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VA's Home Loan Guaranty Program

Statement of
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Subcommittee on Housing and
Memorial Affairs
Committee on Veterans' Affairs
House of Representatives

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Madam Chairwoman and Members of the Subcommittee:

Thank you for this opportunity to appear before you to discuss the Veterans Administration's (VA's) Home Loan Guaranty Program. As you are aware, in recent years there has been a large increase in foreclosures nationally--reportedly, a 100 percent increase over the past 7 years. In some parts of the country, the rate has increased several-fold. As a result, both private mortgage insurers and federal mortgage insurers, including VA, began to experience increased claims against their insurance funds. For example, in fiscal year 1987 VA had over 42,000 foreclosures and lost about $465 million on the sale of its foreclosed properties, up from 33,000 foreclosures and losses of $356 million in fiscal year 1986.

Thus, on September 29, 1987, the Chairman of the Veterans Affairs Committee asked GAO to review several aspects of VA's home loan guaranty program, including activities related to loan servicing, property management, and debt collection, as well as the characteristics of the loans contained in VA's portfolio and VA's future plans for selling them. Our work in each of these areas is continuing. As agreed, my remarks today are focused on issues related to VA's servicing of defaulted guaranteed loans. Specifically, they address

- VA's servicing requirements for lenders and how VA monitors lenders' servicing activities;
- how VA's supplemental servicing activities can be improved; and
- the adequacy of VA staffing to provide effective servicing.

In summary, when a VA-guaranteed loan becomes delinquent, VA requires lenders to contact the veteran to determine the reason for the delinquency and to work with the veteran in solving the problem. VA has a system for monitoring the lender's servicing activities, however, our review to date indicates that VA officials believe that the lender monitoring system could be improved by conducting on-site audits of lender servicing activities. Further, even though VA has recently emphasized to its regional offices the use of foreclosure alternatives--refunding, compromise sales, and deed in lieu of foreclosure--our review shows that VA has not yet extensively used these alternatives. Although foreclosure alternatives have the potential to substantially reduce VA's losses, at the VA offices we contacted, alternatives were used in only about 2.5 percent of the foreclosure cases. VA could better ensure that its foreclosure costs are being held to a minimum by requiring that a least cost analysis of its foreclosure alternatives be prepared and documented for each foreclosure case. Finally, based on interviews with representatives of the VA regional offices, VA's staffing is reportedly inadequate to effectively contact, counsel, and assist the large number of veterans having delinquent loans.

The large increase in claims over the past few years has prompted private mortgage insurers (PMIs)[1] to work more directly with borrowers in developing financial plans to determine the best solutions for curing delinquencies. In addition, lenders told us that the PMIs are more helpful in resolving delinquencies partially because they get involved about 30 days earlier in the foreclosure process than VA. PMI officials told us that their

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[1]To contrast VA's servicing practices with those of the private sector, we visited four PMIs that collectively insure over 70 percent of all conventional mortgages. To evaluate VA's servicing of defaulted loans, we reviewed VA's servicing regulations and procedures, contacted officials at VA headquarters and nine VA regional offices, and visited the top 10 lenders that had the highest number of VA loan foreclosures in fiscal year 1986. We also met with officials at the Office of Management and Budget, the Congressional Budget Office, the National Association of Realtors, and the Mortgage Bankers Association.

companies conduct on-site reviews of the lender's servicing activities, and actively assist the homeowners in selling their homes to prevent foreclosure.

BACKGROUND

Under VA's servicing framework for guaranteed home loans, the lender is required to provide the primary servicing of defaulted loans. VA requires the lender to contact the veteran to determine the reason for the default and to work with the veteran in solving the default. After the veteran misses three monthly installments, however, the lender must report the default to VA. Once notified, VA is required to perform supplemental servicing to protect the interests of the veteran and the government. VA's supplemental servicing activities include reviewing the lender's servicing efforts, contacting the veteran to offer financial counseling and/or financial assistance, and interceding with the lender on behalf of the veteran to obtain forbearance or other financial solutions.

LENDER SERVICING

Under the VA home loan program, for the first 3 months of a delinquency, lenders are responsible for servicing the loan by providing veterans with adequate opportunities to avoid foreclosure. They are to do this by contacting the veteran and providing financial counseling aimed at developing a repayment plan to solve the delinquency before the veteran misses additional mortgage payments and goes deeper in debt. According to loan servicing supervisors at the VA offices we contacted, lenders do not always make personal contact with and provide financial counseling to delinquent homeowners to resolve mortgage delinquencies. Some VA officials told us that they frequently must contact lenders to encourage them to reach agreement with veterans on repayment plans.

VA has a system for monitoring lenders' servicing activities. Basically, the system is designed to measure the completeness and timeliness of the default and intent to foreclose notices provided to VA by the lender and includes a review of the lender's description of the services provided to the veteran. We found that some PMIs will conduct on-site reviews of the lender's servicing files, and some VA officials we contacted said that on-site reviews of lenders could improve VA's current monitoring system. In this regard, the recent VA Task Force on Debt Prevention concluded that VA's monitoring of lenders is not sufficient to ensure that lenders provide veterans with effective servicing. The task force recommended that VA initiate on-site audits to identify lenders that are not meeting their responsibilities for contacting and counseling veterans and working with them in developing repayment plans.

VA SERVICING ACTIVITIES

If a lender's activities are not successful in curing a loan delinquency on a VA-guaranteed loan, VA can use three financial assistance alternatives to prevent a foreclosure. These alternatives are (1) refunding the loan, (2) assisting the veteran to avoid foreclosure by selling the property, and (3) accepting the borrower's voluntary conveyance of the property deed. In testimony before this Subcommittee in May 1987,[2] we pointed out that VA was not taking full advantage of these alternatives. Based on our ongoing work, opportunities still exist for VA to reduce the costs of foreclosure by more aggressively seeking alternatives to foreclosure. Generally, these alternatives will either avoid or decrease the losses experienced on the sale of foreclosed properties. (See exhibit I.) Although foreclosures increased by about 9,000 cases in fiscal year 1987, VA used these alternatives

[2]VA's Home Loan Guaranty Program, GAO/T-RCED-87-24, May 13, 1987.

to foreclosure fewer times than it did during fiscal year 1986. (See exhibits II and III.)

I would now like to discuss briefly the status of each of the foreclosure alternatives, based on our audit work to date.

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.

As we testified last May, our analysis showed 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.) Nonetheless, our audit shows that although VA had more than 75,000 foreclosures during the past two fiscal years, only 473 loans--less than 1 percent--were refunded.

In doing our work, we found that PMIs will refund mortgages. They also have other programs to assist homeowners in keeping their property. In this regard, the PMIs will lend money to delinquent borrowers to enable them to reinstate their loans if the PMIs believe that with the financial assistance the borrowers will be able to meet their current and future mortgage obligations.

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, known as the compromise sales program, under which it may provide the financial assistance necessary to enable the veteran to sell the property. VA provides this assistance when it believes that 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.

During the past year, VA has publicized the compromise sales program because of its potential to reduce foreclosure costs, which averaged about $15,817 per property that VA sold during fiscal year 1987. (See exhibit V.) Nonetheless, our work shows that VA used the alternative in fewer than 1 percent of the fiscal year 1987 foreclosure cases at the nine offices we visited.

PMIs have similar programs to assist delinquent borrowers in avoiding foreclosure by selling their homes and, based on our discussions with the PMIs, they generally make frequent use of these programs. For example, one of the PMIs we interviewed told us that about 30 percent of its claims are settled through its home sales assistance program.

Voluntary conveyance of
deed in lieu of foreclosure

Voluntary conveyance of the property deed 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, VA avoids the foreclosure process and is able to acquire the property more quickly and avoid costs, including interest, taxes, and legal expenses.

In September 1986 the VA Inspector General reported that VA could have saved about $16 million in fiscal year 1985 acquisition costs if it acquired more properties through voluntary conveyances of the property deed. Since that time, however, a smaller percentage of properties has been acquired under this alternative. For example, during fiscal year 1987, VA acquired 1,287 properties through voluntary conveyances--about 3 percent of all foreclosure cases in fiscal year 1987 and a 20-percent reduction from the prior year.

Based on our discussions with representatives of the VA offices we visited, the offices do not generally seek to obtain voluntary conveyances of the property deed, primarily because they want to hold the veteran accountable for the amount of the claim that VA pays the lender as a result of the loan termination. Our review of VA's debt collection performance shows, however, that VA typically collects only about 14 percent of the debt from veterans.

Further, in our May 1987 testimony, we pointed out that VA should determine whether it is feasible to accept voluntary conveyances of the deed based on a veteran's willingness to sign a promissory note to repay the debt. Recently, VA has encouraged its offices to accept the deeds with a promissory note, as appropriate, based on the advice of the regional VA District Counsels. Our ongoing work indicates that PMIs also will accept a deed in lieu with a promissary note, particularly in states that have a very long foreclosure process.

LEAST COST ANALYSIS NEEDED FOR EACH POTENTIAL FORECLOSURE

As we reported in our May 1987 testimony, VA offices generally did not provide information on VA foreclosure alternatives unless the veteran was aware of and requested information on them. In December 1987 the Congress passed the "Veterans Home Loan Program

Improvements and Property Rehabilitation Act of 1987," which now requires VA to provide information to defaulting veterans on the alternatives to foreclosure. This requirement should encourage more contact between VA and veterans, which could increase the use of the alternatives to foreclosure.

However, our work shows that VA regional offices have a great deal of latitude in determining how to deal with delinquencies and that no procedures are in place requiring VA offices to analyze and document a least cost approach for addressing these delinquencies. Although VA maintains that its offices consider foreclosure alternatives in handling each default, VA has not developed and documented a least cost analysis that compares the cost of the various alternatives. Such an analysis should consider the cost of the various foreclosure alternatives, including the government's interest costs and the probability of collecting any deficiency from the veteran.

If VA prepared and documented such an analysis it would promote accountability and a more systematic approach to servicing. To illustrate, we developed an analysis and applied it to the typical VA guaranteed loan in default in King County, Washington, using cost data and assumptions provided by the VA Seattle Regional Office. (See exhibit VI.) Our analysis shows that the cost savings from the use of the different alternatives could range from about $12,500 to about $21,000 per foreclosure in that county. Our purpose for conducting this analysis was to demonstrate that each foreclosure alternative has a cost associated with it, and that the savings associated with selecting the most appropriate alternative can significantly reduce VA's overall foreclosure costs.

VA STAFFING

The VA Task Force on Debt Prevention found that VA's current staffing level was insufficient to contact defaulting veterans and recommended that funds be made available to hire fee personnel. Further, some regional VA officials we interviewed said that VA does not have adequate staff to effectively service its loans. The Director of the Loan Guaranty Program said that the cost to hire fee personnel to conduct servicing would be minimal compared to the projected savings. In this regard, he said that a 2 percent increase in the VA rate of curing delinquent loans would reduce foreclosures and the related losses by about $55 million.

Training is an additional area that VA could address in its efforts to upgrade its servicing capabilities. Only two of the nine offices we visited had a formal training program for its loan servicing personnel. Although VA headquarters recently began developing a training film, no ongoing VA-wide training program exists to instruct servicing personnel on a systematic approach to servicing to prevent foreclosure. The VA task force recommended that such a program be established.

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In closing, Madam Chairwoman, I would like to say that VA has recognized the seriousness of its foreclosure problem and has begun to take actions to emphasize some of its foreclosure alternatives and established the Task Force on Debt Prevention, to deal more effectively with the problem. In many cases, foreclosures are unavoidable and VA will continue to experience losses as will others in the mortgage insurance business. Nonetheless, through effective servicing and financial assistance, VA potentially can alleviate many delinquencies and reduce and/or avoid foreclosure costs through the use of foreclosure alternatives.

This concludes my prepared remarks. I welcome the opportunity to respond to any questions you or members of the Subcommittee may have.

EXHIBIT I

EFFECT OF VA FORECLOSURE ALTERNATIVES ON THE FACTORS CONTRIBUTING TO VA'S FISCAL YEAR 1987 PER-PROPERTY LOSS OF $15,817

		Effect by Program on Foreclosure Costs		
	Foreclosure costs	Refunding program	Compromise sales program	Deed-in-lieu program
Average Acquisition Cost Unpaid mortgage principal Delinquency amount Foreclosure expenses	$55,710	Decrease cost	Avoid cost[a]	Decrease costs[b]
Post-Acquisition Cost Taxes Special assessments Maintenance expenses Sales expenses Other expenses	$ 5,253	Avoid cost	Avoid cost	Same as forclosure
Loss on Sale of Foreclosed Properties	$15,817	Avoid loss	Avoid loss	Decrease loss

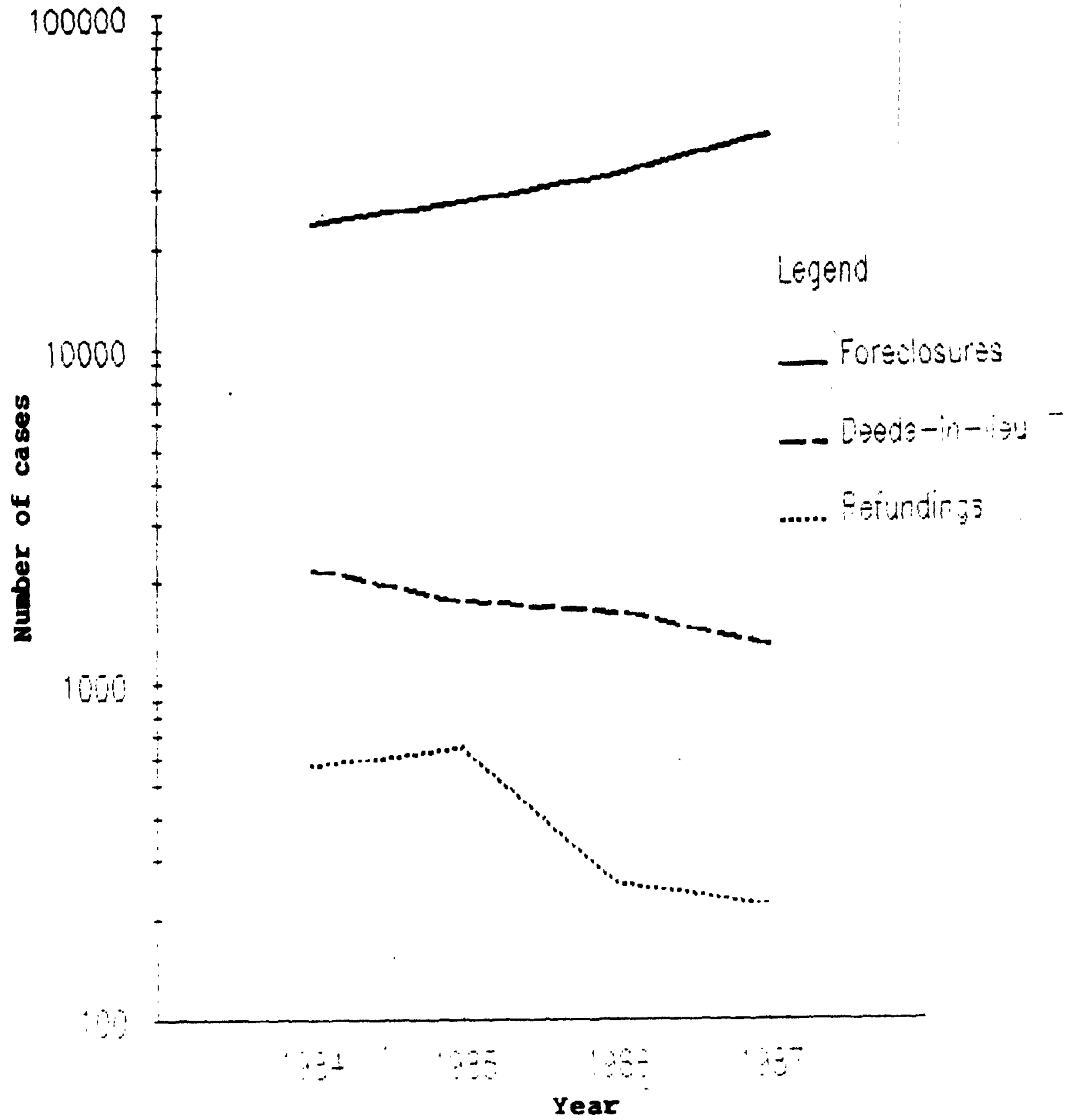
[a]On a compromise sale, VA does not acquire the property; however, VA does provide to the veteran the funds necessary to complete the sale. The amount provided is the difference between the amount the veteran receives from the sale and the amount the veteran needs to complete the sales transaction. (e.g., real estate broker fees and settlement costs.)

[b]VA still has to acquire the property, however, the cost to acquire is less because a deed in lieu of foreclosure is more expedient in states that have long foreclosure processes. Therefore, it reduces the delinquency amount and VA does not incur the foreclosure cost.

Source: Prepared by the General Accounting Office using VA data, March 1988.

EXHIBIT II

VA Use of Foreclosure Alternatives Compared to Foreclosures



The scale of this chart is not in equal increments.

Source: Prepared by the General Accounting Office using VA data, March 1988.

EXHIBIT III
VA FORECLOSURE ACTIONS AND LOSSES

	FY 1984	FY 1985	FY 1986	FY 1987
Number of foreclosures	23,377	27,276	33,022	42,029
Number of refundings	565	635	256	217
Number of compromise sales	unknown[a]	unknown	unknown	unknown
Number of voluntary conveyances	2,178	1,728	1,620	1,287
Average loss on acquired property	$10,784	$14,715	$14,391	$15,817

[a]VA had not developed a system to account for the number of compromise sales as of the end of fiscal year 1987.

Source: Prepared by the General Accounting Office using VA data, March 1988.

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 of a refunded mortgage failure (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

[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.

Source: Prepared by the General Accounting Office using VA data, March 1988.

EXHIBIT V

ANALYSIS OF VA'S FISCAL YEAR 1987 LOSSES ON SALE OF FORECLOSED PROPERTIES

		Average per property		Total on all properties sold (millions)
Cost to Acquire Properties		$55,710		$1,637
Post Acquisition Cost				
(1) Taxes	$ 744		$22	
(2) Special Assess.	55		1	
(3) Maintenance	802		24	
(4) Sales Expenses	2,506		74	
(5) Other Expenses	1,146	5,253	34	155
Total Cost to Acq. & Sell		$60,963		$1,792
Less Selling Price		(45,146)		(1,327)
Loss on Sale of Foreclosed Properties		$15,817		$ 465

Source: Prepared by the General Accounting Office using VA data, March 1988.

EXHIBIT VI

Comparison of Estimated VA Costs on VA Foreclosure Alternatives and Foreclosure for the Typical Property in King County, Washington

Compromise sale	$13,313
Deed-in-lieu	$20,247
Refunding	$21,392
Foreclosure	$34,063

Source: Prepared by the General Accounting Office using data gathered from VA's Seattle Regional Office, March 1988.

Two major factors included in our analysis, which VA does not consider, are: (1) VA's imputed interest cost for the period it owns the acquired property and (2) the probability of collecting the debt assessed the veteran based on VA's historical debt collection experience.