

Principal Reduction Guide FAQs

Overview

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

Q1. What is a Principal Reduction?

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

Q2. Why is a Principal Reduction required?

A Principal Reduction may be required in two (2) different scenarios:

1. The cash to the borrower exceeds the maximum allowed; or
2. Lender Credits in Section J exceed the maximum allowed closing costs charged to the borrower.
 - For any Lender Paid Compensation loan, the Lender Credit can never exceed the sum of all of the charges to the borrower; meaning Section J Lender Credits minus any cure amount must be less than or equal to the Closing Costs Subtotals (D+I) at the closing.
 - For any Borrower Paid Compensation loan, the Lender Credit can never exceed the sum of all of the 3rd party fees charged to the borrower; meaning any fees brokers charge cannot be included to offset the Lender Credit.

Regardless of the Compensation Plan, charges paid outside of closing (POC) by the broker on the Closing Disclosure are not a part of the closing costs which may be used to offset the Lender Credit.

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

Yes. A Principal Reduction is allowed up to maximum of \$2500 or 2% of the loan amount, whichever is lower. (Refer to [NewsBrief CI13-001REV Principal Curtailment Policy](#).)

Q4. How does a Principal Reduction Work?

A Principal Reduction is set up as an offsetting charge on the Closing Disclosure to match the amount required. Since it is marked as a charge to the borrower, the “Cash from Borrower” goes up by that particular amount and the borrower may need to bring additional funds to the closing.

Q5. What does a Principal Reduction mean to my borrower?

A Principal Reduction lowers the borrower’s unpaid principal balance. Once the loan is set up for servicing, a statement will be sent to the borrower that reflects the lower principal balance.

Principal Reduction Guide FAQs *(Cont.)*

Q6. What can be done to avoid Principal Reduction?

The following are some other ways which may possibly fix the issue with excess credit:

1. The broker may lower the rate to reduce the Lender Credit to Borrower.
2. The broker may add an escrow account to offset any excess Lender Credit to Borrower.

Please Note: Paying a premium for insurance or paying a tax installment in advance is not allowed if the payments are not due at the closing.