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

February 29, 1984

This document should not be released before its delivery, scheduled for 10:00 a.m. (E.S.T.) Wednesday, February 29, 1984

Mr. Chairman, it is a pleasure to appear before your Committee today to discuss the operation of the Veterans Administration's (VA) loan guaranty program and the financial condition of the Loan Guaranty Revolving Fund.

The financial prospects of the revolving fund over the next few years are uncertain, Mr. Chairman, because it is not clear under what set of policies the loan guaranty program will be operated. What is clear is that the ongoing effects of the recent recession on the fund have been severe. Foreclosures of VA-guaranteed home loans reached a historical high in fiscal year 1983 and are anticipated to be even higher during 1984. Consequently, a deficit of at least $125 million is to be expected for the revolving fund in fiscal year 1984 if no changes are made in the operating procedures of the program. Additional deficits totalling nearly $1 billion can be expected for 1985 through 1989 under present policies.

THE OPERATION OF THE LOAN GUARANTY PROGRAM AND THE FINANCIAL STATUS OF THE REVOLVING FUND

Through its loan guaranty program, the VA guarantees residential mortgages for 60 percent of their principal value up to a maximum of $27,500. Through the end of fiscal year 1983, the VA has guaranteed a total of 11.5 million loans with an aggregate value of more than $200 billion.

The program is financed through the Loan Guaranty Revolving Fund, which incurs the costs associated with defaults. Under current practices, when a VA-guaranteed loan is in default and the lender forecloses, the agency almost always offers to purchase the property at a price set by the VA. If the VA acquires the property, the agency then offers it for sale, generally financing the sale with a direct loan known as a "vendee loan." The proceeds from the property sale or from the subsequent sale of the vendee loan are then redeposited in the fund.

In the past, the deficits of the Loan Guaranty Revolving Fund have been financed primarily by transfers from the Direct Loan Revolving Fund. However, because the balance of the direct loan fund has now been depleted by past transfers and the liquidation of the fund's loan assets, the VA does not expect additional transfers to be possible within the foreseeable future. Thus, some steps must soon be taken to avoid the impending insolvency of the loan guaranty fund. There are two possible methods for achieving this goal:

- Changes could be instituted to reduce the future operating costs or increase collections of the fund through improved operating efficiency, or
- A new source of external financing for the fund could be found.

In his 1985 budget request, the President announced a series of administrative changes to be made in the operation of the revolving fund as of March 1, 1984, which would reduce the costs of the fund, but which would also reduce the fund's collections. The CBO reestimate of the Administration's proposals indicates that these changes would reduce 1984-1989 net fund outlays by $500 million—eliminating the deficits anticipated for 1984 and 1985 and reducing the deficits in 1986 through 1989 by more than $280 million. Other alternatives are available, however, that would reduce future deficits still further. None of these changes, however, would keep the fund solvent beyond 1987.

CBO estimates that the Administration's proposals would reduce the outlays of the Loan Guaranty Revolving Fund by about $500 million between March 1, 1984, and the end of fiscal year 1989. The options discussed in a forthcoming CBO study, on the other hand, would reduce fund outlays over the same period by $635 million.

In my remarks today I will first examine the Administration's proposals and alternatives to them, and will then discuss options for financing fund deficits in other ways.

ADMINISTRATION PROPOSALS

The principal changes detailed in the President's fiscal year 1985 budget request include the following:

- o The acquisition of property at foreclosure sales involving VA-guaranteed loans would be stopped. The VA would instead pay the lender the amount of the guaranty applicable to the foreclosed loan.
- o The VA would no longer offer agency financing on the resale of properties that have been acquired from foreclosures.

In addition, the Administration proposes that vendee loans, that is, direct loans made by the VA to finance the sale of acquired properties, would no longer be sold by the agency with agreements to repurchase them in case of default. Further, guaranteed loans in default could no longer be purchased by VA from the lender in order to grant the veteran-mortgagor special forbearance.

The CBO analysis of the loan guaranty program indicates that the major inefficiency in the program's current operating procedures is that all loans under foreclosure and all real property available for sale by the agency

are handled in the same manner. We have concluded that the VA can only maximize its financial position on the transactions of this program if it determines its course of action on a case-by-case basis. The changes proposed by the Administration—while they would result in an outlay savings of about $500 million over the 1984-1989 period—do not correct this basic problem. The Administration's changes would merely substitute one single course of action for another.

The alternative of determining property acquisition and sale decisions on a case-by-case basis as outlined below would reduce 1984-1989 outlays by $165 million more than the Administration's plan.

ALTERNATIVE WAYS OF SATISFYING THE GUARANTY ON FORECLOSED LOANS

We examined a sample of 65 recent cases in which the VA had acquired a property as the result of a foreclosure. Among these cases was one in which the appraised value of the property at the time of foreclosure was less than 80 percent of the amount that the VA paid the lender in order to acquire it. Also, there was a property on which the appraised value was 20 percent higher than the VA's initial cost of acquisition. No single approach—neither acquiring the property nor paying the guaranty—would minimize the cost of satisfying the VA's guaranty on both of these loans.

Paying the guaranty in all cases of foreclosure on VA-guaranteed loans, as proposed by the President, would ultimately cost the revolving fund more than the current policy of always acquiring the property, because historically the average amount payable under the VA guaranty is larger than the average net loss experienced by the agency on the acquisition and resale of a property. The proposed policy reversal would result in a large initial reduction in outlays, however, since amounts payable under the guaranty are considerably less than the initial payment required at the time of foreclosure to acquire a property. The initial outlay reduction would in later years be more than offset by the subsequent elimination of collections that

would have resulted from the sale of the properties and related vendee loans. Alternatively, somewhat smaller initial savings could be achieved without the penalty of outyear costs, by making more accurate comparisons of the net financial consequences of the two alternatives on a case-by-case basis.

In the past, the cost comparisons made by the VA have virtually always led it to conclude that it should acquire the property, because a number of the costs incident to property acquisitions were not included in their calculations. Based on our sample of actual acquisition cases, the amounts estimated by VA for the cost of maintaining and reselling properties are considerably below the average amounts expended on these activities historically. Further, the VA does not include administrative

costs or the interest cost on the funds required for the initial acquisition, since these are not paid by the revolving fund. Nevertheless, they are costs that must be borne by the government and, as such, should be included.

If these cost elements were added to the agency's calculations, two effects could be expected: the VA would pay the guaranty instead of offering to acquire the property in about 10 percent of all foreclosure cases; and, in those cases in which the VA did offer to acquire, the price specified by the agency to the lender to be bid at the foreclosure sale would be reduced by an average of about 15 percent. The reduction in the bid price would be expected to induce some outside parties to enter competitive bids at the sale. When a third party makes the successful bid in a foreclosure sale on a VA loan, the agency's obligation to the lender decreases.

We have estimated that this relatively minor change in VA procedures could reduce 1984 outlays by about $110 million. From 1985 through 1989, outlays would be further reduced by more than $200 million.

THE SALE OF ACQUIRED PROPERTIES

The Administration's current and proposed approaches to the disposition of real properties acquired from foreclosures demonstrate similar

inflexibility. Under current procedures, all properties are offered for sale with VA-vendee financing. The Administration now proposes to eliminate vendee financing on property sales. Once again, neither approach would maximize the government's return on all properties. The properties in our sample of actual cases ranged from a $15,000 two-bedroom detached house in an economically depressed neighborhood in Detroit to a $90,000 high-rise condominium, complete with fireplace, in Los Angeles. While the Los Angeles condominium could probably be sold for cash without a significant reduction in the asking price, it is questionable whether the Detroit property could be sold for cash at any reasonable price.

Our analysis indicates that larger net savings could be obtained by offering for sale without vendee financing those properties likely to sell for cash and by tightening the credit standards applied to those vendee loans that are needed to sell the remaining properties at a reasonable price.

OPTIONS FOR FINANCING THE FUND'S DEFICITS

The President's budget states that the Administration's proposals to change the operation of the loan guaranty program will take effect on March 1. It now appears that the effective date has been postponed while further study is made of the issue. If current procedures remain in effect throughout fiscal year 1984, Mr. Chairman," both CBO and VA have estimated that a deficit will be incurred by the revolving fund this year.

Furthermore, none of the changes under discussion will prevent deficits in the fund beyond 1987.

In the absence of transfers from the Direct Loan Revolving Fund, there are three potential external financing sources that could be tapped by the loan guaranty fund to offset the gap between program costs and collections:

- o Appropriating the necessary funds directly or indirectly to the Loan Guaranty Revolving Fund;
- o Authorizing the Loan Guaranty Revolving Fund to borrow from the Treasury; or
- o Crediting Loan-Origination Fees to the Loan Guaranty Revolving Fund.

Appropriations

Appropriations could be provided to the Readjustment Benefits account and transferred to the Loan Guaranty Revolving Fund with no change in the authorizing law, or appropriations could be authorized directly to the revolving fund itself.

Appropriations do not have to be repaid, nor are they constrained by outside economic conditions. Also, Congressional control over program activity would be enhanced by the annual review of appropriation requests.

The major disadvantage is the difficulty of estimating the future needs of the Loan Guaranty Revolving Fund with precision as far in advance as is necessary for the submission of the request. This problem could be avoided, however, by the appropriation of indefinite budget authority. Under this concept, the amount appropriated is not stated as a specific sum, but is defined by a specified variable, such as the amount necessary to cover obligations in excess of collections. This mechanism would insure that the Loan Guaranty Revolving Fund had the authority to incur all necessary obligations in excess of its collections, without appropriating any surplus funds.

Treasury Borrowing

Alternatively, the Loan Guaranty Revolving Fund could be authorized to borrow from the Treasury. Like indefinite appropriations, borrowings could be limited to the specific amounts required and could be timed to meet the needs of the Loan Guaranty Revolving Fund. The drawback to borrowing from the Treasury, however, is that interest must be paid on the

amounts borrowed, thereby increasing total fund costs though not total federal outlays. Further, since the Loan Guaranty Revolving Fund operates at a net loss over time, it is unlikely that the fund would ever be in a position to repay the principal. Thus, the interest payments over time would compound quickly and become a substantial factor in the fund's future operating costs.

Loan Origination Fees

The Omnibus Reconciliation Act of 1982 (Public Law 97-253) established a fee—one-half of one percent of the loan principal—for all non-service-disabled veterans obtaining a VA-guaranteed home loan. During fiscal year 1983, $77.5 million in fees was collected on 236 thousand new loans. These fees were deposited, as stipulated under current law, as miscellaneous receipts of the Treasury.

If the law were amended to credit the fees to the revolving fund, however, the $90 million in fees estimated to be collected in fiscal year 1984 would finance 70 percent of the deficit expected in the fund this year. In order for the fees to provide long-range assistance to the fund, it would be necessary to repeal the provision of current law specifying that the fees be collected only on loans dosed prior to October 1, 1985.

It is estimated that approximately $200 million in origination fees will be collected before the termination date and an additional $600 million from 1986 to 1989 if the termination date is repealed. Over the six-year period these collections would finance more than 70 percent of the deficit that is expected under current policies. Fees could be used to finance the program completely, if they were increased to a level sufficient to fully offset the net costs of the fund. However, origination fees would be an automatic form of financing and, thus, would eliminate the need for annual appropriation review. As a result, Congressional control over the operation of the revolving fund could be diminished.

Unlike the other financing options, the origination fees are paid by veterans. Thus, an extension of the fees beyond the 1985 termination date or an increase in their rate would reduce total government outlays by the amount of fees collected.

ANALYSIS OF S. 1922 AND S. 2265

We have prepared preliminary estimates of the budgetary impact of the two bills under consideration by the Committee.

S. 1922

The Veterans' Housing Foreclosure Assistance Act of 1983, S. 1922, would not be expected to have a major impact on the federal budget for several reasons. Section 1816 of Title 38 (U.S.C) grants the Administrator the authority to acquire loans in default from the lender and to provide the

veteran-borrower whatever forbearance the Administrator deems warranted. We assume that the vast majority of veterans who would qualify for advances under S. 1922 are already being served under current law. CBO has, therefore, estimated that less than 2,000 advances would be made under this provision. In addition, because of the short repayment period of only four years, we have also assumed that 65 percent of the mortgages for which advances were made would terminate in foreclosure despite the assistance.

It was assumed that the direct loan obligations would be made from the Direct Loan Revolving Fund and collections of repayments would be credited to that fund. In this event, the fund's fiscal year 1985 outlays would be expected to increase by about $7 million. With the collection of repayments in the outyears, however, the net five-year outlay impact is estimated at only around $5 million.

Because the advances would allow the veteran-mortgagors involved to avoid foreclosure at least temporarily, the Loan Guaranty Revolving Fund would also be affected by this bill. Outlays of this fund would decrease in 1985 and 1986 by around $47 million, under current policies, as some property acquisitions were avoided. In 1987 and 1988, however, outlays would increase by a total of about $42 million because of the ultimate default of some of these mortgages.

S. 2265

S. 2265, which would increase the guaranty ceiling on home loans, would not be expected to have a significant budgetary impact under the current policy of acquiring properties in virtually all cases of foreclosure on VA-guaranteed loans. This practice represents, in effect, a 100 percent guaranty. If, on the other hand, the Administration's proposal to pay the guaranty in all cases is implemented on March 1, the deficit and the outlays of the Loan Guaranty Revolving Fund could be expected to increase by nearly $200 million between 1985 and 1989 as a result of this bill.

This concludes my statement, Mr. Chairman. I will be pleased to respond to any questions you or other members of the Committee may have.