Chapter 41 — CalVet loan contracts

This chapter discusses the CalVet loan program administered by the California Department of Veterans Affairs and documented by a hybridized lien without mortgage law protection.

Loan alternatives for veterans

The CalVet loan program, set up during World War II, offers loans to qualified veterans for:

- the purchase of farms, homes, condominiums or mobilehomes; and
- the construction of a home. [Calif. Military and Veterans Code §987.53(a), (b)]

A CalVet loan provides a veteran with an interest rate which is generally below market interest rates, low monthly payments and flexible credit standards, as compared to conventional financing, or loans insured by the Federal Housing Administration (FHA) or Veterans Administration (VA).

The CalVet loan program is administered by the California Department of Veterans Affairs. Mortgage companies certified by CalVet can originate CalVet loans directly with veterans. Money for the CalVet loan program is raised by the sale of California state general obligation bonds.

CalVet loans are available to *qualified veterans*, whether or not the veteran lived in California at the time the veteran entered active duty. [M & V C §980]

CalVet originates approximately 2,000 loans annually, ranging from 1,000 to 4,000 in any one year.

Qualifying for a CalVet loan

When negotiating the purchase of a home, a veteran seeking a CalVet loan submits an application to the California Department of Veterans Affairs (CalVet) or a direct mortgage lender certified by CalVet.

California residents who served and were honorably discharged, or honorably released from active duty, during World Wars I and II, the Korean Conflict and the Vietnam War, and citizens on active duty during Desert Storm and Operation Desert Shield or Operation Restore Hope in Somalia, are veterans who can qualify for a CalVet loan. [M & V C §980]

An unremarried surviving spouse of a veteran who lived in California for six months prior to entering active military duty can also qualify for a CalVet loan if the veteran:

- was killed in the line of duty;
- died after discharge from injuries incurred in the line of duty;
- is being held as a prisoner of war; or
- is designated as missing in action. [M & V C §987.58(b), (c)]

Once CalVet determines the veteran is eligible for a loan, CalVet must approve the farm or home the veteran is purchasing, or plans for any proposed residence to be constructed by the veteran. [M & V C §987.59]

A veteran who **already owns property** can obtain a CalVet loan to:

- complete the construction of a home on his property; or

- purchase a mobilehome to be placed on his property.

Additionally, a CalVet loan can be funded for the purchase of a mobilehome park space or share in a nonprofit corporation which has converted a rental park into a shareholder's resident-owned park or subdivision. [M & V C §987.85]

Variable interest rate creates uncertainty

The total debt created by a CalVet loan and the payment schedule set at the time the loan agreement is entered into is uncertain due to the variable interest rate (VIR) charged on the principal. However, the principal balance owed to CalVet is a fixed amount since the principal is not also subject to adjustments or negative amortization.

All CalVet loans are subject to the same interest rate and interest rate fluctuations, no matter when the loan was originated, unless the loan made was:

- a down payment loan permitted to low income veterans which is at a fixed rate and is secured by a second trust deed on the property [M & V C §987.71(h)]; and
- a purchase-assist loan made to purchase mobilehomes located in a mobilehome park, in which case, the interest rate is 1% higher than on all other CalVet loans. [M & V C §987.655]

The VIR on CalVet loans is not linked to an independent, nationally quoted index, as are adjustable rates on conventional or government insured Federal Housing Administration (FHA) or Veterans Administration (VA) loans. Instead, the CalVet interest rate is based on the rate the State of California pays on bonds it issues, a rate which itself varies due to the fiscal policies of the state government.

CalVet annually determines the interest rate adjustment to be paid on CalVet loans. The interest can be raised more than once during the course of a year if an additional rate increase is deemed necessary to maintain the solvency of the government managed CalVet loan fund, or to meet its obligations to bondholders. [M & V C §987.87(a)]

CalVet must give all its borrowers at least 90 days written notice before an increase in the interest rate and the installment payments can be effective. [M & V C §987.87(a), (b)]

Loan payments and PMI

The principal amount of a CalVet loan is referred to as CalVet's *acquisition cost* of the property minus any down payment paid by the veteran.

Approximately 35% of CalVet loans are guaranteed by the US Department of Veterans Affairs (VA). The remainder of CalVet loans are insured by a PMI policy from Radian. CalVet requires the veteran to pay a loan origination fee not to exceed 1% of the CalVet loan. The loan origination fee may be added to the loan amount. [M & V C §987.71(a)]

CalVet may waive the down payment and finance 100% of the price paid for the property by the veteran if the **appraisal** of the property sets the fair market value equal or greater than:

- the **acquisition cost**; plus
- 5%. [M & V C §987.71]

On loan amounts exceeding the 80% loan-to-value ratio (LTV) which are not guaranteed by the VA, CalVet requires private mortgage insurance (PMI). The premium for PMI is a one-time flat fee paid by the veteran.

The loan amount is evidenced by the **loan agreement** and paid in installments amortized over a term not to exceed 40 years for farms or homes and 30 years for mobilehomes. [M & V C § 987.71(b)]

The CalVet loan can be prepaid with any regularly scheduled monthly payment, in part or in full, without penalty. [M & V C §987.71(d)]

CalVet intervenes to take title

After a loan application is submitted to CalVet, the property is appraised to help CalVet determine whether the price agreed to by the veteran reflects the property's fair market value (FMV).

If the veteran qualifies for a CalVet loan, and the property and the price the veteran agreed to pay for the property are approved, CalVet will intervene in the sales transaction by becoming the purchaser of the property in lieu of the veteran.

CalVet, in a legally fictitious transaction, "resells" the property to the veteran by entering into a CalVet loan agreement with the veteran for the amount advanced by CalVet as purchase-assist financing. [M & V C §987.60]

CalVet's **acquisition cost** of the property is:

- the **purchase price** the veteran agreed to pay the seller under the purchase agreement; plus
- the **costs** incurred by CalVet to originate the loan and take title to the property, such as the costs of appraisal and title insurance. [M & V C §987.69]

CalVet, on funding the loan agreement, requires a California Land Title Association (CLTA) policy of title insurance on the loan. [M & V C §987.68]

The maximum purchase price for residential property, including condominiums, townhouses and mobilehomes, together with ownership of the land, is set as the maximum Fannie Mae loan limit for a single-family home. [M & V C §987.65(a)]

The maximum purchase price for a farm is 150% of the maximum amount set by Fannie Mae for a single-family home. [M & V C §987.65(d)]

The purchase price of a mobilehome located in a mobilehome park is limited to $125,000. Further, additional financing is available to a veteran who purchases a space in a mobilehome park which has been converted to a resident-owned park. [M & V C §987.65(b)]

If the purchase price agreed to in the purchase agreement exceeds CalVet's statutory limits, the veteran may pay the difference from his own funds. [M & V C §987.65(c)]

If the veteran is unable to pay the difference from his own funds, but is able to make a 10% cash down payment, he can place a second trust deed loan on the property, such as a seller carryback or private money loan. However, this is a risky position for the seller or lender since they will have to pay off the remaining balance on the CalVet loan if they foreclosure on their second trust deed.

Security device for a Cal-Vet loan

The security device used to place a lien on a property to secure a CalVet loan is not a mortgage or trust deed. The security device which documents the CalVet loan is statutory in origin and used exclusively for CalVet loans. The arrangement provides none of the protection given to owners under California mortgage law.

The veteran and CalVet enter into a loan agreement, called a *participation contract*, which is controlled by a statutory scheme unique to itself and separate from mortgage law. [M & V C §987.50 et seq.]

Under a CalVet **loan agreement**, CalVet takes legal title to the property as security for the veteran's performance on the loan agreement. The arrangement is similar but unrelated to a two-party land sales contract. [M & V C §987.69]

Like a seller who enters into a land sales contract, CalVet does not own the property. While CalVet holds legal title, the veteran is the *equitable owner* of the property and responsible for performing all ownership obligations, including payment of the debt owed to CalVet. While CalVet appears as the vested owner of record, CalVet is a lender with no obligation to comply with any ownership responsibilities. [**Cunningham** v. **Superior Court** (1998) 67 CA4th 743]

CalVet is owed only money. Thus, it merely has a lien against the veteran's property for the amount due on the loan agreement.

For example, a veteran pays off a CalVet loan he obtained to finance the purchase of his home.

On the payoff of the loan, CalVet "reconveys" its lien on the property by recording a grant deed transferring the title of the property to the veteran. Recording the grant deed to the veteran is a formality which clears record title of CalVet's lien on the property.

The veteran owns the property

Although CalVet holds legal title to the property, a veteran is the actual owner of the property. It is a title arrangement similar to a loan secured by a motor vehicle or a sale of real estate on a land sales contract. [M & V C §987.60(a)(3)(A)]

The CalVet loan agreement, similar in its content to care and maintenance provisions in a trust deed, requires the veteran to:

- maintain the property and keep it in good repair [M & V C §987.74(b)];
- pay the property taxes [**Eisley** v. **Mohan** (1948) 31 C2d 637]; and
- pay hazard insurance premiums.

If the veteran impairs the CalVet loan by failing to maintain the property or pay property taxes, CalVet may pay for maintenance and repairs it deems necessary and discharge any tax liens levied against the property. [M & V C §987.75]

Like a beneficiary relying on a future advances clause in a trust deed, CalVet may add the amount of funds expended to avoid impairment of the loan to the amount remaining due on the CalVet loan. The amount advanced by CalVet will bear the same rate of interest as the CalVet loan. Additionally, CalVet may demand the immediate payment of the funds advanced to maintain the property or pay property taxes.

In lieu of a demand for immediate repayment, CalVet may amortize repayment of the funds advanced under the loan agreement or accept repayment under a separate agreed to installment plan.

Occupancy until paid

A veteran or members of his immediate family must begin to reside on the property financed with a CalVet loan within 60 days from the date CalVet takes title to the property. The veteran or his immediate

Hazard insurance premiums

CalVet, not the veteran, selects the insurance company and purchases the hazard insurance for the property financed by the CalVet loan. Both CalVet and the veteran are named as the insureds on the policy. [M & V C §987.74(b)]

CalVet passes on to the veteran the cost of the insurance premiums it negotiates with the carrier. The veteran pays an upfront premium the first year. The premiums are prepaid with regularly scheduled monthly payments as an impound. The premium charged to the veteran must not exceed the actual cost of the policy to CalVet. [M & V C §987.74(a)]

The hazard insurance policy must cover full replacement costs and limited building code upgrades of the policy. [M & V C §987.74(a)]

On the renewal of a hazard insurance policy, CalVet assists the veteran in determining whether the insurance coverage is sufficient to repair or replace the damaged or destroyed dwelling, and if necessary, how to purchase additional coverage. [M & V C §987.74(c)]

Additionlly, CalVet sends the veteran an annual **disclosure notice** which describes:

- the type of insurance coverage;
- the limits of liability for the structure and improvements;
- the amount of any deductibles;
- whether the policy covers any increased costs due to changes in building ordinances or laws regulating construction or repair;
- the importance of having guaranteed replacement cost coverage; and
- whether the policy provides limited building code upgrade coverage, and applicable limits and restrictions. [M & V C §987.74(d)]

family members must continue to occupy the property at all times until the loan is paid in full. [M & V C §987.60(a)(2)]

CalVet may waive the occupancy requirement, one year at a time, if the veteran can demonstrate a good reason for being **unable to occupy** the property. No statutory guidelines exist for determining a good reason for vacating property. [M & V C §987.62]

Property subject to CalVet financing is not intended to be used as investment, rental or business property. Thus, the occupancy requirements restrict the owner to his continued occupancy, rendering him a sort of prisoner in his own home should he not be able to locate a cash buyer or need to relocate for job opportunities, reasons of health or family. [M & V C §987.62]

If the veteran re-enters active service, CalVet may waive the occupancy requirement for the duration of his service and a reasonable period following the completion of his service. CalVet may also consent to the leasing of the property during his period of service, but is not required to otherwise allow the veteran to rent the property in his absence due to job transfers or reasons of health. [M & V C §987.63]

Veteran's transfer of ownership

To sell or transfer ownership of real estate encumbered by a CalVet loan agreement, the veteran assigns the loan agreement to a buyer, and with it, the right to receive title clear of the CalVet lien on final payoff.

However, CalVet does not permit the assignment of its loan to a buyer of the property unless CalVet consents in writing for good cause shown. [M & V C §987.73]

CalVet does not allow a buyer to assume a CalVet loan. Even if the buyer is an eligible veteran, he will be required to originate a new CalVet loan as opposed to assuming the existing loan.

On the legal separation or divorce of a veteran and his spouse, the veteran can assign his ownership interest under the CalVet loan to his spouse.

Although the spouse receiving the ownership interest might not be a veteran, the loan is taken over at the same rate of interest and on the same terms and conditions provided to eligible veterans on CalVet loans.

On a divorce and transfer of the property to a nonveteran spouse, the veteran's spouse can assume a CalVet loan only when:

- the veteran's entire beneficial interest is transferred to the spouse;
- one or more of the veteran's dependent children reside on the property; and
- the spouse continues to live on the property and make payments on the loan agreement. [M & V C §987.721(a)]

Editor's note — A child legally adopted by the veteran is not considered a dependent child of the veteran for the purpose of meeting conditions of assignment for the veteran's divorced or legally separated spouse. [M & V C §987.721(a)]

If the veteran is an inpatient at a medical facility for more than the month of admission and is expected to remain in the facility for a full month more, called a *person in long-term care*, CalVet may consent to an assignment of the loan to the veteran's nonveteran spouse at the same rate of interest and on the same terms and conditions given to the veteran. [M & V C §987.73(c); Calif. Welfare and Institutions Code §14050.3]

The nonveteran spouse of a person in long-term care may assume the loan by assignment only if:

- CalVet is satisfied the veteran is adequately protected; or
- the assignment is pursuant to a court order issued at a hearing of which CalVet had at least 30 days prior notice. [M & V C §987.73(c)]

On the veteran's death, the veteran's rights under a CalVet loan are transferred to his heirs, devisees or personal representatives. A default on a CalVet loan by a successor to the veteran results in a forfeiture of the property to CalVet without the right of reinstatement or redemption of the property. [M & V C §987.82]

One CalVet loan at a time

A veteran or a veteran and his spouse may only own one farm or home purchased with a CalVet loan at any one time. [M & V C §987.86(b)]

For instance, a veteran sells his residence and uses the proceeds to pay off the CalVet loan encumbering the residence.

Can the veteran purchase another residence with a CalVet loan?

Yes! When the veteran sells his home and pays off the original CalVet loan, he can apply to CalVet for a second loan to buy another home. [M & V C §987.86(a)]

Constructing a home

CalVet financing is available to an eligible veteran for construction of a single family residence (SFR).

Veterans who already own a parcel of land can apply for a CalVet loan to construct a home on that land. The amount of the loan is determined by the Department's appraised value of the improvements to be constructed.

If the CalVet loan funds the purchase of vacant land and the construction of a home on that land, the amount of the CalVet loan is based on the appraised value of the land in addition to the improvements to be constructed. [M & V C §987.69]

When the veteran funds the down payment, CalVet will fund the costs of the improvements to be constructed in five progress payments. The progress payments are disbursed on the contractor's written request and CalVet's approval. [M & V C §987.69]

When CalVet funds the construction of a home, the veteran must obtain *course-of-construction* insurance for public liability, property damage and workers' compensation. [M & V C §987.60]

Default on a CalVet loan

The breach of a CalVet loan which allows CalVet to cancel the loan includes:

- failure to reside on the property without CalVet's consent [M & V C §987.62];
- any transfer of any interest in the property;
- an assignment of the CalVet loan;
- a further encumbrance of the property;
- leasing or renting the property to a tenant [M & V C §987.73(a)];
- late installment payments;
- failure to maintain the property [M & V C §987.74(b)]; and
- failure to pay property taxes and assessments. [M & V C §987.75]

However, the veteran is not prevented from transferring the property to a revocable inter vivos (living) trust for the benefit of the veteran or the veteran and his spouse. The transfer of ownership is accomplished by an assignment of the veteran's rights under the CalVet loan agreement to his living trust, called vesting the trust. [M & V C §987.73(b)]

Forfeiture on a default

Although a CalVet loan agreement is similar to a land sales contract, enforcement of a CalVet loan is more severe than a conventional land sales contract or any other security device, such as a mortgage or trust deed.

The CalVet loan program is enforced by a statutory scheme, overriding any ownership rights based on traditional principles of equity or mortgage law which apply to all other relationships between buyers and real estate lenders. [Department of Veterans Affairs v. Duerksen (1982) 138 CA3d 149]

Consider a veteran who purchases a residence with a CalVet loan. The CalVet loan agreement requires the veteran or members of his immediate family to occupy the property. [M & V C §987.60(a)(2)]

The loan agreement prohibits the veteran from selling, further encumbering or leasing the property unless:

- the loan is fully paid off by the veteran; or
- the veteran has obtained written consent from CalVet. [M & V C §987.73(a)]

Later, the veteran needs to sell his residence but is unable to locate a buyer who will pay off the CalVet loan.

However, the veteran finds a buyer willing to purchase the property on a wrap-around land sales contract, all-inclusive trust deed (AITD) or lease-option with the veteran remaining responsible for payment of the CalVet loan.

The veteran and buyer enter into a land sales contract without notifying CalVet and the buyer takes possession of the property.

> CalVet learns of the sale and calls the loan due, demanding full payment of the loan balance. If the loan is not paid in full, CalVet will seize the property and declare a forfeiture.

The veteran does not tender payment of the balance due. CalVet cancels the loan agreement and sues to quiet title to the property, called *strict foreclosure*.

The veteran claims the terms of the CalVet loan agreement are a violation of his right to redeem the property and are an unreasonable restraint on alienation in conflict with California's long-established protection of borrowers from forfeitures and due-on-sale enforcement.

Can CalVet force the veteran to forfeit his equity in the property through a **strict foreclosure** action since the veteran sold the property without CalVet's consent?

Yes! If the veteran **breaches any provision** in the loan agreement, CalVet, without making any demand for a payoff, can cancel the contract and be released from all obligations to:

- accept tender of a payoff; or
- convey legal title to the veteran. [M & V C §987.77]

When a veteran breaches a CalVet loan agreement, CalVet has the authority to seize the property and eject the occupants — the veteran, a buyer or a tenant — without incurring any liability for damages arising from entry or removal. [M & V C §987.77]

When CalVet seizes property on a default, the veteran (or his successor) **forfeits all equity** in the home, whether built up through the down payment, monthly payments, further improvements, regional appreciation or price inflation.

CalVet also keeps all payments the veteran made on the loan agreement as "rent" paid for occupancy of the property. [M & V C §987.77]

Unlike standard trust deed law, the veteran has no *reinstatement* or *redemption rights* should he default. However, CalVet may grant the veteran a 30-day grace period to cure the loan agreement breach, if the breach is curable, such as a monetary default rather than an alienation/transfer violation.

CalVet's failure to immediately cancel the loan and seize the property on their knowledge of a veteran's breach is not a waiver of CalVet's ability to forfeit and seize the property at a later time. [M & V C §987.77]

Editor's note: Veterans should be entitled to more certainty about their ownership rights, such as the certainty provided to nonveterans under trust deed law. Privatization of the CalVet loan program would accomplish this.