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

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HOUSING PROGRAMS

Increased Use of Alternatives to Foreclosure Could Reduce VA's Losses

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Resources, Community, and
Economic Development Division

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December 20, 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 recommendations to the Secretary of Veterans Affairs.

Unless you publicly release its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, copies of the report will be sent to the Secretary, Department of Veterans Affairs; appropriate congressional committees; and the Director, Office of Management and Budget. Copies will also be sent to other parties upon request.

If you have any questions concerning this report, please call me on (202) 275-5525. Major contributors to this report are listed in appendix VIII.

Sincerely yours,

John M. Ols, Jr.

John M. Ols, Jr.
Director, Housing and
Community Development Issues

that the proceeds from the sale do not cover the total indebtedness. This action benefits VA by saving foreclosure time and costs. It benefits the veteran by preserving his or her credit rating.

Results in Brief

Alternatives to foreclosure are seldom used to terminate defaulted VA loans. For example, foreclosure, which is generally the most expensive method of terminating a defaulted loan, was used by lenders to terminate over 97 percent of the defaulted loans that GAO reviewed at nine regional offices during fiscal year 1987, the last year for which foreclosure alternatives were reviewed by GAO.

In deciding whether to allow lenders to foreclose on defaulted loans or use alternatives to foreclosure, VA does not consider all of the costs involved in foreclosure, which may result in VA allowing foreclosure instead of pursuing a less costly alternative. To demonstrate the feasibility of considering various loan termination alternatives and specific cost factors, GAO developed a cost model that identifies costs associated with each termination alternative. Using this model, GAO estimates that VA could have saved between $42 million and $94 million in fiscal year 1987 if VA regional offices had more frequently used foreclosure alternatives, rather than allowing lenders to foreclose.

Private mortgage insurers told GAO that they are more aggressive than VA in finding alternatives to avoid foreclosures. Officials at these companies said they become involved with delinquent borrowers sooner than VA. The private insurers believe that their efforts result in millions of dollars saved each year.

Principal Findings

Alternatives to Foreclosure Offer Opportunities for Significant Savings

Foreclosure is the most expensive approach to terminating a loan. In fiscal year 1987, VA lost $465 million on homes it had acquired and resold. VA holds the veteran whose home loan was terminated liable for much of the loss it incurs. However, very little of the debt is ever collected, due to the low income of defaulting borrowers and/or incomplete implementation of VA collection procedures.

To compare the cost of foreclosure and the available alternatives, GAO developed a cost analysis model. This model includes three costs that VA

Recommendations

By considering the costs and benefits of each loan termination alternative and selecting the least costly means of terminating loans—including alternatives to foreclosure—VA could reduce its losses. Therefore, GAO recommends that the Secretary of the Department of Veterans Affairs

- use GAO's model or develop a similar cost analysis to identify, on a case-by-case basis, the costs of loan termination alternatives, including debt collection rates, interest costs, and the discount on cash sales, and
- require VA loan service representatives to complete and document the loan termination cost analysis and pursue the least costly alternative.

Agency Comments

VA agreed that improvements are needed to facilitate the increased use of foreclosure alternatives and discussed several actions that it has taken toward this end, such as increased staffing and improved training and guidance. VA also agreed to make GAO's model available to its field offices as an additional management tool. Nonetheless, VA stated it did not find any apparent benefit that would justify the extra paperwork and administrative burden resulting from adoption of the model on a nationwide mandatory basis. GAO agrees with the positive steps VA has taken. GAO believes, however, that VA field offices should be required to use GAO's model or a similar cost analysis on a case-by-case basis in order to increase the use of foreclosure alternatives and thereby reduce program costs. Unless VA requires such a cost analysis, GAO believes that VA will not have any assurance that its loan service representatives will consider or compare all cost factors when analyzing loan termination alternatives or that they will pursue the most cost-effective means of terminating a loan. VA's comments along with GAO's responses, are discussed at the end of chapter 4 and in appendix VII.

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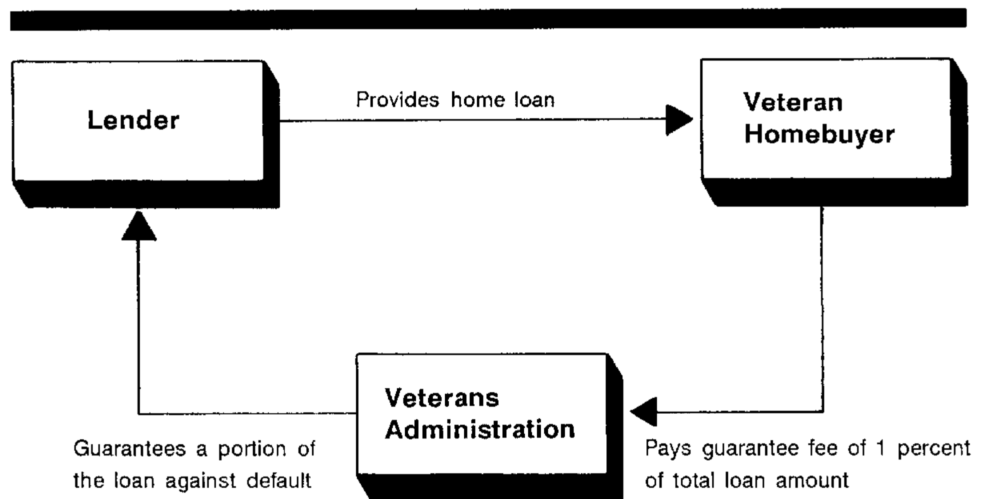
company, a specific amount of money or a percentage of the total loan if the homebuyer defaults on the loan. Figure 1.1 shows the relationship between VA, the lender, and the homebuyer.

A similar arrangement between a lender and a loan guarantor exists for non-VA loans. The private sector has private mortgage insurers (PMI), which insure lenders against losses on home loans. PMIs normally guarantee the top 20 to 25 percent of the loan. According to the PMIs we visited, currently there are 15 PMIs writing mortgage insurance for private-sector home loans.

Figure 1.1: Relationship Between VA, Lender, and Homebuyer



The amount of the guaranty for a VA loan depends on the amount of the loan. Since February 1988, the guaranty has been (1) 50 percent of the loan amount for loans of $45,000 or less or (2) the greater of $22,500 or 40 percent of the loan amount for loans greater than $45,000, to a maximum of $36,000. From October 1980 to February 1988, the guaranty was $27,500 or 60 percent of the purchase price, whichever was less.

A veteran purchasing a home with a VA-guaranteed loan first obtains a certificate of eligibility from VA. The veteran then applies for a loan from a private lender. The process of approving a mortgage loan includes determining a prospective buyer's ability to pay by assessing his or her income, assets, indebtedness, employment, and credit history. The assessment and approval of the loan are completed by VA staff or by designated lenders to which VA has granted automatic lender approval authority.

If VA determines that foreclosure is the solution for the defaulted loan, it must decide how best to satisfy the guaranty on the property. VA has two options: (1) acquiring the property from the lender for the total amount the veteran owes the lender or (2) paying the lender the amount of the guaranty on the loan and leaving the property with the lender. If VA chooses the second option, it must do so because it estimates that the potential loss on the acquisition and sale of the property exceeds the maximum guaranty amount on the loan. (See app. V for a summary of the VA foreclosure process.)

Alternatives to Foreclosure

When a default is insoluble, VA has three alternatives to foreclosure: compromise agreement, voluntary conveyance of the deed (deed in lieu of foreclosure), and refunding.

Compromise Agreement

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 agreement program, through which it may provide the financial assistance necessary to enable the veteran to sell the property.

The veteran must be able to obtain fair market value for the house. However, if the proceeds from the sale do not cover the total debt VA provides the remaining funds needed to pay off the lender. In return, under current regulations VA may require the homeowner to sign a promissory note to repay VA all or part of the debt. However, if the homeowner refuses to sign a promissory note, it may still be in VA's best interest to forgive the debt and not require the promissory note if this action is necessary to persuade the homeowner to complete a compromise sale. VA benefits from a compromise sale because it avoids the cost of acquiring, managing, and reselling a property, and these benefits may outweigh the potential benefits of assessing a debt against the homeowner. As discussed in chapter 2 of this report, VA has previously collected only an estimated 14 percent of such debts.

Voluntary Conveyance of the Deed

Voluntary conveyance permits the veteran to voluntarily transfer a property deed to VA. VA may accept a deed when the government can minimize its losses by avoiding additional interest payments to the lender and the costs of foreclosure. Prior to October 1987, VA's policy and operations manuals stated that accepting a deed released the borrower from liability for any debt that resulted when the proceeds from

Table 1.1: VA-Guaranteed Home Loan Foreclosures, Fiscal Years 1981-89, and Appropriations Needed for the Loan Guaranty Revolving Fund, Fiscal Years 1984-89

Dollars in millions

Fiscal year	Number of foreclosures	Appropriations
1981	12,490	[a]
1982	15,427	[a]
1983	21,176	[a]
1984	23,377	$100.0
1985	27,276	306.6
1986	33,022	200.0
1987	42,029	[a]
1988	46,488	893.8
1989	40,336	770.0
Total		**$2,270.4**

[a]No appropriations for these years.

The increasing number of foreclosures and the depletion of the revolving fund have raised congressional concerns about whether VA is taking appropriate action to work with defaulting homeowners to prevent foreclosures. In July 1987, the Subcommittee on Housing and Memorial Affairs, House Committee on Veterans' Affairs, criticized VA for not counseling homeowners on the financial assistance options available to avoid foreclosure. The Subcommittee cited the figures from our May 1987 testimony concerning the Houston regional office's record of refunding only 7 loans out of 5,600 foreclosures during fiscal year 1986.[1]

In December 1987, the Congress enacted the Veterans Home Loan Program Improvements and Property Rehabilitation Act of 1987 (P.L. 100-198), which requires VA to provide defaulting borrowers with information about the alternatives to foreclosure, including possible methods of curing the default. In addition, the law requires that VA inform the borrower of the financial impact of foreclosure. The authority to do this counseling expires on March 1, 1991. VA published instructions in April 1988 to implement this law. An example of the letter VA began sending to borrowers in January 1988 is contained in appendix IV.

Objectives, Scope, and Methodology

In a letter dated September 29, 1987, the Chairman of the House Committee on Veterans' Affairs asked us to review a number of issues related to the VA Home Loan Guaranty Program. Underscoring a need for changes and noting that the volume of home foreclosures was draining

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

initial audit work at the nine offices. The offices were in Seattle, Washington; Houston, Texas; St. Petersburg, Florida; St. Paul, Minnesota; and Philadelphia, Pennsylvania. These five offices were selected because they represented a range of economic conditions and foreclosure rates and represented each of the geographic areas with significant foreclosure activity among the nine VA regions we reviewed.

In reviewing issues related to VA's servicing efforts, we completed the following activities. We reviewed VA's debt collection activities as they relate to the home loan program by interviewing and gathering data from officials at the Collection and Accounts Receivable System in St. Paul, Minnesota. We determined the differences in state foreclosure laws by obtaining foreclosure information for individual states from VA's Office of the General Counsel in VA headquarters and by contacting district counsels in 48 regional offices by telephone.

We reviewed VA requirements for lender servicing by examining VA's guidance to lenders on the servicing of delinquent VA-guaranteed mortgages and by interviewing 10 lenders handling VA-guaranteed loans. These 10 lenders were selected because they had the highest number of VA loan foreclosures in fiscal year 1986.

We limited our review of VA and lender servicing so as not to duplicate an ongoing audit of these issues by VA's Office of the Inspector General. The Inspector General's audit is focused on whether primary lender and supplemental VA servicing was adequate to provide assistance to veteran borrowers and to protect the government's interest.

We conducted our review between October 1987 and August 1988 in accordance with generally accepted government auditing standards. In addition, we updated certain information as of August 1989.

We found similar results at the nine VA regional offices we examined. For example, foreclosure was used to terminate over 97 percent of the defaulted loans that we reviewed at the nine offices during fiscal year 1987, the last year for which we reviewed the use of foreclosure alternatives. Appendix III shows how often the nine VA offices used foreclosure and each of the alternatives during fiscal years 1986 and 1987. At these nine offices, we were able to obtain information on all three types of alternatives, including estimates of the number of compromise agreements. Although the use of foreclosure alternatives at these offices increased from fiscal year 1986 to fiscal year 1987 (in contrast to the national statistics shown above), their use grew more slowly than the number of foreclosures.

Foreclosure Is an Expensive Approach to Resolving Delinquent Loans

The reliance on foreclosure is expensive because VA incurs losses when it forecloses, acquires, and then resells the property. In fiscal year 1987, VA lost about $465 million in acquiring and disposing of 29,395 properties—an average loss of $15,817 per property. This amount is more than what VA lost in fiscal year 1986, about $356 million on 24,768 properties. Table 2.2 shows the cost to VA of property acquired and resold during fiscal year 1987.

Table 2.2: Loss on 29,395 Properties Acquired by VA and Resold in Fiscal Year 1987

Dollars in millions

Factor	Amount
Acquisition cost	$1,638
Selling and holding expenses	154
Subtotal	1,792
Sales proceeds	−1,327
Net loss	**$465**

VA holds the veteran whose home loan was terminated liable for much of the loss it incurs. The following items are included in the veteran's debt to VA: (1) unpaid principal balance; (2) past due interest; (3) maintenance and repair costs, including taxes and insurance; and (4) foreclosure costs, including legal costs, title search, and recording fees. Subtracted from the total debt is the property's fair market value adjusted for VA's cost to acquire, manage, and resell the property. VA's cost during fiscal years 1987 and 1988 was set at 10.75 percent of the property's appraised value to account for costs such as real estate commissions, management fees, taxes, securing, and cleanup and winterizing costs. Table 2.3 shows that the average amount of the veteran's debt

year 1987 (cited previously) for two reasons: (1) it includes some major VA costs (described in app. I) not included in VA's computations, and (2) the King County property is higher priced and takes longer to acquire and resell than the average VA property.

Table 2.4: Estimate of Potential Savings From Using Alternatives to Foreclosure

		Alternatives to foreclosure		
	Judicial foreclosure	Compromise agreement[a]	Voluntary conveyance[a]	Refunding[b]
Costs charged to the veteran	$20,563	$15,478	$14,823	$15,352
Costs absorbed by the federal government, such as interest costs and loss on resale of property	16,380	[c]	7,500	8,190
Veteran's debt collected	−2,879	−2,167	−2,075	−2,149
Net federal government losses	**$34,064**	**$13,311**	**$20,248**	**$21,393**
Savings if alternative used	[d]	$20,753	$13,816	$12,671

[a]The amounts shown under these alternatives are based on the assumption that the veteran signs a promissory note for the full amount of the veteran's debt.

[b]This column assumes that 50 percent of the refundings are successful and the unsuccessful refundings are followed by judicial foreclosure

[c]VA incurs none of these costs because it does not take possession of the property under a compromise agreement.

[d]Data not applicable.

Compromise Agreements

A compromise agreement may be appropriate if property values have declined below the loan amount or if delinquent interest has increased the loan balance above the fair market value of the property. In these circumstances, for the veteran to be able to sell the property and avoid foreclosure it may be necessary to obtain financial assistance from VA because the proceeds from the sale of the home would not be sufficient to pay the outstanding loan balance and selling expenses. This approach has the potential to save money in several ways. VA avoids the foreclosure costs as well as the cost associated with acquiring, managing, and reselling the property. Since these costs are included in determining the veteran's total indebtedness, the veteran's liability is less under a compromise agreement than under foreclosure.

At the nine regional offices we examined, the use of compromise agreements grew from 13 instances in fiscal year 1986 to 44 in fiscal year 1987. Compromise agreements still constituted only about 0.1 percent of

VA's Inspector General also reported on the cost-saving advantages offered through voluntary conveyances. In September 1986, the Inspector General issued a report covering seven VA regional offices. The report projected that VA could have saved $16.2 million in fiscal year 1985 acquisition costs if it had acquired more properties through voluntary conveyances of the property deed.

The use of voluntary conveyances varied considerably at the nine regional offices we examined. Comments received from VA regional office officials reflect the fact that the feasibility and desirability of obtaining voluntary conveyances are highly dependent on state foreclosure laws and redemption periods, which vary considerably between states. (See app. VI.) At the offices in St. Paul, Minnesota, and Togus, Maine, voluntary conveyances constituted about 24 percent and 35 percent, respectively, of the foreclosure actions taken in fiscal year 1987. Usage at the seven other offices was much less, constituting less than 3 percent of the foreclosures during the same year.

At five of the offices, the use of voluntary conveyances dropped from 41 cases in fiscal year 1986 to 21 cases in fiscal year 1987. The official from Houston said that in Texas, the time required to conduct a foreclosure sale under nonjudicial foreclosure is short and there is no redemption period. The official also stated that this alternative does not save any time or money, since it takes more VA staff time to complete a voluntary deed than to foreclose. We obtained a different opinion from three offices that had a longer foreclosure process and more voluntary conveyances in fiscal year 1987 than in fiscal year 1986. Officials at two of these offices (St. Paul, Minnesota, and Seattle, Washington) said they accepted voluntary conveyances to avoid the redemption period, and an official at the third office (Muskogee, Oklahoma) said the office accepted more deeds to avoid delays caused by veterans' bankruptcies.

Refunding

Refunding is one alternative available to VA that allows the defaulting veteran to retain the property. It is seldom used by VA, even though it may be cost-effective for VA to use it more often. Our analysis shows that refunding is financially advantageous to VA even though veterans often default on refunded loans. On the basis of experience, VA projects that 50 percent of refunded loans will be successfully reinstated and 50 percent will be foreclosed.

Our analysis of VA data, as presented in our May 1987 testimony before the House Subcommittee on Housing and Memorial Affairs and as shown

deep discount, VA could sell the loans with recourse to VA in the event of subsequent foreclosures on the loans.

Officials at five of the nine regional offices we examined (District of Columbia, Seattle, St. Paul, Philadelphia, and St. Petersburg) said they also considered refunding to be a last resort prior to foreclosure. Officials at most of the nine offices agreed that many borrowers in default were not good candidates for refunding for a variety of reasons, such as the lack of income to repay the loan or the absence of a desire to retain the property.

Conclusions

National statistics and the information we developed at the nine regional offices show that VA offices seldom use alternatives to foreclosure. Nonetheless, foreclosure is an expensive option for terminating a loan, and the use of foreclosures may have contributed greatly to the $465 million in losses experienced by the program and the $14,046 average debt established against foreclosed homeowners during fiscal year 1987.

The passage in December 1987 of Public Law 100-198, requiring VA to notify defaulting borrowers of the alternatives to foreclosure, is a step toward improving the program and reducing dollar losses (as mentioned earlier, the authority to do this counseling expires on March 1, 1991). However, the continuing high volume of VA foreclosures and limited use of alternatives indicate that a determined effort by VA loan-servicing officials will be needed to obtain cost savings for VA and benefits for veterans such as retaining the property, avoiding or limiting indebtedness, and maintaining a desirable credit record. This determined effort, as discussed in chapter 3, should include more aggressive servicing of defaulted loans and the development and use of a process that considers all the costs of foreclosure and the alternatives to foreclosure for each defaulted loan. Pursuing the least costly alternative available could significantly reduce losses to VA.

Like VA, some PMIs provide supplemental servicing when the lender is unable to resolve the default.

Although there are about 15 PMIs in the United States, only a few account for the majority of conventional loans that are insured. We interviewed officials of the following four PMIs, which collectively insure about 76 percent of all insured conventional mortgages: Commonwealth Mortgage Assurance Company in Philadelphia, Pennsylvania; Mortgage Guarantee Insurance Company in Milwaukee, Wisconsin; Mortgage Assurance Services Corporation in Madison, Wisconsin; and General Electric Mortgage Insurance Companies in Raleigh, North Carolina.

PMIs Require Early Default Notification

On the basis of our interviews with PMIs, we found that they require notification of delinquent borrowers more quickly than VA. Three of the PMI officials told us that early contact with delinquent borrowers is key to determining the cause of a loan default and developing a strategy for keeping losses to a minimum. Three of the PMIs require that lenders provide them with a notice of default 60 days after the initial default (first missed payment); the fourth requires the notice within 90 days. VA regulations, by comparison, require the notice no later than 105 days after the initial missed payment.

The methods PMIs use to contact delinquent borrowers are more extensive than those used by VA and are more likely to produce face-to-face contact. VA officials at all nine of the regional offices we reviewed contact delinquent borrowers by telephone calls and/or letters. Only three regions said they made any face-to-face contact with borrowers. The PMI methods of contact, by comparison, are as follows:

- One PMI employs telecounselors, who use a nationwide phone system to place calls to delinquent borrowers 6 days a week from 8 a.m. to 9 p.m. Cases are referred to a local mortgage loan counselor, who visits the borrower at home.
- Another PMI said it contracts with service personnel throughout the country to interview borrowers face-to-face.
- Officials from the two remaining PMIs said they work closely with the lenders. One PMI official said PMI personnel work directly with the lender's staff who are servicing loans. The other said the PMI becomes involved in servicing if it believes the lender is not adequately servicing the loan.

Home Sales Assistance

All four PMIs have a home sales assistance program that is similar to VA's compromise agreement program. PMI officials said they provide home sales assistance to borrowers who are moving toward foreclosure. PMIs use real estate specialists to help borrowers market their properties before foreclosure. For example, the real estate specialists for one company meet with the borrower to discuss the property, evaluate the property's condition and marketability, write an opinion of value and a marketing plan, recommend brokers to handle the sale, and track the marketing strategy's success.

Officials from three of the PMIs told us that providing home sales assistance is effective in reducing claim losses on properties that would otherwise be foreclosed. None of the PMIs provided specific figures for the frequency with which the sales assistance program was used. However, an official at one PMI estimated that the program is used successfully on about 30 percent of defaulted loans moving towards foreclosure, saving about $4 million each year. Another PMI official stated that in 1987 the PMI had saved over $4 million using its sales assistance program. By contrast, in the nine VA regional offices we reviewed, the compromise agreement program was used less than 1 percent of the time in fiscal years 1986 and 1987. VA did not have information on the estimated savings resulting from the compromise agreement program.

Voluntary Conveyance of a Property Deed

PMIs, like VA, have the option to accept a voluntary conveyance in lieu of foreclosure. Officials at three of the PMIs told us that voluntary conveyances are appropriate in locations where the time to foreclose on a home is lengthy. However, they do not encourage the use of this alternative because, when accepting a deed from the borrower, they may be required to waive the right to seek a deficiency judgment[2] against the borrower. Officials from two PMIs said that if a deed is accepted, they usually require that the borrower provide some consideration, such as cash or a promissory note.

None of the four PMIs provided specific information about how frequently they accept voluntary deeds, but all of them said that the number is very low. One official estimated that his PMI accepted only three or four voluntary deeds a year. Another estimated that less than 5 percent of their defaulting loans were terminated with a voluntary deed.

[2]A court order to pay the balance owed on a loan and other foreclosure costs if the proceeds from the sale of the house are insufficient to pay off the loan.

PMIs Report Large Savings Through Their Servicing Efforts

Officials from all four PMIs we interviewed said that extensive servicing of loans and the use of alternatives to foreclosure saved money. Three of the four PMIs were able to provide estimates of their savings. One official said his PMI reduced losses by about $14 million between 1986 and 1987. Officials at the two other PMIs reported savings estimates of $16 million and $18 million for 1987 as a result of servicing and the use of alternatives to foreclosure.

Interest

If VA decides to acquire a foreclosed property, it must pay the lender the total amount that the veteran owes the lender. It then must wait to sell the property to be reimbursed. The U.S. Treasury incurs interest costs on this money from the time the lender is paid until VA sells the property and receives payment from the purchaser. For example, on a $50,000 payment by VA to the lender, with interest of 3/4 percent a month (9 percent a year) and a time period of 9 months between paying the lender and receiving payment from selling the property, the imputed interest cost is about $3,375. Not considering this cost results in underestimating the costs of foreclosing on a property.

Debt Collectibility

When VA sells property it has acquired through foreclosure under the loan guaranty program, it usually suffers a loss. VA reported that losses on properties it had acquired and resold totaled about $356 million in fiscal year 1986 and $465 million in fiscal year 1987. VA lost an average of about $14,400 on each property sold in fiscal year 1986 and about $15,800 on each property sold in fiscal year 1987.

When VA pays a claim on a guaranteed loan, federal regulations allow VA to establish a debt against the veteran for the amount of the claim paid. The debt can include the following items: (1) unpaid principal balance, (2) past due interest, (3) accrued taxes, and (4) foreclosure costs, such as court costs, title search, and recording fees. Subtracted from the total debt is the net value of the property sold. In fiscal year 1987, the average amount of VA loan guaranty debt charged to each foreclosed veteran was $14,046, up from $12,144 in fiscal year 1986.

Very little of the debt VA establishes against the veteran may be collected because of the lower income of defaulting borrowers and/or incomplete implementation of VA collection procedures. We estimate that VA will collect only about 14 percent of its September 30, 1986, loan guaranty debt. The remaining 86 percent of the debt will be written off as uncollectible.

At six of the nine offices we reviewed, the loan service representatives did not know or consider the collectibility of the debt when they decided to foreclose. Officials at two offices said they assumed that VA would collect 100 percent of the debts it established against veterans. Not taking such losses into account runs counter to the regional offices' actual experience. For example, estimates from officials at seven offices on the percent of veterans foreclosed upon who declare bankruptcy, and thus are not required to repay their debts, ranged from 10 to 66 percent.

Table 4.1: Potential Savings per Property From Foreclosure Alternatives at Five VA Regional Offices

Alternatives to foreclosure	Savings using alternatives to foreclosure
Compromise agreements	$8,992
Refundings	$10,420
Voluntary conveyances	$1,426

Two regions estimated that they could have avoided 25 percent and 41 percent, respectively, of their foreclosures in fiscal year 1987 by using these alternatives. We estimate that the increased use of alternatives to foreclosure at these regions would have saved VA $8.3 million in fiscal year 1987. If all regions could have achieved similar results and savings in fiscal year 1987, we estimate VA could have saved between $42 million and $94 million. Because the information on which the estimates are based was obtained at a limited number of locations and is not a statistically valid sample, the estimates of savings should be viewed only as approximations. Appendix II illustrates in detail the assumptions and calculations for our savings estimate.

Conclusions

VA loan service representatives do not consider or compare all cost factors when analyzing loan termination alternatives. GAO believes these analyses should include the costs and benefits of each loan termination alternative, including the foreclosure costs charged to veterans but not collected, interest costs associated with acquiring and holding properties in inventory before selling them, and price discounts which VA offers to resell property. Doing so would provide a better comparison of the cost to VA of each loan termination alternative. As a result of considering these costs and selecting the least costly means of terminating loans, VA might greatly increase its use of alternatives to foreclosure. This, in turn, could reduce the losses VA absorbs when terminating loans.

Recommendations

To reduce the cost of the Home Loan Guaranty Program, we recommend that the Secretary of the Department of Veterans Affairs

- use GAO's model or develop a similar cost analysis that, on a case-by-case basis, identifies the costs of loan termination alternatives—including imputed interest costs, debt collection rates, and the discount on cash sales and

Table I.1: Comparison of Net Va Costs for Compromise Agreements, Unsuccessful Refunding, Voluntary Conveyance, and Nonjudicial and Judicial Foreclosure for a Typical Property in King County, Washington
Unpaid loan amount: $75,000 with a 10-percent interest rate
Foreclosure appraisal price: $75,000
Sales price: $70,000 if property is acquired by VA
Sales price: $73,000 for compromise agreement

	Compromise agreement			Voluntary conveyance			
Veteran's debt	**with P.N.[a]**	**without P.N.**	**Unsuccessful refunding[b]**	**with P.N.[a]**	**without P.N.**	**Nonjudicial foreclosure**	**Judicial foreclosure**
Deficiency amount (the difference between the unpaid loan amount and the appraisal price or, for compromise agreements, the sales price)	$2,000	$2,000	c	c	c	c	c
Overdue interest, taxes, and insurance to time of funding, compromise agreement, or VA acquisition of property @ $625/month and property taxes @ $95/month	6,480 (9 mo.)	6,480	$8,640 (12 mo.) 10,800 (subsequent judicial foreclosure —15 mo.)	$5,760 (8 mo.)	$5,760	$8,640 (12 mo.)	$10,800 (15 mo.)
Attorney & appraisal fees prior to foreclosure[d]	c	c	3,200	1,000	1,000	1,500	1,700
Additional fees (taxes management fees, real estate commissions) @ 10.75%[e] of appraisal price	6,998	6,998	8,063	8,063	8,063	8,063	8,063
Subtotal (amount of veteran's debt)	15,478	c		30,703	14,823	c	
VA costs not charged to veteran							
Real estate taxes @ $95/month and management fees @ $20/month during 12-month redemption period	c	c	1,380	c	c	c	1,380
VA loss on sale of property[f]	c	c	5,000	5,000	5,000	5,000	5,000
Imputed interest for period VA holds the property—from payment of claim to lender to receipt of sale proceeds. 4 months plus a 12-month redemption period for judicial foreclosures @ $625 a month.	c	c	10,000[g]	2,500	2,500	2,500	10,000[g]
Subtotal (VA costs not charged to veteran)	**c**	**c**	**16,380**	**7,500**	**7,500**	**7,500**	**16,380**
Total VA cost (Veteran's debt plus VA costs not charged to veteran)	15,478	15,478	47,083	22,323	22,323	25,703	36,943
Less amount of debt collected by VA[h]	2,167	c	4,298	2,075	c	i	2,879
Net VA loss	$13,311	$15,478	$42,785[j]	$20,248	$22,323	$25,703	$34,064
Average net VA loss assuming 50% of refundings are successful[k] ($42,784 x .5)			$21,393				

[a]The promissory note is assumed to be for the full amount of the veteran's debt. In practice, the promissory note is limited to $5,000, according to a Seattle VA official.

[b]Figures in this column are based on the assumptions that the refunding will include 12 months of unpaid interest at $625 per month and property taxes at $95 per month ($8,640), will be unsuccessful, and the property will then go through judicial foreclosure. Thus, costs incurred include all those shown in the judicial foreclosure column The cost of an unsuccessful refunding, both to VA and the veteran,

Assumptions Used in Calculating Estimated Savings From Using Alternatives to Foreclosure

To estimate the potential savings that VA could realize nationwide from increasing its use of alternatives, we first determined the potential dollar savings for each alternative to foreclosure at five VA regional offices. The five VA offices were Seattle, Washington; St. Paul, Minnesota; Philadelphia, Pennsylvania; St. Petersburg, Florida; and Houston, Texas. Because these offices are geographically dispersed and have a wide range in the number of foreclosures, we believe they provide a reasonable indication of the range of savings that can be attained by using alternatives to foreclosure. For each of the five offices, we applied our cost analysis model to a home loan with typical values that were selected by the VA officials at each location. Table II.1 shows the savings for each alternative at these five VA regional offices.

Table II.1: Savings From Using Foreclosure Alternatives at Five VA Regional Offices

	FY 1987		Savings from using alternatives to foreclosure		
VA office	Number of foreclosures	Foreclosure cost	Compromise agreement	Refunding	Voluntary conveyance
Houston	7,916	$27,017	$7,339	$11,238	$0
Philadelphia	459	10,376	490	3,015	482
Seattle	1,400	34,064	18,586	12,672	11,741
St. Paul	835	15,377	12,800	6,576	360
St. Petersburg	1,673	19,526	9,216	8,615	331
Average[a]	2,457	$25,387	$8,992	$10,420	$1,426

[a]Dollar amounts are weighted by the number of foreclosures in the five VA regions in fiscal year 1987.

Next we asked officials at each of the five VA offices to estimate the success rate each alternative would have in reducing the number of foreclosures they experienced during fiscal year 1987. Officials at only two of the offices (Seattle and Philadelphia) provided estimates of the percentage of foreclosures that could be successfully avoided by using the three foreclosure alternatives. Officials at the three other offices did not provide estimates. The estimates we received are shown in table II.2.

Table II.2: Estimate of Percentage of Foreclosures That Could Have Been Avoided in Fiscal Year 1987

VA regional office	Compromise agreement	Refunding	Voluntary conveyance	Total
Seattle	15	1	25	**41**
Philadelphia	10	5	10	**25**

We estimated potential savings that could have resulted if foreclosures were reduced by the percentages estimated by Seattle and Philadelphia. To do this, we multiplied the estimated percentages in table II.2 by the

are needed to pursue alternatives to foreclosure, VA could consider contracting for them. During March 1988 testimony before the House Subcommittee on Housing and Memorial Affairs, Committee on Veterans' Affairs, we cited the statement by the Director of VA's Loan Guaranty Program that, according to the findings of a VA Task Force on Debt Prevention, the cost to hire fee (contract) personnel to conduct servicing would be minimal compared to the projected savings.

Our conversations with PMI officials indicated that limited statistical information was available about the success of alternatives in reducing foreclosures. In the absence of more comprehensive data, we applied the range of estimated success rates obtained from the VA Seattle and Philadelphia offices (table II.2) to the average weighted savings per property in five VA regional offices (table II.1) and to the 42,029 foreclosures VA actually had in fiscal year 1987. For the voluntary conveyance alternative, we used 0 percent as the low end of the range, since an official at the Houston office said that voluntary conveyances are used very little in Texas because the foreclosure process is faster and assures VA of an unencumbered deed.

As table II.4 shows, we estimate that VA could have saved between $42.2 million and $93.6 million if fiscal year 1987 foreclosures were reduced by the percentages estimated by VA officials in Seattle and Philadelphia.

Table II.4 Estimated Nationwide Savings From Increased Use of Alternatives to Foreclosure in Fiscal Year 1987

	Average weighted	Increased use (percent)		Estimated savings (dollars in millions)	
Alternative	**savings per property**	**Low estimate**	**High estimate**	**Low estimate**	**High estimate**
Compromise	$8,992	10	15	$37.8	$56.7
Refundings	10,420	1	5	4.4	21.9
Voluntary conveyance	1,426	0	25	0	15.0
Total				**$42.2**	**$93.6**

Because the information on which the estimates are based was obtained at a limited number of locations and is not a statistically valid sample, the estimated potential savings should be viewed only as approximations. However, considering that the information available from two locations (Seattle and Philadelphia VA Offices) indicated potential savings of $8.3 million based on less than 5 percent of VA's fiscal year 1987 foreclosures, we believe potential nationwide savings are significant.

VA Letter Sent to Defaulting Home Loan Borrowers Containing Methods to Avoid Foreclosure

LOAN NUMBER

We have been notified by the holder of the mortgage on your property that your loan is in default and that the holder intends to foreclose.

It is very important that you find a way to take care of the delinquent payments on your loan without delay. Unless you are able to make satisfactory arrangements for curing the default, you will lose your property and your credit standing will be seriously affected. In addition, if the property should sell for less than the loan indebtedness at the liquidation sale, and VA has to pay a claim on the loan, the amount of claim paid to the holder may represent a debt which you will owe the government. This is true even though the holder of your loan does not or may not be able to hold you personally liable for any deficiency existing after the completion of the foreclosure. Under the law, we are required to make every effort to collect an indebtedness arising from the payment of a claim on a GI loan.

If your loan holder begins foreclosure action, an appraisal of your property will be made by a reputable and qualified fee appraiser. We will use the appraisal to determine the net value of the property to VA and the minimum amount, if any, which the holder must credit to your loan indebtedness as a result of foreclosure. If you are able to reinstate your loan before foreclosure is completed, and the appraisal has already been performed, then you will be required to repay the holder for the cost of the appraisal.

Should you be unable to make arrangements with your loan holder to reinstate your loan, and would like VA to assist you, please telephone us at the number shown below or visit our office between 8:00 a.m. and 4:00 p.m. Monday through Friday. We may be able to help you work out a realistic repayment schedule acceptable to the loan holder. We also offer financial counseling and can discuss other alternatives which may help you to avoid foreclosure and protect your credit standing. A number of ways of avoiding foreclosure are outlined on the back of this letter - one, or more, may be appropriate for you.

In addition to financial counseling, VA offers vocational and educational counseling. Readjustment counseling is also available for veterans experiencing problems associated with service during the Viet Nam era. Information regarding these benefits may be obtained by contacting the Veterans Services Division at our office.

If you are now on active duty in military service (or if you have received official notice requiring you to report for duty within the next 90 days) please advise us of such service and tell us: 1) date of entrance on active duty; 2) your rank; 3) branch of service; and 4) your mailing address.

Chief, Loan Service
and Claims Section

WARNING: If you sell your home without paying off the mortgage, you may remain liable for the debt. Contact VA before selling for information on how to get a release from liability.

VA FORM FEB 1988 26-8762

Loan Default and Foreclosure Process for VA Home Loans

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 default. 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.

Note: 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.

Loan foreclosure is initiated by lender according to state law.

- Judicial foreclosure is used in 27 states.
  - 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.

VA sells property.

- VA pays real estate commissions and resale costs.
- VA places sales proceeds in revolving fund.

State	Redemption period	Anti-deficiency law
District of Columbia	None	No
Georgia	None	Yes
Idaho	None	No
Michigan	6 months	No
Minnesota	6 months	Yes
Mississippi	None	No
Missouri	1 year	No
Montana	None	Yes
Nevada	None	No
New Hampshire	None	No
North Carolina	10 days	Yes
Oregon	None	Yes
Rhode Island	None	No
Tennessee	2 years, but normally waived	No
Texas	None	No
Utah	None	No
Virginia	None	No
West Virginia	None	No
Wyoming	90 days	No

Note: The information in this appendix concerning the various state foreclosure laws was obtained from VA District Counsel offices.

[a]An anti-deficiency law is a state law that prevents a lender from recovering from a foreclosed borrower the loss that results when the proceeds from the sale of foreclosed property is insufficient to repay the debt, that is, the mortgage loan plus the cost of terminating the loan.

2.

Mr. John M. Ols, Jr.

The enclosed fact sheet provides additional information on our initiatives to increase the use of alternatives to foreclosure and contains comments on specific factors related to the development and use of the GAO statistical model.

Sincerely yours,

Edward J. Derwinski
Secretary

Enclosure

2.

See comment 3.

Legislative Requirements. Under current law, the Government holds the borrower responsible for any claim paid as a result of a GI home loan default. This program feature makes it necessary for VA to look at each case on an individual basis when determining which alternative to foreclosure may be most appropriate, especially since certain alternatives may result in loss of the Government's right to establish a debt against the borrowers. On occasion, the alternative that would result in the greatest reduction in the amount of claim payable cannot be pursued because it would require that borrowers with the ability to repay an indebtedness be released from liability.

The best example of the impact of these requirements is found in GAO's own evaluation of the costs of judicial/non-judicial foreclosure in Washington state. Prior to 1987, holders of GI home loans in Washington were routinely authorized to terminate insoluble defaults by non-judicial foreclosure, which is quicker and less costly than judicial foreclosure and avoids a redemption period. An April 3, 1987, court decision (in United States v. Vallejo) held that VA did not have a right to collect an indebtedness after a non-judicial foreclosure in Washington state. As a result, VA now must require holders to terminate loans judicially in order to comply with this feature of the law. (This requirement is not followed blindly in every case; our Seattle office has been instructed to allow holders to foreclose non-judicially whenever it can be determined that the probability of successful collection of a debt is remote.)

Cost Analysis Model. GAO's model discloses the obvious:

- o Faster termination of insoluble defaults reduces claim payments, i.e. there is an advantage to accepting deeds in lieu of foreclosure or, in states where there is a choice, using non-judicial rather than judicial foreclosure;
- o in market areas where VA loses money on property acquisition and disposition, foreclosure alternatives that avoid property acquisition are beneficial, i.e. private sale of the property with payment of a compromise claim by VA, and

See comment 4.

- o VA's current refunding program is cost-beneficial.

The variable that represents the amount of indebtedness VA expects to recover from a veteran cannot be valued until a complete analysis of the veteran's financial, credit and employment situation is available. In addition, the model cannot accurately be used until the liquidation appraisal has been received--normally at the conclusion of the foreclosure process
rather than at the beginning. By this time, alternatives to

4.

See comment 10.

The report states that VA may sell refunded loans and thereby recover the Government's investment. However, a refunded loan normally has a loan to value ratio in excess of 100 percent since VA will capitalize a delinquency and reamortize a loan in order to give the borrower a fresh start. In our experience, loans with a loan to value ratio in excess of 100 percent, and made to borrowers who have a prior default record, could only be sold without recourse at a deep discount, if at all. We, therefore, believe this statement is invalid. VA provides assistance through refunding when the loan holder believes there is no alternative to foreclosure but VA believes the veteran has the desire and ability to retain and pay for his/her home. The fact that VA may not recover its investment for an extended period of time is not a factor in the decision to refund or not refund a loan.

See comment 6.

See comment 11.

Other Issues. GAO did not develop any quantitative data to show the extent to which PMI's service delinquent accounts, the amount of their investment in servicing activities, or a breakdown of the savings achieved through servicing in relation to the number of loans serviced and average loss per case. Accordingly, the only conclusion one can draw is that, with the exception of direct financial assistance, which is also not quantified in the audit, PMI's pursue the same alternatives to foreclosure as does VA through its supplemental servicing. The assertion that PMI's are more aggressive servicers than VA is nowhere supported by data presented.

A final issue the report raises is VA's debt collection performance. GAO's comments regarding the percentage of debts recovered are generally correct. The dollar amounts recovered, however, are not insignificant:

	FY 1987	FY 1988	FY 1989*
Cash Collections	$30.4 mil	$38.7 mil	$29.2 mil

*Collections prior to receipt of funds through the major offset programs initiated for the fiscal year.

More importantly, the cost of collection has steadily declined and will continue to do so as more efficient means of collection are implemented.

See comment 12.

Conclusion. In our opinion, use of the model would burden field station staff with the need to generate additional paperwork to document what they already know. We understand that GAO has distributed their model to a number of VA field stations. Although none of these offices has advised us they are using the model on a routine basis or have found any particular value to it, we would have no objection to making it available to all field stations for use as an instructional tool or other purposes they might find to

6.

5. **Legislation**. Both the House and Senate Veterans' Affairs Committees have endorsed legislative proposals that will absolve veterans from home loan guaranty liability except in cases involving fraud, misrepresentation, material fault or lack of good faith. Enactment should enable VA to make greater use of alternatives to foreclosure because debt collectability will no longer be a factor when compromise claims or deeds in lieu of foreclosure are considered. VA supports these proposals.

These measures clearly indicate VA's concern over the issues of foreclosure and alternatives to foreclosure. It is our opinion that they will contribute to a substantive reduction in VA's losses due to GI loan defaults and terminations.

believe that this degree of precision is needed to choose among alternatives, because substantial differences exist in the costs involved in foreclosure and in the least expensive alternative to foreclosure. For example, as shown in appendix I, for King County, Washington, the least expensive alternative was a compromise agreement resulting in a VA loss of $13,311, or $20,753 less than judicial foreclosure, which was the most used loan termination method in King County.

5. As we pointed out in our July 12, 1989, report entitled Housing Programs: VA Can Reduce Its Guaranteed Home Loan Foreclosure Costs (GAO/RCED-89-58), cash discounts represent a "real" cost of terminating loans and are a factor that should be considered in determining its costs. We believe that the appropriate amount to be included in the model as a cash sales discount should be determined on a case-by-case basis and be in line with VA's use of the discounts in different parts of the county. Naturally, as the discounts are amended or discontinued because of market conditions, they should likewise be amended or discontinued in VA's cost analysis to determine the most appropriate loan termination alternative.

6. Our work did not provide a basis for assuming a specific success rate for the refunding option. On the other hand, our analysis shows that refunding can be a cost-effective alternative and that this and other alternatives are not being systematically considered and documented. In addition, there is no indication from VA records that VA refunds all the loans that qualify for refunding. We also note that refundings declined from 635 cases in fiscal year 1985 to 217 cases in fiscal year 1987, even though the total number of foreclosures increased during that time by 14,753 cases.

Furthermore, VA's Assistant Director for Loan Management told us that the refunding option is an option of last resort because VA's Loan Guaranty Revolving Fund was depleted and refunding requires an immediate outflow from the revolving fund.

7. We recognize that there will be cases in which borrowers will not cooperate with VA or in which property liens or other factors may prevent VA from using certain foreclosure alternatives. Therefore, we do not assume that VA has the ability in every case to successfully pursue the alternative to foreclosure that is most advantageous to the government. However, VA's data show that foreclosure was used in nearly 98 percent of all terminations during fiscal year 1987, and we found that VA's field

have any assurance that VA loan service representatives will consider or compare all cost factors when analyzing loan termination alternatives or that they will pursue the most cost-effective means of terminating a loan.

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offices were not performing and documenting the analyses that are needed to terminate defaulted loans in the least expensive manner.

Also, with regard to VA's assumption that VA "field stations are presently exploring realistic alternatives to foreclosure in every case in which VA succeeds in personally contacting the veteran," we note that the VA Inspector General report of March 31, 1989, states that VA "usually did not perform adequate supplemental servicing." The Inspector General's report also states: "In our sample of 240 loans requiring servicing, there were 211 cases (87.9 percent) that were not effectively serviced . . . ."

8. We did ask VA field office officials why they pursued the more expensive foreclosure method of terminating loans in default rather than pursuing less expensive alternatives. They generally responded that VA placed a higher priority on establishing the borrower's liability for foreclosure costs than on using the most cost-effective means to terminate defaulted loans.

9. We agree that dollar savings cannot be estimated with a high degree of certainty, but we believe that the estimate range we have provided based on our work shows that the potential savings through greater use of foreclosure alternatives are substantial. As discussed in appendix II, the information available from two VA locations indicated potential savings of $8.3 million based on less than 5 percent of fiscal year 1987 foreclosures. In the same appendix we point out that the information on which our estimates are based is not a statistically valid sample and that the estimated potential savings should be viewed only as approximations.

10. We do not suggest that VA sell refunded loans "without recourse." Our assumption was that VA would sell the loans with recourse. We have clarified this in chapter 2.

11. Our view that mortgage insurers are more aggressive than VA in servicing defaulted loans is based on a comparison summarized in chapter 3. Among the key differences are that private lenders are notified of delinquencies and get involved in their resolution earlier and that they make greater use of face-to-face meetings with delinquent borrowers.

12. We believe that the use of GAO's model or a similar cost analysis is needed to increase the use of foreclosure alternatives and thereby reduce the costs of VA's loan guarantee program. Unless VA requires a model to be used on a case-by-case basis, we do not believe that VA will

GAO Comments

1. Although alternatives to foreclosure are discussed at length in VA's manuals, our work showed that they were used only 2.2 percent of the time at the offices we visited.

2. We recognize that many loan defaults are cured either by lenders or VA, and we concur that VA's supplemental servicing should begin with an attempt to cure the default. The focus of our report, however, is the methods used by VA to terminate loans that have proven to be insoluble. As the report states in chapter 1, when a veteran falls behind on mortgage payments, the loan holder has the primary responsibility to contact the veteran and attempt to work out a solution to the problem. If after 105 days the loan holder is unsuccessful in restoring payment—referred to as "curing the default"—the loan holder notifies VA of the default. VA then is required to provide supplemental servicing, which consists of contacting the borrower using letters, telephone calls, and/or office visits in order to protect the interests of the borrower and the government.

To clarify our position, we have added a comment in chapter 1 stating that curing the default is the most desirable option available to VA, but when this is not possible and the default is insoluble, VA must terminate the loan through a foreclosure or through a foreclosure alternative.

3. We recognize that VA needs to consider the veteran's ability to repay when determining how to terminate a loan in default. Our review shows, however, that at six of the nine offices we reviewed, loan service representatives did not know or consider the collectibility of the debt when they decided to foreclose. For example, Seattle VA office officials informed us that they use the judicial foreclosure process about 90 percent of the time, although after foreclosure they expect to collect only about 5 percent of the borrower's debt. Thus, even though the probability of successful collection of the debt is remote for most foreclosures, the VA office usually uses the more expensive judicial foreclosure process to protect its right to attempt to collect the debt.

4. VA states that GAO's model cannot accurately be used until the liquidation appraisal has been received—normally at the conclusion of the foreclosure process rather than at the beginning. In fact, the use of our model requires only reasonable estimates of the value of the property and the collectibility of the debt, the same estimates that VA loan servicing officials currently make in cases in which they consider the cost-effectiveness of choosing among loan termination alternatives. Although a current appraisal of the property would be beneficial, we do not

5.

be beneficial. We do not, however, find any apparent benefit that would justify adoption of the model on a nationwide mandatory basis.

Specific measures are being undertaken to facilitate increased use of alternatives to foreclosure.

1. **Augmenting Loan Servicing Staff**. VBA has been authorized 88 additional loan servicing positions beginning with Fiscal Year 1990. This additional staffing will allow regional offices to apply the labor intensive activities to servicing loans that are in trouble by pursuing alternatives to foreclosure at an increased rate.

2. **Deeds in Lieu of Foreclosure**. Field stations were provided with revised instructions for use in considering deeds in lieu of foreclosure on August 24, 1988. These instructions state a deed in lieu of foreclosure should be approved whenever it is obtainable, legally feasible, and acceptance will result in a decrease in VA's liability. If, however, a review of the borrowers' income and assets indicates that a debt established after foreclosure would be collectible or there are other specific reasons for proceeding with foreclosure, a deed in lieu of foreclosure would not be accepted.

3. **Training**. The most extensive written procedural guidelines may be less than fully productive unless they are augmented by employee training. During FY 1989, VBA's Loan Guaranty Service prepared and held a 1-week training program for all loan service and claims section chiefs. In addition, 2-week training programs were held for loan service and claims technicians who are relatively new to their positions. Each training program devoted a substantial amount of time to supplemental servicing of GI loans and use of alternatives to foreclosure.

4. **Regulations**. The Secretary has approved development of regulations that would authorize waiving or compromising VA's debt collection rights prior to foreclosure when VA is able to reduce the Government's liability claim as a result of the veteran's cooperation in pursuing an alternative to foreclosure or the veterans's circumstances are such that no portion of the debt appears collectible in any event. These regulations are intended to encourage use of foreclosure alternatives and to improve VA's debt collection efforts by establishing debts that can be realistically repaid within a set period of time. The proposed regulations are in the concurrence process.

3.

foreclosure should have already been explored--if they have not, there would appear to be little if any benefit to delaying foreclosure while VA tries to convince the borrower to cooperate in taking whatever action is dictated by the analysis.

See comment 5.

Use of a factor to represent cash sale discounts is improper because such discounts are marketing tools that are applied at VA's discretion. Cash discounts may be amended or discontinued at any time based on current market conditions.

See comment 6.

Furthermore, GAO's proposal to use refunding as an alternative to foreclosure assumes that VA can expand the number of refunded loans while maintaining the same success rate. We submit, however, that VA has historically refunded loans that, after extensive servicing, appeared to be headed for foreclosure and for which there is a good likelihood the veteran will maintain the loan obligation in the future. Increasing this activity would entail refunding loans that simply do not qualify. This would require VA to assume a great deal more risk and would likely reduce the current success rate on these accounts.

See comment 7.

GAO Assumptions. The audit recommendations rest on assumptions that are either unproven or invalid. The assumption that VA has the ability to select and successfully pursue the alternative to foreclosure, which appears most advantageous to the Government is not adequately supported. Based on VBA supplemental servicing requirements and procedures, we would expect that field stations are presently exploring realistic alternatives to foreclosure in every case in which VA succeeds in personally contacting the veteran. GAO, however, found officials at two field stations who provided unsupported estimates as to how much the use of alternatives to foreclosure could be increased. GAO used the two estimates to project a nationwide potential for improvement, rather than asking the question why the two responding offices were not operating at a level of performance they estimated to be attainable. We recognize there is potential for improvement in this area; however, we do not believe that the level of improvement that could be attained can be quantified.

See comment 8.

See comment 9.

See comment 7.

There are factors that limit VA's effectiveness in encouraging veterans to use alternatives to foreclosure. We would suggest that one significant barrier is that the compromise agreement and voluntary conveyance alternatives both require the cooperation of the borrowers. Such cooperation may not be in the borrowers' best interest or may be precluded by circumstances beyond their control, for example, a depressed real estate market may make a private sale impossible, and secondary liens may preclude a voluntary conveyance.

HOUSING PROGRAMS: Increased Use of Alternatives to Foreclosure Could Reduce Losses
(GAO/RCED-89-131)

ISSUE: The principal findings of the report are:

- foreclosure of a VA-guaranteed loan is more costly to the Government than alternatives to foreclosure; and,

- increased use of alternatives to foreclosure would result in savings to the Government.

Based on these findings, GAO recommends that I :

- use GAO's model or develop a similar cost analysis to identify, on a case-by-case basis, the costs of loan termination alternatives, including debt collection rates, interest costs, and the discount on cash sales, and

- require VA loan service representatives to complete and document the loan termination analysis and pursue the least costly alternative.

See comment 1.

DISCUSSION: We agree that alternatives to foreclosure are generally beneficial to the Government and to the veteran-borrower. This is the basis for VA's continuing its longstanding practice of providing personal supplemental servicing to delinquent veterans. Compromise claims, acceptance of deeds in lieu of foreclosure, and refunding are discussed at length in VBA operational manuals that provide instruction on supplemental servicing activities. VA loan service representatives are encouraged to consider them as alternatives to foreclosure whenever appropriate.

See comment 2.

Loan Servicing. The audit team focused its analysis on terminated loans and, therefore, made recommendations with respect to handling insoluble defaults. As a result, the audit does not take into account the actual work environment faced by VA in dealing with loan defaults or the full range of alternatives to foreclosure pursued by VA. At the time a loan default is reported, it is seldom evident whether or not the default is insoluble. Therefore, VA begins personal supplemental servicing in every case by considering the alternative to foreclosure that is most beneficial to the veteran and to the Government: curing the default. The validity of VA's practice is evidenced by the fact that, during the first three quarters of Fiscal Year (FY) 1989, cures outnumbered loan terminations by 84,910 to 34,385. We feel that any recommendation regarding supplemental servicing must begin with an attempt to cure the default.

Comments From the Department of Veterans Affairs

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

THE SECRETARY OF VETERANS AFFAIRS
WASHINGTON

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

Dear Mr. Ols:

Thank you for your letter of July 19, 1989, transmitting your draft report entitled HOUSING PROGRAMS: Increased Use of Alternatives to Foreclosure Could Reduce Losses (GAO/RCED-89-131). I appreciate the opportunity to comment on the draft.

We agree with GAO's principal conclusion that foreclosure can be the most expensive approach to terminating a loan. We also agree that increased use of alternatives to foreclosure can result in lower claim payments by the Department of Veterans Affairs (VA).

The GAO recommends that VA should use GAO's statistical model to identify, on a case-by-case basis, the costs of loan termination alternatives, including debt collection rates, interest costs, and the discount on cash sales. We believe that the GAO model has some shortcomings in its assumptions and methodology; nevertheless, the Veterans Benefits Administration will make GAO's statistical model available to its regional office staff as an additional management tool.

In addition, the Department is taking action to increase the use of alternatives to foreclosure. Specifically, we are:

- augmenting the loan servicing staff in our regional offices,
- strengthening our deed in lieu of foreclosure instructions,
- augmenting employee training,
- establishing regulations that would enable VA to reduce the Government's liability claims, and
- endorsing legislative proposals that would enable greater use of alternatives to foreclosure.

State Foreclosure Laws

States Where VA Uses Judicial Foreclosure

State	Redemption period	Anti-deficiency law[a]
Arkansas	10 days	No
Connecticut	None	No
Delaware	None	No
Florida	10 days	No
Hawaii	2 months between date of sale and court confirmation of sale	No
Illinois	30 days, but rarely applies to most loans	No
Indiana	3 months	No
Iowa	1 year if deficiency established; 6 months if no deficiency established	Yes
Kansas	6 months	No
Kentucky	None, unless property sells for less than two-thirds of appraised value	No
Louisiana	None	No
Maine	None	No
Maryland	None	No
Massachusetts	None	No
Nebraska	Up to 1 year, but normally waived	No
New Jersey	10 days	No
New Mexico	30 days	No
New York	None	No
North Dakota	6 months	Yes
Ohio	3 days	No
Oklahoma	None	No
Pennsylvania	None	No
South Carolina	None	No
South Dakota	180 days	No
Vermont	None	No
Washington	1 year	No
Wisconsin	6 months if occupied; 2 months if abandoned	Yes

States Where VA Uses Nonjudicial Foreclosure

State	Redemption period	Anti-deficiency law
Alabama	10 days for homeowners	No
Alaska	None	Yes
Arizona	6 months if occupied; 30 days if unoccupied	Yes, if 2-1/2 acres or less
California	None	Yes
Colorado	75 days	No

(continued)

- Of the 27 states, 16 require a redemption period, which 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.
  - Of the 23 states and District of Columbia, 9 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, and taxes) 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 is 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.

METHODS FOR AVOIDING FORECLOSURE

PAY THE DELINQUENCY. Under most circumstances, GI loan holders are required to accept payment of the full delinquency and reinstate the loan. The delinquency may include certain legal costs if you are already in foreclosure. Many holders require certified funds for reinstatement.

FORBEARANCE/REPAYMENT SCHEDULE The most common way of resolving a loan default is to work out a plan which will let you repay part of the delinquency each month, along with your regular monthly installment. If you are temporarily unable to meet your monthly mortgage obligation, your holder may extend forbearance by agreeing to suspend payments or accept partial payments for a limited period of time until you will be able to begin a repayment schedule. VA cannot require the holder to extend forbearance or to agree to a specific repayment schedule; however, holders will usually cooperate so long as you can show that you will be able to resume payments on a specific date in the near future.

PAYMENT ASSISTANCE. Many State and local governments, as well as private charitable organizations, have programs which will pay all or part of your mortgage obligation for a fixed period of time. VA can provide information on these programs; we do not, however, have a program which would enable VA to give you direct payment assistance.

REAMORTIZATION. If your loan is reamortized, the delinquency is added to the loan balance in order to bring your payments up to date. This increases your loan amount and will also increase your monthly payments. The amount of the payment increase will not be as great if the life of your loan is extended at the same time. Your loan holder is allowed to extend and/or reamortize your loan by VA regulations; however, we cannot require the holder to do so.

PRIVATE SALE. If you do not believe you will be able to reinstate your loan and cure the default, a private sale of the property will enable you to meet your obligations and receive any equity you may have built up. Most private sales are for more than the amount owing on the loan. You may sell the property to a buyer who gets his or her own financing and pays off your GI loan or to a buyer who will assume your responsibility for the loan. If the buyer is assuming your loan, you should contact VA and obtain a release of liability before the sale is closed. If your property cannot be sold for an amount which is greater than or equal to what you owe on the loan, VA may pay a "compromise claim" for the difference in order to help you go through with the sale. You must contact VA to discuss the situation and get prior approval for a sale with a compromise claim payment.

DEED IN LIEU OF FORECLOSURE. If you will be unable to cure the default, and a private sale does not appear realistic, VA will consider accepting a deed in lieu of foreclosure. If there are no liens on the property, and VA agrees to accept a deed, you will have to sign legal papers making VA the owner of the property. Normally, VA will have to pay your loan holder a claim for the difference between the value of the property and the amount you owe on the loan. If a deed is accepted, you may be released from all further liability, or you may be asked to agree to repay the Government for all or part of the claim we paid. VA representatives can discuss this with you in detail.

REFUNDING. VA has the discretionary authority to buy a loan from the holder and take over the servicing. This is called "refunding." We consider this alternative for every loan before foreclosure is completed. If you have the ability to make mortgage payments, or will have the ability in the near future, but your loan holder has decided it cannot extend further forbearance or a repayment plan, you may qualify for refunding. If refunding is appropriate, VA will notify you.

Comparison of VA's Use of Foreclosures and Foreclosure Alternatives at Nine Regional Offices

VA regional offices	Number of foreclosures	Number of foreclosure alternatives: Compromise agreements	Voluntary conveyances	Refunds	Total	Alternatives as percentage of foreclosures
FY 1986						
Houston, TX	5,645	0	1	3	**4**	0.1
Muskogee, OK	1,406	0	13	33	**46**	3.3
Philadelphia, PA	498	3	22	10	**35**	7.0
Seattle, WA	1,245	7	33	1	**41**	3.3
St.Paul, MN	709	3	171	8	**182**	25.7
St.Petersburg, FL	1,413	0	8	6	**14**	1.0
Togus, ME	40	0	9	1	**10**	25.0
Waco, TX	1,643	0	2	10	**12**	0.7
Washington, DC	330	0	1	0	**1**	0.3
Total	**12,929**	**13**	**260**	**72**	**345**	**2.7**
FY 1987						
Houston, TX	7,916	1	0	25	**26**	0.3
Muskogee, OK	1,909	1	22	19	**42**	2.2
Philadelphia, PA	459	8	10	7	**25**	5.4
Seattle, WA	1,400	20	34	8	**62**	4.4
St.Paul, MN	835	5	201	4	**210**	25.1
St.Petersburg, FL	1,673	6	3	2	**11**	0.7
Togus, ME	23	3	8	0	**11**	47.8
Waco, TX	3,120	0	3	2	**5**	0.2
Washington, DC	412	0	0	1	**1**	0.2
Total	**17,747**	**44**	**281**	**68**	**393**	**2.2**

actual number of foreclosures the Seattle and Philadelphia VA offices had in fiscal year 1987 and then multiplied the results by the estimated savings attainable for each alternative to foreclosure, based on typical costs and property values, at the respective offices, as shown in table II.1.

Table II.3 shows the estimated savings the VA Seattle and Philadelphia offices could have achieved in fiscal year 1987 if foreclosures were reduced by the percentages shown in table II.2.

Table II.3: Estimated Savings by Increased Use of Alternatives to Foreclosure in Fiscal Year 1987

VA regional office	Compromise agreement	Refunding	Voluntary conveyance	Total
Seattle	$3,903,060	$177,408	$4,109,350	**$8,189,818**
Philadelphia	22,540	69,345	22,172	**114,057**
Total	**$3,925,600**	**$246,753**	**$4,131,522**	**$8,303,875**

For defaulted loans on which alternatives to foreclosure are not applicable, we estimate that the Seattle VA office could have saved an additional $6.2 million in fiscal year 1987 if it had foreclosed using the quicker and less costly nonjudicial process rather than the judicial process. After an April 1987 court ruling (see footnote i in app. I), the Seattle VA office used the judicial foreclosure process on about 90 percent of all foreclosures, according to Seattle VA's loan guaranty officer. This savings results because, according to this official, the judicial foreclosure process allows the veteran to occupy and/or redeem the property for a 12-month period following foreclosure. The official added that there is no occupancy/redemption right following a nonjudicial foreclosure. For a typical property in the area, the cost difference between a judicial foreclosure ($34,064) and a nonjudicial foreclosure ($25,703) is $8,361, as shown appendix I.

We discussed our cost analysis model and the savings achievable by using alternatives to foreclosure with VA officials at headquarters and five regional offices. They acknowledged that savings were achievable using alternatives to foreclosure but stated that more loan-servicing staff would be needed if VA is to actively pursue alternatives to foreclosure. We recognize that pursuing alternatives to foreclosure may require more loan servicing staff than are currently being used. However, any increase in staff should be partially offset by a reduction in the need for property management and disposition staff, since two of the alternatives (refunding and compromise sales) eliminate the need for VA to acquire, manage, and dispose of affected properties. If additional staff

would be lower in this example if VA acquired the property through a voluntary conveyance or nonjudicial foreclosure or assisted the owner to complete a compromise agreement. As our model illustrates, even if 50 percent of the refunds are unsuccessful, the average net VA loss under this alternative would still be less than the loss incurred by VA's going directly to foreclosure.

[c]Data not applicable.

[d]This category consists of processing costs—such as attorney fees, appraisal cost, title search, filing fees, publication cost, copying costs, and sheriff sale fees—as estimated by a Seattle VA official.

[e]This figure is used nationally by VA. Actual VA costs may be more or less than 10.75 percent of the appraised price. The $6,998 figure is used for compromise agreements because VA's management and other expenses are less for this option, according to a Seattle VA official.

[f]VA's loss is due to the difference between the appraisal price at the time of foreclosure and the price at which VA sells the house. The sales price is lower because the property declines in value during the period that VA holds it ($500 in this example) and, most importantly, because VA accepts up to 10 percent less than appraised price for cash sales. According to a Seattle VA official, about 60 percent of VA's sales in King County, Washington, are for cash and the discount accounts for $4,500 of the $5,000 loss figure used in this example.

[g]This figure assumes that VA sells the property 4 months after the end of the redemption period (16 months).

[h]We estimate this to be 14 percent of the debt owed by the veteran.

[i]As a result of a 1987 court ruling, VA does not attempt to collect from veterans on whom it has foreclosed nonjudicially. VA uses the judicial foreclosure process in the state of Washington. The Director of VA's Loan Guaranty Service stated the following in an April 16, 1987, letter to the Director of the Seattle VA Regional Office:

> "All foreclosure proceedings started after the date of this letter should be pursued on a judicial basis in order to preserve the right to a deficiency judgment. An exception can be made when it is determined that the probability of collection of the debt from the borrower is remote."

[j]The incremented cost of an unsuccessful refunding compared with a judicial foreclosure is $8,721 ($42,785 - $34,064), and VA's estimated loss on a judicial foreclosure in this example is $34,064, or 3.9 times as much. Thus a single successful refunding is sufficient to support 3.9 unsuccessful attempts. This differs from the 6.6 ratio discussed previously primarily because this example assumes it will take VA 12 months rather than 4.4 months to complete a refunding. However, if 50 percent of VA refunding is successful, refunding is clearly advantageous to VA for either ratio.

[k]The 50-percent figure is taken from a December 7, 1987, letter from the VA Administrator to the Chairman of the Senate Committee on Veterans Affairs, concerning a proposed refinancing and interest subsidy program for VA guaranteed home loans. We did not attempt to independently determine the success rate of VA's refunded loans

Model for Comparing VA Costs of Foreclosure and Alternatives to Foreclosure

As described in chapter 4, VA loan-servicing officials have no formal process for considering three federal costs when deciding whether to foreclose on a property or use one of the alternatives to foreclosure. These costs are (1) VA's interest cost during the period it holds a property, (2) the portion of VA's loss on the sale of a property that is due to the discount VA offers for cash purchases, and (3) the portion of the veteran's debt that VA does not collect. The costs for the latter two factors may vary between VA regional offices and for each defaulted loan. We developed a model that takes these factors into account and estimates VA's net loss for foreclosure and the alternatives to foreclosure for any given property. We applied the model to a typical property in King County, Washington, in which Seattle is located, using costs and time periods that VA's Chief Loan Service and Claims Officer in Seattle stated would be typical for the property.

The model shows that judicial foreclosure, which a Seattle official stated is used for most loan terminations in Washington, is VA's most costly option for terminating a loan. However, the director of VA's Loan Guaranty Service informed us that the veteran's debt is established in the state of Washington only by judicial foreclosure and that it is VA's policy to establish the veteran's debt when possible. This is done despite the fact that little of the debt is collected and VA could save an estimated $8,000 on each foreclosed property in Seattle if it used the quicker non-judicial foreclosure process. Thus, VA incurs an additional $11,000 in costs on each foreclosure in Seattle in order to establish the veteran's debt, of which we estimate VA will ultimately collect less than $3,000. The Seattle VA loan guaranty officer said she knew of no other guarantor, insurer, or lender in the state of Washington that regularly used the judicial foreclosure process to terminate non-VA-guaranteed home loans.

- require VA loan service representatives to complete and document the loan termination cost analysis and pursue the least costly alternative available.

Agency Comments

VA agreed that improvements are needed to facilitate the increased use of foreclosure alternatives and discussed several actions that it has taken toward this end. These actions are to

- augment the loan servicing staff in regional offices,
- strengthen deed in lieu of foreclosure instructions,
- augment employee training,
- establish regulations that would enable VA to reduce the government's liability claims, and
- endorse legislative proposals that would enable greater use of alternatives to foreclosure.

VA also agreed to make GAO's model available for its field staff to use voluntarily in evaluating the costs of loan termination alternatives. VA did not agree, however, to require its field offices to use either our model or a similar cost analysis to identify, on a case-by-case basis, the costs of foreclosure and foreclosure alternatives. VA stated that it found no apparent benefit that would justify adopting the model on a nationwide mandatory basis.

While the actions that VA is taking are appropriate means to increase the use of foreclosure alternatives, we believe that greater control is needed to ensure that loan termination decisions are cost-effective. Our analyses and interviews with loan-servicing staff at VA field offices show that the use of foreclosure to terminate loans in default is a deep-rooted and pervasive practice that accounted for nearly 98 percent of loan terminations during fiscal year 1987. Further, field office decisions to use the costly foreclosure alternative were made without the benefit of a systematic and documented analysis taking into account all costs. Consequently, we believe that accountability for loan termination decisions, which would be provided through a systematic, documented analysis, is a prerequisite for ensuring that in the future VA chooses foreclosure alternatives that are in the best financial interests of the government.

VA's comments are provided, along with additional GAO responses, in appendix VII.

Cash Discounts

In disposing of acquired properties, VA may either sell the properties for cash or finance loans on which the purchasers make monthly payments to VA. To encourage cash purchase offers, VA accepts offers that are equal to or greater than 90 percent of the property's list price. In effect, VA offers up to a 10-percent discount for cash offers. The Veterans' Home Loan Program Improvements and Property Rehabilitation Act of 1987 (P.L. 100-198), passed by the Congress on December 21, 1987, requires VA to sell at least 35 percent but no more than 50 percent of its acquired properties for cash.

By not considering the cost of cash discounts, which VA offers to sell the property, VA underestimates its cost of foreclosing on the property.

Cost Analysis Model Would Allow VA to Consider Costs and Benefits of Alternatives

To demonstrate the feasibility of analyzing various loan termination alternatives and specific cost factors, we developed a model that identifies costs associated with each loan termination alternative. Our model compares net costs to VA for foreclosure, compromise agreements, voluntary conveyances, and an unsuccessful refunding followed by a compromise agreement, voluntary conveyance, or foreclosure. Our model takes into account cost factors such as (1) U.S. Treasury interest costs; (2) past due loan interest; (3) processing costs, such as attorney and appraisal fees; (4) deficiency amounts; and (5) debt collected. The cost factors can be modified to account for individual case and geographic differences.

The model is explained in greater detail in appendix I. The alternatives, cost data, and assumptions for it were reviewed by the Chief of Loan Service and Claims of the Seattle VA regional office, who confirmed that the figures used were reasonable.

Using the model to estimate cost and savings for each alternative to foreclosure, as we described in chapter 2, we analyzed typical properties in five VA regional offices—Seattle, St. Paul, Philadelphia, St. Petersburg, and Houston. For the five offices as a group, we determined the weighted average of the potential savings for each alternative based on the number of foreclosures that each office experienced during fiscal year 1987. The potential savings for each alternative is presented in table 4.1.

VA Could Reduce Losses by Making Greater Use of Foreclosure Alternatives

VA needs to implement a process that takes into account all costs when the agency decides to allow the lender to foreclose on a defaulting loan or use alternatives—such as compromise agreements, voluntary conveyances, and refundings—that are available to resolve loan defaults. Our review shows that all costs are not considered and that this may result in VA's selecting foreclosure over a less costly alternative.

Using an alternative to foreclosure to cost-effectively terminate a loan may not always be possible because of differences in state foreclosure laws, borrowers' individual financial situations and preferences, and the strength of local housing markets. However, by identifying the most cost-beneficial alternative and pursuing it whenever possible, VA can reduce its losses. This chapter presents an economic analysis model that can be used to make such determinations.

VA Does Not Consider All Costs in Choosing Alternatives for Terminating Loans

VA regulations give loan service representatives considerable discretion in resolving delinquent loans. The regulations are not specific about how a loan termination should be analyzed, what cost factors should be included, or when in the foreclosure process the termination analysis should be made. For example, VA's regulation for loan management and servicing policies, procedures, and methods simply states that by the time a loan is determined to be insoluble, "due regard will have been given to the most expeditious means of liquidation." Loan service representatives are required to explore the possibilities for curing the default and submit a field report describing the situation. But the regulation for completing the field report does not require VA officials to document the reasons they rejected loan termination alternatives or the factors they used to select the chosen alternative.

VA does not consider three major factors that should be included in an analysis of costs and benefits when it selects a method to terminate loans. These factors are (1) the interest cost incurred on the funds used by VA to acquire property until VA sells the property and receives payment, (2) the probable amount of the veteran's debt that VA will ultimately collect, and (3) the discount of up to 10 percent of the property's list price that VA offers buyers who purchase VA properties for cash. These factors are discussed in the following section, followed by an example of how each factor can be included in an economic analysis comparing loan termination alternatives. More detailed information on these three factors and other related factors is contained in our separate report, Housing Programs: VA Can Reduce Its Guaranteed Home Loan Foreclosure Costs (GAO/RCED-89-58), dated July 12, 1989.

Loan Purchasing From Lenders

All of the PMIs that we reviewed sometimes purchase the loan from the loan holder. One PMI's loan purchase program was similar to VA's refunding program in that the PMI purchases the loan from the lender and restructures or modifies the terms of the loan to a payment that the borrower can afford. None of the PMIs we reviewed provided statistics showing how often the loan purchase option is used.

Direct Financial Assistance

Direct financial assistance, an option that VA does not use, is used by some PMIs for qualified borrowers who are experiencing temporary financial problems and have the ability to resume payments. Two of the PMI officials said that when feasible, they favor some form of financial assistance over foreclosure to minimize losses.

With the agreement of the lender, the PMI loans the borrower the money needed to reinstate the mortgage and resume payments. However, before the PMI makes such a loan, the lender must agree to offset the amount of the loan against a possible insurance claim against the PMI. In effect, this limits the PMI's potential loss to the amount of the original insured loan. Two of the PMIs we interviewed said that the borrower is required to sign a promissory note to repay this loan; another said that lenders write agreements with borrowers to increase monthly payments until the PMI's loan is repaid. The term of the PMI loan varies among the companies. One PMI said that it provides loans for up to 1 year; another said it provides the loan for up to 5 years.

Officials at three of the PMIs said they are very selective when providing direct financial assistance. One of these officials said that the PMI uses this option only occasionally because the PMI is usually successful in other servicing techniques that do not require additional funding. Another PMI official said that a direct loan is suitable in those cases in which forbearance is no longer feasible but the borrower has the ability to repay an additional loan. While three of the four PMIs did not give us figures on how often this option is used, one PMI representative said that his firm uses direct financial assistance to cure about 3 percent of its cured loans.

PMI officials told us they work with lenders to develop plans to cure the loan and avoid foreclosure. They also said they encourage lenders to grant forbearance[1] and to modify or refinance loans to avoid foreclosure.

PMI Alternatives to Foreclosure

The alternatives to foreclosure used by PMIs are similar to those available to VA. A cost-effective alternative to foreclosure used by PMIs is home sales assistance, which is similar to VA's compromise agreement program. Other alternatives to foreclosure occasionally used by PMIs are accepting a voluntary conveyance of the property deed and purchasing the loan from the lender. Another alternative occasionally used by PMIs, which is not available to VA, is direct financial assistance.

PMI officials said that when a borrower defaults on the home loan, they encourage early borrower counseling to determine the cause of the default so that the loan can be cured to prevent foreclosure. If there is no alternative to foreclosure, the PMIs encourage lenders to use the home sales assistance program so that the home can be sold before foreclosure occurs. PMI officials told us that when a foreclosure occurs, they usually do not acquire the property because the acquisition and holding costs are higher than the cost of paying the claim to the lender. Regarding the homes going to foreclosure, one PMI official estimated that the PMI paid the claim 80 percent of the time, another estimated 99 percent, and a third estimated 96 percent of the time. The fourth PMI official did not estimate how often the property is left with the lender but said that the PMI rarely acquires the property.

In comparison, VA leaves the property with the lender less often. For example, in fiscal year 1987, VA left 21 percent of foreclosed properties with the lender. One reason property is left with the lender less often is that when VA analyzes the value of the property, it does not consider significant cost factors, such as (1) the interest cost incurred on the funds used to acquire the property, (2) the portion of the debt charged to the veteran that is never collected, and (3) the price discount given to cash buyers of VA property acquired and resold. These cost factors are discussed in detail in chapter 4. In addition, since VA guarantees a greater portion of the loan than PMIs (40 to 50 percent versus 20 to 25 percent) for defaults with similar characteristics, leaving a property with the lender is less frequently a financially desirable alternative for VA than it is for PMIs.

[1] To refrain for a specific period from enforcing or claiming a debt that has become payable.

Private Mortgage Insurers

PMIs more aggressively service defaulting home loans to prevent foreclosure than VA does. Our interviews with officials of four PMIs that collectively insure an estimated 76 percent of all insured conventional mortgages showed that PMIs become involved with delinquent borrowers earlier—up to 45 days sooner than VA—and more frequently use face-to-face interviews. They also use a home sales assistance program, whose objective is similar to that of VA's compromise agreement program, as an alternative to foreclosure. PMIs use other alternatives, such as accepting a voluntary conveyance of the property deed, providing direct financial assistance, and purchasing the loan from the lender (similar to refunding). Table 3.1 compares PMI and VA activity to cure defaults.

Table 3.1: Comparison of PMI and VA Loan Guaranty Default Activity

Activity	PMI	VA
Percentage of loan guaranteed	20-25 percent	40-50 percent
Lender notification of missed payment (default)	60-90 days	105 days
Methods used to cure defaults	Telephone calls	Telephone calls
	Letters	Letters
	Visits by loan counselors	Work with lender's staff
	Work with lender's staff	
Alternatives used to avoid foreclosure	Home sales assistance	Compromise agreement
	Voluntary conveyance	Voluntary conveyance
	Loan purchase	Refunding
	Direct financial assistance	

PMIs believe that their servicing efforts result in large savings. Officials at three of the four PMIs provided savings estimates. These estimates ranged from $14 million to $18 million for each PMI in 1987.

Role of the PMI in Conventional Mortgages

PMIs guarantee conventional mortgages in a manner similar to the way VA guarantees mortgages for veterans. However, PMI officials said the guaranty is normally 20 to 25 percent of the amount of the loan, whereas VA presently guarantees from 40 to 50 percent, depending on the size of the loan.

Servicing a conventional mortgage is also similar to servicing a VA-guaranteed home loan. When a PMI-guaranteed loan goes into default, it is the lender's responsibility, as it is with a VA loan, to initially service the loan.

in table 2.5, demonstrates that the average additional loss VA incurs when a refunded mortgage fails is $2,394. However, as we noted earlier in this chapter, VA's average loss on a foreclosed loan in fiscal year 1987 was $15,817, or about 6.6 times as much. Consequently, as shown in table 2.5, a single success is sufficient to support six unsuccessful attempts. Appendix I compares the cost of refunding and other alternatives to the cost of foreclosure for a property in King County, Washington. The comparison shows a ratio of 3.9 rather than 6.6 primarily because the calculation assumes that it will take 12 months rather than 4.4 months to complete refunding. However, because the estimated success rate is 50 percent, refunding is clearly financially advantageous to VA for either ratio.

Table 2.5: Analysis of the Incremental Cost Associated With a Refunding Failure

Factor	Result
Average monthly payment of a refunded loan	$544[a]
Total number of months refunding decision delayed	x4.4[b]
Average additional loss if a refunded mortgage failed (4.4 months x $544)	$2,394
Average foreclosure loss on property acquired in fiscal year 1987	$15,817
Failure-to-success ratio	6.6 to 1

[a]The average monthly payment on a refunded loan of $53,883 at 9.5 percent interest for 30 years.

[b]The average number of months between default and the lender's notice of intention to foreclose is 3.4 months, and the refunding decision takes 1 month.

At the nine offices we examined, only 140 refundings were completed, or about 0.5 percent of all foreclosure actions taken in fiscal years 1986 and 1987. While the use of refundings decreased from 72 in fiscal year 1986 to 68 in fiscal year 1987, the number of foreclosures increased by about 5,000.

In a May 1987 VA circular, VA's Chief Benefits Director stated that the decision to refund should not be delayed until loan termination procedures have started. However, we found little evidence of early consideration of refunding. VA's Assistant Director for Loan Management told us that the refunding option is an option of last resort because VA's Loan Guaranty Revolving Fund, as of March 1988, was depleted and refunding requires an immediate cash outflow from VA's revolving fund, which is then paid back over the life of the loan through the monthly mortgage payments. However, VA can sell the refunded loan to the secondary market and use the proceeds to replenish the revolving fund, thereby addressing the cash flow problem. To sell the loans without a

foreclosed loans. Officials at several of these offices said this alternative was little used because they lacked knowledge of the alternative until late in fiscal year 1987. According to a Washington, D.C., regional office official, in September 1987 VA reemphasized the use of compromise agreements during a meeting of the agency's loan guaranty officers.

VA instructions attach certain conditions to compromise agreements. The instructions state that before VA can initiate a compromise agreement, the defaulting homeowner (1) must have a buyer, (2) must have an offer for the property at the fair market value, and (3) may be required to remain liable for the claim VA will pay the loan holder.

Some regional offices take a more active role than others in helping veterans qualify for compromise agreements. The Togus, Maine, office, according to a VA official there, assists a defaulting veteran by writing the newspaper advertisement announcing the home sale and by allowing the veteran 1 month to sell the property. The office in St. Paul, Minnesota, is flexible in determining property market value. Instead of setting market value by the appraisal, St. Paul officials said they consider the appraisal as only one method of determining market value and will consider any offer to buy the property.

Voluntary Conveyances

A voluntary conveyance of the property deed to VA is advantageous to the veteran because it avoids a documented foreclosure on the veteran's credit rating and may release the veteran from the liability to repay all or part of the claim paid by VA. It is advantageous to VA because it saves foreclosure time and costs. In addition, the property can be resold sooner because the redemption period required under foreclosure does not apply when the veteran conveys the deed.

Our analysis shows that voluntary conveyances can terminate loans sooner than foreclosures. Using VA's Liquidation and Claims System database for the period from fiscal year 1986 through fiscal year 1987, we determined that the average VA foreclosure was completed in 205 days, or about 7 months after VA processed the lender's notice of intent to foreclose. The average time for VA to complete a voluntary conveyance was about 152 days, or about 5 months. The time to complete the voluntary conveyance was measured from the date VA processed the notice of intent to foreclose to the date the voluntary conveyance was recorded.

charged by VA increased from $12,144 in fiscal year 1986 to $14,046 in fiscal year 1987.

Table 2.3: Average Veteran's Debt After Foreclosure

Dollars in millions

	Fiscal year	
Category	1986	1987
Debt accounts established	25,934	31,728
Value of accounts	$315.0	$445.6
Average account debt	$12,144	$14,046

Even though VA holds veterans liable for loan guaranty debts, very little of the debt is ever collected. For example, in a previous examination of VA's financial statements for fiscal year 1986 that showed VA had not completely implemented required debt collection initiatives, we estimated that VA would collect only about 14 percent of its home loan debt.[2] The analysis was based on (1) loan guaranty accounts receivable as of September 30, 1986, and (2) VA's projected collections. The VA's Office of Inspector General performed a similar audit, which showed that about 75 percent of veteran debtors had little ability to pay debts because their incomes were less than $10,000 per year.[3]

Alternatives Offer Cost-Saving Opportunities but Are Seldom Used

Foreclosure may be the only available option in some instances of default, such as when the property is vacant and foreclosure is the only way to obtain the title to the property. However, in many instances, depending on the individual state foreclosure law and redemption period[4] the law allows, the alternatives to foreclosure can save considerable money for the government. Table 2.4 shows the savings that are possible from using alternatives other than foreclosure for a typical property in King County, Washington. The estimates are based on the economic analysis model described in detail in appendix I. The savings from using the alternatives range from $12,671 for refunding of the loan to $20,753 for a compromise agreement. In this example, the net federal government loss of $34,064 for a foreclosure is substantially greater than the $15,817 average loss per property reported by VA for fiscal

[2]Veterans Administration's Financial Statements for Fiscal Year 1986 (GAO/AFMD-87-38, July 29, 1987).

[3]Audit of VA's Debt Collection Program (VAIG 7AM-G99-069, June 3, 1987).

[4]The redemption period, required by many state laws, is a specific time after foreclosure during which the borrower may pay all past due amounts and repossess the property. Not all states require redemption periods; in those that do, the redemption periods range from 3 days to 1 year.

VA Makes Little Use of Alternatives to Foreclosure

VA seldom makes use of alternatives to foreclosing on defaulted loans. The number of VA foreclosures nationwide increased from 27,276 in fiscal year 1985 to 42,029 in fiscal year 1987, the last year covered by our review. During the same period, the number of voluntary conveyances and refundings declined from 2,363 to 1,504. Nationwide statistics were not available on the use of the third alternative to foreclosure—compromise agreements—but our review at nine VA regional offices showed that compromise agreements were used less often than the two other alternatives. For these nine offices in fiscal year 1987, the three alternatives collectively were used in only 2.2 percent of all loan foreclosures.

Foreclosure is in many instances the most expensive approach to terminating a loan. In fiscal year 1987, VA lost $465 million on homes it had acquired and resold, or an average of $15,817 per home.[1] Our review at VA headquarters and at nine regional offices indicated that greater use of foreclosure alternatives could substantially reduce VA losses.

VA Uses Foreclosure in Nearly All Loan Liquidations

Nationwide figures show that foreclosure is the predominant method VA uses to liquidate delinquent loans and that its use is growing. Table 2.1 shows the number of foreclosures, voluntary conveyances, and refundings for fiscal years 1985-87. The table does not include compromise sales, VA's other foreclosure alternative, because VA did not keep nationwide statistics on these sales prior to September 1987. As the table shows, the number of foreclosures increased from 27,276 to 42,029 during this period, an increase of about 54 percent. In contrast, the use of voluntary conveyances and refundings decreased. In fiscal year 1985, the two alternatives were used in 2,363 instances; in fiscal year 1987, they were used in 1,504 instances.

Table 2.1: Comparison of VA's Use of Foreclosures and Alternatives

Fiscal year	Total foreclosures, voluntary conveyances, and refunds	Number of foreclosures	Number of foreclosure alternatives: Voluntary conveyances	Refunds	Total
1985	29,639	27,276	1,728	635	**2,363**
1986	34,898	33,022	1,620	256	**1,876**
1987	43,533	42,029	1,287	217	**1,504**

[1] VA paid out an additional $150 million on about 6,900 foreclosed loans (about $21,740 per loan) on which it did not acquire the property but paid the guaranty to the lender.

the program's resources, the Chairman asked us to review the servicing VA conducts to supplement lenders' servicing efforts, compare VA's practices with those used by PMIs, and determine how VA's supplemental servicing activities can be improved.

To review VA's supplemental servicing activities, we reviewed VA loan servicing regulations and developed a set of questions for which we obtained answers at 9 of VA's 49 regional offices. The basis for selecting these nine locations is as follows.

We randomly selected four states from among the eight states that had more than 1,000 foreclosures in fiscal year 1987. We reviewed five regional offices in these four states: Houston and Waco, Texas; Muskogee, Oklahoma; St. Petersburg, Florida; and Seattle, Washington. Four regional offices were randomly selected from among the remaining 42 states, Puerto Rico, and the District of Columbia: Philadelphia, Pennsylvania; St. Paul, Minnesota; Togus, Maine; and the District of Columbia. This sample is not statistically representative, but it includes some of the areas hit hardest with increases in foreclosures.

The questions we asked covered a variety of topics related to VA servicing, such as VA's servicing procedures for homeowners in default, alternatives to foreclosure and the frequency of their use, and state foreclosure laws. We obtained the information from VA records and regional loan guaranty officials at the nine offices. We visited eight of the nine offices to obtain the information requested; the ninth, in Togus, Maine, was completed through a telephone interview because it had very few foreclosures (23 in fiscal year 1987). For each of the nine offices, we determined the number of foreclosures and foreclosure alternatives for fiscal years 1986 and 1987.

To compare VA loan-servicing procedures with those used by PMIs, we interviewed officials from four PMIs, which insure an estimated 76 percent of the insured loans in the conventional mortgage market. The PMI officials did not provide documentation to support any of their estimates of dollar savings or the frequency with which they use alternatives to foreclosure, which are referred to in chapter 3.

To determine how VA's supplemental servicing activities can be improved, we developed a computerized economic analysis program. This program compares the cost of each option available to VA when it is servicing a loan in default. The program was used at five of the nine VA regional offices whose activities we reviewed after completion of our

the sale of the property were insufficient to pay off the borrower's debt. However, this policy has been changed, and VA may now require the veteran to sign a promissory note for all or part of the debt in states where this is legally feasible.

Refunding

When a lender will not restructure a loan (i.e., reduce the monthly payment through a lower interest rate or longer payment period) so that the borrower can resume payments, VA may pay the lender the outstanding loan amount as an alternative to foreclosure. VA then assumes the role of the lender and establishes a repayment plan based on the veteran's ability to repay the loan, thereby enabling the veteran to keep the property. Refunding is appropriate when the lender will not refinance the loan and the veteran wants to keep the house and has sufficient income to make lower monthly payments. VA regulations require VA to review every guaranteed loan in default for possible refunding prior to foreclosure.

Rising Number of Foreclosures Threatens Loan Guaranty Fund

VA's Loan Guaranty Revolving Fund is used to pay loan guarantees for terminated home loans. The Congress established the fund in 1960 to pay guarantees and to purchase and maintain properties associated with VA home foreclosures. The fund has been financed by a funding fee of 1 percent of the loan amount paid by the veteran, the sale of VA-held properties, principal and interest payments from VA-held home loans, rental income on certain properties owned by VA, and repayments of veterans' debts.

In recent years, there has been a large increase in the number of VA foreclosures. VA-guaranteed loan foreclosures rose from 12,490 in fiscal year 1981 to 40,336 in fiscal year 1989. This increasing number of foreclosures has caused expenditures by VA's Loan Guaranty Revolving Fund to exceed its income. From fiscal years 1984 through 1989, the revolving fund received a total of over $2.2 billion in appropriations to meet its obligations, as shown in table 1.1.

When there is doubt about whether a veteran qualifies for a home loan, it is VA's practice to encourage the lender to resolve the doubt in favor of the veteran. Therefore, unlike the private sector, VA takes higher risks by approving (or urging approval of) loans considered borderline by private lenders. One of the reasons that VA-guaranteed loans are more risky than conventional loans is that many of VA's borrowers make no down payment and therefore have no equity in the house at the time the loan is made. For example, in fiscal year 1986, 73 percent of the VA-guaranteed-loan borrowers made no down payment. VA studies show that the default rate for VA loans with no down payment is two to three times greater than for VA loans for which the down payment is 10 percent or more.

Procedures for Loans in Default

When a veteran falls behind on mortgage payments, the loan holder has the primary responsibility to contact the veteran and attempt to work out a solution to the problem. If after 105 days the loan holder is unsuccessful in restoring payment—referred to as "curing the default"—the loan holder notifies VA of the default. VA is then required to provide supplemental servicing, which consists of contacting the borrowers using letters, telephone calls, and/or office visits, in order to protect the interests of the borrower and the government in those cases in which the loan holder has exhausted all reasonable possibilities to reinstate the loan or to avoid foreclosure. Curing the default is the most desirable option but often is not possible. When the default is insoluble, VA must terminate the loan through foreclosure or through foreclosure alternatives.

Foreclosure

Foreclosure, an action governed by state law, is taken by the lender to terminate the borrower's ownership of a property. After being notified by the lender of its intent to foreclose, VA has 15 days to decide whether the veteran will be held responsible for the debt and to respond to the lender's notice. If VA does not respond, the lender may proceed to terminate the loan in any lawful manner 30 days after notifying VA of its intent to foreclose. However, VA generally instructs the lender to foreclose and holds the borrower liable for the debt that results if the proceeds from the sale of the house do not cover the balance of the loan and the additional expenses that VA must pay the lender. There are two types of foreclosure—judicial and nonjudicial. VA uses judicial foreclosure in 27 states and nonjudicial in 23 states and the District of Columbia. (See app. VI for a list of state foreclosure laws.) Judicial foreclosure requires court action, while nonjudicial foreclosure does not.

Introduction

The Home Loan Guaranty Program of the Department of Veterans Affairs (VA) provides credit assistance to eligible veterans purchasing homes. This program (U.S. Code, title 38, chapter 37) authorizes VA to provide a government guaranty on a mortgage that the veteran can use in lieu of a down payment when applying for a home loan. This assistance is intended to compensate for the economic opportunity lost during the veteran's military service. From its inception in 1944 through 1988, the program helped more than 12.6 million veterans obtain housing with mortgage credit totaling over $323 billion.

From fiscal year 1981 to 1989, the number of foreclosures of VA-guaranteed home loans more than tripled from 12,490 to 40,336. This rising number of foreclosures has increased the number of guarantee payouts to lenders. To meet its obligations, the Loan Guaranty Revolving Fund needed appropriations totaling more than $2.2 billion for fiscal years 1984 through 1989. These conditions have raised congressional concerns about the adequacy of VA's efforts to contact delinquent borrowers and attempt to solve loan repayment problems. Such efforts to contact delinquent borrowers and help to solve problems are called "servicing" the loans. This report, requested by the Chairman of the House Committee on Veterans' Affairs, addresses VA's servicing efforts, particularly VA's efforts at using alternatives to foreclosure. In addition, we recently completed a second request from the Chairman of the House Committee on Veterans' Affairs, focusing on the effect of requirements established by the Deficit Reduction Act of 1984 on VA's Home Loan Guaranty Program and the issue of whether VA's property acquisition and disposition process could be improved to reduce program costs. This second report, entitled Housing Programs: VA Can Reduce Its Guaranteed Home Loan Foreclosure Costs (GAO/RCED-89-58), was issued on July 12, 1989.

The Loan Guaranty Program

VA-guaranteed home loans are available to three categories of veterans: (1) those who served on active duty during World War II, the Korean conflict, or the Vietnam era and whose total service was for 90 days or more; (2) those who were discharged or released from active duty for a service-connected disability; and (3) service personnel who have served at least 181 days of peacetime active-duty service. In addition, the loans are available to unmarried surviving spouses of veterans who died from service-connected causes and to spouses of service personnel officially listed as missing in action, or captured, for more than 90 days.

The loan guaranty program does not lend money directly to veterans. Instead, VA guarantees a lender, such as a bank or a savings and loan

Figure

Figure 1.1: Relationship Between VA, Lender, and Homebuyer 11

Abbreviations

AFMD	Accounting and Financial Management Division
GAO	U.S. General Accounting Office
PMI	private mortgage insurer
RCED	Resources, Community, and Economic Development Division
VA	Department of Veterans Affairs
VAIG	VA Inspector General's Office

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loan service officers do not consider in deciding whether to foreclose: (1) the portion of VA costs charged to veterans that is never collected, (2) the interest costs on funds used to acquire and hold property, and (3) the price discount of up to 10 percent that VA allows on cash offers for properties sold. Applying the model to typical properties of five VA regional offices, GAO found that the cost of the three alternatives was, on average, considerably less than the $25,387 average cost of foreclosure. The model was applied to these five regions because they represented a range of economic conditions and represented each of the geographic areas with significant foreclosure activity among the nine regions GAO reviewed. Specifically, the model showed the following:

- Refunding was $10,420 less than foreclosure.
- Compromise agreement was $8,992 less than foreclosure.
- Voluntary conveyance was $1,426 less than foreclosure.

These alternatives cannot be used cost effectively in all cases because of differences in state foreclosure laws, borrowers' individual financial situations and preferences, and the strength of local housing markets. Nonetheless, on the basis of estimates made by officials at VA regional offices, GAO estimates that VA could have saved between $42 million and $94 million during fiscal year 1987 by using foreclosure alternatives. Because the information on which the estimates are based was obtained at a limited number of locations and is not statistically valid, the estimated potential savings should be viewed only as approximations.

Private Insurers Report Saving Millions by Servicing Defaulted Loans and Using Foreclosure Alternatives

Private mortgage insurers guarantee conventional mortgage loans in a manner similar to the way VA guarantees mortgages for veterans. The private insurers use alternatives to foreclosure that are similar to those available to VA. They use home sales assistance, which is similar to VA's compromise agreement program. They also avoid foreclosures by accepting voluntary conveyances of the property deed, purchasing loans from lenders, or providing direct financial assistance.

According to officials of four private mortgage insurers that collectively insure an estimated 76 percent of all insured conventional mortgages, the firms become involved with delinquent borrowers sooner than VA. Officials from three of the four private mortgage insurers each reported savings ranging from $14 million to $18 million for 1987 as a result of servicing and the use of alternatives to foreclosure.

Executive Summary

Purpose

Under the Home Loan Guaranty Program, the Department of Veterans Affairs (VA) helps eligible veterans buy homes by guaranteeing the lender that VA will repay part of the loan amount if the homebuyer defaults. These guarantees are paid from VA's Loan Guaranty Revolving Fund. However, as foreclosures on VA-guaranteed loans rose from 12,490 to 40,336 between fiscal years 1981 and 1989, expenditures from the revolving fund exceeded income and a total of over $2.2 billion in appropriations was made to the fund in fiscal years 1984 through 1989.

Concerned about the drain on the program's resources, the Chairman of the House Committee on Veterans' Affairs asked GAO to review VA's loan termination practices and the extent to which changes in VA practices could reduce the number and cost of foreclosures and revolving fund losses.

Background

When a borrower does not make scheduled payments on a VA-guaranteed loan, the lender has primary responsibility for resolving (curing) the default or terminating the loan by foreclosure. VA regulations allow the lender 105 days to cure the default before it must be reported to VA. VA then is responsible for providing supplemental servicing, which consists of letters, telephone calls, and/or office visits to resolve the default and avoid foreclosure.

If the default cannot be cured, VA may allow the lender to foreclose on the loan or pursue the following alternatives to foreclosure:

- Refunding: VA may pay the lender the outstanding loan amount and then restructure the loan according to the veteran's ability to repay by reducing the monthly payment, lowering the interest rate, or lengthening the payment period. Refunding thus allows the veteran to keep the property, while VA avoids foreclosure.
- Compromise agreement: This alternative enables the veteran to sell the property, with VA providing the financial assistance to do so. For example, if the proceeds from the sale do not cover the total indebtedness, VA provides the remaining funds to pay off the lender. VA then may require the veteran to sign a promissory note for the amount VA provides. By using this alternative, VA avoids foreclosure costs as well as the costs associated with acquiring, managing, and reselling the property.
- Voluntary conveyance of the property deed: Under this action, the veteran voluntarily conveys the property deed to VA. Before accepting the conveyance, in states where it is legally feasible VA may require the veteran to sign a promissory note for all or part of any debt in the event