United States General Accounting Office 133230

GAO

Testimony

For Release
on Delivery
Expected at
10:00 a.m. EDT
Wednesday,
June 17, 1987

VA's Home Loan Guaranty Program

Statement of
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Before the
Committee on Veterans' Affairs
United States Senate

133230

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GAO/T-RCED-87-31

Mr. Chairman and Members of the Subcommittee:

We appreciate this opportunity to provide information on the Veterans Adminstration's (VA's) Home Loan Guaranty Program. As you are aware, on May 13, 1987, we testified on this program before the House Committee on Veterans' Affairs. On June 2, 1987, you requested that we provide a written statement on the information we obtained in performing our work for the House Committee. Specifically, you asked us to

-- determine the impact of the Deficit Reduction Act of 1984 on the program,

-- evaluate VA's servicing of defaulted loans, and

-- determine whether VA's property acquisition and disposition process can be improved to reduce program costs.

In summary, our review to date indicates that based on its implementation of the act, VA has reduced its losses by leaving more properties with lenders. However, the debt of veterans who default on their loans has increased.

The extent of servicing (loan counseling and financial assistance) provided to veterans varied among the offices we visited and none of the offices voluntarily notified veterans of all the financial assistance options available to cure their defaulted loans. Some offices said they did not have adequate staff to provide effective assistance and our review shows that VA does not have a system to determine the number of delinquent loans that can be effectively handled by its servicing technicians.

We found that VA can improve its acquisition practices to reduce losses by avoiding unnecessary delays in acquiring property, encouraging additional bidding at foreclosure sales, and reducing the costs of obtaining title policies on acquired property. In fiscal year 1986, VA sold nearly 25,000 acquired properties at a loss of about $356 million.

To accomplish our review objectives, we conducted interviews with loan guaranty officials at seven VA regional offices and at VA headquarters. The VA offices we visited included Portland, Seattle, Denver, Detroit, Houston, Pittsburgh, and Philadelphia. We also reviewed property management and loan servicing records and files and met with Federal Housing Administration (FHA) officials and mortgage bankers to discuss their foreclosure practices. Before discussing our tentative findings, let me briefly highlight the VA program and its associated foreclosure processes.

BACKGROUND

The VA Home Loan Guaranty Program was established by The Serviceman's Readjustment Act of 1944 to assist returning veterans in obtaining housing as compensation for the lost opportunity experienced during their period of military service. The VA is authorized to aid the veteran in obtaining a home by requiring no down payment, providing low interest rates, and guaranteeing the home loan. The current amount of guaranty is limited to the lesser of $27,500 or 60 percent of the loan amount. As of September 30, 1986, VA had guaranteed about 11.8 million home loans since the inception of the program and about 4.1 million loans were outstanding.

According to VA, in fiscal year 1986 about 74 percent of the 351,242 loans guaranteed that year were made without a down payment from the veteran purchaser. These no down payment loans had an average purchase price and loan amount of about $66,100. For those veterans who obtained loans with a down payment, the purchase price averaged about $92,000 with an average loan amount of about

$80,500. Thus, these veteran purchasers made a down payment of about $11,500 or about 12.5 percent of the purchase price.

During fiscal year 1986, lenders foreclosed on over 33,000 VA-guaranteed loans. (See exhibit I.) When a veteran defaults on a loan, VA must decide whether to acquire the property. Prior to the Deficit Reduction Act of 1984, VA, in making this decision, was not required to include certain post-acquisition costs, including repairs, maintenance, security, and taxes. The act, however, required VA to include these costs and limit its losses to the guaranty amount. If VA determines its losses would be more than the guaranty, it simply pays the guaranty and leaves the property with the lender. If VA decides to acquire the property, it attempts to purchase the property for the minimal cost, prepare and list the property for sale as quickly as possible, and sell the property for the best possible price. Mr. Chairman, now I will discuss the effects of the Deficit Reduction Act.

EFFECTS OF THE DEFICIT REDUCTION ACT OF 1984

Our review shows that VA's implementation of the Deficit Reduction Act has resulted in an increase in the debt of veterans who default on their loans. VA calculates the veteran's debt based on the amount of indebtedness the veteran owes the lender, minus the estimated net value of the veteran's property. The act required post-acquisition costs to be included in VA's acquisition decision, and their inclusion has the effect of reducing the net value of the veteran's property. VA also includes these post-acquisition costs in calculating the Veteran's debt, and this has resulted in an average increase of $2,700 in the veteran's debt.

The act has also resulted in an increase in properties left with lenders. In fiscal year 1986, VA left 5,236 properties with lenders, an increase of 3,735 over the number left in fiscal year 1984. (See exhibit II.)

The results of a Mortgage Bankers Association survey showed that the average loss on properties left with lenders was about $16,500 during fiscal year 1986. Data provided by VA showed that it anticipated transferring an average loss of $3,750 on property it did not acquire. (See exhibit III.) In asking the Mortgage Bankers Association about this difference, we were told that its estimated losses were not based on a scientific sample and included interest costs that VA does not include in its calculation. Further, our analysis of the Association's data showed that the average value of sampled properties included in the survey was about $43,000 higher than the average value of properties on which VA based its estimate. The higher valued properties generally have a greater potential for loss to the lenders because of the limit on VA's guarantee.

MORTGAGE SERVICING

Under VA's Home Loan Guaranty Program, mortgage lenders are required to service their VA loans by providing veterans with adequate opportunity to avoid foreclosure. However, the lender reports the delinquency to VA once the veteran has failed to make three payments on the mortgage loan. VA then takes an active role in protecting the financial interests of the veteran and the government by attempting to cure the delinquency.

We found that the extent of loan servicing varies widely among VA's regional offices. For example, in two of the offices we visited, attempts were made to contact each veteran to determine whether a loan repayment plan could be developed to cure the delinquency. At three of the other offices, however, we were told that the number of staff was inadequate to effectively contact, counsel, and assist the large number of veterans having delinquent loans. Based on the scope and objectives of our review of VA's servicing system, we were not able to determine whether there is a statistical correlation between the contacts made by VA offices and the cure rate on delinquent loans. However, at the VA offices we visited, we noted that those which had the highest rate of personal contact also had the highest cure rates. (See exhibit V.)

The number of delinquent loans handled by servicing technicians at the offices we visited ranged from 400 to 1500 loans. VA does not have a system to determine the number of delinquent loans that can be effectively handled by its servicing technicians.

According to VA regional officials, they encourage veterans to reach agreement with lenders on how to cure the loans. However, VA usually does not provide information on financial assistance options which VA can provide, unless the veteran is aware of and requests information on these options. VA's financial assistance options include (1) encouraging the lender to reduce the interest rate of the loan, (2) refunding the loan, and (3) assisting the veteran to avoid foreclosure by selling the property. We were told by the Assistant Director for Loan Management that VA has not informed veterans of the latter two options because they might not attempt to cure their loans by reaching repayment agreements with mortgage lenders.

Reducing the interest rate

Many of VA's delinquent loans were made during the high interest rate period of 1982 to 1984. Therefore, an option that VA can sometimes use to cure loans is to encourage the lender to refinance the loans at lower interest rates. Refinancing would provide some veterans with a lower monthly payment, thus increasing their likelihood of staying in the home. However, the VA is not contacting all veterans with delinquent loans to make an assessment on the feasibility of refinancing; accordingly, this option is not being fully utilized.

Refunding

When lenders will not refinance delinquent loans, VA may pay the lender the outstanding loan amount as an option to foreclosure, enabling the veteran to keep the property. VA then "refunds" the loan and establishes a repayment plan based on the veteran's ability to repay the loan. In effect, VA assumes the role of the lender.

The average cost avoidance possible through refunding in fiscal year 1986 was $14,400 per property. This is based on the average amount of loss that VA incurred on the sale of acquired properties. Our analysis shows that the cost avoidance from one successful refunded loan would be sufficient to offset the additional foreclosure costs to refund six loans that subsequently fail. (See exhibit IV.) According to VA's Assistant Director of Loan Management, refunding has been successful in about 50 percent of the cases in which it has been used. Nonetheless, during fiscal year 1986, VA refunded only one mortgage for every 129 foreclosures.

Assisting veterans to sell their homes

As an alternative to foreclosure, veterans may sell their homes and pay their outstanding loan balances. However, they sometimes need financial assistance to do this because the proceeds from the sale are not adequate to pay both the outstanding loan balance and the selling expenses. VA has a program under which it may provide, in exchange for a promissory note from the veteran, the financial assistance necessary to enable the veteran to sell the property. VA provides this assistance when it believes it is cost effective to do so because the veteran can obtain the fair market value for the property and VA can avoid foreclosure costs.

Again, however, VA does not generally inform veterans that this option is available to them.

VA's ACQUISITION AND DISPOSITION PROCESS

When VA decides that it is in the best interests of the government to acquire a property, it should minimize its acquisition costs. In fiscal year 1986, VA lost an average of about $14,400 on the properties it sold. Our review indicates that VA can reduce its losses by (1) seeking to obtain more "voluntary deeds" from veterans in lieu of lengthy and expensive foreclosure actions, (2) encouraging more competitive "third party" bidding at foreclosure sales, and (3) reducing its costs for title insurance policies when it acquires property from lenders.

Voluntary deed in lieu of foreclosure

Voluntary deed conveyance is an expeditious means of terminating a delinquent loan. The veteran voluntarily conveys the property deed and is released from liability to repay the government for any claim VA pays as a result of the loan termination. In so doing, the foreclosure process is avoided and VA is able to acquire the property more quickly and avoid costs, including interest, taxes, and legal expenses.

In fiscal year 1985, VA acquired about 7 percent of its properties by voluntary deed. A report issued in September 1986 by the VA Inspector General estimated that, by more aggressively seeking deeds in lieu of foreclosure, VA could have acquired about 20 percent of the properties through voluntary deeds during fiscal year 1985. The Inspector General estimated that this would have saved VA about $16 million in acquisition costs, or about $5,300 per property.

We found that VA acquired only about 6 percent of properties through voluntary deeds during fiscal year 1986. In performing our review, we noted that VA generally does not accept a voluntary deed if it believes that it can collect from the veteran the amount of the claim VA pays the lender as a result of the loan termination. However, at one of the offices we visited, voluntary deeds were accepted if veterans were willing to sign a promissory note to repay the claim. VA should determine whether it is feasible to use this practice in other offices as a means for reducing the debt of veterans and avoiding the considerable expenses associated with foreclosures.

Third-party bidding

VA's acquisition costs could potentially be reduced if more third parties (individuals other than lenders) made successful bids at foreclosure sales. When third parties purchase the property, VA pays the lender the difference between the total indebtedness and the bid price, and avoids both acquisition and post-acquisition costs. We noted, however, that only about 5 percent of foreclosed properties were acquired by third parties during fiscal year 1986.

To increase third party bidding, VA could establish a minimum bid amount that reflects the net amount that VA expects to realize on the sale of property. We found that the minimum bid amount, which is based on the appraised amount less post-acquisition costs, often exceeds the net amount VA realizes when it sells the property. For example, we noted that in fiscal year 1986 the average appraisal amount per property was about 8.5 percent higher than the average selling price per property. This difference could then be factored into each office's determination of the minimum bid amount to encourage third-party bidding.

Title insurance

When VA acquires property, it requires lenders to provide it with assurance of good and marketable title to the property. In April 1986 VA instructed its field offices to obtain title insurance policies from title companies, rather than continuing to analyze title documentation to assure that lenders were providing good and marketable title.

VA decided to obtain title insurance policies, which generally cost several hundred dollars each, because it believed their use would expedite the property-acquisition process. Based on our review, however, title policies have not reduced the time needed to complete the acquisition process. Now, VA officials are considering eliminating the requirement for title insurance policies since they are not achieving their anticipated purpose of expediting property acquisitions.

We concur with VA's decision to reconsider whether to require the purchase of title policies. Further, in the event that VA decides to continue purchasing the policies, it could still reduce its costs by purchasing them for the lowest possible cost. For example, the minimum title policy in Pennsylvania costs $263 for $15,000 worth of insurance. However, in fiscal year 1986, VA insured the average property in Pennsylvania for $27,000, the appraised value of the property, at a cost of $353.

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In closing, Mr. Chairman, we would like to reemphasize that VA's Home Loan Guaranty Program is experiencing a large number of foreclosures. The foreclosure process is costly for VA, the veteran, and sometimes the lender, particularly in depressed housing markets. Since the Deficit Reduction Act of 1984 has been implemented, VA appears to have accomplished the broad intent of the act by minimizing its losses within the guaranty amount. However, the losses of lenders who participate in the program and the average debt of veterans who default on their loans have increased. To help reduce these costs, more emphasis should be placed on servicing to prevent foreclosure. Once foreclosure is evident, VA should try to minimize the cost of acquisition.

Mr. Chairman, I have highlighted some areas in which VA can improve its Home Loan Guaranty Program based on our preliminary findings, and this concludes my prepared remarks. We are planning to complete our work and issue a report to the Chairman of the House Veterans' Affairs Committee containing our conclusions on the areas we have discussed. Mr. Chairman, I will be happy to respond to any questions you may have.

EXHIBIT I

VA FORECLOSURE ACTIONS AND LOSSES

	FY 1984	FY 1985	FY 1986
Number of foreclosures	23,377	27,276	33,022
Number of voluntary conveyances	2,178	1,728	1,620
Number of properties left with lenders	1,501	3,059	5,236
Number of refundings	565	635	256
Average loss on acquired property	$10,784	$14,715	$14,391
Average loss[a]	$11,136	$15,216	$15,258

[a]Includes claims paid by VA for properties left with lenders.

Source: Prepared by the General Accounting Office using VA data, May 1987

EXHIBIT II

VA FORECLOSURE ACTIONS AND NUMBER OF PROPERTIES LEFT WITH LENDERS

Fiscal year	Foreclosure actions[a]	Number of properties left with lenders	Number of properties left as percentage of total foreclosure actions
1981	13,729	358	2.61
1982	17,071	238	1.39
1983	23,349	689	2.95
1984	25,555	1,501	5.87
1985	29,004	3,059	10.55
1986	34,642	5,236	15.11

[a]Includes voluntary conveyances

Source: Prepared by the General Accounting Office using VA data, May 1987

EXHIBIT III

EXAMPLE OF DECISION TO LEAVE THE PROPERTY WITH THE LENDER AND PAY THE GUARANTY

Total indebtedness		$93,900
Appraised value	$70,000	
Minus holding costs @ 10.5%	7,350	
Estimated net VA value		62,650
Loss		$31,250
Maximum VA guaranty amount		27,500
Loss transferred to lender		$ 3,750

Because the estimated loss of $31,250 is more than the maximum guaranty amount of $27,500, VA would not acquire this property. If VA had acquired the property, it would lose $3,750 above the guaranty amount. By not acquiring the property, VA transfers the $3,750 loss to the lender.

EXHIBIT IV

ANALYSIS OF THE INCREMENTAL COST ASSOCIATED WITH A REFUNDING FAILURE

Average monthly payment of a refunded loan		$544 [a]
Average number of months between default and the lender's notice of intention to foreclose	3.4	
Refunding decision period (months)	1.0	
Total[b]		4.4 months
Average loss if a refunded mortgage failed (4.4 x $544)		$ 2,394
Average foreclosure loss on property acquired in fiscal year 1986		$14,391
Success-to-failure ratio ($14,391 to $2,394)		1 to 6

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[a] Average acquisition value in fiscal year 1986 ($53,883) at 9 1/2 percent for 30 years and the average monthly tax payment.

[b] According to the provisions of 38 C.F.R. 36.4318 the refunding decision should be made within 30 days after the lender has notified VA of its intention to foreclose or unless other arrangements have been made with the lender.

EXHIBIT V

PERSONAL CONTACT AND CURE RATE

VA office	Period	Personal contact rate[b] (percent)	Cure rate (percent)
Philadelphia	Oct. 85--Dec. 86	83	89.2
Pittsburgh	Jan. 86--June 86 & Oct. 86--Dec. 86[a]	66[c]	31.0
Detroit	Oct. 85--Sep. 86	76	77.8
Portland	Oct. 85--Dec. 86	70	68.8
Denver	Apr. 86--Mar. 87	61	65.5
Seattle	Oct. 85--June 86 & Oct. 86--Dec. 86[a]	60	60.0
Houston	Oct. 85--Sep. 86	33	54.5

[a]Data was not available for July through September 1986.

[b]Telephone, financial counseling, field visit or office visit.

[c]Our review showed that VA's Pittsburgh Office was attempting to personally contact each delinquent homeowner. However, according to the loan servicing supervisor, the personal contact rate indicated above should have been much higher because one servicing technician was not coding his contacts into the computer system.

Source: Prepared by the General Accounting Office using VA data, May 1987