

COVID-19 Home Retention Waterfall and COVID-19 Refund Modification

1. **Purpose.** This Circular provides VA’s waterfall of home retention options for helping borrowers affected financially by the COVID-19 pandemic. This Circular also announces the COVID-19 Refund Modification, a type of loan modification specific to those borrowers needing payment reductions when exiting COVID-19 forbearance.

2. **Effective Date.** This Circular is effective on July 27, 2021.

3. **Background.** Current VA regulations outline a “preferred order of consideration” (that is, a hierarchy for review) for servicers to follow when evaluating borrowers for loss mitigation.¹ Generally, successful home retention options are, in VA’s preferred order, repayment plans, special forbearance, and loan modifications.² These options qualify for monetary incentives from VA.³ Options that are not incentivized are loan deferment and the COVID-19 Veterans Assistance Partial Claim Payment (COVID-VAPCP).⁴

a. Another home retention option (also not incentivized) is when VA, at VA’s discretion, purchases from a servicer a borrower’s outstanding indebtedness.⁵ This process is called a loan refund and is usually offered only as a last resort and only in limited circumstances.

b. To help servicers apply VA’s preferred order of home retention options when assisting borrowers affected by the COVID-19 pandemic, VA has developed the COVID-19 Home Retention Waterfall.⁶ Servicers are to follow this waterfall, choosing appropriate options based on borrowers’ self-assessment of their ability to resume regular payments on a VA-guaranteed loan⁷ and to repay amounts missed under a COVID-19 forbearance.⁸

4. **How This Circular Is Arranged.** Section 5 identifies the borrowers to whom the COVID-19 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 a new type of loan modification (the COVID-19 Refund Modification) to help borrowers who need significant financial assistance. In

¹ See 38 C.F.R. § 36.4319.

² See 38 C.F.R. § 36.4319.

³ See 38 C.F.R. § 36.4319.

⁴ See Circular 20-20-33, Deferment as a COVID-19 Loss Mitigation Option for CARES Act Forbearance Cases, (Sept. 14, 2020), https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_20_33.pdf; 38 C.F.R. § 36.4800, et seq. (effective July 27, 2021).

⁵ See 38 C.F.R. § 36.4320.

⁶ See Exhibit A for a pictorial representation of the waterfall.

⁷ VA-guaranteed loans are hereafter referred to as “guaranteed loans”.

⁸ 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.

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 is an infographic providing an at-a-glance pictorial of this Circular. Exhibit B offers a side-by-side comparison of the COVID-VAPCP and the COVID-19 Refund Modification explained in this Circular.

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 forbearance⁹. 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**,¹⁰ **loan deferment**,¹¹ or a **COVID-VAPCP**.¹² 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

⁹ Amounts the borrower missed under a COVID-19 forbearance are hereafter referred to as "arrearages".

¹⁰ See 38 C.F.R. § 36.4315(a); VA Servicer Handbook M26-4, Ch. 5.06(f).

¹¹ See VA Circular 26-20-33, Deferment as a COVID-19 Loss Mitigation Option for CARES Act Forbearance Cases, (Sept. 14, 2020), https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_20_33.pdf.

¹² Servicers must follow COVID-VAPCP requirements. See 86 FR 28692 (May 28, 2021) codified at 38 C.F.R. § 36.4800 et seq. For example, the COVID-VAPCP is only available if the borrower's guaranteed loan was current or less than 30 days past due as of March 1, 2020.

loan modification. Servicers can consider all of VA's existing loan modifications,¹³ in addition to a measure VA is calling the **COVID-19 Refund Modification**, as described below. Until now, VA's current procedures have not allowed servicers to offer similar terms and conditions without first obtaining VA approval. Through this Circular, however, VA now is providing parameters within which a servicer has VA's consent for offering the COVID-19 Refund Modification.

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.¹⁴ 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. It is like the COVID-VAPCP in that VA can purchase indebtedness up to 30 percent of a borrower's unpaid principal balance (UPB).¹⁵ Additionally, VA does not require a financial evaluation for every case. However, unlike the COVID-VAPCP, the COVID-19 Refund Modification is not a stand-alone option. Instead, VA provides a partial loan refund alongside a servicer's loan modification. Also, the servicer receives VA's usual financial incentive for having completed a successful loan modification.¹⁶

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: Servicers may use HAF relief, if available, to assist with meeting any of the targeted outcomes.¹⁷)

(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 20 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 20 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.

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

¹³ 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).

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

¹⁵ UPB means the unpaid principal balance on the date corresponding to the first day of the borrower's COVID-19 forbearance.

¹⁶ See 38 C.F.R. § 36.4319.

¹⁷ 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>.

(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 portion of principal would achieve a PI payment reduction of at least 20 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.

(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. 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. The servicer is not to initiate alternatives to foreclosure (that is, deed-in-lieu of foreclosure or compromise sale) until after this process is complete. The servicer is to proceed to foreclosure only if none of VA's home retention options and alternatives to foreclosure would work for a borrower.

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, and no more than 1 percent higher than the existing interest rate on the loan. 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) repayment schedule that extends for up to 120 months, as measured from the guaranteed loan's original maturity date (unless the original repayment term of the guaranteed loan was less than 360 months, in which case the modified loan's repayment schedule can extend to 480 months, as measured from the date on which the first installment on the guaranteed loan was due).

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

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

c. COVID-19 Refund Payment. To aid servicers' implementation, the procedures for calculating the COVID-19 Refund Payment is the same as that under the COVID-VAPCP, 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.

d. 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 (IC) 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 number 2900-0021 and the COVID-19 Refund Modification IC. 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 email to valerihelpdesk.vbaco@va.gov.

10. Rescission. This Circular is rescinded July 1, 2023.

By Direction of the Under Secretary for Benefits

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