

(3) *Method of rate changes.* Interest rate changes may only be implemented through adjustments to the borrower's monthly payments.

(4) *Initial rate and magnitude of changes.* The initial contract interest rate of an adjustable rate mortgage shall be agreed upon by the lender and the veteran. The rate must be reflective of adjustable rate lending. Annual adjustments in the interest rate shall be set at a certain spread or margin over the interest rate index prescribed in paragraph (e)(1) of this section. Except for the initial rate, this margin shall remain constant over the life of the loan. Annual adjustments to the contract interest rate shall correspond to annual changes in the interest rate index, subject to the following conditions and limitations:

(i) No single adjustment to the interest rate may result in a change in either direction of more than one percentage point from the interest rate in effect for the period immediately preceding that adjustment. Index changes in excess of one percentage point may not be carried over for inclusion in an adjustment in a subsequent year. Adjustments in the effective rate of interest over the entire term of the mortgage may not result in a change in either direction of more than five percentage points from the initial contract interest rate.

(ii) At each adjustment date, changes in the index interest rate, whether increases or decreases, must be translated into the adjusted mortgage interest rate, rounded to the nearest one-eighth of one percent, up or down. For example, if the margin is 2 percent and the new index figure is 6.06 percent, the adjusted mortgage interest rate will be 8 percent. If the margin is 2 percent and the new index figure is 6.07 percent, the adjusted mortgage interest rate will be  $8\frac{1}{8}$  percent.

(5) *Pre-loan disclosure.* The lender shall explain fully and in writing to the borrower, no later than on the date upon which the lender provides the prospective borrower with a loan application, the nature of the obligation taken. The borrower shall certify in writing that he or she fully understands the obligation and a copy of the signed certification shall be placed in

the loan folder and included in the loan submission to VA. Such lender disclosure must include the following items:

(i) The fact that the mortgage interest rate may change, and an explanation of how changes correspond to changes in the interest rate index;

(ii) Identification of the interest rate index, its source of publication and availability;

(iii) The frequency (*i.e.*, annually) with which interest rate levels and monthly payments will be adjusted, and the length of the interval that will precede the initial adjustment; and

(iv) A hypothetical monthly payment schedule that displays the maximum potential increases in monthly payments to the borrower over the first five years of the mortgage, subject to the provisions of the mortgage instrument.

(6) *Annual disclosure.* At least 25 days before any adjustment to a borrower's monthly payment may occur, the lender must provide a notice to the borrower which sets forth the date of the notice, the effective date of the change, the old interest rate, the new interest rate, the new monthly payment amount, the current index and the date it was published, and a description of how the payment adjustment was calculated. A copy of the annual disclosure shall be made a part of the lender's permanent record on the loan.

(Authority: 38 U.S.C. 3707, 3712)

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#### § 36.4213 Capacity of parties.

Nothing in the § 36.4200 series shall be construed to relieve any lender of responsibility for any loss caused by lack of legal capacity of any person to contract, sell, convey or encumber, or by the existence of other legal disability or defects invalidating or rendering unenforceable in whole or in part either the loan obligation or the security therefor.

#### § 36.4214 Geographical limits.

The site for any manufactured home purchased with a guaranteed loan must be located within the United States of America, which for the purposes of 38 U.S.C. 3712 comprises the several States, the Territories and possessions