1.09: Taxes and Insurance (02/94)

a. **Payment of Taxes.** Security instruments uniformly require the obligor to pay taxes timely to prevent a lien with priority over the mortgage. Failure to pay taxes timely must be reported to VA if it continues for 180 days (38 CFR 36.4315(a)(2)). Most security instruments require maintenance of an escrow account by the holder to ensure payments are timely. Since VA requires the holder to maintain the priority status of the mortgage lien (38 CFR 36.4325(b)(1)), internal controls should be in place to confirm payment of taxes by the holder or the borrower.

b. **Maintenance of Hazard Insurance.** (38 CFR 36.4326) It is the holder's responsibility to assure that insurance policies are maintained in an amount sufficient to protect the security against risks or hazards and to the extent customary in the locality. Questions about the insurance coverage should be referred to the VA regional office of jurisdiction. Subject to reasonable requirements of mortgagees, borrowers may choose their insurance carrier.

c. **Prohibitively High Premiums**

(1) Holders should not pay prohibitively high insurance premiums for force-placed coverage without prior approval of VA. If the hazard insurance is canceled (other than for nonpayment of premium) or renewal is refused, holders should attempt to obtain coverage through a State pool or otherwise. If coverage cannot be obtained except at prohibitive cost, the holder should promptly send VA the following information:

(a) The reason for cancellation or for the refusal to renew the coverage;

(b) The evidence of efforts made to obtain coverage and if obtainable, the lowest cost for such coverage;

(c) The amount and type of coverage of the policy being canceled or not renewed;

(d) The condition and current estimated value of the property improvements and the cost of any repairs required to obtain coverage;

(e) The current estimated value of the land; and,

(f) The current unpaid principal balance of the loan.

(2) Upon receipt of notification, VA will determine whether or not it is in VA's interest to give the holder assurance that a future claim under guaranty will not be adjusted for failure to maintain hazard insurance and advise the holder of the determination.

d. **Insurance During Loan Termination.** When a loan is being terminated and existing coverage has been canceled or renewal refused and the holder is unable to obtain hazard insurance except at high cost, the holder should advise VA. At the same time, the holder may request that VA not make a claim adjustment for failure to maintain hazard insurance in the event of an uninsured loss. Alternatively, the holder may choose to obtain high risk insurance rather than rely on receiving VA's assurance that a future claim would not be adjusted for failure to obtain hazard insurance. In such cases VA will partially reimburse the cost of high risk insurance in the claim. Reimbursement is based upon the portion of the premium attributable to coverage to the date of loan termination or to the date termination should have occurred (i.e., the cutoff date), whichever is earlier. The percentage of guaranty is then applied to this portion of the premium. The resulting amount is payable in the claim.

e. **Amount Required.** The amount of hazard insurance required is limited to the insurable value of the property or the current loan balance, whichever is less. The borrower may take out a larger policy if desired.

f. **Flood Insurance.** (38 CFR 36.4326) Flood insurance is required on loans closed on and after March 2, 1974, located in a special flood hazard area designated by HUD (Department of Housing and Urban

Development) where flood insurance is available under the National Flood Insurance Program. The amount of insurance should be the outstanding balance of the loan or the maximum limit of coverage available, whichever is less.

g. **Application of Loss Payments** (38 CFR 36.4326)

(1) All payments for insured losses must be applied to the restoration of the security or to the loan balance. (See par. 6.06d(2).) Any other disposition must be approved in advance by VA, unless there is a balance remaining after the security has been fully restored.

(2) Settlement of a total or near total loss case should be sufficient to restore the security. When it appears that settlement proceeds will not be sufficient to pay off the loan balance or to restore the security, holders should consult VA before consenting to an insurance settlement. The holder should send VA a copy of the claim adjuster's report giving a detailed breakdown of the damage sustained. VA will also inspect the property before any loss settlement and estimate the cost of repairs.

(3) If the settlement proceeds are not to be applied to the loan balance, VA can assist holders in obtaining the services of compliance inspectors, at the holder's or borrower's expense, to assure satisfactory restoration of the security.

(4) To minimize the possibility that a claim may be adjusted for failure to obtain an adequate loss settlement, holders are encouraged to advise VA as soon as a major loss has occurred and obtain VA's estimate of the cost of restoration before accepting a loss settlement. Holders should also be cautious about completing foreclosure while a loss is pending settlement because sale proceeds may affect settlement. In some jurisdictions, it may be possible to have a disputed settlement adjudicated as part of the foreclosure proceedings, but holders should keep VA advised of their efforts to settle a disputed loss claim.