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Report to the Chairman, Committee on Veterans' Affairs, House of Representatives

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HOUSING PROGRAMS

VA Can Reduce Its Guaranteed Home Loan Foreclosure Costs

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Resources, Community, and
Economic Development Division

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July 12, 1989

The Honorable G. V. (Sonny) Montgomery
Chairman, Committee on Veterans' Affairs

House of Representatives

Dear Mr. Chairman:

This report discusses ways that the Department of Veterans Affairs can further reduce guaranteed home loan foreclosure losses under its Home Loan Guaranty Program. The report contains several recommendations to the Secretary of Veterans Affairs.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time we will send copies of the report to the Secretary, Department of Veterans Affairs; appropriate congressional committees; and the Director, Office of Management and Budget. We will also make copies available to others upon request.

This work was done under the direction of John M. Ols, Jr., Director, Housing and Community Development Issues, (202) 275-5525. Other major contributors are listed in appendix V.

Sincerely yours,

J. Dexter Peach
Assistant Comptroller General

Executive Summary

Purpose

Foreclosure actions on Department of Veterans Affairs (VA) home loans increased from 13,729 in fiscal year 1981 to 43,316 in fiscal year 1987. Related losses to VA rose from about $51 million to about $615 million in the same period. In view of the increasing foreclosure actions and related losses by VA under its Home Loan Guaranty Program, the Congress enacted provisions of the Deficit Reduction Act of 1984 to reduce losses associated with foreclosure actions. The Chairman, House Committee on Veterans' Affairs, requested GAO to review certain aspects of VA's home loan program to determine

- the effect of requirements on VA's Home Loan Guaranty Program, established by the Deficit Reduction Act of 1984, limiting VA's estimated loss per foreclosed property to the amount of the guaranty on each property and increasing the percentage of foreclosed properties that VA sells for cash and
- whether VA's property acquisition and disposition process could be improved to reduce program costs.

Background

Under the Home Loan Guaranty Program, VA is authorized to aid the veteran in obtaining a home by guaranteeing the mortgage loan. The amount of the guaranty depends on the loan amount. For loans of $45,000 or less, VA guarantees 50 percent of the loan amount. For loans greater than $45,000, VA guarantees the greater of $22,500 or 40 percent of the loan amount, up to a maximum of $36,000.

The Deficit Reduction Act required VA, in deciding whether to pay the guaranty on defaulted loans or acquire the property, to limit its estimated loss to the amount of the guaranty. If VA's estimated loss from acquiring and selling the property is less than its guaranty, VA acquires and resells the property. If the estimated loss exceeds the amount of the guaranty, VA pays the guaranty and leaves the property with the lender.

The act also intended to provide immediate revenue for the Home Loan Guaranty Program by requiring VA to sell more of its acquired properties for cash rather than financing the sale of the homes. The act specifically required VA to sell at least 25 percent, but not more than 40 percent, of its acquired properties for cash. The Congress has since required VA to sell at least 35 percent, but not more than 50 percent, of its acquired properties for cash. The remainder of the properties are to be sold with VA financing the buyer's mortgage loan.

Results in Brief

As required by the Deficit Reduction Act, VA has limited its estimated loss on home loans to the amount of the loan guaranty. As a result, the percentage of cases in which VA pays the guaranty and leaves the property with the lender has substantially increased. However, losses can be further reduced if VA, in deciding how to satisfy its guaranty, considers the interest costs associated with holding properties in its inventory before selling them. By adding these costs to its loss estimate, VA would acquire even fewer properties, resulting in cost savings by leaving more properties with lenders.

VA also has achieved the cash sales requirement of the Deficit Reduction Act by (1) using incentives, such as cash discounts and (2) always giving preference to cash offers equal to or greater than 90 percent of the property's listed price over noncash offers (offers based on VA's providing the financing). VA is currently studying the cost-effectiveness of the incentives it uses to achieve cash sales. GAO believes that VA should also study whether it would be appropriate, on a case-by-case basis, to accept offers financed by VA when they exceed the listed price rather than always giving preference to cash offers that are for 90 percent or more of the listed price.

Additional opportunities exist for improving VA's property acquisition and disposition process. These opportunities include (1) encouraging more competitive bidding by third parties at foreclosure sales and (2) reducing the cost associated with purchasing property title insurance policies.

Principal Findings

Opportunities for Cost Reduction

Although VA has met the requirements of the Deficit Reduction Act by limiting its estimated loss to the guaranty amount, VA does not, in estimating its loss, include the interest costs of holding property in inventory until the property is sold. On the basis of an analysis performed by VA's Inspector General, GAO estimates that, if VA had considered interest costs in fiscal year 1987, it would have reduced costs by approximately $16.6 million. GAO further estimates that by recognizing interest costs and not acquiring additional properties VA can also avoid the losses it incurs from a reduction in property value before the property is sold and from cash discounts it offers to resell the property. GAO estimates that during fiscal year 1987 VA could have reduced its losses from such declines in property value and discounts by about $25 million.

Need to Expand Cash Sales Study

In disposing of acquired properties, VA may either sell the properties for cash or finance loans that the buyers repay to VA. Advantages exist for VA when it sells property for cash. Cash sales provide immediate revenue for VA's loan guaranty fund, and VA has no exposure to future loan defaults. Prior to passage of the Deficit Reduction Act, VA sold about 5 percent of its acquired properties for cash. Under the act, however, cash sales have increased significantly, representing 34 percent of sales in fiscal year 1987.

To increase cash sales, VA generally accepts cash offers over offers based on VA financing. Specifically, under its current policy, VA gives preference to cash offers that are equal to or greater than 90 percent of the property's listed price. While cash sales have benefits, cases may occur where these benefits would be more than offset when buyers are willing to pay more than the listed price for properties if VA finances the mortgage loan. VA could consider such noncash offers on a case-by-case basis and still implement its overall requirement to sell between 35 percent and 50 percent of its properties for cash. It could also examine the appropriateness of accepting such noncash offers in its current cash sales incentives study.

More Economical Property Acquisition and Disposition Practices Needed

VA can improve its property acquisition procedures by promoting more competitive bidding by third parties (individuals other than the lender) for properties at foreclosure sales. VA can promote such bidding by establishing a minimum amount for lenders to bid that reflects VA's acquisition and disposition costs, including cash discounts. Third party bidding at foreclosure sales is advantageous to VA because, when third parties purchase VA-insured property, VA does not have to use its resources to hold and resell the property and VA avoids substantial depreciation costs on the properties. In fiscal year 1987 only about 5 percent of foreclosed VA-guaranteed loans were acquired by third parties during foreclosure sales.

For those cases in which VA has acquired the property, VA can reduce the costs associated with purchasing title insurance policies on foreclosed properties. VA buys these policies to accelerate the disposition process, and less expensive policies would serve this purpose.

Recommendations

To ensure that VA's property acquisition and disposition procedures result in the best financial interests of the government, GAO recommends that the Secretary of Veterans Affairs take the following actions:

- Consider the interest costs associated with acquiring and disposing of properties when deciding on whether to leave properties with lenders.
- Determine the cost-effectiveness of VA's policy of always giving preference to qualified cash offers over noncash offers requiring VA financing as part of VA's study on cash sale incentives.

GAO makes other recommendations in this report to reduce the costs of the loan guaranty program by improving VA's property acquisition and disposition process. (See ch. 3.)

Agency Comments

VA concurred with GAO's recommendations to consider interest costs in acquisition decisions and to study VA's cash preference policy (see app. IV). VA's comments on GAO's other recommendations to reduce the costs of the loan guaranty program by improving VA's property acquisition and disposition process, along with GAO's responses, are discussed in chapter 3.

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GAO	General Accounting Office
VA	Department of Veterans Affairs

Introduction

Unless a borrower can pay cash for a home, he or she must borrow to finance the difference between the purchase price and the down payment. The amount of the funds borrowed is referred to as a mortgage loan. The home is used as the collateral for the mortgage loan, which is typically repaid in monthly installments, generally over a 30-year period. The originator of the loan is usually a bank, savings and loan association, mortgage company, mortgage banker, or insurance company.

Background

Lenders generally require borrowers of home mortgages to obtain mortgage insurance if the down payment is less than 20 percent of the property's value. If the borrower qualifies, this insurance can be obtained from private mortgage insurers, the Department of Veterans Affairs (VA), or the Department of Housing and Urban Development. The insurance protects the lender against some or all of the losses if the borrower defaults.

Foreclosure is a legal procedure to cause a transfer of property ownership from the borrower to the lender or a third party to satisfy the mortgage debt after the borrower has defaulted. Generally, the final step of the foreclosure process is the foreclosure sale, which is conducted by the local jurisdiction. At the foreclosure sale lenders and other individuals (known as third parties) are allowed to bid on the property. In most cases the lender who holds the loan is the successful bidder. Some states, however, have laws requiring a redemption period, during which the homeowner has the right to reacquire the property upon payment of the lender's outstanding claim. Expiration of the redemption period is the final step in those states. The length of the redemption period ranges among states from a few days to 1 year after the foreclosure sale.

VA Operation of the Home Loan Guaranty Program

The VA Home Loan Guaranty Program was established by the Servicemen's Readjustment Act of 1944 to assist returning veterans in obtaining housing as compensation for the lost opportunity to accumulate savings or establish a credit rating during their period of military service. The VA is authorized to aid the veteran in obtaining a home mortgage with no down payment by guaranteeing the mortgage loan. From October 1980 to January 1988, VA's maximum guaranty was the lesser of $27,500 or 60 percent of the amount of the loan. As of February 1988, under the Veterans' Home Loan Program Improvements and Property Rehabilitation Act of 1987, the amount of the guaranty is limited to 50 percent of the loan amount for loans that are $45,000 or less.

For loans over $45,000 the guaranty is limited to 40 percent of the loan amount, except that the guaranty cannot be less than $22,500 or more than $36,000. As of September 30, 1987, VA had guaranteed a total of about 12 million home loans, of which about 4 million were outstanding.

If VA-guaranteed mortgages are in default for more than 3 months, the lender may notify VA of the lender's intention to foreclose. At this point several things can occur. First, the veteran may sell the home to avoid foreclosure. If the veteran does not sell, the lender may foreclose or obtain a deed-in-lieu of foreclosure. Under a deed-in-lieu of foreclosure, the veteran gives up all rights to the property and transfers title to the lender.

If the veteran does not sell the home or the lender does not obtain a deed-in-lieu of foreclosure, VA has two options for satisfying its guarantee: (1) it can pay the lender the amount of the guaranty and leave the property with the lender or (2) VA can purchase the property from the lender after the lender forecloses on it, thereby reimbursing the lender for its losses on the loan. However, under the latter option, if a third party acquires the property at the foreclosure sale, the bid amount of the third party is deducted from the total indebtedness owed to the lender by the veteran. VA then compensates the lender for the difference between the amount of the bid and the total indebtedness owed to the lender and has no further involvement with the property. (See app. I for a description of the loan default and foreclosure process for VA home loans.)

Under VA regulations a veteran who defaults on a VA-guaranteed loan becomes indebted to the government for the amount of the guaranty that is paid to the lender.

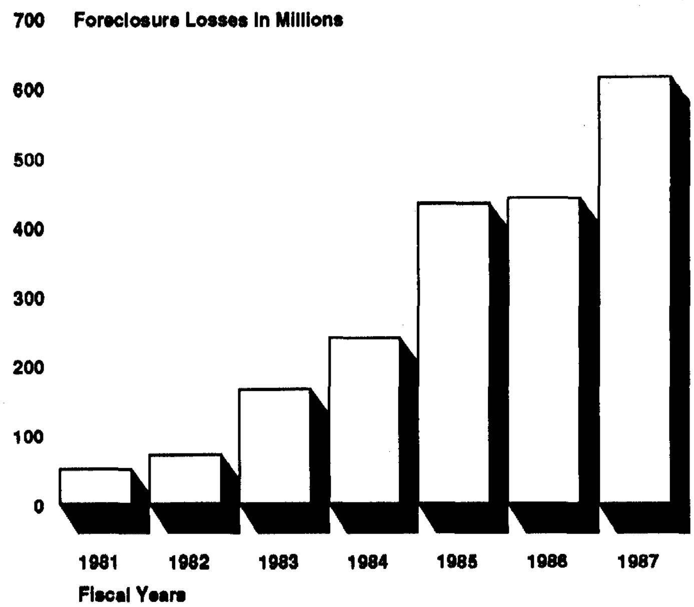
Funding for the loan guaranty program is provided through the Loan Guaranty Revolving Fund. Income for the fund is derived primarily from the sale of foreclosed properties that VA has acquired and from VA's collection of a funding fee of 1 percent of the loan amount from (1) veterans who obtain VA-guaranteed housing loans and (2) parties who obtain "vendee" loans. Vendee loans are direct loans that VA makes to individuals to finance the sale of properties that VA has acquired after the foreclosure sale. VA also obtains income for the revolving fund by selling vendee loans to investors.

The expenses incurred by the loan guaranty fund result primarily from VA's (1) acquiring foreclosed properties from lenders and (2) paying the guaranty on foreclosed loans and leaving the properties with lenders.

Losses Have Increased

Foreclosure actions (foreclosures and voluntary conveyances of the property by the borrower to avoid foreclosure) and related losses have risen substantially since fiscal year 1981. For example, foreclosure actions increased over 215 percent from 13,729 cases in fiscal year 1981 to 43,316 cases in fiscal year 1987. Losses in this same period rose from about $51 million in fiscal year 1981 to about $615 million in fiscal year 1987. (See fig. 1.1.)

Figure 1.1: VA Home Loan Guaranty Program Foreclosure Action Losses



Foreclosure losses are based on the amount of the guaranty paid or, for acquired properties, the amount that VA receives when it sells the properties less VA's costs to acquire, manage, and dispose of the properties, except for normal internal program administrative costs. The increase in losses in recent years resulted primarily from a large number of foreclosures on mortgage loans guaranteed by VA. Regions whose economies were closely tied to the energy industry were affected the most. States having the largest number of VA foreclosures in fiscal year 1987 included Texas, Colorado, Oklahoma, California, and Ohio.

Foreclosures are not only costly to VA, but they also are costly for veterans and, sometimes, the lender. In most cases, after veterans lose their homes by foreclosure, they remain indebted to VA, sometimes for as much as the amount of the total guaranty on the loan. Likewise, lenders incur losses when the amount of the loss on the loan exceeds the amount of the VA guaranty and VA decides to pay the guaranty rather than acquire the property. According to a December 1986 study by the Mortgage Bankers Association, members of the association lost about $86 million on VA-guaranteed loans during fiscal year 1986.

Provisions of the Deficit Reduction Act Intended to Reduce Losses and Increase Revenue

In view of increasing foreclosures on VA-guaranteed loans, the Congress enacted provisions of the Deficit Reduction Act of 1984 to reduce losses to the Home Loan Guaranty Fund. The act required VA to limit its total loss to the amount of its guaranty on the loan.

Prior to the act, VA's losses sometimes exceeded the guaranty amount because VA incurred additional costs, such as maintenance costs, after it had acquired the property from the lender. In this regard, in deciding whether to accept conveyance of foreclosed property or leave it with the lender and pay the guaranty, historically VA considered the acquisition costs it would incur including the (1) unpaid amounts of the mortgage principal, interest, taxes, and insurance, and (2) foreclosure expenses including attorney, advertising, and title costs. Excluded from consideration were postacquisition costs such as repairs, maintenance, security, taxes, and resale costs. In enacting the Deficit Reduction Act, the Congress required VA to consider these previously excluded postacquisition costs in determining whether to acquire foreclosed property.

After computing the total estimated costs of acquiring and disposing of property on the basis of above cost factors, VA determines the net potential loss on the property by subtracting from the appraised value of the property the total estimated acquisition and postacquisition costs. VA then decides whether it will (1) acquire the property from the lender after the lender forecloses on it, thereby reimbursing the lender for its losses on the loan or (2) pay the guaranty and leave the property with the lender, as shown in table 1.1.

Table 1.1: Acquisition Decision

Situation	Decision
The guaranty is greater than the estimated net loss.	VA will acquire the property rather than pay the guaranty.
The guaranty is less than the estimated net loss.	VA leaves the property with the lender and pays the guaranty.

The Deficit Reduction Act also was intended to increase revenue for the Home Loan Guaranty Fund. To increase revenue for the fund, the Deficit Reduction Act required VA to sell at least 25 percent, but not more than 40 percent, of its acquired properties for cash, which is deposited in the fund. The remainder of the acquired properties were to be sold with VA providing financing for the loan and the purchaser making subsequent monthly payments to the Home Loan Guaranty Fund.

Objectives, Scope, and Methodology

The Chairman, House Committee on Veterans' Affairs, requested that we review selected aspects of VA's Home Loan Guaranty Program. In subsequent discussions with the Chairman's office, we agreed to determine

- the effect of requirements on VA's Home Loan Guaranty Program, established by the Deficit Reduction Act of 1984, that limited VA's estimated loss per foreclosed property to the amount of the guaranty on each property and increased the percentage of acquired properties that VA sells for cash and
- whether VA's property acquisition and disposition process can be improved to reduce program costs.

To determine the effect of the requirements on the Home Loan Guaranty Program established by the Deficit Reduction Act, we used VA's Liquidation and Claims System data to identify the potential additional losses that VA would have experienced if it had accepted properties that, under the act, VA was required to leave with lenders. We reviewed VA procedures and regulations concerning the property acquisition decision process and discussed these procedures and regulations with officials of the VA Home Loan Guaranty Program, the Mortgage Bankers Association, and a number of judgmentally selected mortgage lenders. We also reviewed VA procedures and regulations concerning property sales and discussed them with VA Home Loan Guaranty Program officials. To evaluate VA's property acquisition and disposition process, we reviewed VA regulations and procedures and property files and discussed the process with VA field and headquarters officials.

We also assessed the controls applicable to the acquisition and disposition process, to the extent necessary, as determined by the audit objectives. Our limited testing of these controls did not identify any fraudulent activities in the acquisition and disposition procedures reviewed to meet our objectives.

In conducting our review, we interviewed officials at the VA offices located in Denver, Colorado; Detroit, Michigan; Houston, Texas; Philadelphia and Pittsburgh, Pennsylvania; Portland, Oregon; and Seattle, Washington. These offices, selected to provide geographical coverage, accounted for about one-third of VA's foreclosures during fiscal years 1986 and 1987.

The computerized information used in this report came from VA's Liquidation and Claims System. We tested the validity and reliability of this data base at the Philadelphia and Pittsburgh VA offices. We randomly selected and reviewed 81 case files and compared the data in the file with the computerized data. Our test indicated that VA's computer system is reliable; however, this testing was insufficient to render an opinion on the entire system. Nevertheless, VA Home Loan Guaranty Program officials told us that they believe the data presented in this report are representative of foreclosure cases.

Our review, conducted between June 1987 and August 1988, was made in accordance with generally accepted government auditing standards.

Impact of the Deficit Reduction Act and Opportunities for Additional Cost Reduction

The Deficit Reduction Act of 1984 required VA to limit its loss on each loan to the amount of VA's loan guaranty. VA has met this requirement. However, total losses can be further reduced if VA, in determining whether to acquire foreclosed properties or leave them with lenders, considers the interest costs associated with holding the properties in VA's inventory before selling them. These are the costs to the government measured by the interest it would have to pay if it were necessary to borrow the funds needed for the particular acquisition. This cost, which increases the estimated loss, continues to be incurred until the property is sold, should be considered as part of the total estimated cost when VA is determining whether to acquire properties or leave them with lenders.

The Deficit Reduction Act also required VA to sell at least 25 percent, but not more than 40 percent, of its acquired properties for cash when disposing of the properties. In disposing of properties, VA may either sell the properties for cash or finance loans on which the purchasers make monthly payments to VA over the period covered by the loan agreement. To encourage cash purchase offers, VA accepts offers that are equal to or greater than 90 percent of the property's listed price. In effect, VA offers up to a 10-percent discount for cash offers and gives preference to such offers, even though a buyer may be willing to pay a premium (higher than the listed price) for the property with VA financing. While benefits are associated with selling properties for cash, such as immediate revenue for VA's loan guaranty fund, sometimes these benefits may be more than offset by offers based on VA financing when the buyer is willing to pay more than the listed price. VA is currently studying the cost-effectiveness of its cash-sale incentives. We believe that VA should examine the costs associated with its policy of always giving preference to cash offers as part of that study.

VA Has Increased the Number of Properties Left With Lenders

One of the provisions of the Deficit Reduction Act requires VA, in deciding whether to acquire a property, to consider its costs and limit its losses to the amount of the guaranty. The act specifically identified certain postacquisition costs to be considered, including repairs, taxes, maintenance, and selling expenses.

VA issued regulations to comply with the Deficit Reduction Act, thereby limiting its losses to the amount of its guaranty. As shown in table 2.1, since the Deficit Reduction Act was implemented in fiscal year 1985, the number of cases in which VA has decided to pay the guaranty and leave the properties with lenders has substantially increased—rising from less than 3 percent of all foreclosure actions during fiscal year 1981 to 21 percent in fiscal year 1987.

Table 2.1: Total Foreclosure Actions and Number of Properties VA Left With Lenders

Fiscal year	Total foreclosure actions[a]	Properties left with lenders	Properties left with lenders as a percentage of total liquidations
1981	13,729	358	2.6
1982	17,071	238	1.4
1983	23,349	689	3.0
1984	25,555	1,501	5.9
1985	29,004	3,059	10.5
1986	34,642	5,236	15.1
1987	43,316	9,097	21.0

[a]Foreclosures and voluntary conveyances of the property by the borrower.

Recognizing Interest Costs in Acquisition Decisions Would Further Reduce VA Losses and Budgetary Requirements

In its acquisition decisions, VA does not consider the interest costs to the government associated with holding properties in VA's inventory until the properties are sold. If these costs were considered, in fiscal year 1987 VA would have acquired fewer properties, resulting in the following:

- Estimated cost savings to the federal government of $41.6 million due to a reduction in interest costs; property depreciation (a reduction in property value) costs; and cash discounts associated with acquiring, holding, and reselling the properties.
- Reduced expenditures of an estimated $128 million needed to acquire foreclosed properties. While not an additional cost savings, such reduced expenditures would, in the first year of implementation, provide benefits by reducing the federal deficit and the amount of congressional appropriations needed to operate VA's home loan program. In subsequent years, however, this benefit would be largely offset by a similar reduction in revenues from VA's property sales.

In September 30, 1986, the VA Inspector General recommended that in deciding whether to acquire property, VA should consider interest costs associated with holding property in inventory. The Inspector General estimated that a total of 3,516 properties, or about 14 percent of the properties that VA acquired during fiscal year 1985, would not have been acquired if interest costs had been considered in VA's acquisition decision process. VA loan guaranty program officials told us that they do not believe that VA has legal authority to recognize interest costs in determining whether to acquire property. In addition, according to these officials, if VA were to include interest in its acquisition decisions, under VA's regulations these costs would result in an increase in the debt established against the foreclosed veteran.

We believe, while the Deficit Reduction Act does not require VA to include interest costs in its acquisition decisions, the act does not preclude VA from doing so. Further, in our opinion, VA is not legally obligated to increase the debt of the veteran as a result of including interest in its acquisition decisions. Thus, any decision to charge these costs to veterans would be based on agency discretion, not legal obligation.

Achieving Cost Savings by Leaving More Properties With Lenders

As discussed in chapter 1, if VA's estimated loss on a foreclosed property is less than its guaranty, VA acquires and resells the property. If the estimated loss exceeds the amount of the guaranty, VA pays the guaranty and leaves the property with the lender. Recognizing the interest costs associated with acquiring and holding properties in inventory would increase VA's estimate of the loss from such action and consequently would result in more cases in which VA pays the guaranty and leaves the property with the lender. An example of the impact that recognizing interest costs could have on VA's calculation of the total costs of acquiring a property is shown in appendix II.

The VA Inspector General's September 30, 1986, report estimated that, for fiscal year 1985, savings of about $13 million could have been achieved by the government if interest costs had been considered in VA's acquisition decision-making process and additional properties were left with the lenders. In calculating the $13 million savings, the Inspector General reviewed fiscal year 1985 acquisitions in seven VA offices and determined the number of such properties that, when interest costs were added to the loss figure, resulted in a loss greater than the guaranty. The Inspector General estimated that 14 percent of the acquisitions would not have been acquired if interest costs were included in VA's acquisition decision. The average dollar savings per property would have been $3,715, according to the Inspector General's estimates. We did not verify the methodology used in the Inspector General's analysis.

As shown previously in table 2.1, 43,316 foreclosure actions occurred in fiscal year 1987. Of these foreclosures, VA acquired 31,942 properties. The remaining 11,374 properties were comprised of various types, including those left with the lender and those acquired by third parties.

If the same figures estimated by the Inspector General—14 percent of acquisitions and average savings of $3,715—were applied to these 31,942 fiscal year 1987 acquisitions, VA could have acquired 4,472 fewer properties for an estimated savings of $16.6 million. The actual savings would be contingent on the government's borrowing rate and the estimated holding period.

In addition to the cost savings, our work shows that leaving additional properties with lenders would also reduce the depreciation losses that VA incurs while holding properties in inventory and the cash discount losses when selling them. In this regard, VA, on average, does not obtain the property value used in the acquisition decision when it does sell the property primarily because of property depreciation and cash discounts that VA offers to meet the cash sale requirements of the Deficit Reduction Act.

For example, our analysis of VA's property sales during fiscal year 1987 showed that it received $5,622 less per property than the amount for which the property had been appraised when VA decided to acquire it from the lender. (Depreciation accounted for about two-thirds of the reduction in the final sales price while cash discounts were primarily responsible for the remaining one-third.) On the basis of the $5,622 difference between the sales price and the appraisal value, if the recognition of interest costs had resulted in VA leaving about 14 percent of its acquired properties with lenders (as estimated by the VA Inspector General), VA would have left an estimated 4,472 additional properties with lenders and reduced losses due to property depreciation and cash sales discounts by about $25 million ($5,622 x 4,472 properties).

We estimate that if, during fiscal year 1987, VA had included interest cost in its property acquisition decision-making process, total cost savings from a reduction in interest costs, property depreciation, and cash discounts would have totaled about $41.6 million.

Reduced Budgetary Requirements From Not Acquiring Foreclosed Properties

In addition to the above savings, recognizing interest costs and thereby not acquiring properties would reduce the annual expenditures required from the loan guaranty fund to acquire properties. While this does not represent any additional savings to VA, it would, in the first year of implementation, provide benefits by reducing the federal deficit and the amount of congressional appropriations needed to operate the home loan program. After the first year, however, these benefits would be largely offset by a similar reduction in revenues flowing into the fund from the sale of properties acquired by VA.

For example, during fiscal year 1987, the average amount VA paid to acquire a property was about $56,200, which is $28,700 more than the $27,500 maximum amount that VA would have paid under its guaranty if it had left a property with the lender rather than acquiring it. As such, the $28,700 represented VA's investment in the property—an investment that VA anticipated recouping when it resold the property.

Assuming that VA had implemented a policy in fiscal year 1987 of recognizing interest costs in its acquisition decisions and that this resulted in a reduction in property acquisitions by 14 percent, or 4,472 properties, VA would have expended about $128 million less for property acquisitions in that year ($28,700 x 4,472). On the basis of fiscal year 1987 data on the average time needed to sell properties, about one-third of the properties acquired in fiscal year 1987 would have been sold in the same year, which would result in outlays being reduced by about one-third, or by about $43 million of the $128 million. Therefore, in fiscal year 1987 VA could have reduced congressional appropriations needed for the loan guaranty fund by $85 million ($128 million -$43 million).

Assuming the number of foreclosures remains relatively constant, this reduction in expenditures needed to acquire properties would be likely to continue in future years. The net outlay reduction, however, would be much lower after the first year because, by recognizing interest costs, VA would not only reduce the number of properties acquired, it would also have fewer properties for sale. Thus, after the first year, the reduction in expenditures for property acquisitions would be largely offset by a corresponding decrease in collections from property sales.

VA Has Discretion to Recognize Interest Costs

Historically, VA considered neither interest nor other postacquisition costs in deciding whether to acquire foreclosed property or leave it with the lender and pay the guaranty. Excluded from consideration, in addition to interest, were such postacquisition costs as repairs, maintenance, security, taxes, and resale costs.

As noted earlier, the Deficit Reduction Act of 1984 required VA to consider postacquisition costs in determining whether to acquire any foreclosed property and, in specifying the costs VA was to consider, included "other costs resulting from the acquisition and disposition of the property." Accordingly, VA now includes postacquisition costs in its economic analysis calculations to determine whether to accept conveyance of the property or pay the guaranty.

However, VA does not include interest costs in its acquisition decision analysis. In this regard, according to VA's Chief Benefits Director, the Conference Committee on the Deficit Reduction Act did not intend for VA to change its policy and consider these costs, and consequently VA does not do so.

We believe that while the Deficit Reduction Act does not require VA to include interest costs in determining whether to acquire foreclosed properties, neither the act nor its legislative history precludes VA from doing so. The report of the Conference Committee on the Deficit Reduction Act stated the following:

"In connection with the VA's calculation of the costs of acquiring and disposing of properties, the conferees do not intend to change the VA's current policy of not considering interest costs that the United States would incur if it were necessary for the Government to borrow the funds for a particular acquisition."

However, immediately following this statement the Conference Committee said,

"If the Administrator determines that a change to this policy [not considering interest costs] is warranted, notwithstanding the conferee's [sic] position as stated above, the Administrator shall, not later than February 1 preceding the fiscal year in which a proposed change would take effect, provide the Veterans' Affairs Committee with notice of the change."

Thus, although the Conference Committee made it clear that it did not intend to require a change in VA's policy of not considering interest, it left to VA the decision whether to effect such a change (provided VA gave due notice to the Veterans' Affairs Committee). Accordingly, VA is not legally precluded from including the interest cost in its economic analysis calculations.

Veterans Debt Would Not Have to Be Increased

Under its regulations VA establishes a debt against the veteran for all of its recognized costs on a foreclosed VA-guaranteed loan. VA deducts a percentage (currently 10.75 percent), representing VA's estimated acquisition and postacquisition costs, from the "fair market value" of the property to establish the "net value" of the property. The difference, if any, between the veteran's total indebtedness and the net value of the property represents VA's estimated loss on a foreclosure. The difference, up to the amount of the guaranty, is also the amount of the debt that VA establishes against the veteran.

Before VA began considering postacquisition costs in its acquisition decisions, it also did not add these costs to the foreclosed veteran's deficiency owed to VA. Instead VA, by not taking these costs into account, absorbed them. However, when it began recognizing postacquisition costs, VA also began deducting these costs from the credit the veteran receives on the value of the property, thus increasing the claim payable by the veteran to VA (up to VA's maximum liability on its guaranty). Furthermore, in responding to the Inspector General's report, VA's Chief Benefits Director stated that if VA were to include interest in its economic analysis calculations, the debt established against the foreclosed veteran would increase.

Our review shows that the statutory provisions governing VA procedure on default and foreclosure of VA-guaranteed loans are concerned with the rights and responsibilities of the lender and VA to each other and with the circumstances under which VA may accept conveyance of the property from the lender and those under which it may not. The statute and the legislative history are silent on the nature and extent of the foreclosed veteran's debt to VA and on how that debt is to be determined. Thus, the governing statute does not require VA to increase the veteran's debt as a result of including interest costs in its calculations.

On the basis of our discussion with VA's Office of General Counsel, the charging of all recognized costs to the veteran is a result of the agency's exercise of discretionary authority and has been the practice since the inception of the loan guaranty program. Thus, when VA, following passage of the Deficit Reduction Act, was required to recognize and include postacquisition costs as part of its foreclosure costs, the agency charged these newly recognized costs to the veteran by increasing the percentage deduction from the property's fair market value. According to the Office of General Counsel, these costs were charged as a matter of routine adherence to past agency policy, not as a conscious agency decision based on an opinion that VA was legally obligated to do so.

Similarly, if VA were to include interest costs in its acquisition analysis, any decision to charge, or not charge, these costs to foreclosed veterans (by further increasing the percentage deduction from fair market value) would be based on agency discretion, not legal obligation.

Cash Sales Requirement Has Been Met but Study Is Not Complete

As required by the Deficit Reduction Act, VA has increased its use of cash sales when disposing of foreclosed properties. Although benefits are associated with cash sales, VA could benefit from a study to determine whether circumstances exist under which it would be preferable to accept offers based on VA's providing the financing for the sale.

Requirements for and Efforts to Increase Cash Sales

The Deficit Reduction Act intended to provide increased revenue for the Home Loan Guarantee Program by requiring VA to sell at least 25 percent, but not more than 40 percent, of its acquired properties for cash. Prior to the act, VA sold only about 5 percent of its acquired properties for cash. VA has achieved its legislative requirement by selling for cash about 28 percent of its acquired properties in fiscal year 1985 and 34 percent in fiscal years 1986 and 1987. VA has continued to sell the rest of its inventory by providing financing for the loans, with the purchasers making subsequent monthly payments directly to VA. (Such VA-financed loans are referred to as vendee loans.)

On December 21, 1987, the Congress passed the Veteran's Home Loan Program Improvements and Property Rehabilitation Act (P.L. 100-198), which, among other things, increased the cash sale requirements established by the Deficit Reduction Act. VA is now required to sell at least 35 percent, but not more than 50 percent, of its acquired properties for cash.

Advantages exists for VA when it sells property for cash. For example, cash sales provide immediate revenue for VA's loan guaranty fund. Likewise, when properties are sold for cash, VA eliminates any possibility that it will incur future costs related to providing counseling or financial assistance on delinquent VA-financed loans or foreclosing on such loans in default.

To increase cash sales, VA gives preference to any "qualified" cash offer regardless of the amounts offered based on VA financing. An offer is considered to be qualified if it is for at least 90 percent of the property's listed price. VA also has initiated several other methods to promote cash sales. These incentives include paying certain financing fees charged by lenders that make mortgage loans for VA's cash purchasers and using auction sales to obtain cash for properties that VA has not been able to sell for extended periods.

Cash Sales Study and GAO Sales Analyses

In August 1987 VA reported to the Congress on the impact of the Deficit Reduction Act. VA reported that, in comparing its use of cash sales before and after the act, its average loss on cash sales increased after the act was passed. VA believes that the increase in the average loss is due to the incentives it offers to encourage purchasers to pay cash. VA said it would continue to review the use of incentives, such as price discounts, paying financing fees, and auction sales to determine which are cost-effective. As of March 1989 VA had not completed this study.

Our analysis of VA sales of acquired property for fiscal year 1987 showed that cash sales resulted in VA's obtaining about 82 percent of the appraised property value at foreclosure. VA-financed sales, during the same period, resulted in VA's obtaining 93 percent of the appraised value. However, VA said in its August 1987 report to the Congress that, overall, considering all cost factors, such as the costs associated with servicing and foreclosing the loans it finances to sell properties, losses on VA-financed sales and cash sales are about equal. In arriving at its conclusion, however, VA did not look at individual property sales.

While overall losses from cash or VA-financed sales may be about equal, and while VA is required to sell between 35 percent and 50 percent of its properties for cash, VA may be unnecessarily incurring losses by always accepting cash offers whenever they are for at least 90 percent of the listed price. For example, we noted that VA accepted a $40,000 cash offer for a property with a listed price of $39,500 and rejected a noncash offer from a buyer willing to purchase the property for $47,000 provided that VA would finance the purchase.[1] Moreover, under VA's cash sales policy of always giving preference to cash offers of at least 90 percent of the listed price, VA would have automatically accepted even a cash offer of $35,550 without considering whether the $47,000 noncash offer would be more financially advantageous to VA than the cash offer.

VA could consider such noncash offers on a case-by-case basis and still implement its overall requirement to sell between 35 and 50 percent of its properties for cash. VA, however, does not examine whether individual cases may exist in which it would be more beneficial for VA to accept noncash offers financed by VA when they exceed the listed price rather

[1] In this case VA had one offer of $47,000 and three offers of $46,000 provided that VA would finance the purchase. There are two possible reasons why these offers were more than the listed price. First, VA may have listed the property below the appraised value in order to increase the likelihood of a quick sale or, since appraising property is not a science, the property may have been appraised at a lower value than the amount buyers were willing to pay for it. In either case, VA will finance up to the total amount of the bid less a required down payment of at least $1,000.

than substantially lower cash offers that are for 90 percent or more of the listed price.

Conclusions

VA has achieved the Deficit Reduction Act of 1984 requirement of limiting its overall losses to the guaranty amount. In its acquisition analysis, however, VA does not include the interest costs of holding property in its inventory until the property is sold. We believe that recognizing these costs in VA's acquisition decision-making process would result in improved accountability for the costs of the VA guaranty program, an increase in the number of properties left with lenders on the basis of considering the interest costs associated with the government's holding the properties, and a related reduction in the costs of the program.

Our review also shows that VA has met the requirements of the Deficit Reduction Act by increasing the number of its acquired properties sold for cash. We believe, however, that as part of its study on cash-sale incentives, VA should examine the costs that are associated with VA's giving preference to cash offers, regardless of the amount offered based on VA financing.

We believe that the results of this study would be useful to VA in determining whether there are circumstances under which it would be appropriate to accept a VA-financed offer rather than a cash offer. In this regard, while cash sales are beneficial to VA, these benefits could be more than offset when a prospective buyer is willing to pay substantially more for a property if VA finances the mortgage loan.

Recommendations

To ensure that VA's property acquisition and disposition procedures result in the best financial interests of the government, we recommend that the Secretary of Veterans Affairs take the following actions:

- Consider the interest costs associated with acquiring and disposing of properties in deciding whether to leave properties with lenders.
- Determine the cost-effectiveness of VA's policy of always giving preference to qualified cash offers over offers requiring VA financing as part of VA's study on cash-sale incentives.

Agency Comments

VA concurred with our recommendation to consider interest costs in deciding whether to leave properties with lenders. Accordingly, VA said it would process an amendment to its regulations to implement the change.

VA concurred with our recommendation to determine the cost-effectiveness of VA's policy of always giving preference to qualified cash offers over offers requiring VA financing.

The full text of VA's comments is provided in appendix IV of this report.

Improved Property Acquisition and Disposition Policies Could Reduce Costs

During fiscal year 1987, VA lost about $615 million, based on sales losses and guarantees paid on over 36,000 properties.[1] Given the number of foreclosures in recent years, it is essential that VA use economical methods for acquiring and disposing of properties. Our review shows that VA can improve its property acquisition and disposition practices by

- encouraging more successful third party bidding for properties by establishing a minimum acquisition amount for lenders which reflects VA's acquisition and disposition costs, including cash discounts, and
- eliminating or reducing the costs associated with purchasing title insurance policies.

Lower Bid Prices Could Result in More Competitive Bidding at Foreclosure Sales

VA has two options for satisfying its guaranty: (1) it can pay the lender the amount of the guaranty and leave the property with the lender or (2) VA can reimburse the lender for its losses on the loan after the lender forecloses on the property. VA chooses the second option if its potential loss is less than the amount of its guaranty. VA calculates its potential loss by subtracting from the borrower's debt the net of the appraised value of the property less VA's estimated postacquisition costs for items such as repairs, maintenance, taxes, sales commissions, and resale costs. If VA chooses the second option, under the terms of its agreement with lenders, the lenders can and usually do convey the properties to VA after they purchase the properties at foreclosure sales.

Each state has its own foreclosure process but, generally, the process terminates with a foreclosure sale. The sales are generally conducted by the local jurisdiction. At foreclosure sales, lenders and others, known as third parties, are allowed to bid on the property.

If a third party acquires the property at the foreclosure sale, VA has no further involvement with the property. VA simply pays the lender the amount of the borrower's debt, less the amount of the third party's bid. However, if the lender rather than the third party acquires the property, VA generally acquires the property from the lender and must use its management resources to hold and resell the property.

Winning bids by third parties at foreclosure sales are advantageous to VA because, when third parties purchase VA-guaranteed property, VA does

[1] As shown in table 2.1, 43,316 foreclosures actions occurred during fiscal year 1987. During the same period, there were 36,299 properties that VA sold from its inventory or that were not acquired by VA because VA paid the lender the guaranty and left the property.

not have to use its management resources to hold and resell the property and because VA avoids substantial costs from depreciation (about 7 percent) on properties it acquires from lenders. However, only about 5 percent of foreclosed VA-guaranteed loans resulted in properties being acquired by third parties during fiscal year 1987.

At foreclosure sales, lenders and third parties submit competing bids with the highest bidder obtaining title to the property. Lenders usually bid the amount of the appraised value of the property, less the amount that VA estimates as the postacquisition costs. Lenders bid this amount because this represents the net value of the property to VA. Third parties must, therefore, bid at least one dollar more than this amount to obtain the property. Appendix III presents an example of this bidding process.

To enhance third party bidding VA could, as an option to lenders' current bidding practice, establish a minimum amount for lenders to bid that would include not only the postacquisition costs but also the cash sales discounts, as given when VA sells the property. The minimum amount would reflect the net value of the property to VA, that is, the appraised value less (1) VA's estimated postacquisition costs and (2) the cash sales discount that VA would offer to sell the property for cash if it acquired the property.

Establishing such a minimum bid amount would provide the lender with a lower basis on which to initiate bidding and, in turn, lower the amount necessary for a winning bid from a third party. Moreover, if a lender chose to obtain the property by competing with a third party by bidding more than the minimum bid amount, VA would be required to reimburse the lender for only the difference between the borrower's debt and the amount of the lender's bid rather than the greater difference between the borrower's debt and the minimum bid amount. VA could then leave the property with the lender and avoid the use of VA's resources in holding and reselling the property and avoid the costs of property depreciation. Thus, reducing the minimum bid amount would not result in an increase in costs to VA.

Assurance of Property Title Can Be Obtained for Less Cost

Lenders, after foreclosing on VA-guaranteed mortgages, are required to provide VA with a good and marketable title to those properties that VA ultimately acquires, thereby assuring VA that it has the legal right to sell the property. Lenders can provide assurance of title by several means, the most common of which is title insurance. The specific costs of title insurance policies vary depending on the state in which they are purchased and the amount of insurance coverage they provide. At the seven VA offices we visited, title policies were the most common form of evidence lenders used to show evidence of good and marketable title to properties acquired through foreclosures. VA reimburses the lenders several hundred dollars for each policy they obtain.

VA has instructed lenders to obtain title insurance policies in order to expedite the process under which lenders provide VA with good and marketable title to foreclosed property. However, our review shows that the use of these policies has not expedited the process, and VA is reconsidering their use.

According to VA's Assistant Director for Loan Management, in conveying property to VA, prior to April 1986 lenders were generally required to submit all pertinent documents to VA, such as the foreclosure documents, showing that the lenders had good and marketable title to the property obtained from homeowners who defaulted on their VA-guaranteed loans. In an April 1986 memorandum, VA instructed its field offices to encourage lenders to obtain title insurance policies to document that good and marketable title was being transferred to VA and thus expedite the property acquisition process. According to the assistant director, title policies were more costly than VA's previous process for obtaining title, but VA believed the time saved would justify the additional costs.

Our review showed that obtaining a title policy has not accelerated the process. In calendar years 1984 and 1985, VA averaged 91 and 95 days respectively to accept clear and marketable title following the lender's notification of intent to convey the property. It took an average of 102 days during 1986 and the first 6 months of 1987, the period we reviewed.

We also noted during our review that, even if VA decides to continue purchasing title policies, it could reduce its costs by purchasing less expensive policies that provide lower insurance coverage. In this regard, the costs of title policies vary depending on the amount of insurance they provide. The least expensive policies carry only a minimal amount of insurance and are appropriate for VA, since VA buys the policies to accelerate the acquisition process, not to protect itself with insurance against a defect in the title.

The Chief Benefits Director testified on June 17, 1987, before the Senate Committee on Veterans' Affairs, that VA was (1) examining various methods for reducing title acquisition costs and (2) considering whether to accept less expensive title insurance policies that provide only minimal insurance coverage. On a trial basis, VA has instructed its offices in Texas—where, because of the depressed economy, VA has more foreclosed properties than in any other state—to obtain title by obtaining from the lender a general warranty deed, under which the lender certifies that it has good and marketable title, rather than a title policy. If the Houston office, where we performed our audit work, had been obtaining warranty deeds throughout fiscal year 1987, we estimate that over $1 million would have been saved.

On August 23, 1988, the Director of the VA's Home Loan Guaranty Program told us that some Texas lenders were reluctant to provide general warranty deeds because of the financial risk to the lender if the title to the property was defective. Furthermore, VA's Office of General Counsel has concluded that, if lenders obtain a title policy, VA is obligated to reimburse the lender for the costs. Nevertheless, the director said VA would continue to encourage Texas lenders to provide general warranty deeds voluntarily in order to reduce title acquisition costs. Also according to the director, VA would continue to explore whether a title policy, if acquired, can be purchased for less money.

Conclusions

At foreclosure sales held at the conclusion of the foreclosure process, lenders and third parties bid on VA-guaranteed properties. When third parties acquire foreclosed properties, VA does not have to hold and resell the properties. In contrast, when lenders acquire the properties, they generally convey the properties to VA, which then must hold and resell the properties and incur depreciation costs. We believe that VA should establish a minimum amount for lenders to bid at foreclosure sales based on the appraised value of the property, less VA's estimated postacquisition costs and the cash sales discount offered by VA after it acquires property from lenders following the foreclosure sales. By doing this, VA could promote more sales to third parties.

In an attempt to speed up the title acquisition process, VA allowed lenders to purchase title policies to demonstrate good and marketable title to foreclosed properties and reimbursed the lenders for the title policy costs. However, the title acquisition process has not been accelerated, and VA is now reconsidering the need for title policies. We believe that it is appropriate that VA reconsider the use of the title policies and encourage lenders throughout the country to provide VA with assurance of good and marketable title through the least expensive means available. Moreover, if VA continues to purchase the policies, it could reduce its costs by having lenders purchase policies offering a minimal amount of title insurance at the lowest costs.

Recommendations

To reduce the costs of the loan guaranty program, we recommend that the Secretary of Veterans Affairs take the following actions to improve the property acquisition and disposition process:

- Encourage more successful third party bidding at foreclosure sales by establishing a minimum amount for lenders to bid that reflects VA's acquisition and disposition costs, including cash discounts.
- Encourage VA offices to obtain from lenders assurance of good and marketable title through the least expensive means available. If VA offices continue to obtain title insurance policies, they should purchase the least expensive policies.

Agency Comments

VA did not concur with our recommendation that it should establish a minimum amount for lenders to bid that reflects VA's acquisition and disposition costs, including cash discounts. VA's concerns and our views on them are as follows.

First, VA stated that any practice that stimulates speculators to acquire a significant number of properties through foreclosure sales would represent disposal of the properties for less than their value. We recognize that considering the cash discount in determining the minimum bid amount would result in the sale of the property for less than its fair market value. However, we note that the minimum bid amount currently reflects the fair market value less VA's anticipated postacquisition costs and that implementation of our recommendation would simply establish in the minimum bid amount the additional costs that truly are involved in selling the property. Establishing these additional costs would more accurately reflect the value of the property to VA. As stated in chapter 3, while the bid price reduction would have advantages to third party bidders (and therefore would promote competitive bidding), it should not result in an increase in costs to VA. To the contrary, there would be an overall reduction in costs, since VA would avoid property depreciation costs.

VA states that cash discounts are a marketing tool applied at VA's discretion and that, unlike acquisition and disposition costs, a necessary relationship does not exist between the use of a cash sale discount and the value of a property at foreclosure. We agree. Our point is that it would be beneficial to VA to use the marketing tool at the time of foreclosure to promote third party bidding. VA also points out that cash discounts may be amended or discontinued at any time based on current market conditions. We recognize that cash discounts can be amended or discontinued and, when such events occur, we would anticipate that the discount costs would likewise be amended or discontinued at the foreclosure sale.

VA also states that adoption of the minimum bid recommendation would have a significant impact on program participants, since it would increase the number of cases in which VA pays a maximum claim and the lender must dispose of the property in order to recover the balance of its investment. VA raises several related concerns, such as the possible need for statutory changes, to consider these costs in the property acquisition decision. Our recommendation addresses only the recognition of the discount costs in establishing the minimum bid amount at the foreclosure sale; it does not address VA's calculation to determine whether to leave properties with the lenders. We believe that any VA actions to consider these costs in its decision analysis for acquiring properties would be based on agency discretion and that the implementation of our recommendation would impose no requirement on VA, legal or otherwise, to consider these costs in the acquisition decision.

In addition, VA states that it does not believe that changes to provide for including cash discounts in the minimum bid amount could be drafted in such a way that would provide VA the flexibility to amend cash sale procedures in a timely fashion to take advantage of local market conditions. We anticipate that, as changes occur in market conditions, discounts will likewise be amended or discontinued. In this regard, we anticipate that the use of the cash discounts in the minimum bid amount would be linked to the local VA office's practice with regard to offering cash discounts in selling acquired property and that VA regulations can be drafted to reflect this linkage.

Regarding our recommendation that VA reduce the costs of title policies, VA conditionally concurred, pending completion of VA's further research on the availability of title insurance policies for amounts less than the property value.

The full text of VA's comments is provided in appendix IV of this report.

Loan Default and Foreclosure Process for VA Home Loans[1]

Default or Foreclosure Occurrence

Default occurs:

- If default not cured, lender must report to VA within 105 days after initial default.

- VA supplemental servicing begins with letter advising veteran on actions to reinstate loan.

- Lender can notify VA of intent to foreclose after loan in default for 90 days.

VA has 15 days to respond to lender's notice of foreclosure. Lender can terminate the loan in any lawful manner if VA does not respond in 30 days.

VA continues supplemental servicing to cure the default.

VA considers alternatives to foreclosure if default cannot be cured:

- Compromise agreement: Borrower sells property with VA financial assistance and is usually held liable by VA for the amount VA pays.

- Voluntary conveyance: Borrower voluntarily offers VA the property deed. VA may hold borrower liable for all or part of its loss on the property.

- Refunding: VA pays the lender the loan amount and restructures the loan so the borrower can resume payments.

VA, if alternatives are not possible, generally allows the lender to foreclose and VA holds the borrower liable for the debt that may result if the proceeds from the house sale do not cover the loan balance and the additional expenses that VA incurs in acquiring, maintaining, and selling the property.

Loan foreclosure is initiated by lender according to state law:

- Judicial foreclosure is used in 27 states:

[1] This appendix illustrates the type and schedule of actions of a typical VA-guaranteed home mortgage foreclosure. Depending on the provisions of the state foreclosure law applicable and the individual case characteristics, the described actions and order of action may differ.

- Length of process varies but is usually longer than nonjudicial foreclosure. The process averages 284 days, ranging from 181 days for Columbia, South Carolina VA office to 364 days for the Cleveland, Ohio VA office.
- Sixteen of the 27 states require a redemption period that ranges from 3 days to 1 year during which the borrower may remain on the property, repay the indebtedness, and reclaim the property.

- Nonjudicial foreclosure is used in 23 states and the District of Columbia:

- The length of the process averages 200 days. It ranges from 101 days in Winston-Salem, North Carolina VA office to 286 days for Boise, Idaho VA office.
- Nine of the 23 states and the District of Columbia require a redemption period ranging from 10 days to 1 year.

VA may continue to pursue alternatives to foreclosure during this period.

VA decides which of two procedures should be used to satisfy the loan guaranty:

- VA can pay the lender the guaranty amount (a maximum $27,500 for loans guaranteed prior to February 1988 and $36,000 after February) and then leave the property with the lender.

- VA can pay the lender the total amount that the veteran owes the lender. VA chooses this option if its potential loss (borrower's debt less appraised property value plus estimated costs for items such as repairs, maintenance, taxes, sales commissions, and resale costs) is less than the guaranty amount.

Foreclosure sale activities:

- Lenders bid the net value of the property which is the appraised value less estimated costs for repair, maintenance, taxes, sales commissions, and other resale costs.

- Third party bidding allowed. Third party bidders will usually acquire the property with a bid of more than the net value of the property.

If the lender acquires the property at the foreclosure sale, in most instances the lender conveys the property to VA:

- VA acquires property title and performs market analysis.

VA lists property for sale:

- VA allows 10-percent discount for cash sales.

- VA pays real estate taxes, repair, and maintenance costs.

VA sells property:

- VA pays real estate commissions and resale costs.

- VA places sales proceeds in revolving fund.

Example of the Impact of Recognizing Interest Costs

	Recognizing interest costs in acquisition decision	Method VA currently uses in acquisition decision
Borrower debt	$96,647	$96,647
Less net property value[a]	−71,400	−71,400
Loss currently recognized by VA	$25,247	$25,247
Plus interest cost[b]	+4,608	
Total estimated loss to the government	$29,855	
Maximum guaranty VA would have paid by not taking the property	27,500[c]	
Net savings to the government	$2,355	

[a]Includes a reduction in value to cover estimated postacquisition costs that would be incurred in holding and selling the property. These costs would include such items as repairs, maintenance, security, taxes, sales commissions, and other resale costs.

[b]Interest is calculated using an annual rate of 10 percent, an 8-month holding period, and an investment of $69,143 ($96,647 in borrower debt less the $27,500 VA guaranty). Under the current method VA uses in its acquisition decision, these costs are not recognized by VA, but they nevertheless do result in an additional loss to the government.

[c]By recognizing interest costs, the property would not have been acquired because the government's estimated loss ($29,855) was greater than the guaranty ($27,500), and the government would have realized a savings of $2,355.

Example of the Impact of Lowering the Foreclosure Sale Bid Price

	Without cash discount	With cash discount
Property value	$100,000	$100,000
Less estimated postacquisition costs (10.75 percent)	10,750	10,750
Less cash discount (10 percent)	•	10,000
Total	**$89,250**	**$79,250**
Lender bid price[a]	$89,250	$79,250
Minimum bid by third party necessary to acquire the property	$89,251	$79,251

[a]If a lender chose to bid more than the minimum bid amount in order to acquire the property, VA would reimburse the lender for only the difference between the borrower's debt and the amount of the lender's bid rather than the greater difference between the borrowers's debt and the minimum bid amount. VA would then leave the property with the lender and avoid the use of VA's resources in holding and reselling the property and avoid the costs of property depreciation. In effect, VA would obtain the same benefits that it does when third parties purchase the property.

Comments From the Department of Veterans Affairs

Office of the
Administrator
of Veterans Affairs

Washington DC 20420

Veterans
Administration

APR 11 1989

Mr. John M. Ols, Jr.
Director, Housing and Community Development Issues
Resources, Community, and Economic Development Division
U. S. General Accounting Office
Washington, DC 20548

Dear Mr. Ols:

This responds to your request that the Department of Veterans Affairs (VA) review and comment on the General Accounting Office (GAO) March 3, 1989, draft report HOUSING PROGRAMS: VA Can Reduce Its Guaranteed Home Loan Foreclosure Losses. GAO sought to determine (1) the effect of requirements established by the Deficit Reduction Act of 1984 on VA's Home Loan Guaranty Program and (2) if the property acquisition and disposition process could be improved to reduce program costs.

We concur in the recommendations to consider the interest costs associated with acquiring and disposing of properties when deciding whether or not to leave properties with lenders, and to determine the cost effectiveness of our policy of always giving preference to cash offers over offers requiring VA financing.

We do not concur in the recommendation to encourage more successful third party bidding at foreclosure sales by establishing a minimum amount for lenders to bid that reflects VA's acquisition and disposition costs, including cash discounts.

Pending completion of further research on the availability of title insurance policies for amounts less than the property value, we conditionally concur in the recommendation to obtain from lenders assurance of good and marketable title through the least expensive means available.

The enclosure responds to the recommendations in more detail.

Sincerely yours,

Edward J. Derwinski
Secretary

Enclosure

Enclosure

DEPARTMENT OF VETERANS AFFAIRS COMMENTS ON THE
MARCH 3, 1989, DRAFT REPORT
HOUSING PROGRAMS: VA CAN REDUCE ITS GUARANTEED HOME
LOAN FORECLOSURE LOSSES

To ensure that VA's property acquisition and disposition procedures result in the best financial interests of the Government, GAO recommends that the Secretary of Veterans Affairs take the following actions:

--Consider the interest costs associated with acquiring and disposing of properties when deciding whether or not to leave properties with lenders.

We agree that including the imputed interest cost of holding properties in inventory pending sale will more realistically reflect the true cost to the Government of a decision to provide the holder of a loan the option of conveying the property to VA. This, in turn, would ensure that VA would not acquire foreclosed properties except when it is in the best interest of the Government to do so. Accordingly, on January 4, 1989, the then Administrator approved the necessary implementing actions. A proposed amendment to 38 CFR 36.4301 is being processed.

We wish to point out that an action which appears beneficial in a simple cost analysis may have further implications from a program standpoint. VA-guaranteed loans are funded by the private sector and any increase in the number of cases in which the holder must recover part of its investment from the resale of the property rather than recovering its total investment from VA will increase losses to lenders who participate in the Loan Guaranty Program. Increased losses may result in reduced program participation by lenders, or in lender efforts to recover these losses by means of increased charges for origination or servicing of VA-guaranteed loans. The increased charges would likely be directly or indirectly passed on to veterans. Therefore, we expect considerable opposition to the proposed regulation change when it is published for comment.

--As part of VA's study on cash sale incentives, determine the cost effectiveness of VA's policy of always giving preference to cash offers over offers requiring VA financing.

We concur and will be examining the cost-effectiveness of giving preference to cash offers over offers that require VA financing.

To reduce the costs of the Loan Guaranty Program, GAO recommends that the Secretary of Veterans Affairs take the following actions to improve the property acquisition and disposition process:

--To encourage more successful third-party bidding at foreclosure sales, establish a minimum amount for lenders to bid that reflects VA's acquisition and disposition costs, including cash discounts.

2.

We do not concur in this recommendation. Because most third-party bidders at foreclosure sales are speculators who are only interested in acquiring properties for substantially less than their fair market value, any practice that stimulates third-party bidders to acquire a significant number of veteran-owned properties through foreclosure sales would represent disposal of potential Government assets for far less than their value.

Current procedures take VA's acquisition and disposition costs into account when the net value of the property and the minimum acquisition amount are determined. If the proposed regulation to include imputed interest cost is promulgated, these costs will also be taken into account in the net value/minimum bid calculation. We do not, however, agree that cash sale discounts should be included in the net value calculation; they are a marketing tool applied at VA's discretion. Unlike acquisition and disposition costs, there is no necessary relationship between the use of cash sale discounts and the value of a property at foreclosure. Further, cash discounts may be amended or discontinued at any time based on current market conditions.

Adoption of this recommendation would have a signficant impact on program participants since, like the proposal for including imputed interest in the net value calculation, it would increase the number of cases in which VA pays a maximum claim and the lender must dispose of the property in order to recover the balance of its investment. Implementation would require regulatory, and possibly statutory, changes. We do not believe these changes could be drafted in a way that would provide VA the flexibility to amend cash sale procedures in a timely fashion, when necessary, to take advantage of local market changes. In markets where values are increasing, the result would be an increase in claims paid by VA (since our claim amount represents the difference between the net value of the property and the total account indebtedness at foreclosure) and a loss to third-party bidders of precisely those properties that could most likely be resold by VA at a gain.

GAO also recommends that the Secretary encourage VA offices to obtain from lenders assurance of good and marketable title through the least expensive means available. In the event that VA offices continue to obtain title insurance policies, they should purchase the least expensive policies.

We conditionally concur in this recommendation. VA's preliminary research of this matter indicates that title insurance companies are generally not willing to offer insurance in reduced amounts, i.e., for amounts less than the value of the property. We will research this issue further, and our eventual concurrence or nonconcurrence will depend upon our findings with respect to insurance availability through major insurance companies and the quality of coverage provided, if such insurance is available.

3.

The fact that the title acquisition process has not been accelerated through the use of title insurance policies does not necessarily indicate that using this procedure has been unsuccessful. While the recommended procedure may accelerate the process, the fact that property acquisition volume was nearly 50 percent greater in Fiscal Year 1987 than in Fiscal Year 1984 suggests that using title insurance does minimize the title acquisition processing time. Otherwise, the increased workload would have been reflected in considerably increased processing time.

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