



Principal Reductions Guide & FAQs

Overview

The following Frequently Asked Questions (FAQs) are to help guide brokers and their customers with Principal Reductions.

Q1. What is a Principal Reduction?

Principal Reduction is an offset to a new loan amount, which is done at closing. Principal Reduction can be considered as a borrower payment towards principal, at closing.

Q2. Why is Principal Reduction required?

Principal Reduction is required due to Lender Credit (Line 802) exceeding max allowed closing costs charged to the borrower.

- On any Lender Paid Compensation loan, Lender Credit can never exceed all charges to borrower; meaning HUD Line 1400 can never be a credit.
- On any Borrower Paid Compensation loan, Lender Credit can never exceed all 3rd party fees charged to the borrower; meaning any fees brokers charge cannot be included to offset the Lender Credit.
- Regardless of Compensation Plan, POC items on the HUD are not a part of closing costs charges which may be used to offset Lender Credit.

Q3. Can Principal Reduction be done if “Cash To Borrower” exceeds maximum allowed amount?

No. Principal Reduction is allowed only if Lender Credit exceeds max allowed closing costs.

Q4. How does Principal Reduction Work?

Principal Reduction is set up as an offsetting charge on HUD Line 1300 to match the amount required. Since it is marked as a charge to the borrower – borrower’s “Cash to Close” goes up by that particular amount.

Q5. What does Principal Reduction mean to my borrower?

Principal Reduction lowers borrower’s unpaid principal balance. Once the loan is setup for servicing – a statement, which will be sent to borrower, will reflect a lower principal balance.

Q6. What is the maximum Principal Reduction allowed?

Interbank Mortgage Company’s policy states, Principal Reduction cannot exceed \$500. However, exceptions will be made on case-by-case basis.

Q7. What can be done to avoid Principal Reduction?

The following are some other ways which may possibly fix the issue with Excess Credit:

- Broker may lower the rate to reduce Lender Credit to Borrower.
- Broker may add an escrow account to offset excess Lender Credit to Borrower.
- Changing Compensation Plan from “Borrower Paid” to “Lender Paid” might benefit the borrower and may reduce amount of Principal Reduction.
 - Box 1 of the GFE may not increase during this transition.
- Paying a premium for insurance or tax installment in advance is not allowed if payments are not due at closing.