of such charges has been called to the lender's attention by VA, or refusal to refund such charges after notification by VA; or

(vi) There are other instances of lender actions which are prejudicial to the interests of veterans such as deliberate delays in scheduling loan closings.

(3) Withdrawal for a period of from one year to three years:

(i) The lender fails to properly disburse loans (e.g., loan disbursement checks returned due to insufficient funds);

(ii) There is involvement by the lender in the improper use of a veteran's entitlement (e.g., knowingly permitting the veteran to violate occupancy requirements, lender involvement in sale of veteran's entitlement, etc.).

(4) A continuation of actions that have led to previous withdrawal of automatic authority justifies withdrawal of automatic authority for the next longer period of time.

(5) Withdrawal of automatic processing authority does not prevent a lender from processing VA guaranteed loans on the prior approval basis.

(6) Action by VA to remove a lender's automatic authority does not prevent VA from also taking debarment or suspension action based on the same conduct by the lender.

(7) VA field facilities are authorized to withdraw automatic privileges for 60 days, based on any of the violations set forth in paragraphs (b)(1) through (b)(3) of this section, for nonsupervised lend-

ers without operations in other stations' jurisdictions. All determinations regarding withdrawal of automatic authority for longer periods of time or multi-jurisdictional lenders must be made in Central Office.

(c) VA will provide 30 days notice of a withdrawal of automatic authority in order to enable the lender to either close or obtain prior approval for a loan on which processing has begun. There is no right to a formal hearing to contest the withdrawal of automatic processing privileges. However, if within 15 days after receiving notice the lender requests an opportunity to contest the withdrawal, the lender may submit in person, in writing, or through a representative, information and argument in opposition to the withdrawal.

(d) If the lender's submission in opposition raises a dispute over facts material to the withdrawal of automatic authority, the lender will be afforded an opportunity to appear with a representative, submit documentary evidence, present witnesses, and confront any witnesses VA presents. The Under Secretary for Benefits will appoint a hearing officer or panel to conduct the hearing.

(e) A transcribed record of the proceedings shall be made available at cost to the lender, upon request, unless the requirement for a transcript is waived by mutual agreement.

(f) In actions based upon a conviction or civil judgment, or in which there is no genuine dispute over material facts, the Under Secretary for Benefits shall make a decision on the basis of all the information in the administrative record, including any submission made by the lender.

(g) In actions in which additional proceedings are necessary to determine disputed material facts, written findings of fact will be prepared by the hearing officer or panel. The Under Secretary for Benefits shall base the decision on the facts as found, together with any information and argument submitted by the lender and any other

§ 36.4350

information in the administrative record.

(Authority: 38 U.S.C. 501, 1803(c)(1))

(The information collection requirements in this section have been approved by the Office of Management and Budget under control numbers 2900-0574)

[56 FR 40562, Aug. 15, 1991, as amended at 61 FR 28059, June 4, 1996; 63 FR 12007, Mar. 12, 1998]

§ 36.4350 Estate of veteran in real property.

(a) The estate in the realty acquired by the veteran, wholly or partly with the proceeds of a guaranteed or insured loan, or owned by him and on which construction, or repairs, or alterations or improvements are to be made, shall be not less than:

(1) A fee simple estate therein, legal or equitable; or

(2) A leasehold estate running or renewable at the option of the lessee for a period of not less than 14 years from the maturity of the loan, or to any earlier date at which the fee simple title will vest in the lessee, which is assignable or transferable, if the same be subjected to the lien; however, a leasehold estate which is not freely assignable and transferable will be considered an acceptable estate if it is determined by the Under Secretary for Benefits, or the Director, Loan Guaranty Service, (i) that such type of leasehold is customary in the area where the property is located, (ii) that a veteran or veterans will be prejudiced if the requirement for free assignability is adhered to and, (iii) that the assignability and other provisions applicable to the leasehold estate are sufficient to protect the interests of the veteran and the Government and are otherwise acceptable; or

(3) A life estate, provided that the remainder and reversionary interests are subjected to the lien; or

(4) A beneficial interest in a revocable Family Living Trust that ensures that the veteran, or veteran and spouse, have an equitable life estate, provided the lien attaches to any remainder interest and the trust arrangement is valid under State law.

The title to such estate shall be such as is acceptable to informed buyers,

38 CFR Ch. I (7-1-03 Edition)

title companies, and attorneys, generally, in the community in which the property is situated, except as modified by paragraph (b) of this section.

(b) Any such property or estate will not fail to comply with the requirements of paragraph (a) of this section by reason of the following:

(1) Encroachments;

(2) Easements;

(3) Servitudes;

(4) Reservations for water, timber, or subsurface rights;

(5) Sale and lease restrictions:

(i) Except as to condominiums, the right in any grantor or cotenant in the chain of title, or a successor of either, to purchase for cash, which right was established by an instrument recorded prior to December 1, 1976, and by the terms thereof is exercisable only if:

(A) An owner elects to sell,

(B) The option price is not less than the price at which the then owner is willing to sell to another, and

(C) Exercised within 30 days after notice is mailed by registered mail to the address of optionee last known to the then owner of the then owner's election to sell, stating the price and the identity of the proposed vendee;

(ii) A condominium estate established by the filing for record of the Master Deed, or other enabling document before December 1, 1976 will not fail to comply with the requirements of paragraph (a) of this section by reason of:

(A) Prohibition against leasing a unit for a period of less than 6 months.

(B) The existence of a right of first option to purchase or right to provide a substitute buyer reserved to the condominium association provided such option or right is exercisable only if:

(1) An owner elects to sell,

(2) The option price is not less than the price at which the then owner is willing to sell to another,

(3) The terms and conditions under which the option price is to be paid are identical to or are not less favorable to the owner than the terms and conditions under which the owner was willing to sell to the owner's prospective buyer, and

(4) Notice of the association's decision to exercise the option must be mailed to the owner by registered or

Department of Veterans Affairs**§ 36.4350**

certified mail within 30 days after notice is mailed by registered or certified mail to the address of the association last known to the owner of the owner's election to sell, stating the price, terms of sale, and the identity of the proposed vendee;

(iii) Any property subject to a restriction on the owner's right to convey to any party of the owner's choice, which restriction is established by a document recorded on or after December 1, 1976, will not qualify as security for a guaranteed or insured loan. A prohibition or restriction on leasing an individual unit in a condominium will not cause the condominium estate to fail to qualify as security for such loan, provided the restriction is in accordance with § 36.4358(c);

(iv) Notwithstanding the provisions of paragraphs (b)(5) (i), (ii), and (iii) of this section, a property shall not be considered ineligible pursuant to paragraph (a) of this section if:

(A) The veteran obtained the property under a State or local political subdivision program designed to assist low- or moderate-income purchasers, and as a condition the purchaser must agree to one or more of the following restrictions:

(1) If the property is resold within a time period as established by local law or ordinance, after the purchaser acquires title, the purchaser must first offer the property to the government housing agency, or a low- or moderate-income purchaser designated by such agency, provided the option to purchase is exercised within 90 days after notice by the purchaser to the agency of intention to sell;

(2) If the property is resold within a time period as established by local law or ordinance after the purchaser acquires title, a governmental agency may specify a maximum price which the veteran may receive for the property upon resale; or

(3) Such other restriction approved by the Secretary designed to insure either that a property acquired under such program again be made available to low- or moderate-income purchasers, or to prevent a private purchaser from obtaining a windfall profit on the resale of such property, while assuring that the purchaser has a reasonable op-

portunity to dispose of the property without undue difficulty at a reasonable price.

The sale price of a property under any of the restrictions of paragraph (b)(5)(iv)(A) of this section shall not be less than the lowest of the following: The price designated by the owner as the asking price; the appraised value of the property; or the original purchase price of the property, increased by a factor reflecting all or a reasonable portion of the increased costs of housing or the percentage increase in median income in the area between the date of original purchase and resale, plus the reasonable value or actual costs of any capital improvements made by the owner plus a reasonable real estate commission less the cost of necessary repairs required to place the property in saleable condition; or other reasonable formula approved by the Secretary. The veteran must be fully informed and consent in writing to the housing restrictions. A copy of the veteran's consent statement must be forwarded with the application for home loan guaranty or the report of a home loan processed on the automatic basis; or

(Authority: 38 U.S.C. 3703(c))

(B) A recorded restriction on title designed to provide housing for older persons, provided that the restriction is acceptable under the provisions of the Fair Housing Act, title VIII of the Civil Rights Act of 1968, as amended by the Fair Housing Amendments Act of 1988, 42 U.S.C. 3601 *et seq.* The veteran must be fully informed and consent in writing to the restrictions. A copy of the veteran's consent statement must be forwarded with the application for home loan guaranty or the report of a home loan processed on the automatic basis;

(Authority: 38 U.S.C. 501, 3703(c)(1))

(6) Building and use restrictions whether or not enforceable by a reverter clause if there has been no breach of the conditions affording a right to an exercise of the reverter;

(7) Any other covenant, condition, restriction, or limitation approved by the Secretary in the particular case. Such

§ 36.4351

38 CFR Ch. I (7-1-03 Edition)

approval shall be a condition precedent to the guaranty or insurance of the loan;

Provided, That the limitations on the quantum or quality of the estate or property that are indicated in this paragraph, insofar as they may materially affect the value of the property for the purpose for which it is used, are taken into account in the appraisal of reasonable value required by 38 U.S.C. chapter 37.

(c) The following limitations on the quantum or quality of the estate or property shall be deemed for the purposes of paragraph (b) of this section to have been taken into account in the appraisal of residential property and determined by the Secretary as not materially affecting the reasonable value of such property:

(1) *Building or use restrictions*. Provided, (i) no violation exists, (ii) the proposed use by a veteran does not presage a violation of a condition affording a right of reverter, and (iii) any right of future modification contained in the building or use restrictions is not exercisable, by its own terms, until at least 10 years following the date of the loan.

(2) *Violations of racial and creed restrictions*. Violations of a restriction based on race, color, creed, or national origin, whether or not such restriction provides for reversion or forfeiture of title or a lien for liquidated damages in the event of a breach.

(3) *Violations of building or use restrictions of record*. Violations of building or use restrictions of record which have existed for more than 1 year, are not the subject of pending or threatened litigation, and which do not provide for a reversion or termination of title, or condemnation by municipal authorities, or, a lien for liquidated damages which may be superior to the lien of the guaranteed or insured mortgage.

(4) *Easements*. (i) Easements for public utilities along one or more of the property lines and easements for drainage or irrigation ditches, provided the exercise of the rights thereof do not interfere with the use of any of the buildings or improvements located on the subject property.

(ii) Mutual easements for joint driveways located partly on the subject

property and partly on adjoining property, provided the agreement is recorded in the public records.

(iii) Easements for underground conduits which are in place and which do not extend under any buildings in the subject property.

(5) *Encroachments*. (i) On the subject property by improvements on the adjoining property where such encroachments do not exceed 1 foot within the subject boundaries, provided such encroachments do not touch any buildings or interfere with the use or enjoyment of any building or improvement on the subject property.

(ii) By hedges or removable fences belonging to subject or adjoining property.

(iii) Not exceeding 1 foot on adjoining property by driveways belonging to subject property, provided there exists a clearance of at least 8 feet between the buildings on the subject property and the property line affected by the encroachment.

(6) *Variations of lot lines*. Variations between the length of the subject property lines as shown on the plot plan or other exhibits submitted to Department of Veterans Affairs and as shown by the record or possession lines, provided such variations do not interfere with the current use of any of the improvements on the subject property and do not involve a deficiency of more than 2 percent with respect to the length of the front line or more than 5 percent with respect to the length of any other line.

(Authority: 38 U.S.C. 501, 3703(c), 3712(g))

[15 FR 4550, July 18, 1950, as amended at 24 FR 2656, Apr. 7, 1959; 33 FR 18026, Dec. 4, 1968; 34 FR 11095, July 1, 1969; 41 FR 44039, Oct. 6, 1976; 44 FR 47338, Aug. 13, 1979; 45 FR 55720, Aug. 21, 1980; 47 FR 49394, Nov. 1, 1982; 55 FR 25976, June 26, 1990; 61 FR 28059, June 4, 1996]

§ 36.4351 Loans, first, second, or unsecured.

Loans for the purchase of real property or a leasehold estate as limited in the regulations concerning guaranty or insurance of loans to veterans, or for the alteration, improvement, or repair thereof, and for more than \$1,500 and more than 40 percent of the reasonable value of such property or estate prior thereto shall be secured by a first lien

Department of Veterans Affairs**§ 36.4355**

on the property or estate. Loans for such alteration, improvement, or repairs for more than \$1,500 but 40 percent or less of the prior reasonable value of the property shall be secured by a lien reasonable and customary in the community for the type of alteration, improvement, or repair financed. Those for \$1,500 or less need not be secured, and in lieu of the title examination the lender may accept a statement from the borrower that he or she has an interest in the property not less than that prescribed in § 36.4350(a).

[43 FR 51016, Nov. 2, 1978]

§ 36.4352 Tax, special assessment and other liens.

Tax liens, special assessment liens, and ground rents shall be disregarded with respect to any requirement that loans shall be secured by a lien of specified dignity. With the prior approval of the Secretary, Under Secretary for Benefits, or Director, Loan Guaranty Service, liens retained by nongovernmental entities to secure assessments or charges for municipal type services and facilities clearly within the public purpose doctrine may be disregarded. In determining whether a loan for the purchase or construction of a home is secured by a first lien the Secretary may also disregard a superior lien created by a duly recorded covenant running with the realty in favor of a private entity to secure an obligation to such entity for the homeowner's share of the costs of the management, operation, or maintenance of property, services or programs within and for the benefit of the development or community in which the veteran's realty is located, if the Secretary determines that the interests of the veteran-borrower and of the Government will not be prejudiced by the operation of such covenant. In respect to any such superior lien to be created after June 6, 1969, the Secretary's determination must have been made prior to the recordation of the covenant.

[40 FR 34594, Aug. 18, 1975, as amended at 61 FR 28059, June 4, 1996]

§ 36.4353 Combination residential and business property.

If otherwise eligible, a loan for the purchase or construction of a combination of residential property and business property which the veteran proposes to occupy in part as a home will be eligible under 38 U.S.C. 3710, if the property is primarily for residential purposes and no more than one business unit is included in the property.

[40 FR 34594, Aug. 18, 1975]

§ 36.4354 [Reserved]**§ 36.4355 Supplemental loans.**

(a) Any loan for the alteration, repair, improvement, extension, replacement, or expansion of a home, with respect to which a guaranteed or insured obligation of the borrower is currently outstanding, may be reported for guaranty or insurance coverage, if such loan is made by the holder of the currently outstanding obligation, notwithstanding the fact no guaranty entitlement remains available to the borrower;

Provided, That if no entitlement remains available the maximum amount payable on the revised guaranty shall not exceed the amount payable on the original guaranty on the date of closing the supplemental loan, and the percentage of guaranty shall be based upon the proportion the said maximum amount bears to the aggregate indebtedness, or, in the case of an insured loan, no additional credit to the holder's insurance account may be made: *Provided further*, That the prior approval of the Secretary shall be required if

(1) The loan will be made by a lender who is not the holder of the currently guaranteed or insured obligation; or

(2) The loan will be made by a lender not of a class specified in 38 U.S.C. 3702(d); or

(3) An obligor liable on the currently outstanding obligation will be released from personal liability.

In any case in which the unpaid balance of the prior loan currently outstanding is combined or consolidated with the amount of the supplemental

§ 36.4356

loan, the entire aggregate indebtedness shall be repayable in full within the maximum maturity currently prescribed by statute for the original loan. No supplemental loan for the repair, alteration, or improvement of residential property will be eligible for guaranty or insurance unless such repair, alteration, or improvement substantially protects or improves the basic livability or utility of the property involved.

(b) Such loans shall be secured as required in § 36.4351: *Provided*, That a lien of lesser dignity than therein specified will suffice if the lien obtained is immediately junior to the lien of the original guaranteed or insured obligation: *Provided further*, The liens of successive supplemental loans may be of lesser dignity so long as they are immediately junior to the lien of the last previous guaranteed or insured obligation having a lien of required dignity.

(c) Upon providing or extending guaranty or insurance coverage in respect to any such supplemental loan, the rights of the Secretary to the proceeds of the sale of security shall be subordinate to the right of the holder to satisfy therefrom the indebtedness outstanding on the original and supplemental loans.

[13 FR 7742, Dec. 15, 1948, as amended at 19 FR 4003, July 1, 1954; 21 FR 5015, July 6, 1956; 24 FR 2656, Apr. 7, 1959; 40 FR 34594, Aug. 18, 1975]

§ 36.4356 Condominium loans—general.

(a) *Authority—applicability of other loan guaranty regulations, 38 CFR Part 36.* A loan to an eligible veteran to purchase a one-family residential unit in a condominium housing development or project shall be eligible for guaranty or insurance to the same extent and on the same terms as other loans under 38 U.S.C. 3710 provided the loan conforms to the provisions of chapter 37, title 38 U.S.C., except for sections 1811 (direct loans), and 1827 (structural defects). The loan must also conform to the otherwise applicable provisions of the regulations concerning the guaranty or insurance of loans to veterans. Sections 36.4353, 36.4355, and 36.4364 shall not be applicable.

38 CFR Ch. I (7-1-03 Edition)

(b) *Definitions.* On and after July 1, 1979, the following definitions shall be applicable to each condominium loan entitled to be guaranteed or insured, and shall be applicable to such loans previously guaranteed or insured to the extent that no legal rights vested thereunder are impaired. Whenever used in 38 U.S.C. chapter 37 or the § 36.4300 series, unless the context otherwise requires, the terms defined in this paragraph shall have the meaning stated.

(1) *Affiliate of declarant.* Affiliate of declarant means any person or entity which controls, is controlled by, or is under common control with, a declarant.

(i) A person or entity shall be considered to control a declarant if that person or entity is a general partner, officer, director, or employee of the declarant who:

(a) Directly or indirectly or acting in concert with one or more persons, or through one or more subsidiaries, owns, controls, or holds with power to vote, or holds proxies representing, more than 20 percent of the voting shares of the declarant;

(b) Controls in any manner the election of a majority of the directors of the declarant; or

(c) Has contributed more than 20 percent of the capital of the declarant.

(ii) A person or entity shall be considered to be controlled by a declarant if the declarant is a general partner, officer, director, or employee of that person or entity who:

(a) Directly or indirectly or acting in concert with one or more persons or through one or more subsidiaries, owns, controls, or holds with power to vote, or holds proxies representing, more than 20 percent of the voting shares of that person or entity;

(b) Controls in any manner the election of a majority of the directors of that person or entity; or

(c) Has contributed more than 20 percent of the capital of that person or entity.

(2) *Condominium.* Unless otherwise provided by State law, a condominium is a form of ownership in which the

Department of Veterans Affairs**§ 36.4357**

buyer receives title to a three dimensional air space containing the individual living unit together with an undivided interest or share in the ownership of common elements (restatement of § 36.4301, Condominium).

(3) *Conversion condominium.* Condominium projects not originally built and sold as condominiums but subsequently converted to the condominium form of ownership.

(4) *Declarant.* Any person who has executed a declaration or an amendment to a declaration to add additional real estate to the project or any successors or assigns of the declarant who offers to sell or sells units in the condominium project and who assumes declarant rights in the project including the right to: Add, convert or withdraw real estate from the condominium project; maintain sales offices, management offices and rental units; exercise easements through the common elements for the purpose of making improvements within the condominium; or exercise control of the owner's association. Declarant is further defined as any sponsor of a project or affiliate of the declarant who is acting on behalf of or exercising the rights of the declarant.

(5) *Existing—declarant in control or marketing units.* A condominium in which all onsite or offsite improvements were completed or the conversion was completed prior to appraisal by the Department of Veterans Affairs, but the declarant is in control of the owners' association and/or is currently marketing units for initial transfer to individual unit owners.

(6) *Existing—resale.* A condominium in which all onsite or offsite improvements were completed, or the conversion was completed prior to appraisal by the Department of Veterans Affairs, and the declarant is no longer in control of the owners' association and/or marketing units for initial transfer to individual unit owners.

(7) *Expandable condominium.* A project which may be increased in size by the declarant. An expandable condominium is constructed in phases (or stages). After each phase is completed and constituted, the common estates are merged. Each unit owner, thereby,

gains an individual interest in all of the facilities of the common estate.

(8) *Foreclosure.* Foreclosure shall mean the termination of a lien by either judicial or nonjudicial procedures in accordance with local law or the voluntary transfer of property by a deed-in-lieu of foreclosure or similar procedures.

(9) *High rise condominium.* A condominium project which is a multi-story elevator building.

(10) *Horizontal condominium.* A condominium project in which generally no part of a living unit extends over or under another living unit.

(11) *Low rise condominium.* A condominium project in which all or a part of a living unit extends over or under another living unit, e.g., garden apartment or walk-up project.

(12) *Proposed condominium.* A condominium project that is to be constructed or is under construction. In the case of a condominium conversion, the declarant proposes to convert a building or buildings to the condominium form of ownership, or the declarant is in the process of converting the building or buildings to the condominium form of ownership.

(13) *Series condominium.* A number of adjoining but separately constituted condominiums. An association of owners is established for each project, and each association is responsible for maintenance and upkeep of the common elements in its own project. Cross-easements between the separate condominiums may be created to permit members of the separate condominiums to use the common areas of the other condominiums.

(c) *Project approval.* Prior to Department of Veterans Affairs guaranty of an individual unit loan in a condominium, the legal documentation establishing the condominium project or development must be approved by the Secretary.

(Authority: 38 U.S.C. 501, 3703(c)(1), 3710(a)(6))

[44 FR 47338, Aug. 13, 1979, as amended at 50 FR 5978, Feb. 13, 1985]

§ 36.4357 Acceptable ownership arrangements and documentation.

(a) *Types of condominium ownership.* The following types of basic ownership

§ 36.4357

arrangements are generally acceptable provided they are established in compliance with the applicable condominium law of the jurisdiction(s) in which the condominium is located:

(1) Ownership of units by individual owners coupled with an undivided interest in all common elements.

(2) Ownership of units by individual owners coupled with an undivided interest in general common elements and specified limited common elements.

(3) Individual ownership of units coupled with an undivided interest in the general common elements and/or limited common elements, with title to additional property for common use vested in an association of unit owners, with mandatory membership by unit owners or owners' associations. Any such arrangement must not be precluded by applicable State law.

(Authority: 38 U.S.C. 501, 3710(a)(6))

(b) *Estate of unit owner.* The legal estate of each unit owner must comply with the provisions of § 36.4350. The declaration or equivalent document shall allocate an undivided interest in the common elements to each unit. Such interest may be allocated equally to each unit, may be proportionate to that unit's relative size or value, or may be allocated according to any other specified criteria provided that the method chosen is equitable and reasonable for that condominium.

(Authority: 38 U.S.C. 501(1), 1803(c)(1), (d)(3), 1810(a)(6))

(c) *Condominium documentation—(1) Compliance with applicable law.* The declaration, bylaws and other enabling documentation shall conform to the laws governing the establishment and maintenance of condominium regimes within the jurisdiction in which the condominium is located, and to all other laws which apply to the condominium.

(2) *Recordation.* The declaration and all amendments or modifications thereof shall be placed of record in the manner prescribed by the appropriate jurisdiction. If recording of plats, plans, or bylaws or equivalent documents and all amendments or modifications thereof is the prevailing practice or is required by law within the jurisdiction where the project is located, then such documents shall be placed of record. If the bylaws are not recorded, then covenants, restrictions and other matters requiring record notice should be contained in the declaration or equivalent document.

38 CFR Ch. I (7-1-03 Edition)

risdiction where the project is located, then such documents shall be placed of record. If the bylaws are not recorded, then covenants, restrictions and other matters requiring record notice should be contained in the declaration or equivalent document.

(3) *Availability.* The owner's association shall be required to make available to unit owners, lenders and the holders, insurers and guarantors of the first mortgage on any unit, current copies of the declaration, bylaws and other rules governing the condominium, and other books, records and financial statements of the owners' association. The owners' association also shall be required to make available to prospective purchasers current copies of the declaration, bylaws, other rules governing the condominium, and the most recent annual audited financial statement, if such is prepared. "Available" as used in this paragraph (c)(3) shall at least mean available for inspection, upon request, during normal business hours or under other reasonable circumstances.

(4) *Amendments to documents after Department of Veterans Affairs project approval.* While the declarant is in control of the owners' association, amendments to the declaration, bylaws or other enabling documentation must be approved by the Secretary. The declarant should have proposed amendments reviewed prior to recordation. This provision does not apply to amendments which annex additional phases to the condominium regime in accordance with a general plan of development (§§ 36.4360(a)(3) and 36.4360(a)(6)).

(Authority: 38 U.S.C. 501, 3703(c)(1), 3710(a)(6))

(d) *Real property descriptions in the declaration—(1) Clarity—conformity with the law of the jurisdiction.* The description of the units, common elements, any recreational facilities and other related amenities, and any limited common elements shall be clear and in conformity with the law of the jurisdiction where the project is located. Responsibility for maintenance and repair of all portions of the condominium shall be set forth clearly.

Department of Veterans Affairs**§ 36.4358**

(2) *Developmental plan—proposed condominiums.* The declaration or other legally enforceable and binding document must state in a reasonable manner the overall development plan of the condominium, including building types, architectural style and the size of the units for those phases of the condominium which are required to be built. Under the applicable provisions of the declaration or such other legally enforceable and binding document, the development of the required portion of the condominium must be consistent with the overall plan, except that the declarant may reserve the right to change the overall plan or decide not to construct planned units or improvements to the common elements if the declaration sets forth the conditions required to be satisfied prior to the exercise of that right the time within which the right may be exercised, and any other limitations and criteria that would be necessary or appropriate under the particular circumstances. Such conditions, time restraints and other limitations must be reasonable in light of the overall plan for the condominium. In an expandable project, additional phases which are not required to be built may be described in the development plan in very general terms, or the declaration may provide that the declarant makes no assurances concerning the construction, building types, architectural style and size of the units, etc. of these phases. However, the minimum number of units to be built should be that which would be adequate to reasonably support the common elements. (See § 36.4360(a)(6).)

(Approved by the Office of Management and Budget under control number 2900-0448)

(Authority: 38 U.S.C. 501, 3703(c)(1), 3710(a)(6))
[44 FR 47339, Aug. 13, 1979, as amended at 50 FR 5979, Feb. 13, 1985; 50 FR 26359, June 26, 1985]

§ 36.4358 Rights and restrictions.

(a) *Declarant's rights and restrictions—*
(1) *Disclosure and reasonableness of reserved rights.* Any right reserved by the declarant must be reasonable and set forth in the declaration.

(2) *Examples of reserved rights of declarant, sponsor, or affiliate of declarant*

which are usually unacceptable. Binding the owners' association either directly or indirectly to any of the following agreements is not acceptable unless the owner's association shall have a right of termination thereof which is exercisable without penalty at any time after transfer of control, upon not more than 90 days' notice to the other party thereto:

(i) Any management contract, employment contract or lease of recreational or parking areas or facilities;

(ii) Any contract or lease, including franchises and licenses, to which a declarant is a party.

The requirements of paragraphs (a)(2)(i) and (ii) of this section do not apply to acceptable ground leases.

(3) *Examples of reserved rights which are usually acceptable.* The following rights in the common elements may usually be reserved by the declarant for a reasonable period of time, subject to a concomitant obligation to restore:

(i) Easement over and upon the common elements and upon lands appurtenant to the condominium for the purpose of completing improvements for which provision is made in the declaration, but only if access thereto is otherwise not reasonably available.

(ii) Easement over and upon the common elements for the purpose of making repairs required pursuant to the declaration or contracts of sale made with unit purchasers.

(iii) Right to maintain facilities in the common areas which are identified in the declaration and which are reasonably necessary to market the units. These may include sales and management offices, model units, parking areas, and advertising signs.

(Authority: 38 U.S.C. 501, 3703(c)(1), 3710(a)(6))

(b) *Owners' association's rights and restrictions—*(1) *Right of entry upon units and limited common elements.* The owners' association shall be granted a right of entry upon unit premises and any limited common elements to effect emergency repairs, and a reasonable right of entry thereupon to effect other repairs, improvements, replacement or maintenance as necessary.

(2) *Power to grant rights and restrictions in common elements.* The owners' association should be granted other

§ 36.4358

38 CFR Ch. I (7-1-03 Edition)

rights, such as the right to grant utility easements under, through or over the common elements, which are reasonably necessary to the ongoing development and operation of the project.

(3) *Responsibility for damage to common elements and units.* A provision may be made in the declaration or bylaws for allocation of responsibility for damages resulting from the exercise of any of the above rights.

(4) *Assessments—(i) Levy and collection.* The declaration or its equivalent shall describe the authority of the owners' association to levy and enforce the collection of general and special assessments for common expenses and shall describe adequate remedies for failure to pay such common expenses. The common expenses assessed against any unit, with interest, late charges, costs and a reasonable attorney's fee shall be a lien upon such unit in accordance with applicable law. Each such assessment, together with interest, late charges, costs, and attorney's fee, shall also be the personal obligation of the person who was the owner of such unit at the time the assessment fell due. The personal obligation for delinquent assessments shall not pass to successors in title or interest unless assumed by them, or required by applicable law. Common expenses as used in this subdivision shall mean expenditures made or liabilities incurred by or on behalf of the owners' association, together with any assessments for the creation and maintenance of reserves.

(ii) *Reserves and working capital.* There shall be in new or proposed condominium projects (including conversions) a provision for an adequate reserve fund for the periodic maintenance, repair and replacement of the common elements, which fund shall be maintained out of regular assessments for common expenses. Additionally, a working capital fund must be established for the initial months of the project operations equal to at least a 2 months' estimated common area charge for each unit.

(iii) *Priority of lien.* Any assessment lien must be subordinate to any Department of Veterans Affairs guaranteed mortgage except as provided in § 36.4352. A lien for common expense charges and assessments shall not be

affected by any sale or transfer of a unit except that a sale or transfer pursuant to a foreclosure of a first mortgage shall extinguish a subordinate lien for common expense charges and assessments which became payable prior to such sale or transfer. Any such sale or transfer pursuant to a foreclosure shall not relieve the purchaser or transferee of a unit from liability for, nor the unit so sold or transferred from the lien of, any common expense charges thereafter becoming due.

(Authority: 38 U.S.C. 501, 3703(c)(1), (d)(3), 3710(a)(6))

(c) *Unit owners' rights and restrictions—(1) Obligation to pay expenses.* The declaration or equivalent document shall establish a duty on each unit owner, including the declarant, to pay a proportionate share of common expenses upon being assessed therefor by the owners' association. Such share may be allocated equally to each unit, may be proportionate to that unit's common element interest, relative size or value, or may be allocated according to any other specified criteria provided that the method chosen is equitable and reasonable for that condominium.

(2) *Voting rights.* The declaration or equivalent document shall allocate a portion of the votes in the association to each unit. Such portion may be allocated equally to each unit, may be proportionate to that unit's common expense liability, common element interest, relative size or value, or may be allocated according to any other specified criteria provided that the method is equitable and reasonable for that condominium. The declaration may provide different criteria for allocations of votes to the units on particular specified matters and may also provide different percentages of required unit owner approvals for such particular specified matters.

(3) *Ingress and egress of unit owners.* There may not be any restriction upon any unit owner's right of ingress and egress to his or her unit.

(4) *Encroachments—units and common elements—(i) Easements for encroachments.* In the event any portion of the common elements encroaches upon any unit or any unit encroaches upon the common elements or another unit as a

Department of Veterans Affairs**§ 36.4359**

result of the construction, reconstruction, repair, shifting, settlement, or movement of any portion of the improvements, a valid easement for the encroachment and for the maintenance of the same shall exist so long as the encroachment exists. The declaration may provide, however, reasonable limits on the extent of any easement created by the overlap of units, common elements, and limited common elements resulting from such encroachments; or

(ii) *Monuments as boundaries.* If permitted by the governing law within the jurisdiction where the project is located, the existing physical boundaries of a unit or a common element or the physical boundaries of a unit or a common element reconstructed in substantial accordance with the original plats and plans thereof become its boundaries rather than the metes and bounds expressed in the deed, plat or plan, regardless of settling or lateral movement of the building, or minor variance between boundaries shown on the plats, plans or in the deed and those of the building. The declaration should provide reasonable limits on the extent of any such revised boundary(ies) created by the overlap of units, common elements, and limited common elements resulting from such encroachments.

(5) *Right of first refusal.* The right of a unit owner to sell, transfer, or otherwise convey his or her unit in a condominium shall not be subject to any right of first refusal or similar restriction if the declaration or similar document is recorded on or after December 1, 1976. If the declaration was recorded prior to December 1, 1976, the right of first refusal must comply with § 36.4350(b)(5)(ii); *Provided, however,* restrictions on the basis of age or restrictions established by a State, Territorial, or local government agency as part of a program for providing assistance to low- and moderate-income purchasers shall be governed by § 36.4350(b)(5)(iv).

(Authority: 38 U.S.C. 3703(c))

(6) *Leasing restrictions.* Except as provided in this paragraph, there shall be no prohibition or restriction on a condominium unit owner's right to lease

his or her unit. The following restrictions are acceptable:

(i) A requirement that leases have a minimum initial term of up to 1 year, or

(ii) Age restrictions or restrictions imposed by State or local housing authorities which are allowable under § 36.4308(e) or § 36.4350(b)(5)(iv).

(d) *Rights of action.* The owners' association and any aggrieved unit owner should be granted a right of action against unit owners for failure to comply with the provisions of the declaration, bylaws, or equivalent documents, or with decisions of the owners' association which are made pursuant to authority granted the owners' association in such documents. Unit owners should have similar rights of action against the owners' association.

(Authority: 38 U.S.C. 501, 3703(c)(1), 3710(a)(6))

[44 FR 47339, Aug. 13, 1979, as amended at 47 FR 49394, Nov. 1, 1982; 50 FR 5979, Feb. 13, 1985]

§ 36.4359 Miscellaneous legal requirements.

(a) *Declarant transfer of control of owners' association—(1) Standards for transfer of control.* The declarant shall relinquish all special rights, expressed or implied, through which the declarant may directly or indirectly control, direct, modify, or veto any action of the owners' association, its executive board, or a majority of unit owners, and control of the owners' association shall pass to the owners of units within the project, not later than the earlier of the following:

(i) 120 days after the date by which 75 percent of the units have been conveyed to unit purchasers, or

(ii) The last date of a specified period of time following the first conveyance to a unit purchaser; such period of time is to be reasonable for the particular project. The maximum acceptable period usually will be from 3 to 5 years for single-phased condominium regimes and 5 to 7 years for expandable condominiums.

(iii) On a case basis, modifications or variations of the requirements of paragraphs (a)(1)(i) and (ii) of this section

§ 36.4360

will be acceptable, particularly in circumstances involving very large condominium developments.

(2) *Declarant's unit votes after transfer of control.* The requirements of paragraph (a)(1) of this section shall not affect the declarant's rights, as a unit owner, to exercise the votes allocated to units which declarant owns.

(3) *Unit owners' participation in management.* Declarants should provide for and foster early participation of unit owners in the management of the project.

(b) *Taxes.* Unless otherwise provided by State law, real estate taxes must be assessed and be lienable only against the individual units, together with their undivided interests in the common elements, and not against the multifamily structure. The owners' association usually owns no real estate, so it has no obligation concerning ad valorem taxes. Unless taxes are assessed only against the individual units, a tax lien could amount to more than the value of any particular unit in the structure.

(c) [Reserved]

(d) *Policies for bylaws.* The bylaws of the condominium should be sufficiently detailed for the successful governance of the condominium by unit owners. Among other things, such documents should contain adequate provisions for the election and removal of directors and officers.

(e) *Insurance and related requirements—(1) Insurance.* The holder shall require hazard and flood insurance policies to be procured and maintained in accordance with § 36.4326. Because of the nature of condominiums, additional types of insurance coverages—such as tort liability insurance for injuries sustained on the premises, personal liability insurance for directors and officers managing association affairs, boiler insurance, etc.—should be considered in appropriate circumstances.

(2) *Fidelity bond coverage.* The securing of appropriate fidelity bond coverage is recommended but not required, for any person or entity handling funds of the owners' association, including, but not limited to, employees of the professional managers. Such fidelity bonds should name the association as

38 CFR Ch. I (7-1-03 Edition)

an obligee, and be written in an amount equal to at least the estimated maximum of funds, including reserve funds, in the custody of the owners' association or the management agent at any given time during the term of the fidelity bond. However, the bond should not be less than a sum equal to 3 months' aggregate assessments on all units plus reserve funds.

(Authority: 38 U.S.C. 501, 3703(c)(1), 3710(a)(6))
[44 FR 47340, Aug. 13, 1979, as amended at 50 FR 5979, Feb. 13, 1985]

§ 36.4360 Documentation and related requirements—flexible condominiums and condominiums with off-site facilities.

(a) *Expandable condominiums.* The following policies apply to condominium regimes which may be increased in size by the declarant:

(1) The declarant's right to expand the regime must be fully described in the declaration. The declaration must contain provisions adequate to ensure that future improvements to the condominium will be consistent with initial improvements in terms of quality of construction. The declarant must build each phase in accordance with an approved general plan for the total development (§ 36.4357(d)(2)) supported by detailed plats and plans of each phase prior to the construction of the particular phase.

(2) The reservation of a right to expand the condominium regime, the method of expansion and the result of an expansion must not affect the statutory validity of the condominium regime or the validity of title to the units.

(3) The declaration or equivalent document must contain a covenant that the condominium regime may not be amended or merged with a successor condominium regime without prior written approval of the Secretary. The declarant may have the proposed legal documentation to accomplish the merger reviewed prior to recordation. However, the Secretary's final approval of the merger will not be granted until the successor condominium has been legally established and construction completed. The declarant may add phases to an expandable condominium regime without the prior approval of

Department of Veterans Affairs**§ 36.4360**

the Secretary if the phasing implements a previously approved general plan for the total development. A copy of the amendment to the declaration or other annexation document which adds each phase must be submitted to the Secretary in accordance with § 36.4360a(b)(6).

(4) Liens arising in connection with the declarant's ownership of, and construction of improvements upon, the property to be added must not adversely affect the rights of existing unit owners, or the priority of first mortgages on units in the existing condominium property. All taxes, assessments, mechanic's liens, and other charges affecting such property, covering any period prior to the addition of the property, must be paid or otherwise satisfactorily provided for by the declarant.

(5) The declarant must purchase (at declarant's own expense) a general liability insurance policy in an amount not less than \$1 million for each occurrence, to cover any liability which owners of previously sold units are exposed to as a result of further condominium project development.

(6) Each expandable project shall have a specified maximum number of units which will give each unit owner a minimum percentage of interest in the common elements. Each project shall also have a specified minimum number of units which will give each unit owner a maximum percentage of interest in the common elements. The minimum number of units to be built should be that which would be adequate to reasonably support the common elements. The maximum number of units to be built should be that which would not overload the capacity of the common facilities. The maximum possible percentage(s) and the minimum possible percentage(s) of undivided interest in the common elements for each type of unit must be stated in the declaration or equivalent document.

(7) The declaration or equivalent document shall set forth clearly the basis for reallocation of unit owner's ownership interests, common expense liabilities and voting rights in the event the number of units in the condominium is increased. Such reallocation shall be

according to the applicable criteria set forth in §§ 36.4357(b) and 36.4358(c)(1) and (2).

(8) The declarant's right to expand the condominium must be for a reasonable period of time with a specific ending date. The maximum acceptable period will usually be from 5 to 7 years after the date of recording the declaration. On a case basic, longer periods of expansion rights will be acceptable, particularly in circumstances involving sizable condominium developments.

(b) *Series projects.* (1) Each phase in the series approach is to be considered as a separate project. A separate set of legal documents must be filed for each phase or project that relates to the condominium within its own boundary. The declaration for each phase must describe the particular project as a part of the whole development area, but subject only the one phase to the condominium regime. A separate unit ratio must be established that would relate each unit to all units of the particular condominium for purposes of ownership in the common areas, voting rights and assessment liability. A separate association may be created to govern the affairs of each condominium. Each phase is subject to a separate presale requirement.

(2) In the case of proposed projects, or projects under construction, the declaration should state the number of total units that the developer intends to build on other sections of the development area.

(c) *Other flexible condominiums.* Condominiums containing withdrawable real estate (contractable condominiums) and condominiums containing convertible real estate (portions of the condominium within which additional units or limited common elements, or both, may be created) will be considered acceptable provided the flexible condominium complies with the § 36.4300 series.

(Authority: 38 U.S.C. 501, 3703(c)(1), 3710(a)(6))

(Approved by the Office of Management and Budget under control number 2900-0448)

[44 FR 47341, Aug. 13, 1979, as amended at 50 FR 5980, Feb. 13, 1985; 50 FR 26359, June 26, 1985]

§ 36.4360a

§ 36.4360a Appraisal requirements.

(a) *Existing resale condominiums.* Upon acceptance by the local office of the organizational documents, the project and unit(s) proposed as security for guaranteed financing shall be appraised to ensure that they meet MPR's (Minimum Property Requirements) and are safe, sanitary, and structurally sound. The Department of Veterans Affairs MPR's for existing construction apply to all existing resale condominiums including conversions, except that water, heating, ventilating, air conditioning and sewer service may be supplied from a central source.

(Authority: 38 U.S.C. 501, 3703(c)(1), 3710(a)(6), (b)(5))

(b) *Proposed condominiums or existing condominiums with declarant in control or marketing units—(1) Low rise and high rise condominiums.* Low rise and high rise condominiums shall comply with local building codes. Only the alterations, improvements, or repairs to low rise and high rise buildings proposed to be converted to the condominium form of ownership must comply with current local building codes, unless local authorities require total code compliance on the entire structure when a building is being converted to the condominium form of ownership. In those areas where local standards are nonexistent, inferior to, or in conflict with Department of Veterans Affairs objectives, a certification will be required from a registered professional architect and/or registered engineer certifying that the plans and specifications conform to one of the national building codes which is typical of similar construction methods and standards for condominiums used in the area. Those portions of the condominium conversion which are not being altered, improved or repaired must be appraised in accordance with paragraph (a) of this section.

(2) *Horizontal condominiums.* Department of Veterans Affairs policies and procedures applicable to single-family residential construction shall also apply to horizontal condominiums. Proposed or existing (declarant in control or marketing units) horizontal condominium conversions shall comply with current local building codes for

38 CFR Ch. I (7-1-03 Edition)

alterations and improvements or repairs made to convert the building to the condominium form of ownership unless local authorities require total code compliance on the entire structure when a building is being converted to the condominium form of ownership. In those areas where local standards are nonexistent, inferior to, or in conflict with Department of Veterans Affairs objectives, a certification will be required from a professional architect and/or registered engineer certifying that the plans and specifications conform to one of the national building codes which is typical of similar construction methods and standards for condominiums used in the area. Those portions of the condominium conversion which are not being altered, improved or repaired must be appraised in accordance with paragraph (a) of this section.

(Authority: 38 U.S.C. 501, 3703(c)(1))

(3) *Unit completion.* All units in the individual project or phase must be substantially completed except for customer preference items, such as interior finishes, appliances or equipment.

(4) *Common element completion.* All amenities of the condominium (to include offsite community facilities), that are to be considered in the unit value, must be bound legally to the condominium regime. All such amenities as well as the common elements of the project, must be substantially completed and available for use by the unit owners. In large multi-phase projects, the declarant should construct common elements in a manner consistent with the addition of units to support the entire development. The Secretary, in appropriate cases, may approve the placement of adequate funds by the declarant in an escrow or otherwise earmarked account or accept a letter of credit or surety bond to assure completion of amenities and allow closing of VA-guaranteed (or insured) loans. Such funds must be adequate to assure completion of the amenities free and clear of all liens.

(Authority: 38 U.S.C. 501, 3703(c)(1), 3710(a)(6))

(5) *Information brochure/public offering statement.* When units are being sold by

Department of Veterans Affairs**§ 36.4360a**

the declarant (not applicable to resales), an information brochure/public offering statement must be given to veteran buyers prior to the time a downpayment is received and an agreement is signed, unless State law authorized receipt of the downpayment and delivery of the information brochure followed by a period in which purchasers may cancel the purchase agreement without penalty for a specified number of days. Information brochures must be written in simple terms to inform buyers that the association does not provide owner's contents and personal liability policies which are the owner's responsibility. In the event the development is expandable, series, etc., there must be full disclosure of the impact of the total development plan. In expandable, series or other projects with more than one phase, the information brochure must disclose fully later development rights, and the general plans of the declarant for additional phases. If the declarant makes no assurance concerning phases which are not required to be built, the declarant should state that no assurances are given concerning construction, unit sizes, building types, architectural styles, etc. In condominium conversions, the information brochure must list the major structural and mechanical components and the estimated remaining useful life of the components. A brief explanation must be furnished in the brochure explaining that certain major structural or mechanical components may require replacement within a specified time period. If the declarant has elected to place funds into a condominium reserve fund for replacement of a major component under the provisions of § 36.4360a(b)(7), the amount of the contribution into the reserve fund must be specified in the information brochure.

(6) *Evidence of proper phasing.* In an expandable or flexible condominium, evidence of the addition of each phase in accordance with a previously approved general plan of development must be submitted to the Secretary prior to the guaranty of the first loan in the added area.

(7) *Additional condominium conversion requirements.* (i) The declarant of a condominium project, which is (A) pro-

posed, (B) under construction, or (C) an existing project with a declarant in control or marketing units not previously occupied, must furnish structural and mechanical common element component statements on the present condition of all accessible structural and mechanical components material to the use and enjoyment of the condominium. These statements must be completed by a registered professional engineer and/or architect prior to the guaranty of the first unit loan in the project. Each statement must also give an estimate of the expected useful life of the roof, elevators, heating and cooling, plumbing and electrical systems assuming normal maintenance. A minimum of 10 years estimated remaining useful life is required on all structural and mechanical components. In the alternative, the declarant may contribute an amount of funds to the condominium reserve fund equal to a minimum of $\frac{1}{10}$ (one-tenth) of the estimated costs of replacement of a major structural or mechanical component (as determined by an independent registered professional architect or engineer) for each year of estimated remaining useful life less than 10 years, e.g. 7 years remaining useful life equals a $\frac{3}{10}$ required declarant contribution to the reserve fund of the component's estimated replacement cost. The noted statements and remaining useful life requirement are not applicable to existing resale conversion projects when the declarant is no longer marketing units and/or in control of the association. Expandable or series condominium conversions require engineering and architectural statements on each stage or phase.

(ii) In declarant controlled projects, a statement(s) by the local authority(ies) of the adequacy of offsite utilities servicing the site (e.g., sanitary or water) is required. If a local authority(ies) declines to issue such a statement(s), a statement(s) may be obtained from a registered professional engineer. If local authority(ies) declines to issue such a statement(s), a statement(s) may be obtained from a registered professional engineer.

(c) *Presale requirements—(1) Proposed construction or existing declarant in control.* Bona fide agreements of sale must

§ 36.4360a

38 CFR Ch. I (7-1-03 Edition)

have been executed by purchasers other than the declarant (who are obligated contractually to complete the purchase) of 70 percent of the total number of units in the project. Lenders shall certify as to satisfaction of the presale requirement prior to VA guaranty of the first unit loan. When a declarant can demonstrate that a lower percentage would be justified, the Secretary, on an individual case basis, may approve a presale requirement of less than 70 percent. Reduction of the 70 percent presale requirement will be considered when:

- (i) Strong initial sales demonstrate a ready market, or
- (ii) The declarant will provide cash assets or acceptable bonds for payment of full common area assessments to the owners' association until such assessments are assumed by unit purchasers, or
- (iii) Subsequent phases of an overall development are being undertaken in a proven market area, or
- (iv) Previous experience in similar projects in the same market area indicates strong market acceptance, or
- (v) The development is in a market area that has repeatedly indicated acceptance of such projects.

(2) *Multiphase—proposed or existing declarant in control.* The requirements of paragraph (c)(1) of this section shall apply to each individual phase of a multiphase development, taking into consideration that each individual phase must be capable of self-support in the event that the developer does not complete all planned phases.

(d) *Warranty.* Except in condominium conversion projects, each CRV (Certificate of Reasonable Value) issued by the Secretary relating to a proposed or existing not previously occupied dwelling unit in a condominium project shall be subject to the express condition that the builder, seller, or the real party in interest in the transaction shall deliver to the veteran purchasing the dwelling unit with the aid of a guaranteed or insured loan a warranty against defects for the unit and common elements. The unit shall be warranted for 1 year from the date of settlement or the date of occupancy (whichever first occurs). The common elements shall be warranted for 2 years from the date each of

the common elements is completed and available for use by the unit owners, or 2 years from the date the first unit is conveyed to a unit owner other than the declarant, whichever is later, in the particular phase of the condominium containing the common element. For these purposes, defects shall be those items reasonably requiring the repair, renovation, restoration, or replacement of any of the components constituting the unit or common elements. Items of maintenance relating to the unit or common elements are not covered by the warranty. No certificate of guaranty or insurance credit shall be issued unless a copy of such warranty, duly receipted by the purchaser, is submitted with the loan papers.

(e) *Ownership and operation of offsite facilities—(1) Title requirements.* Evidence must be presented that the offsite facility owned by an owners' association with mandatory membership by condominium unit owners or condominium unit owners' associations has been completed and conveyed free of encumbrances by the declarant for the benefit of the unit owners with title insured by an owner's title policy or other acceptable title evidence. Offsite facilities conveyed to a nonprofit corporation are the preferred method of offsite facilities ownership; however, the Secretary will consider other forms of ownership on an individual case basis.

(2) *Mandatory membership.* The declaration of the condominium (each condominium in a series development) and the legal documentation of the corporation or association which owns the offsite facility must provide the following:

- (i) The owner of a condominium unit is automatically a member of the offsite facility corporation or association and that upon the sale of the unit, membership is transferred automatically to the new owner/purchaser. It is also acceptable if each condominium owners' association (in lieu of each individual unit owner) is automatically a member of the offsite facility corporation or association coupled with use rights for each of the unit owners or residents. If membership in an offsite owners' association is voluntary, no

Department of Veterans Affairs**§ 36.4362**

credit in the CRV valuation may be given for such offsite amenities.

(ii) Each member of the offsite facility corporation or association must be entitled to a representative vote at meetings of the offsite facility corporation or association. If the individual condominium owners' association is a member of the offsite facility corporation or association, each condominium owners' association must be entitled to a representative vote at meetings of the offsite facility corporation or association.

(iii) Each member must agree by acceptance of the unit deed to pay a share of the expenses of the offsite facility corporation or association as assessed by the corporation or association for upkeep, insurance, reserve fund for replacements, maintenance and operation of the offsite facility. The share of said expenses shall be determined equitably. Failure to pay such assessment must result in a lien against the individual unit in the same manner as unpaid assessments by the association of owners of the condominium. If each condominium owners' association is a member of the offsite facility in lieu of individual unit owners, failure of the condominium owners' association to pay its equitable assessment to the offsite facility must result in an enforceable lien.

(3) *Declarant payment of offsite facility in a series project.* Until the declarant has completed all of the intended condominium phases in a total condominium development or established each condominium regime by filing a separate declaration in a series development, the balance of the total sum of the expenses of the offsite facility not covered by the assessment against the unit owners should be assessed against and be payable by the declarant commencing on the first day of the first month after the first unit is conveyed to a homeowner in the first phase. If this balance is not paid, it must become a lien against those parcels of land in the development area which are owned by the declarant. The collection of such debt and enforcement of such lien may be by foreclosure or such other remedies afforded the corporation or association under local law.

(f) *Professional management.* Many condominiums are small enough and their common areas so minimal that professional management is not necessary. VA does not have a requirement for professional management of condominiums. The powers given to the owners' association by the declaration and bylaws are fundamentally for "use control" and maintenance of the undivided interest all of the owners have in the common areas. These powers normally include management which may, if desired, be delegated to a professional manager. However, if the board of directors wants professional management, the management agreement must be terminable for cause upon 30 days' notice, and run for a reasonable period of from 1 to 3 years and be renewable for consent of the association and the management. (Management contracts negotiated by the declarant should not exceed 2 years.)

(g) *Commercial areas.* With respect to existing and proposed condominiums, commercial areas within condominium developments are acceptable, but such interests will be considered in value.

(Authority: 38 U.S.C. 501, 3703(c)(1), 3710(a)(6))

(Approved by the Office of Management and Budget under control number 2900-0448)

[44 FR 47342, Aug. 13, 1979, as amended at 50 FR 5980, Feb. 13, 1985; 50 FR 26359, June 26, 1985; 55 FR 34913, Aug. 27, 1990]

§ 36.4362 Requirement of construction warranty.

Each certificate of reasonable value issued by the Secretary relating to a proposed or newly constructed dwelling unit, except those covering one-family residential units in condominium housing developments or projects within the purview of §§ 36.4356 through 36.4360a, shall be subject to the express condition that the builder, seller, or the real party in interest in the transaction shall deliver to the veteran constructing or purchasing such dwelling with the aid of a guaranteed or insured loan a warranty, in the form prescribed by the Secretary, that the property has been completed in substantial conformity with the plans and specifications upon which the Secretary based the valuation of the property, including any modifications thereof, or

§ 36.4363

changes or variations therein, approved in writing by the Secretary, and no certificate of guaranty or insurance credit shall be issued unless a copy of such warranty duly receipted by the purchaser is submitted with the loan papers.

[40 FR 34595, Aug. 18, 1975, as amended at 44 FR 47343, Aug. 13, 1979]

§ 36.4363 Nondiscrimination and equal opportunity in housing certification requirements.

(a) Any request for a master certificate of reasonable value on proposed or existing construction, and any request for appraisal of individual existing housing not previously occupied, which is received on or after November 21, 1962, will not be assigned for appraisal prior to receipt of a certification from the builder, sponsor or other seller, in the form prescribed by the Secretary, that neither it nor anyone authorized to act for it will decline to sell any property included in such request to a prospective purchaser because of his or her race, color, religion, sex or national origin.

(b) On requests for appraisal of individual proposed construction received on or after November 21, 1962, the prescribed nondiscrimination certification will be required if the builder is to sell the veteran the lot on which the dwelling is to be constructed, but will not be required if:

(1) The veteran owns the lot; or

(2) The lot is being acquired by the veteran from a seller other than the builder and there is no identity of interest between the builder and the seller of the lot.

(c) Each builder, sponsor or other seller requesting approval of site and subdivision planning shall be required to furnish a certification, in the form prescribed by the Secretary, that neither it nor anyone authorized to act for it will decline to sell any property included in such request to a prospective purchaser because of his or her race, color, religion, sex or national origin. Site and subdivision analysis will not be commenced by the Department of Veterans Affairs prior to receipt of such certification.

(d) No commitment shall be issued and no loan shall be guaranteed or in-

38 CFR Ch. I (7-1-03 Edition)

sured under 38 U.S.C. Chapter 37 unless the veteran certifies, in such form as the Secretary shall prescribe, that

(1) Neither he/she, nor anyone authorized to act for him/her, will refuse to sell or rent, after the making of a bona fide offer, or refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny the dwelling or property covered by this loan to any person because of race, color, religion, sex, or national origin;

(2) He/she recognizes that any restrictive covenant on the property relating to race, color, religion, sex or national origin is illegal and void and any such covenant is specifically disclaimed; and

(3) He/she understands that civil action for preventive relief may be brought by the Attorney General of the United States in any appropriate U.S. District Court against any person responsible for a violation of the applicable law.

[28 FR 7673, July 27, 1963, as amended at 36 FR 13032, July 13, 1971; 40 FR 34595, Aug. 18, 1975]

§ 36.4364 Correction of structural defects.

(a) The purpose of this section is to specify the types of assistance that the Secretary may render pursuant to 38 U.S.C. 1827 to an eligible borrower who has been unable to secure satisfactory correction of structural defects in a dwelling encumbered by a mortgage securing a guaranteed, insured or direct loan, and the terms and conditions under which such assistance will be rendered.

(b) A written application for assistance in the correction of structural defects shall be filed by a borrower under a guaranteed, insured or direct loan with the Director of the Department of Veterans Affairs office having loan jurisdiction over the area in which the dwelling is located. The application must be filed not later than 4 years after the date on which the first direct, guaranteed or insured mortgage loan on the dwelling was made, guaranteed or insured by the Secretary. A borrower under a direct, guaranteed or insured mortgage loan on the same dwelling which was made, guaranteed or insured subsequent to the first such

Department of Veterans Affairs**§ 36.4365**

loan shall be entitled to file an application if it is filed within 4 years of the date on which such first loan was made, guaranteed or insured by the Secretary.

(c) An applicant for assistance under this section must establish that:

(1) The applicant is the owner of a one- to four-family dwelling which was inspected during construction by the Department of Veterans Affairs or the Federal Housing Administration.

(2) The applicant is an original veteran-borrower on an outstanding guaranteed, insured or direct loan secured by a mortgage on such dwelling which was made, guaranteed or insured on or after May 8, 1968. The Secretary may, however, recognize an applicant who is not the original veteran-borrower but who contracted to assume such borrower's personal obligation thereunder, if the Secretary determines that such recognition would be in the best interests of the Government in the particular case.

(3) There exists in such dwelling a structural defect, not the result of fire, earthquake, flood, windstorm, or waste, which seriously affects the livability of the dwelling.

(4) The applicant has made reasonable efforts to obtain correction of such structural defect by the builder, seller, or other person or firm responsible for the construction of the dwelling.

(d) In those instances in which the Secretary determines that assistance under this section is appropriate and necessary the Secretary may take any of the following actions:

(1) Pay such amount as is reasonably necessary to correct the defect, or

(2) Pay the claim of the borrower for reimbursement of the borrower's expenses for correcting or obtaining correction of the defect, or

(3) Acquire title to the property upon terms acceptable to the borrower and the holder of the guaranteed or insured loan.

(e) To the extent of any expenditure made by the Secretary pursuant to paragraph (d) of this section the Secretary shall be subrogated to any legal rights the borrower or applicant described in paragraph (c)(2) of this section may have against the builder, sell-

er, or other persons arising out of the structural defect or defects.

(f) The borrower shall not be entitled, as a matter of right, to receive the assistance in the correction of structural defects provided in this section. Any determination made by the Secretary in connection with a borrower's application for assistance shall be final and conclusive and shall not be subject to judicial or other review. Authority to act for the Secretary under this section is delegated to the Under Secretary for Benefits.

(g) For the purpose of this section, the term "structural defects seriously affecting livability" shall in no event be deemed to include (1) defects of any nature in a dwelling in respect to which the applicant for assistance under this section was the builder or general contractor, or (2) structural features, improvements, amenities, or equipment which were not taken into account in the Secretary's determination of reasonable value.

[33 FR 16088, Nov. 1, 1968, as amended at 36 FR 321, Jan. 9, 1971; 40 FR 34595, Aug. 18, 1975; 61 FR 28059, June 4, 1996]

§ 36.4365 Advertising and Solicitation Requirements.

Any advertisement or solicitation in any form (e.g., written, electronic, oral) from a private lender concerning housing loans to be guaranteed or insured by the Secretary:

(a) Must not include information falsely stating or implying that it was issued by or at the direction of VA or any other department or agency of the United States, and

(b) Must not include information falsely stating or implying that the lender has an exclusive right to make loans guaranteed or insured by VA.

(Authority: 38 U.S.C. 3703, 3704)

[67 FR 9402, Mar. 1, 2002]

LOANS UNDER 38 U.S.C. 3703

SOURCE: Sections 36.4370 to 36.4375 appear at 13 FR 7281, Nov. 27, 1948, unless otherwise noted.