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DEPARTMENT OF VETERANS AFFAIRS

8320-01

38 CFR Part 36

RIN 2900-AP32

Loan Guaranty Vendee Loan Fees

AGENCY: Department of Veterans Affairs.

ACTION: Proposed rule.

SUMMARY: This document proposes to amend the Department of Veterans Affairs (VA) Loan Guaranty Service (LGY) regulations to establish reasonable fees that VA may charge in connection with the origination and servicing of vendee loans made by VA. Fees proposed in this rulemaking are consistent with those charged in the private mortgage industry, and such fees would help VA to ensure the sustainability of this vendee loan program. The loans that would be subject to the fees are not veterans' benefits. This rule would also ensure that all direct and vendee loans made by the Secretary are safe harbor qualified mortgages.

DATES: Comments must be received by VA on or before [insert date 60 days after date of publication in the Federal Register].

ADDRESSES: Written comments may be submitted through www.Regulations.gov; by mail or hand-delivery to Director, Regulation Policy and Management (00REG), Department of Veterans Affairs, 810 Vermont Avenue, NW, Room 1068, Washington, DC 20420; or by fax to (202) 273-9026. Comments should indicate that they are submitted in response to "RIN 2900-AP32-Loan Guaranty Vendee Loan Fees." Copies

of comments received will be available for public inspection in the Office of Regulation Policy and Management, Room 1068, between the hours of 8:00 a.m. and 4:30 p.m., Monday through Friday (except holidays). Please call (202) 461-4902 for an appointment. (This is not a toll-free number.) In addition, during the comment period, comments may be viewed online through the Federal Docket Management System (FDMS) at www.Regulations.gov.

FOR FURTHER INFORMATION CONTACT: Andrew Trevayne, Assistant Director for Loan and Property Management (261), Veterans Benefits Administration, Department of Veterans Affairs, 810 Vermont Avenue, NW, Washington, DC 20420, (202) 632-8795. (This is not a toll-free number.)

SUPPLEMENTARY INFORMATION: This document proposes to amend VA regulations to establish reasonable fees in connection with loans made by VA, commonly referred to as vendee loans. The proposed fees associated with vendee loans are standard in the mortgage industry. The vendee loans that would be subject to the fees are not veterans' benefits and are available to any purchasers, including investors, who qualify for the loan.

Specifically, this rulemaking would permit VA to establish a fee to help cover costs associated with loan origination. The proposed rule would also permit certain reasonable fees to be charged following loan origination, during loan servicing. Fees permitted would be those charged for ad hoc services performed at the borrower's request or for the borrower's benefit, as well as standard fees specified in loan

instruments. Lastly, third-party fees, those not charged by VA, would be included in this proposed rule solely to clarify for borrowers the various costs that a borrower may incur when obtaining a vendee loan.

Vendee Loans

When a holder forecloses a VA-guaranteed loan, the holder has the option, pursuant to 38 U.S.C. 3732 and 3720, of conveying the foreclosed property to the Secretary of Veterans Affairs (the Secretary). For properties VA acquires this way, VA sells them as a salvage operation and deposits the sales proceeds into the Veterans Housing Benefit Program Fund (VHBPF), as required by 38 U.S.C. 3722, to help offset the housing operation costs of the Home Loan Guaranty Program.

In addition to selling properties as part of the salvage operation, the Secretary has authority under 38 U.S.C. 3720 and 3733 to finance the sales upon such terms as the Secretary determines reasonable. VA refers to loans made pursuant to these provisions as vendee loans. The loans are not classified as veterans' benefits and are available to any purchaser VA determines creditworthy and whose bid is awarded a sales contract. Purchasers can be individuals or corporations, and the properties can be purchased as owner-occupied residences or as investments. Additionally, the Secretary may make vendee loans to certain entities pursuant to 38 U.S.C. 2041 for the purpose of assisting homeless veterans and their families acquire shelter.

Under 38 U.S.C. 3733(a)(4), vendee loans may generally be made for up to 95 percent of the purchase price of the property. A vendee loan may exceed 95 percent of the purchase price to the extent the Secretary determines necessary to competitively

market the property. A vendee loan may also exceed 95 percent of the purchase price in instances where the Secretary includes, as part of the vendee loan, an amount to be used for the purpose of rehabilitating such property. Additionally, 38 U.S.C. 3733(a)(6) provides that the Secretary shall make a vendee loan at an interest rate that is lower than the prevailing mortgage market interest rate in areas where, and to the extent the Secretary determines, in light of prevailing conditions in the real estate market involved, that such lower interest rate is necessary in order to market the property competitively and is in the interest of the long-term stability and solvency of the VHBPF. These provisions demonstrate that this program is to be competitively marketed to borrowers so long as it is financially sustainable. In fiscal years (FYs) 2011 and 2012, the most recent period when VA made direct loans, VA sold, on average, 175 real-estate owned (REO) properties per month with vendee financing, with an average loan amount of \$114,925.

Vendee financing is not a veterans' benefit; rather, it is a competitive lending program with the primary goal of providing financing to help VA dispose of its REO properties. Vendee loans enable VA to sell more of its properties and to sell them quicker. Nevertheless, this program helps veterans by contributing to the long-term viability of the VHBPF, as the principal and interest resulting from repayment of vendee loans are deposited into the VHBPF to help offset the housing operation costs of the Home Loan Guaranty Program.

Authority for Fees

Section 3720 of title 38 U.S.C. states that the Secretary may purchase property upon such terms and for such prices as the Secretary determines to be reasonable, and similarly sell, at public or private sale, any such property. It also authorizes the Secretary to otherwise deal with any property acquired or held pursuant to chapter 37 of title 38, U.S.C.

Section 3720 authorizes the Secretary to sell REO properties upon such terms and for such prices as the Secretary determines reasonable. See 38 U.S.C. 3720(a). Section 3720 further authorizes the Secretary to exercise this discretion notwithstanding any other provision of law. Given the common industry practice of including fees when negotiating the terms and prices of real estate transactions, and for other reasons explained below, the Secretary has determined that it is reasonable to negotiate fees in the terms and prices of any sale of the Secretary's REO properties. The specific types of allowable fees will be explained in-depth later in this preamble.

VA considered alternatives to charging fees. One option was to increase the sales prices of properties to account for the funds that fees would generate. VA decided, however, that increasing sales prices might extend the time that VA must hold properties before selling them. This would also increase costs for taxpayers, rather than the small population of borrowers enjoying the advantages of vendee loans. VA also considered adjusting interest rates, but as explained earlier, Congress has established a preference for lower-than-market interest rates in order to market properties competitively. See 38 U.S.C. 3733(a)(6). Consequently, VA believes that having the flexibility to negotiate fees is the most fiscally sound way to protect the

integrity of the VHBPF and ensure that taxpayers who do not participate in the vendee program do not unfairly bear the burden of its costs.

All origination-related fees and post-origination fees proposed under this rule will be deposited into the VHBPF. Under 38 U.S.C. 3722, amounts paid into the VHBPF under section 3729 or any other provision of law or regulation established by the Secretary imposing fees on persons or other entities constitute assets of the VHBPF. See 38 U.S.C. 3722(c)(2). These fees would be designated to the proper account as required under the Federal Credit Reform Act of 1990. See 2 U.S.C. 661, et seq.

The Proposed Rule

To help ensure that VA's REO portfolio is administered in a cost-effective manner, VA is proposing to authorize certain reasonable fees in connection with the origination and post-origination servicing of vendee loans. The proposed fees would prevent against windfalls to the small population of vendee borrowers by ensuring that they, rather than the taxpayers at-large, pay for the unique advantages of vendee financing. The types of fees proposed are standard in the lending industry, and as such, would not significantly affect the program's competitiveness.

In addition to the reasonable fees proposed herein, borrowers obtaining vendee financing may be required to pay certain third-party fees. Third-party fees are collected on behalf of, or payable to, persons other than the Secretary. These include, for instance, recording fees, force-placed insurance premiums, and inspection fees. VA does not control these third-party fees, as they are not collected on behalf of the

Secretary. VA is identifying them in this proposed rule to help participants more fully understand the types of expenses that typically could affect borrowers.

Section 36.4500 Applicability and Qualified Mortgage Status.

VA proposes to add § 36.4500(e) to clarify the applicability of the sections proposed under this rulemaking. It would state that proposed §§ 36.4528, 36.4529, and 36.4530 would be applicable to all vendee loans.

VA also proposes to amend paragraph (c)(2), regarding which vendee loans are qualified mortgages. The purpose and effects of this proposed change are explained later in this preamble in the section on safe harbor qualified mortgages.

Section 36.4501 Definitions.

VA proposes to update the authority citation for the definition of vendee loan, as provided in § 36.4501. The authority citation currently includes 38 U.S.C. 3720 and 3733. VA proposes to add 38 U.S.C. 2041 to this citation. This change would have no substantive effect on vendee loans but would merely ensure that the authority citation for the definition of vendee loans fully reflects the authorities under which the Secretary may make these loans.

VA also proposes to clarify existing policy with regard to vendee loan terms. The rule would state specifically that the terms of a vendee loan (e.g., amount of down payment; amortization term; whether to escrow taxes, insurance premiums, or homeowners' association dues; fees etc.) are negotiated between the Secretary and the borrower on a case-by-case basis, subject to the requirements of 38 U.S.C. 2041 or

3733. The terms may vary depending on, among other factors, the creditworthiness of the buyer/borrower and the purpose of the realty purchase – investment versus residence. Except for the addition of the Secretary’s discretion to negotiate fees, this is not a substantive change. VA would also state that the terms related to allowable fees are subject to proposed §§ 36.4528 through 36.4530 of this part.

In addition, the rule would add a new definition for safe harbor qualified mortgage. The definition is consistent with that in the guaranteed loan program. See 38 CFR 36.4300(b)(1). It is necessary to add the definition to clarify the applicability of safe harbor provisions to all of VA’s direct loan programs, not just the guaranteed programs.

Section 36.4528 Vendee Loan Origination Fee

VA is proposing a new regulatory provision to be found in 38 CFR 36.4528. Proposed § 36.4528 would authorize an allowable fee that may be charged in connection with the origination of vendee loans. This proposed rule would permit VA to charge an origination fee not to exceed one-and-a-half percent of the loan amount. The proposed origination fee is distinct, and in addition to, the loan fee required to be paid by 38 U.S.C. 3729 for vendee loans made pursuant to 38 U.S.C. 3733. All or part of the proposed origination fee may be paid in cash at loan closing, or all or part of the fee may be included in the loan. In computing the fee, VA would disregard any amount included in the loan to enable the borrower to pay such fee. In other words, if a borrower opts to include the fee into the loan amount, VA would not increase the amount of origination fee due. Under no circumstance may the total fee agreed upon

between the Secretary and the borrower result in an amount that would cause the loan to be designated as a high-cost mortgage, as defined by section 103(bb) of the Truth in Lending Act (TILA), codified in 15 U.S.C. 1602(bb), and implementing regulations in 12 CFR part 1026.

VA understands that it is common industry practice for lenders to charge an “origination fee” of approximately one percent of the loan value. Bankrate.com explains that for many loans a one percent origination fee is common.¹ This fee is customarily charged by lenders to cover certain expenses involved with evaluating borrowers’ creditworthiness and preparing a mortgage loan. VA currently permits a one percent fee to be charged in connection with originating loans in its Home Loan Guaranty Benefit Program (38 CFR 36.4313(d)(2)). Vendee financing is distinct from VA’s benefit program. Nonetheless, VA believes that if private lenders are permitted to charge a one percent origination fee to eligible servicemembers and veterans utilizing their home loan benefit, then it is reasonable to establish up to a one-and-a-half percent fee in connection with the origination of non-benefit vendee loans, which may be made to any borrowers, including investors, who qualify.

To the extent the maximum one-and-a-half percent fee proposed herein may on occasion exceed the total amount charged at origination by certain private lenders, the unique characteristics of vendee financing would make the extra one-half percent reasonable and help the vendee program remain competitive. As explained above in the section on vendee loans, 38 U.S.C. 3733(a)(6) requires the Secretary to make vendee loans at an interest rate lower than the prevailing mortgage market interest rate

¹ Loan Comparison Calculator, BANKRATE.COM, <http://www.bankrate.com/calculators/home-equity/compare-loans-calculator.aspx#ixzz34FMEFGk5> (last visited May 8, 2015).

in situations where, based on the local conditions in an area's real estate market, such lower interest rate is necessary to market the property competitively. In such situations, VA does not have the flexibility to charge above market interest rates to offset costs associated with loan origination, as a private lender might. Further, VA offers these lower interest rates without charging discount points collected in exchange for this lower interest rate at the time of loan origination. In private sector transactions, borrowers can pay up to three or four discount points, depending on how much they want to lower their interest rates. One discount point is an upfront payment of one percent of the loan amount, in addition to the other fees. The mortgage's interest rate is usually reduced by a quarter of a percentage point for every discount point paid.

In addition to offering below-market interest rates without discount points, VA offers vendee financing for up to 95 percent of the purchase price of the property and, in instances where the Secretary deems it necessary to market the property competitively, may offer vendee financing in an amount that exceeds 95 percent of the purchase price. The average loan amount to sale price ratio for vendee loans exceeded 85 percent in FY11 and 88 percent in FY12.

Generally, if a borrower's down payment on a home is less than 20 percent of the sale price, a private lender will require mortgage insurance to protect itself in case the borrower defaults on the payments. The borrower pays the premiums, and the lender is the beneficiary.² Private mortgage insurance typically costs about 0.25 to two percent of the loan balance per year, depending on the amount of the down payment, loan term,

² Private mortgage insurance—The Basics of PMI, BANKRATE.COM, <http://www.bankrate.com/finance/mortgages/the-basics-of-private-mortgage-insurance-pmi.aspx> (last visited May 8, 2015).

and borrower's credit score, and continues until the borrower reaches 20 percent equity.³ In contrast, VA does not require a borrower to purchase private mortgage insurance on any vendee loan, regardless of the loan-to-purchase price ratio.

Furthermore, the rule would provide that under no circumstances may the total fees agreed upon between the Secretary and the borrower result in an amount that would cause the loan to be designated as a high-cost mortgage loan under TILA and its implementing regulations (15 U.S.C. 1602(bb); 12 CFR part 1026). High-cost mortgages are those where the annual percentage rate (APR) or points and fees charged exceed certain threshold amounts. Loans that meet such high-cost coverage tests are subject to special disclosure requirements and restrictions on loan terms.

Accordingly, this rulemaking would include authority for VA to charge an amount not to exceed a one-and-a-half percent origination fee in connection with the origination of vendee loans. Fees that may be charged by third parties at the time of loan origination (for example, courier fees or fees for termite inspection) are not included under 38 CFR 36.4528 and are discussed later in this preamble. In establishing this reasonable fee to cover costs associated with loan origination, VA is managing the non-benefit, vendee loan program in a business-like manner more consistent with private industry standards, and in so doing, ensuring that purchasers who utilize this financing, rather than taxpayers at-large, help bear the expenses associated with originating vendee loans.

Section 36.4529 Vendee Loan Post-Origination Fees

³ Definition Of 'Private Mortgage Insurance-PMI', INVESTOPEDIA.COM, <http://www.investopedia.com/terms/p/privatemortgageinsurance.asp> (last visited May 8, 2015).

VA is also proposing a new regulatory provision, 38 CFR 36.4529, which would allow VA to charge reasonable service-related fees following loan origination. These fees would not constitute the general servicing fee paid by VA to its contractor to perform functions normally considered part of prudent loan servicing activities. Rather, these fees would be charged to the borrower to cover the costs of ad hoc, special services that are requested and performed on the borrower's behalf, and are beyond the regular services performed in connection with loan servicing.

It is common industry practice to charge specific fees in accord with the rendering of additional services on an account. Accordingly, VA is establishing, under proposed § 36.4529(a), maximum amounts to be charged per fee in exchange for the Secretary's performance of certain services that are above and beyond ordinary and customary loan servicing activities. VA surveyed some of the larger private entities that perform loan servicing. The frequency, applicability, and amount of these fees generally vary by state, loan status, and other loan characteristics. As such, VA notes that the amounts proposed in this rulemaking would represent maximums; the specific fees to be charged on each account may be negotiated between the Secretary and the borrower.

Under the proposed rule, VA could charge a borrower an assumption processing fee when a purchaser assumes a VA direct loan. This fee would be assessed when VA approves a request for the transfer of legal liability of repaying the mortgage. VA intends for the assumption fee to help offset the costs associated with processing the application, determining the creditworthiness of the assumptor, and revising the ownership records when the approved transfer is complete. VA would be permitted to

charge an amount not to exceed \$300, plus the actual cost of any credit report required. If the assumption were denied, VA would only charge the actual cost of the credit report. The disclosed maximum assumption fees in the fee schedules surveyed for this rulemaking ranged from \$350 (including the cost of the credit report) to \$1300 (however, the \$1300 fee also included attorney fees).

The rule would also permit VA to charge the borrower a fee, not to exceed \$350, for processing a subordination request to ensure that a modified vendee loan retains first lien position over another debt on the same property. VA will only modify a loan if it will retain its priority lien position on that property. State laws differ as to whether a basic loan modification will affect priority status of a senior loan holder, and in which situations such a modification would affect priority status. Accordingly, if VA consents to the modification of a loan, VA must ensure that its modified mortgage loan retains first-lien position. The maximum subordination fee disclosed by the private servicers surveyed for this rulemaking was \$350.

The proposed rule would permit a reasonable partial release fee, not to exceed \$350, to be charged when a borrower seeks to exclude some of the collateral from the mortgage contract once a certain amount of the mortgage loan has been paid. A borrower might request a partial release of real property from the security for a number of reasons; for example, to release acreage from the original secured lot so that it can be used for other purposes or to release some portion of the property to adjust the lot line or resolve a lot line dispute. Of the private servicers surveyed, two disclosed a maximum fee of \$350 and the third disclosed a maximum fee for this service of \$500.

If VA agrees to release an obligor from a mortgage loan in connection with a division of real property, this rule would permit VA to charge a release of lien fee not to exceed \$15 for executing and providing documentation of this release. Occasionally, joint owners of real property may be subject to a judicial decree (such as a divorce judgment) that divides the property into separately owned parcels according to each owner's proportionate share in the property. Generally, neither owner receives any cash consideration in connection with the partition. In these circumstances, following this division, the fee may be incurred if the borrower who has possession of the land that is to be released from the security requests a release from liability under the mortgage loan. Consistent with VA's proposed maximum, the maximum fee disclosed in VA's survey of private industry is \$15.

VA could charge a fee not to exceed \$30 for processing payoff statements. Consistent with VA's proposed maximum, the private industry servicers VA surveyed disclosed a maximum payoff statement fee of \$30.

VA could charge a reasonable fee to the borrower to offset the costs of processing payments a borrower may elect to submit by phone. To cover the expenses associated with providing this service, which borrowers may prefer to traditional payment by check, the fee would not exceed \$12 when a representative handles the payment, and would not exceed \$10 when an interactive voice response system (an automated phone system) handles the payment. The industry fee schedules that VA surveyed for this rulemaking disclosed maximum payment by phone fees that ranged from \$9 to \$20. The schedules also showed that, when a borrower makes a payment

by phone, it usually costs the borrower \$3 to \$10 more to speak with a representative than it does for the borrower to use an interactive voice response system.

In addition to the proposed fees being standard in private industry, there is precedent for the collection of fees in exchange for the performance of special ad hoc services in another Federal Government direct home loan program. Specifically, the Rural Housing Service (RHS) at the Department of Agriculture (USDA) regulates the collection of fees in exchange for the performance of certain special services. RHS provides financing to help very low and low income individuals, who cannot obtain credit from other sources, obtain housing in rural areas. VA notes that RHS permits these fees even though its loan program is targeted to very low and low income families, whereas sales of REO properties with vendee financing are intended to help VA dispose of its REO inventory helping fund the VHBPF.

For example, 7 CFR 3550.161(c) states that RHS may charge a fee for payoff statements if more than two statements are requested for the same account in any 30-day period. Under § 3550.161(d), RHS explains that borrowers who make cash payments, rather than submitting payment through check, money order, or bank draft, will be assessed a fee to cover the conversion to money order. RHS stated in its Interim Final Rule, Reengineering and Reinvention of the Direct Section 502 and 504 Single Family Housing Programs, published on November 22, 2006 (61 FR 59762, 59772), that two commentators strongly opposed RHS's requirement that a cash payment must be accompanied by an amount sufficient to cover the cost of a money order, stating that such proposal was unfair to very low and low income families. It explained, however, that RHS provides supervised credit. RHS encourages, like all

lenders, customers to send payments by check, money order or bank draft. Cash payments in local offices are discouraged. Since RHS must obtain a money order in order to transmit the payment, the customer should pay that fee. Id.

In addition, RHS regulations at 7 CFR 3550.159 provide that certain borrower actions require RHS approval. Specifically, § 3550.159(c) explains that RHS may consent to a transaction affecting the security, such as a sale or exchange of security property, and grant a partial release of the security, so long as certain conditions are met. Among those conditions is the requirement that the proceeds from the sale of any portion of the security property or other similar transaction requiring RHS consent must first be used to pay customary and reasonable costs related to the transaction that must be paid by the borrower. Additionally, if an appraisal must be conducted, the regulation states that the appraisal fee will be charged to the borrower.

As authority for its rule permitting such fees, RHS cites 42 U.S.C. 1480, which provides that the Secretary of Agriculture shall have the power to sell RHS-acquired properties based on terms and conditions the Secretary of Agriculture determines reasonable and to make loans to the purchasers of such properties. The statutory authority cited by RHS to permit fees to cover the costs of performing additional post-origination services is analogous to 38 U.S.C. 3720, which provides the Secretary the power to dispose of VA-owned properties on terms the Secretary determines reasonable. Thus, the proposed rule would be consistent with the rule of at least one other Federal Government direct home loan program that authorizes reasonable fees to cover unanticipated, additional expenses incurred after loan origination.

The rule would state expressly, at proposed § 36.4529(b), that the Secretary may negotiate fees on a case-by-case basis. It would also require the Secretary to review, bi-annually, the maximum fees proposed under § 36.4529(a) to ensure that the fees continue to reflect the reasonable costs for the services performed. If VA determines that the maximum fees listed in § 36.4529(a) no longer reflect the reasonable amounts necessary to perform the associated services, VA would propose amendment of the regulation. This would allow VA to timely address any imbalance in the maximum fee schedule and keep the vendee loan program both cost-effective and competitively priced for its participants.

In addition to the ad hoc post-origination fees proposed under § 36.4529(a), proposed § 36.4529(c) would identify, for informational purposes, standard fees as established in loan instruments. Fees established in loan instruments are generally considered deterrents to default, and a means by which the lender can minimize losses if a loan does default. These expenses often relate to termination of the loan, regardless of whether the loan is ultimately foreclosed, and are capitalized into the indebtedness.

VA, like many lenders, uses the standard loan documents developed and adopted by the Federal National Mortgage Association (Fannie Mae). Fannie Mae's security instruments usually provide that the lender may charge reasonable fees for services performed in connection with default and loan termination to protect the lender's interest in the property and rights under the deed of trust. Various Fannie Mae security instruments can be viewed at <https://www.fanniemae.com/singlefamily/security-instruments>.

Fannie Mae's standard security instruments also generally provide that if the borrower fails to perform the covenants and agreements contained in the security instrument, the lender may do and pay for whatever is reasonable or appropriate to protect the lender's interest in the property and rights under the security instrument. A lender may not charge any fees prohibited by the instrument or by applicable federal, state, or local laws or regulations. State laws control whether any fees charged by the lender, or amounts expended by the lender to protect its interest in the property and rights under the loan instrument, are to be added to the borrower's indebtedness.

Pursuant to proposed § 36.4529(d), any fee included in the loan instrument and permitted under proposed § 36.4529(c) would be based on the amount customarily charged in the industry for the performance of the service in the particular area, the status of the loan, and the characteristics of the affected property. VA is not prescribing specific maximum amounts for these fees. Rather, as these fees are governed by the loan instrument and may be capitalized into the principal balance of the loan, state law sets the maximum amounts for these fees. Nevertheless, VA seeks to clarify through this rulemaking that any borrower obtaining vendee financing may incur reasonable fees as provided for in standard loan instruments.

An example of a fee permitted by the standard loan instrument would be a property inspection fee that VA could collect. For instance, when a foreclosure seems necessary, VA must perform a limited inspection to determine the physical condition or occupancy status of a property purchased with vendee financing. In situations where VA must perform work to maintain a vacant property, the loan instrument permits a reasonable property preservation fee to be charged to the borrower. As a result, this

fee would cover services to protect a vacant property from further damage or to maintain a property to prevent city code violations. Such services could range from mowing the yard to constructing a fence around the property to winterizing the property. The fees charged would need to reflect the reasonable cost of performing the particular type of property preservation service.

Additionally, standard loan instruments used by VA permit VA to collect reasonable appraisal or attorneys' fees. Appraisal fees would include, for example, the cost of obtaining a liquidation appraisal in the event of default to determine the value of a property prior to a liquidation sale or short sale. Appraisal fees could also include the cost of an appraisal of property to determine its value prior to a partial release.

Attorneys' fees may be incurred in cases where the property goes into serious delinquency and servicers must hire attorneys to assure VA's interests are protected. Examples of legal work incurring attorneys' fees include providing proper and timely notice to borrowers in the event of foreclosure, determining lien position if there are multiple liens on the property, and, in judicial foreclosure states, assuring correct paperwork is submitted to the court. In addition, attorneys' fees may be incurred in cases where a loan is referred to foreclosure, but the foreclosure is not completed, the default is cured, and the loan is reinstated.

Along with the fees for default-related services, there are other reasonable fees that are specified in the loan instrument that, if incurred, can be capitalized as part of the borrower's total indebtedness. These fees offset the additional expense of collection activities and usually serve as incentives for repaying a loan obligation in a timely manner or, more aptly, as deterrents to delinquency that might otherwise interrupt

the Government's scheduled flow of income. These fees include, but are not limited to, late fees incurred to cover the added expense involved in handling delinquent payments, and a returned-check (non-sufficient funds) fee incurred when a mortgage payment is made from an account that does not have sufficient funds to cover the payment. Other fees that are reasonably necessary for the protection of the lender's investment are also permitted under the loan instrument.

VA notes that RHS, in addition to including standard fees in its loan instrument, also addresses some of these fees in regulation. For example, RHS servicing regulations state that RHS may assess reasonable fees including a tax service fee, fees for late payments, and fees returned for insufficient funds (7 CFR 3550.153). In justifying the potential to charge late fees to its very low and low income borrowers, RHS explains that it recognizes its mission to provide supervised credit, but that it also believes a late fee encourages its clients to make payments on a timelier basis. See 61 FR 59763. Further, § 3550.156(a) explains that RHS borrowers are expected to meet a variety of obligations outlined in the loan documents, including maintaining the security property and paying hazard and flood insurance and other related costs when due. Paragraph (b) of the rule states that if a borrower fails to fulfill these obligations, RHS may obtain the needed service and charge the cost to the borrower's account. Accordingly, VA is similarly including reasonable fees established in loan instruments under this proposed rulemaking.

Section 36.4530 Vendee Loan Other Fees

The loan fee required by 38 U.S.C. 3729 and the fees included in proposed 38 CFR 36.4528 and 36.4529 are not the only types of fees associated with vendee loans. There are other types of fees necessary for the origination and servicing of vendee loans that may be permitted under this rulemaking. As such, VA is proposing to add § 36.4530 to clarify for borrowers of vendee loans that they may incur fees associated with their financing, in addition to, and unaffected by, those fees specified in 38 U.S.C. 3729 and proposed §§ 36.4528 and 36.4529.

Other types of fees that that may be charged in connection with vendee loans are fees charged by third parties. These fees, which are also permitted in connection with the guaranteed loan benefit program, are not collected on behalf of the Secretary. These types of fees are collected to pay for goods or services such as termite inspections, hazard and force-placed insurance premiums, courier fees, tax certificates, and recorder's fees. They are standard in closing transactions, and borrowers of vendee loans would be expected to pay these fees for the goods and services provided by the third parties. VA is identifying these fees in this proposed rule to help clarify the types of expenses that may be incurred in connection with vendee financing and ensure that borrowers of vendee loans clearly understand the financial obligations that may be expected of them. The list of third-party fees in proposed 38 CFR 36.4530 is not exhaustive. Rather, it is meant to provide examples.

Safe Harbor Qualified Mortgages

VA proposes a change to § 36.4500(c)(2) to clarify that all direct loans would be safe harbor qualified mortgages. VA's qualified mortgage rule was first published on

May 9, 2014. See 79 FR 26620. Although VA intended to designate as qualified mortgages all VA direct loans, VA did not expressly include all authorities under which VA makes loans. Consequently, it might appear as if VA intentionally excluded some of VA's direct loans from qualified mortgage status.

To eliminate ambiguity, the proposed change would state expressly that any VA direct loan made by the Secretary pursuant to chapter 20 or 37 of title 38, U.S.C., is to be considered a safe harbor qualified mortgage. VA would also revise the authority citation for paragraph (c)(2) to include citations to 38 U.S.C. 2041, 3711, 3720, 3733, and 3761 in addition to the current citation to 38 U.S.C. 3710 and 15 U.S.C. 1639C(b)(3)(B)(ii). Again, this change is not intended to be substantive, but rather, would ensure the paragraph's authority reflects all of the different statutory authorities under which VA may make direct loans.

Executive Orders 12866 and 13563

Executive Orders 12866 and 13563 direct agencies to assess the costs and benefits of available regulatory alternatives and, when regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, and other advantages, distributive impacts, and equity). Executive Order 13563 (Improving Regulation and Regulatory Review) emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility. Executive Order 12866 (Regulatory Planning and Review) defines a "significant regulatory action" requiring review by the Office of Management and Budget (OMB), unless OMB waives such review, as "any

regulatory action that is likely to result in a rule that may: (1) Have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; (2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive Order."

The economic, interagency, budgetary, legal, and policy implications of this regulatory action have been examined, and it has been determined not to be a significant regulatory action under Executive Order 12866. VA's impact analysis can be found as a supporting document at <http://www.regulations.gov>, usually within 48 hours after the rulemaking document is published. Additionally, a copy of the rulemaking and its impact analysis are available on VA's Web site at <http://www.va.gov/orpm/>, by following the link for VA Regulations Published from FY2004 to FYTD.

Unfunded Mandates

The Unfunded Mandates Reform Act of 1995, 2 U.S.C. 1532, requires agencies to prepare an assessment of anticipated costs and benefits before issuing any rule that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more (adjusted annually for inflation) in any

one year. This proposed rule would have no such effect on State, local, and tribal governments, or on the private sector.

Paperwork Reduction Act

This proposed rule contains no provisions constituting a collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3521).

Regulatory Flexibility Act

This proposed rule would affect individuals and small businesses who choose to obtain a vendee loan from VA to finance the purchase of a VA-owned property rather than alternate financing. A party who wants to purchase a VA-owned property may choose whatever source of financing he wishes. Presumably the purchaser would select the least expensive financing option available, which may or may not be a VA vendee loan. VA does not believe that this proposed rule would impose any significant economic impact for the following reasons. Should the purchaser decide that the VA vendee program was not the most economically advantageous to the purchaser then he would obtain alternate financing. Parties would have to choose to be subject to the impact, if any, imposed by this rule.

Accordingly, the Secretary certifies that the adoption of this proposed rule would not have a significant economic impact on a substantial number of small entities as they are defined in the Regulatory Flexibility Act (5 U.S.C. 601-612). Therefore, under 5 U.S.C. 605(b), this rulemaking is exempt from the initial and final regulatory flexibility analysis requirements of sections 603 and 604.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance number and title for the program affected by this document is 64.114, Veterans Housing—Guaranteed and Insured Loans.

Signing Authority

The Secretary of Veterans Affairs, or designee, approved this document and authorized the undersigned to sign and submit the document to the Office of the Federal Register for publication electronically as an official document of the Department of Veterans Affairs. Gina S. Farrisee, Deputy Chief of Staff, Department of Veterans Affairs, approved this document on October 18, 2016, for publication.

Dated: October 18, 2016

Jeffrey Martin
Office Program Manager
Office of Regulation Policy & Management
Office of the Secretary
Department of Veterans Affairs

List of Subjects in 38 CFR Part 36

Condominiums, Flood insurance, Housing, Indians, Individuals with disabilities, Loan programs-housing and community development, Loan programs-Indians, Loan programs-veterans, Manufactured homes, Mortgage insurance, Reporting and recordkeeping requirements, Veterans.

For the reasons set out in the preamble, VA proposes to amend 38 CFR part 36, subpart D as set forth below:

PART 36—LOAN GUARANTY

1. The authority citation for part 36 continues to read as follows:

AUTHORITY: 38 U.S.C. 501 and as otherwise noted.

Subpart D—Direct Loans

2. Amend § 36.4500 by:
 - a. Revising paragraph (c)(2).
 - b. Revising the authority citation for paragraph (c)(2).
 - c. Adding paragraph (e).

The revisions and addition read as follows:

§ 36.4500 Applicability and qualified mortgage status.

* * * * *

(c) * * *

(2) Applicability of safe harbor qualified mortgage. Any VA direct loan made by the Secretary pursuant to chapter 20 or 37 of title 38, U.S.C., is a safe harbor qualified mortgage.

(Authority: 15 U.S.C. 1639C(b)(3)(B)(ii), 38 U.S.C. 2041, 3710, 3711, 3720, 3733, and 3761)

* * * * *

(e) Sections 36.4528, 36.4529, and 36.4530, which concern vendee loans, shall be applicable to all vendee loans.

3. Amend § 36.4501 by adding in alphabetical order a definition for “Safe harbor qualified mortgage” and revising the definition “Vendee Loan” to read as follows:

§ 36.4501 Definitions.

* * * * *

Safe harbor qualified mortgage means a mortgage that meets the Ability-to-Repay requirements of sections 129B and 129C of the Truth-in-Lending Act (TILA) regardless of whether the loan might be considered a high cost mortgage transaction as defined by section 103bb of TILA (15 U.S.C. 1602bb).

* * * * *

Vendee loan means a loan made by the Secretary for the purpose of financing the purchase of a property acquired pursuant to chapter 37 of title 38, United States

Code. The terms of a vendee loan (e.g., amount of down payment; amortization term; whether to escrow taxes, insurance premiums, or homeowners' association dues; fees, etc.) are negotiated between the Secretary and the borrower on a case-by-case basis, subject to the requirements of 38 U.S.C. 2041 or 3733. Terms related to allowable fees are also subject to §§ 36.4528 through 36.4530 of this part.

(Authority: 38 U.S.C. 2041, 3720, 3733)

* * * * *

4. Add §§ 36.4528, 36.4529, and 36.4530 to read as follows:

§ 36.4528 Vendee loan origination fee.

(a) In addition to the loan fee required pursuant to 38 U.S.C. 3729, the Secretary may, in connection with the origination of a vendee loan, charge a borrower a loan origination fee not to exceed one-and-a-half percent of the loan amount.

(b) All or part of such fee may be paid in cash at loan closing or all or part may be included in the loan. The Secretary will not increase the loan origination fee because the borrower chooses to include such fee in the loan amount financed.

(c) In no event may the total fee agreed upon between the Secretary and the borrower result in an amount that will cause the loan to be designated as a high-cost mortgage as defined in 15 U.S.C. 1602(bb) and 12 CFR part 1026.

(Authority: 38 U.S.C. 2041, 3720, 3733)

§ 36.4529 Vendee loan post-origination fees.

(a) The Secretary may charge a borrower the following reasonable fees, per use, following origination, in connection with the servicing of any vendee loan:

(1) Processing assumption fee for the transfer of legal liability of repaying the mortgage when the individual assuming the loan is approved. Such fee will not exceed \$300, plus the actual cost of the credit report. If the assumption is denied, the fee will not exceed the actual cost of the credit report.

(2) Processing subordination fee, not to exceed \$350, to ensure that a modified vendee loan retains its first lien position;

(3) Processing partial release fee, not to exceed \$350, to exclude collateral from the mortgage contract once a certain amount of the mortgage loan has been paid;

(4) Processing release of lien fee, not to exceed \$15, for the release of an obligor from a mortgage loan in connection with a division of real property;

(5) Processing payoff statement fee, not to exceed \$30, for a payoff statement showing the itemized amount due to satisfy a mortgage loan as of a specific date;

(6) Processing payment by phone fee, not to exceed \$12, when a payment is made by phone and handled by a servicing representative;

(7) Processing payment by phone fee, not to exceed \$10, when a payment is made by phone and handled through an interactive voice response system, without contacting a servicing representative.

(b) The specific fees to be charged on each account may be negotiated between the Secretary and the borrower. The Secretary will review the maximum fees under paragraph (a) of this section bi-annually to determine that they remain reasonable.

(c) The Secretary may charge a borrower reasonable fees established in the loan instrument, including but not limited to the following:

- (1) Property inspection fees;
- (2) Property preservation fees;
- (3) Appraisal fees;
- (4) Attorneys' fees;
- (5) Returned-check fees;
- (6) Late fees; and
- (7) Any other fee the Secretary determines reasonably necessary for the protection of the Secretary's investment.

(d) Any fee included in the loan instrument and permitted under paragraph (c) of this section would be based on the amount customarily charged in the industry for the performance of the service in the particular area, the status of the loan, and the characteristics of the affected property.

(Authority: 38 U.S.C. 2041, 3720, 3733)

§ 36.4530 Vendee loan other fees.

(a) In addition to the fees that may be charged pursuant to 38 CFR 36.4528 and 36.4529 and the statutory loan fee charged pursuant to 38 U.S.C. 3729, the borrower may be required to pay third-party fees for services performed in connection with a vendee loan.

(b) Examples of the third party fees that may be charged in connection with a vendee loan include, but are not limited to:

- (1) Termite inspections;
- (2) Hazard insurance premiums;
- (3) Force-placed insurance premiums;
- (4) Courier fees;
- (5) Tax certificates; and
- (6) Recorder's fees.

(Authority: 38 U.S.C. 2041, 3720, 3733)

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