

Updates to VA's COVID-19 Home Retention Waterfall and COVID-19 Refund Modification

1. Purpose. The purpose of this Circular is to update, clarify, and consolidate instructions related to the COVID-19 Home Retention Waterfall and COVID-19 Refund Modification home retention option. Key features include a 40-year repayment term for a COVID-19 Refund Modification, clarification of VA's expectations under Starting Point III, Step D, of the COVID-19 Home Retention Waterfall, and extension of the availability of COVID-19 related assistance through May 31, 2024.

2. Effective and Applicability Dates. This Circular is effective immediately. This Circular applies to borrowers being offered assistance under the COVID-19 Home Retention Waterfall. Servicers are to utilize the COVID-19 Home Retention Waterfall as part of their available loss mitigation options through May 31, 2024.

3. Background. In July 2021, VA published Circular 26-21-13,¹ which outlines VA's preferred order of home retention options to help servicers assist borrowers affected by the COVID-19 pandemic. In July 2023, VA published VA Circular 26-23-12,² which (1) updated the COVID-19 Home Retention Waterfall to remove the COVID-19 Veterans Assistance Partial Claim Payment option (COVID-VAPCP),³ and (2) reiterated the parameters of the COVID-19 Refund Modification with two updates. Through this Circular, VA is once again updating the COVID-19 Home Retention Waterfall to reiterate existing home retention options, including the COVID-19 Refund Modification, for borrowers who received COVID-19 forbearance. VA remains committed to assisting borrowers who experience financial hardship due directly or indirectly to the COVID-19 pandemic.

Servicers are to follow this updated waterfall, choosing appropriate options based on borrowers' self-assessment of their ability to resume regular payments on a VA-guaranteed loan⁴ and to repay amounts missed under a COVID-19 forbearance.⁵ VA is also reminding servicers that, where applicable, servicers must comply with all Ginnie Mae program requirements.

4. How This Circular Is Arranged. Section 5 identifies the borrowers to whom the COVID-19

¹ See Circular 26-21-13, COVID-19 Home Retention Waterfall and COVID-19 Refund Modification, (July 23, 2021), https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_21_13.pdf.

² See Circular 26-23-12, COVID-19 Home Retention Waterfall and COVID-19 Refund Modification, (July 19, 2023), <https://www.benefits.va.gov/HOMELOANS/documents/circulars/26-23-12.pdf>.

³ 38 C.F.R. § 36.4809(c) ("...the Secretary will not accept a request for a partial claim payment after October 28, 2022.").

⁴ VA-guaranteed loans are hereafter referred to as "guaranteed loans."

⁵ COVID-19 forbearance means any forbearance of scheduled monthly guaranteed loan payments, granted to a borrower under section 4022 of the Coronavirus Aid, Relief, and Economic Security Act (Public Law 116-136). It can also include any forbearance of scheduled monthly guaranteed loan payments, granted to a borrower for a financial hardship due, directly or indirectly, to the COVID-19 national emergency.

Home Retention Waterfall applies. Section 6 outlines where to start in the COVID-19 Home Retention Waterfall, based on a borrower's indication of an ability to resume making monthly payments. Section 7 provides advance VA consent for the COVID-19 Refund Modification to help borrowers who need significant financial assistance. In 7a., VA describes the steps (roadmap) servicers are to follow to help borrowers reach certain payment relief targets through a COVID-19 Refund Modification. In connection with that, 7b., 7c., and 7d. describe the parameters of the COVID-19 Refund Modification, the process for obtaining the COVID-19 refund payment, and the note and security instrument for securing VA's junior lien.

Exhibit A offers a side-by-side comparison of the COVID-VAPCP and the COVID-19 Refund Modification.

5. How to Use the COVID-19 Home Retention Waterfall. Servicers are to use the waterfall to assist borrowers in cases where all the following conditions are met:

- a. The borrower missed at least one payment covered by a COVID-19 forbearance;
- b. The borrower's guaranteed loan was current or less than 120 days past due as of March 1, 2020, or the guaranteed loan was made on or after March 1, 2020; and
- c. The borrower occupies, as the borrower's residence, the property securing the guaranteed loan.

6. COVID-19 Home Retention Waterfall. The COVID-19 Home Retention Waterfall consolidates VA's various home retention options and arranges them into a step-by-step process. To use the waterfall, servicers ask the borrower whether the borrower can resume normal monthly guaranteed loan payments and whether the borrower is able to pay amounts the borrower missed under a COVID-19 forbearance.⁶ Based on the borrower's response, the servicer then selects the appropriate Starting Point from the following:

- a. Starting Point I: If the borrower indicates the borrower can resume normal monthly guaranteed loan payments and can, through a **repayment plan**, repay the COVID-19 arrearages, the servicer offers the repayment plan without requesting VA's prior approval. If the borrower and servicer cannot agree upon a repayment plan, the servicer proceeds to Starting Point II.
- b. Starting Point II: If the borrower indicates the borrower can resume normal monthly guaranteed loan payments but cannot repay the COVID-19 arrearages, the servicer offers a **VA Disaster Extend Modification**⁷ or a **loan deferment**.⁸ VA's prior approval is not required for these options.
- c. Starting Point III: If the borrower indicates the borrower cannot resume normal monthly guaranteed loan payments and cannot repay the COVID-19 arrearages, the servicer considers loan modification. Servicers can consider all of VA's existing loan

⁶ Amounts the borrower missed under a COVID-19 forbearance are hereafter referred to as "arrearages".

⁷ See 38 C.F.R. § 36.4315(a); VA Servicer Handbook M26-4, Ch. 5.06(f).

⁸ See Circular 26-24-3, Updates to Loan Repayment Relief for Borrowers Affected by COVID-19, (February 9, 2024), <https://www.benefits.va.gov/HOMELOANS/documents/circulars/>.

modifications,⁹ in addition to the **COVID-19 Refund Modification**, as described below. (IMPORTANT: If servicers are unable to offer COVID-19 Refund Modifications or the borrower has previously received a COVID-19 Refund Modification or Partial Claim payment, servicers should still review the loan under Step D and refer to the VA loan technician, as appropriate.)

7. COVID-19 Refund Modification. Under this type of loan modification, VA consents to the servicer's modification of a guaranteed loan and purchases a portion of a borrower's indebtedness from the servicer.¹⁰ The indebtedness is then secured as a junior lien in favor of VA. VA's junior lien does not accrue interest; does not require monthly payments; and only becomes due when the property is sold, the guaranteed loan is paid off, or the guaranteed loan is refinanced, whichever occurs first. This option can allow for significant reductions in a borrower's monthly payments, increasing the likelihood that the borrower will enjoy lasting homeownership. VA can purchase indebtedness up to 30 percent of a borrower's unpaid principal balance (UPB).¹¹ VA does not require a financial evaluation for every case. However, VA's purchase of unpaid principal is not a stand-alone option. Instead, VA only provides a partial loan refund alongside a servicer's loan modification, for which the servicer also receives VA's usual financial incentive for having completed a successful loan modification.¹²

a. Steps for Achieving Targeted Repayment Relief. The amount of VA assistance at Starting Point III corresponds to targeted outcomes. The servicer follows four steps (listed below) and determines whether the target outcome described by each step would be achieved. The servicer proceeds from one step to another only after determining a target outcome would not be achieved or the borrower indicates that the borrower cannot afford the proposed payment. (NOTE: Where appropriate, servicers should encourage borrowers to use Homeowner Assistance Fund (HAF) relief, if available, to assist with meeting any of the targeted outcomes.¹³)

(1) Step A (VA purchases arrearages up to 30 percent UPB, servicer modifies guaranteed loan): The servicer determines whether VA's purchase of the arrearages (up to 30 percent UPB) plus the servicer's modification of the guaranteed loan would achieve at least a 10 percent reduction in the borrower's monthly principal and interest (PI) payment. For any arrearages exceeding 30 percent of UPB, the servicer can either waive those amounts or include them in the modified loan amount, if affordable for the borrower. If this 10 percent reduction target is achievable, the servicer offers the COVID-19 Refund Modification.

(a) If the target is achievable but the borrower indicates the payment would still be unaffordable, the servicer proceeds to Step B.

⁹ See 38 U.S.C. § 3720(a)(2) ("Notwithstanding the provisions of any other law...the Secretary may...consent to the modification...of any note, contract, mortgage or other instrument..."); VA Servicer Handbook M26-4, Ch. 5.06 (listing modifications for which VA has already provided consent).

¹⁰ 38 U.S.C. §§ 3720(a)(2), 3720(a)(5), and 3732(a)(2).

¹¹ UPB means the unpaid principal balance on the date corresponding to the first day of the borrower's COVID-19 forbearance.

¹² See 38 C.F.R. § 36.4319.

¹³ HAF is the Homeowner Assistance Fund. For more information, visit <https://home.treasury.gov/policy-issues/coronavirus/assistance-for-state-local-and-tribal-governments/homeowner-assistance-fund>. See also National Council of State Housing Agencies website at <https://www.ncsha.org/homeowner-assistance-fund/>.

(b) Similarly, if the target is not achievable, the servicer proceeds to Step B.

(2) Step B (VA purchases arrearages plus additional principal, servicer modifies guaranteed loan): The servicer calculates whether VA's purchase of the arrearages plus some additional portion of principal would achieve a PI payment reduction of at least 10 percent but not greater than 25 percent. If the reduction target is achievable without exceeding the 30 percent UPB limit, the servicer offers the COVID-19 Refund Modification. In calculating the additional portion of principal to include in the COVID-19 Refund Payment, the servicer should work with the borrower to find an affordable target that meets the PI payment reduction target while minimizing the total amount of principal included in the COVID-19 Refund Payment. To identify an affordable target, servicers may ask borrowers the amount of monthly mortgage payment they can afford.

(a) If the reduction target is achievable, but the borrower indicates the modified monthly payment would still be unaffordable, the servicer proceeds to Step C.

(b) Similarly, if the reduction target is not achievable without exceeding the 30 percent UPB, the servicer proceeds to Step C.

(3) Step C (financial evaluation): The servicer completes a financial evaluation customary for a traditional loan modification and determines the borrower's gross monthly household income. Gross monthly household income is, for the purposes of the COVID-19 Home Retention Waterfall, the sum of all monthly income (before any deductions) from salary, employment, pensions, and any other form of regular compensation received by the borrower, the borrower's spouse who lives in the home securing the guaranteed loan, and all obligors on the guaranteed loan.

(a) The servicer then calculates whether the borrower's new monthly mortgage payment could correspond to 31 percent of the borrower's gross monthly household income, without causing VA's total purchase (of COVID-19 arrearages and principal) to exceed 30 percent of the UPB. The new monthly mortgage payment is the amount the borrower would owe each month on the modified loan, including amounts for principal, interest, property taxes, insurance, condominium fees, and homeowners' association fees (PITIA). If this outcome is achievable, the servicer offers the COVID-19 Refund Modification, regardless of the percentage by which such assistance would reduce the borrower's payment.

(b) If the outcome is not achievable, or if the outcome is achievable but the borrower indicates that the borrower cannot afford the payment, the servicer is to contact VA. See Step D.

(4) Step D (Contact with VA): The servicer submits to VA the loan information and the results of the financial evaluation collected during the Step C review. **The servicer is not to initiate foreclosure or alternatives to foreclosure at this point.** Rather, a VA loan technician reviews the file and attempts to work with the borrower and servicer to identify potential ways to help a borrower retain the borrower's home.

(a) VA has observed that, under the previous waterfall Circulars, servicers may not have fully understood Step D, and servicers may have begun foreclosure or offered alternatives to foreclosure (that is, deed-in-lieu of foreclosure or short sale) before VA had the opportunity to determine whether an option not specifically identified in the waterfall could help a borrower retain their home. VA's intended outcome, however, is that under Step D, VA will conduct an in-depth review of the loan. Depending on the results of VA's review, VA may, at VA's sole discretion, offer assistance that is tailored to the unique needs of the borrower. This assistance may include, but will not be limited to, the following:

i. VA may tailor thresholds set out above (i.e., in Steps A-C) based on the borrower's needs and likelihood of returning to normal repayment. In cases where a recasting of monthly loan payments is unnecessary to reach an affordable target, a loan modification may be unnecessary.

ii. VA may allow servicers additional flexibility to offer VA modification options. This may include a variation of the VA Disaster Extend Modification, which allows the borrower to retain their current interest rate.

iii. VA may instruct servicers to place the borrower on a special forbearance after determining the loan meets qualifying criteria for the upcoming VA Servicing Purchase (VASP) program. VA will provide additional guidance when VA releases the VASP program.

iv. VA may elect to exercise its loan refunding authority under 38 U.S.C. § 3732 and purchase a delinquent loan from the holder and assume primary servicing responsibilities.

(b) Servicers are to refer all loans, under Step D, to VA for review if there are no other home retention options available.

b. Terms of the Modified Guaranteed Loan.

(1) The modified loan is to bear a fixed-interest rate not exceeding the weekly Freddie Mac Primary Mortgage Market Survey Rate for 30-year fixed rate conforming mortgages, rounded to the nearest one-eighth of one percent (0.125 percent), as of the date the modification agreement is approved, plus 50 basis points. Servicers may offer an interest rate below the maximum allowable rate at their discretion.

(2) The servicer is to provide either for a—

(a) 360-month repayment schedule for the modified loan, as measured from the due date of the first installment required under the modification; or

(b) 480-month repayment schedule for the modified loan, as measured from the due date of the first installment required under the modification.

(3) With the modification, the servicer is to reinstate the guaranteed loan to current status, ensuring the guaranteed loan remains in first lien position.

(4) A trial payment plan (TPP) is NOT required.

c. COVID-19 Refund Modification Submission. Servicers are able to submit initial COVID-19 Refund Modification requests to VA through May 31, 2024. Resubmissions will be accepted through December 31, 2025.

d. COVID-19 Refund Payment. To aid servicers' implementation, the procedures for calculating the COVID-19 Refund Payment are the same as those outlined at 38 C.F.R. § 36.4805(e), EXCEPT:

(1) Any actual costs incurred, and legally chargeable, accumulated prior to March 1, 2020, may be included. All unpaid late fees will be waived and servicers shall not include any amounts (for example, fees, penalties, or interest) beyond the amounts scheduled or calculated as if the borrower made all contractual payments on time and in full under the terms of the guaranteed loan on or after March 1, 2020.

(2) The servicer may capitalize any arrearages exceeding the 30 percent UPB into the

modified loan.

e. Note and Security Instrument. To aid servicers' implementation, the procedures are the same as those under the COVID-VAPCP. All loan documents are to be fully executed not later than 120 days after the borrower exits the COVID-19 forbearance. Servicers can refer to 38 C.F.R. § 36.4806 for details on the preparation and execution of the note and security instrument and to 38 C.F.R. § 36.4807 for timeframes for requesting a COVID-19 Refund Payment and providing the executed note and security instrument to VA.

8. Paperwork Reduction Act. The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. § 3501-3520) and assigned OMB control numbers 2900-0021 and 2900-0889. In accordance with the Paperwork Reduction Act, VA may not conduct or sponsor, and a person is not required to respond, to a collection of information unless the collection displays a currently valid OMB control number.

9. Questions. Any questions regarding this Circular should be submitted via ServiceNow at <https://www.benefits.va.gov/HOMELOANS/contact.asp>.

10. Rescission. Circular 26-23-12 and Circular 26-23-12 Change 1 are immediately rescinded. This Circular is rescinded on June 1, 2024.

By Direction of the Under Secretary for Benefits

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