EVALUATION OF VA'S HOME LOAN GUARANTY PROGRAM

FINAL REPORT

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EXECUTIVE SUMMARY

Overview of VA Home Loan Guaranty Program

The Department of Veterans Affairs (VA) Home Loan Guaranty program provides transition assistance and other benefits to a very large and diverse clientele who served or are serving in the Armed Forces of the Nation. Since the inception of the program in 1944, an important objective has been to assist eligible veterans to transition from military to civilian life. VA Home Loan Guaranty program is also intended to provide a benefit to the men and women who serve their country and over time has been expanded to include active duty servicemembers, reservists, and certain surviving spouses. It is not designed to fulfill general economic or social objectives.

Study Objective

The purpose of this evaluation is to assess the effectiveness and efficiency of the VA Home Loan Guaranty program in assisting eligible veterans, active duty military personnel, and reservists with home ownership. This evaluation fulfills the requirements of P.L. 103-62, the *Government Performance and Results Act of 1993;* Title 38 §527, Evaluation and Data Collection; and 38 C.F.R. §1.15, Standards for Program Evaluation.

Conducted as an objective, third-party evaluation of the VA Home Loan Guaranty program, this study focuses on determining whether the program meets its statutory intent, its intended outcomes, and the expectations of program participants, legislators, program officials, and other stakeholders.

Methodology

The study applied several methods to conduct the program evaluation, including interviewing stakeholders, analyzing VA administrative data, conducting a survey of participants in the program, and analyzing data from secondary sources. Stakeholders who were consulted include VA administrators, managers, and policymakers; Veterans Service Organizations; other Federal Agencies (Office of Management and Budget, Department of Housing and Urban Development (HUD), General Accounting Office); the House and Senate Veterans Affairs Subcommittees staff; mortgage industry representatives; and minority and special program representatives. Secondary data sources include documents from VA, literature, and administrative or survey data from governmental and private sources.

The study survey of VA home loan borrowers addressed several research topics such as veterans' access to the loan program, financial assistance that the program provides, participants' views of the application process, and their satisfaction. The VA Loan Survey population consists of participants in the VA Home Loan Guaranty program who originated a VA home loan between fiscal years 1999 and 2003. The VA Loan Survey population consisted of four groups: 1) veterans, 2) active duty military personnel, 3) reservists, and

4) borrowers who received default assistance from VA (cured loans). A total of 1,755 responses were received.

Legislative Intent

The program's intent has evolved from its original conception for transition assistance for World War II veterans into the premise that housing assistance is justified for any period of active service, not just wartime service, because service removes the veteran from civilian life. In addition, Congress has recognized that VA housing benefit provides incentive value for the volunteer military. For these reasons, the program has been made permanent, and benefits have been extended to qualifying members still on active duty, to members serving in the Selected Reserve, and to certain surviving spouses.

Congress has continually expanded coverage, added features, and sought to maximize the program's appeal and utility to veterans. The initial short-term or one-time benefit program has gradually expanded until it has become a permanent benefit that can be used multiple times over a lifetime. The program was extended to cover special groups such as those needing specially adapted living facilities and Native Americans living on trust lands in recognition that their unique needs should also be served by the program. The definition of a qualifying "veteran" was expanded to include active servicemembers to support the volunteer military and, later, members of the Selected Reserve in recognition of growing active/reserve Total Force mission sharing.

Program Operations

A conclusion of the study is that VA successfully and efficiently operates the VA Home Loan program to meet legislative requirements for eligibility determination, lender monitoring, and loss mitigation. Over the past decade, significant consolidation of field operations and technology advances have decreased full-time equivalent VA administrative staff from about 1,800 to 900. The consolidation resulted in greater consistency and accuracy as well as reduction in full-time equivalent employees (FTEs). The consolidation of field operations and technology advances allowed for the 50 percent downsizing of full-time equivalent VA administrative staff without a decrease in the services being provided or quality.

In fact, dramatic increases in speed of service complement increases in administrative efficiency. For example, for about half of the borrowers, eligibility determination is made online in a matter of a few minutes rather than in 2 weeks or several days without the online access. Improvements in the VA appraisal process have accelerated the appraisal process by 75 percent. VA notifies lenders electronically within 24 hours that the Government has received the funding fee, in contrast to the previous time lag of 10 to 12 days.

Administrative costs constitute a relatively small portion—less than 10 percent—of the total capital and operating costs. The predominant costs are claims costs and other costs associated with foreclosure and alternatives taken to avoid foreclosure. Each claim costs the Government about $20,000. However, revenues that VA collects from different sources, including the funding fee that borrowers pay, property sales, and proceeds from acquired loans and vendee loans, offset this cost.

Management of claims losses is effective such that the loan subsidy rate has been virtually zero for loan cohorts for the past ten years. This means that the program costs the taxpayer relatively little or no money.

Benefit Outcomes for Veterans

The VA Home Loan program is intended to provide a benefit to veterans for their service to the country, not to fulfill broad social objectives. In contrast, HUD's Federal Housing Administration (FHA) loan program is intended to fulfill social objectives, that is, help low-income and minority groups gain access to loan markets that they might not have due to low income or discrimination. The benefit that veterans gain from VA's Home Loan program offers several advantages relative to conventional loans or other available alternatives, including: no down payment; limitations on closing costs; no private mortgage insurance; easier credit standards to qualify for a loan; default assistance to avoid foreclosure; and recognition of service to country.

The no down payment and no PMI are unique features of the program and possibly its most attractive benefits. In contrast, HUD's loan program requires a three percent down payment and PMI. While the private sector offers some opportunity for no down payment loans, this is the exception and not the rule and has offsetting disadvantages such as generally requiring an excellent credit history and a higher interest rate. Veterans can obtain a loan without giving a down payment, without having to pay a higher interest rate, and without having to pay private mortgage insurance. In addition to these benefits, the VA Home Loan program offers default assistance to veteran borrowers in financial difficulty through a higher level of service and a greater range of alternatives to avoid foreclosure. Delinquency and foreclosure rates for VA loans are substantially less than for FHA loans.[1]

Home Ownership

One of the outcomes for the VA Home Loan Guaranty program is that the veteran home ownership rate exceeds the rate for the general population. Study results reveal that veteran home ownership rates exceed the general population home ownership rates by 13 percent or more, depending on the year and data source. Home ownership for veterans is at about 80 percent or higher while for the general population it is about 68 percent.

When controlling for the demographic and socioeconomic composition of the general population, a veteran household is 5 percent more likely to own a home than a comparable general household is. Since differences in home ownership rates between the veteran and general populations are a function of the demographic and socioeconomic makeup of the two populations, it is appropriate to take the relative demographic and socioeconomic composition of the two populations into account.

The greatest increases in home ownership for the veteran population occurred between the end of World War II and 1960. The VA loan program was instrumental in the increase in home ownership for veterans. Any additional increases in home ownership in the future are likely to be only incremental given the current high levels of home ownership.

[1] The reader is referred to Chapters 2, 5, 6, and 7 for comparison of VA and FHA loans.

Barriers to home ownership can be grouped into three main categories: liquidity constraints (e.g., money available for a down payment), lending/borrowing constraints (e.g., strict mortgage qualifying criteria), and housing affordability. The most frequently mentioned barrier to home ownership in the literature is a person's ability to procure the down payment for a home. Housing affordability is a function of housing prices, household incomes, and interest rates; when one of these variables changes, it has an effect on the other two variables. Housing affordability is satisfactory when these three variables are balanced.

Credit constraints and financial uncertainty about the future are barriers to home ownership among veterans, as well as the general population. However, good credit history is less important in determining home ownership for veteran households than for non-veteran households. This suggests that the VA loan program mitigates some of the difficulties that veteran households with less than perfect credit history would face getting mortgages that are not VA-backed.

Financial Assistance

A current program goal that VA states for the VA Home Loan Guaranty program is: "Provide financial assistance to veterans seeking to purchase a home." The respective performance measure for the goal is: "At least 80 percent of VA loans are to veterans whose limited financial resources preclude conventional financing." Conventional loans are defined as loans that are not insured or guaranteed by a Government agency (i.e., FHA and VA). Also, conventional loans are sold on the secondary market if they meet nationally accepted underwriting criteria established by the national secondary market investors, Fannie Mae and Freddie Mac.

Analysis of VA Home Loan borrower financial records reveals that the percentage of VA loan borrowers who could not qualify for a conventional loan is 82 percent for one-time or first-time users and 76 percent for multiple users. This result meets VA's current 80 percent target for the financial assistance outcome. The percentage not qualified for a conventional mortgage is based on typical guidelines issued by the secondary market, that is, a 5 percent down payment or more and an income-to-debt ratio of 36 percent or less. The percentage of VA loan borrowers who could not qualify for an FHA loan is 61% for one-time users, based on the requirements of 3% down payment and a maximum debt-to-income ratio of 41%.

VA Home Loan borrowers report that the program provides significant benefits to them. For example, 88 percent of the survey respondents indicate that the no down payment feature was an important reason for using the VA Home Loan program. More than three-fourths of the respondents indicate that they are better off with their VA loan relative to their alternatives without a VA loan. More than three-fourths of the respondents state that the VA Home Loan program helped them catch up with their civilian counterpart and readjust to civilian life after active duty.

Program Participation and Access

Measures of the utilization of the program further substantiate the value of the program to veterans. Nearly 60 percent of veterans who have ever obtained a loan to purchase a home, make home improvements, or refinance a home loan used a VA loan at some point, according to the 2001 National Survey of Veterans (NSV). The program retained its high benefit value over the past decades as we observe the same high participation rate for the youngest borrowers (less than 35 years) to the oldest borrowers (75 years or older).

This high level of utilization confirms that veterans perceive the program as providing a valuable benefit. Lack of or declining participation in the program would reflect that the program is offering little or declining benefit value to veterans and servicemembers. Since the intent of the legislation is to make the benefit available to all veterans and servicemembers, the level and extent of participation is an important and positive outcome of the program.

Multiple use of the VA Home Loan program is another indicator of the value and desirability of the program for veteran borrowers. The legislation gives clear and explicit authority for multiple use. Multiple use is defined as borrowers reusing their entitlement to obtain a purchase loan, whereas one-time use is defined as not having a previous VA loan.

Approximately one-third of VA loan borrowers are multiple users, although the estimate varies depending on periods and loan cohorts covered. Multiple users have a favorable foreclosure rate, which is about 40 percent lower than that of one-time borrowers, and they pay a higher funding fee. Hence, the cost is significantly less than for first-time borrowers. Also, the multiple use feature receive the highest satisfaction score compared to other features of the program.

An important element of VA's overall strategic plan is to provide an environment that fosters effective communication of its programs. Hence, the veterans' and servicemembers' awareness of the VA Home Loan program is another important outcome or performance of the program.

The 2001 NSV provides information on the reasons why veterans do not participate in the VA Home Loan program. On the basis of the 2001 NSV data, 35 percent of the veterans did not participate because they—

- ► Were not aware of the program (19%)
- ► Thought they were not eligible (11%)
- ► Did not know how to apply for a loan (4%).

In comparison, the 2001 NSV source indicates that 17 percent of veterans are not aware of VA health care benefits, 35 percent are not aware of life insurance benefits, and 41 percent are not aware of veterans burial benefits.

Maximum Loan Amount

An important policy question is whether the maximum VA loan amount has kept pace with industry and the cost of living. The study found that the loan limit restricts veterans in using VA loans in high cost areas. The average VA loan amount is higher than non-VA loans in low-cost Metropolitan Statistical Areas (MSAs) and lower than non-VA loans in high-cost MSAs. Almost 1 out of 2 survey respondents suggested tying the maximum loan amount to area home prices.

Lenders and real estate agents in higher cost areas stated that a higher loan limit would attract higher quality veteran borrowers and increase their portfolio of VA loans. Several lenders and realtors mentioned the effects of rising housing costs. Veterans may not win bids in rising housing cost markets because they cannot make up the difference between the guaranty limit and the owner's asking price. Industry stakeholders also told the Study Team that the effective maximum VA loan limit lags behind the ceiling for conventional loans in the private industry and that they would like to see it indexed similarly to how the FHA program indexes its loan limit.

Funding Fee

First-time program participants with loans with no down payment are required to pay a funding fee of 2.2 percent of the loan amount (2.4 percent for reservists) at the time of loan closing. The funding fee is calculated on the basis of whether the borrower is a veteran, active duty personnel, surviving spouse, or reservist; the amount of down payment made (which is not required); loan type; and number of times using their entitlement. The funding fee is 3.3 percent for multiple users. This fee may be included in the loan and paid from the loan proceeds. Some program participants are exempt from having to pay the applicable funding fee, including veterans receiving VA compensation for service-connected disabilities.

The funding fee was first introduced in 1966, and it was .5 percent of the loan amount. Changes since then have resulted mostly in increases in the fee. The Study Team conducted statistical analysis of the effects of historical increases in the funding fee on program participation and found that funding fee increases adversely affected participation in the VA Home Loan Guaranty program. More specifically:

- ► Mortgages originated during years when the funding fee was .5 percent are 18 percent less likely to be VA loans than mortgages originated during the years when there was no funding fee.
- ► Mortgages originated during years when the funding fee was 1.0 percent or 1.25 percent are 23 percent less likely to be VA loans than mortgages originated during the years when there was no funding fee.
- ► Mortgages originated during years when the funding fee was 1.875 percent or 2.00 percent are 32 percent less likely to be VA loans than mortgages originated during the years when there was no funding fee.

Defaults and Foreclosures

VA Loan Guaranty Service (LGY) default data are generally limited to only those defaults reported by lenders to VA as being seriously late (i.e., more than 105 days late). VA reports 118,426 defaults for Fiscal Year (FY) 1999, 132,147 defaults for FY 1998, and 132,534 defaults for FY 1997. Loans in default at the end of the fiscal year as a percentage of loans outstanding was 3.85 percent in FY 1999, 4.14 percent in FY 1998, and 4.00 percent in FY 1997. (Default rates for the most recent years are not reported here in order to allow time for defaults to occur.) The average number of loans outstanding varied from 3.045 million in FY 2001 to 3.315 million in FY 1997.

HUD's FHA loan program insures about 18 percent of all mortgage loans on average and encompasses a riskier set of borrowers than those with conventional loans. FHA borrowers tend to be younger and more credit constrained than other borrowers. FHA insures the full amount of selected loans made by private lenders, in contrast to VA loans, which are guaranteed for only a portion of the loan.

In 1998, the percentage of delinquent FHA loans was between 7 and 8 percent. As of the second quarter of 2003, that percentage had risen to nearly 13 percent. In contrast, the percentage of delinquent VA loans was between 6 and 7 percent in 1998 and had only risen slightly in 2003 to between 7 and 9 percent. Both Government-subsidized loan programs have much higher loan delinquency rates than those of conventional loans. Conventional loans had a delinquency rate between 2 and 4 percent in 1998, which had only risen a fraction of a percentage point by 2003.

In any comparison of VA loan default and foreclosure rates with conventional rates, it must be recognized that VA loans do not require a down payment, whereas most conventional loans do. Loans with no down payment are riskier than conventional loans with a down payment. Additional factors that may affect valid comparisons include income, income-to-loan ratio, the ratio of original loan to home value, and demographic characteristics.

Defaults and foreclosures are attributable to a number of factors. The leading reason identified for default and/or foreclosure is loss of or reduced income. Many factors cause loss or reduction of income, including but not limited to unemployment, underemployment, change of jobs, change in marital status, and disability.

Some of the individual characteristics found to contribute positively to the probability of a VA loan being in default included active duty service status. Borrowers who are on active duty are more likely to default than veterans are. Younger borrowers are also more likely to default. Those who do not qualify for a conventional mortgage are more likely to default. Those with high loan-to-value ratios and lower income are also more likely to default.

Default Assistance

A significant proportion of VA loan administrative staff provide assistance to borrowers in default to help them avoid foreclosure. This can be viewed as an operational issue for the

Government to minimize foreclosure claims costs, but it provides an important benefit for borrowers as well when the outcome is avoidance of foreclosure.

A current VA outcome for the VA Home Loan program is: "VA intervention will help veterans avoid termination of home ownership." The performance measure of the success of default interventions currently used by VA LGY is the Foreclosure Avoidance Through Servicing (FATS) ratio. The FATS ratio is the number of successful interventions plus other foreclosure avoidance outcomes divided by the number of foreclosures plus the number of successful interventions and other foreclosure avoidance outcomes for a given year or month. The corresponding current performance measure is: "Forty-five percent of veterans who would otherwise face foreclosure will avoid it because of VA intervention activities."

Significant improvement in the FATS ratio occurred between 1996 and 2003 for all of the Regional Loan Centers (RLCs) except one. The FATS ratio was 46% in 2003, 43% in 2002, and less than 40% in earlier years. Explanation for the general improvement relates to the consolidation of RLCs from 45 to 9 during that period and an improving economy in the most recent years. The recently implemented policy of rewarding employees with cash awards is an incentive for better performance as well. Also, regional variations in housing markets and mortgage laws contribute to differing rates of foreclosure avoidance.

The VA Loan Survey included respondents who received lender or VA default assistance in cases where foreclosure was avoided. Analysis of the survey responses revealed that borrowers are more satisfied with the assistance they receive from VA than with the assistance they receive from the lender. Approximately 13 percent more of the participants were very satisfied with the assistance provided from VA, compared to those who were satisfied with lender assistance. A higher percentage (65%) of those who received VA service are satisfied or very satisfied, compared to those who received lender assistance (53%).

Satisfaction

Survey respondents graded their level of satisfaction with the VA loan program on a six-point scale ranging from "very satisfied" (equals 6) to "very dissatisfied" (equals 1). Satisfaction of the borrowers in the VA Home Loan program is slightly higher than "satisfied," that is, the average satisfaction score was 5.06 where 5.0 equals "Satisfied." Average satisfaction scores are about the same among the three population groups of veterans, active duty, and reservists.

All of the average satisfaction ratings for the various program attributes were above 4.0, or "somewhat satisfied." The amount of funding fee paid by the borrower to obtain a VA Home Loan received the lowest score of 4.13. Its score of 4.13 for borrowers was .72 lower than the second lowest rated attribute, "Service provided by your real estate agent."

The "Service provided by VA" and "Being able to use your VA loan guaranty benefit to purchase another home in the future" (i.e., multiple use) are key attributes that contribute significantly to overall satisfaction. Although the average overall satisfaction score for the program was “satisfied,” there is potential for improvement. Increasing “Maximum Amount of Loan” has the greatest potential to increase overall satisfaction.

Eighty-three percent of the respondents indicate that the VA program makes them feel that the Nation recognizes their service.

Specialty Programs

Specially Adapted Housing Program

Veterans who have permanent and total disabilities due to military service may be entitled to a grant for constructing an adapted dwelling or modifying an existing home to meet their needs. Veterans who receive care at VA medical centers obtain a medical determination; if eligible, VA Specially Adapted Housing (SAH) office contacts the veterans about the SAH grant. There are two types of grants available:

- ► Part I SAH Grant is for disabled veterans who are entitled a wheelchair accessible home especially adapted for their needs.
- ► Part II SAH Grant is for disabled veterans who are entitled to adaptations because of blindness in both eyes with 5/200 visual acuity or less, or includes the anatomical loss or loss of use of both hands.

The Veterans Benefits Act of 2003 (December 16, 2003) increased the amounts for the two types of grants from $48,000 (SAH Type A) and $9,250 (SAH Type B) to their current levels of $50,000 (SAH Type A) and $10,000 (SHA Type B).

The Study Team conducted a survey to assess the veteran’s awareness of the SAH program, the adequacy of the maximum grant amounts, and whether having the grant improved the quality of life of disabled veterans. The Study Team surveyed the entire population of disabled veterans who received a SAH grant in fiscal year 2002. Approximately 500 veterans received a SAH grant in 2002.

On the topic of awareness of the program, 31 percent of the survey respondents indicated that they first learned about the SAH program from a VA office, 26 percent from VA letter awarding service-connected disability, and 20 percent from Veteran Service Organizations. Thirty-nine percent learned about SAH more than one year after they received their 100 percent disability rating.

Survey results indicate that the SAH program offers a needed benefit to disabled veterans. Most participants are satisfied with the program, with 49 percent reporting that they are very satisfied with the program while 46 percent reported being satisfied. Sixty percent felt that the grant amount was very adequate, and 29 percent indicated somewhat adequate. We conclude that the maximum grant amount of $50,000 is generally sufficient to adapt a house according to the SAH adaptation requirements. Ninety-nine percent of the respondents said that SAH adaptations improved their quality of life. In addition, 98 percent of the veterans responded that the adaptations helped them live more independently. These results indicate a successful program that is exceeding its performance standard for participants.

Native American Direct Loan Program

VA's Direct Home Loan Program (NADL) to Native American Veterans Living on Trust Lands was established by Congress in 1992 as a 5-year pilot initiative to assist those veterans in obtaining mortgage financing and home ownership. It has been extended twice and is currently authorized until 2005.

Since the program's inception in 1993, only 386 loans have been made. Reasons for not using the program include: low income; lack of infrastructure; community ownership of land prevents it from being used as loan collateral; not knowing about the benefit or how to apply; and using other programs or funding. Native Hawaiians are using the program at a higher rate because they receive assistance with infrastructure from the Department of Hawaiian Homelands and the local economy provides incomes that are sufficient to qualify for a loan.

Homeownership among Native Americans living on Trust Lands is about the same as that of the general population (69 percent), but infrastructure and housing conditions are poor. Low income among Native Americans is a systemic problem on the largely rural Tribal Lands that lack an economic base. This problem requires a broad range of interventions that are beyond VA's scope in its NADL program. Other Federal housing programs assist Native Americans living on Trust Lands, but these programs all face the same barriers. The 2002 report of the Millennium Housing Commission made certain recommendations to Congress to address the broader systemic housing problems present on tribal lands.

Recommendations

Policy Recommendations

Stakeholder interviews for the study raised several policy issues, pertaining to:

- Multiple use of the VA Home Loan entitlement
- Indexing of maximum loan amount
- Funding fee increases
- Availability of Adjustable Rate Mortgages
- Lack of use of Native American Direct Loan program.

Multiple Use. While the legislation gives explicit authority for multiple use, some stakeholders raised the question of whether there is any particular need for multiple use. Since military members generally transition only once from military to civilian status, an argument is made that multiple use is not especially needed. However, VA borrowers perceive multiple use as a valuable benefit. The multiple use feature received the highest satisfaction score. In addition, multiple users have a favorable foreclosure rate, which is 40% lower than one-time borrowers, and they pay a higher funding fee.

Policy Recommendation P1: Retain the multiple use feature of VA Home Loan program.

Maximum Loan Amount. One approach to consider for indexing the maximum loan amount is to apply the FHA insured loan ceiling formula, or a modification of the formula, to the maximum VA loan amount. The statutory FHA loan ceiling is set at 87 percent of the Freddie Mac conventional or "conforming" loan limit. For each county, the FHA loan maximum is the lesser of the national ceiling and 95 percent of the county median housing price as measured by HUD.

The FHA national loan ceiling has been higher than the effective VA limit for the past several years. Given the current VA loan guarantee structure, the statutory change could include a provision to establish the loan guaranty maximum at 25 percent of the conventional loan maximum. Therefore, the maximum guaranty would change simultaneously with changes in the conventional loan maximum.

The Study Team examined three alternative scenarios for applying this limit to the VA loan maximum, setting the maximum at 85, 90, and 95 percent of the conventional loan limit. The maximum VA loan amount would have been $274,300, $290,400, and $306,600, respectively, in 2003, compared to the actual VA loan limit of $240,000 or the FHA loan ceiling of $280,700 in 2003. We determined that these loan limits, even at 95 percent of the conventional loan limit, to be substantially less than the median price for a single-family in certain high-cost areas such as Boston, Honolulu, New York, and San Diego.

Policy Recommendation P2: Base the maximum loan amount on automatic indexing and set at 100 percent of the conventional loan limit.

Automatic indexing would prevent the maximum loan amount from lagging behind increases in housing costs, help more veterans obtain loans, and add stability to the program by eliminating the need for Congressional action.

The only compelling reason for setting the loan limit at less than 100 percent of the conventional loan limit or adjusting for geographic differences is increased claim costs. The evidence refutes the notion that the claim costs would be higher. Overall, claim costs for VA loans, net of offsetting revenues, have been virtually zero over the past 10 years. Furthermore, foreclosure rates are lower for higher income households who would be taking advantage of a higher VA loan limit and paying a higher funding fee.

Geographic adjustment is not necessary given the experience that VA Loan Guaranty program participants are generally not borrowing at the maximum loan limit in low cost areas. In other words, VA average loan amounts are lower in low-cost areas and higher in high-cost areas, reflecting prevailing average income and housing price levels in different locales. Geographic adjustment would complicate administration and add complexity to the VA loan program.

Funding Fee Increases. Funding fee increases in the past have had substantial negative effects on veteran participation in the VA Home Loan Guaranty program and detract from the benefit value of the program. Increases in the funding fee in the past have not been tied or linked to particular requirements or conditions of the VA Home Loan program.

Policy Recommendation P3: There is no need to increase the funding fee, particularly when the program cost to the taxpayer is relatively little or zero.

Adjustable Rate Mortgages (ARMs). Another important policy issue is whether to make the ARM type of loan available to veterans with the VA Home Loan program. Historically, the default rates on the ARM type of loan are higher than conventional loans. However, the hybrid type ARM, which has an initial fixed rate period of at least 3 years before being subject to annual adjustments, is less risky than other ARM programs. The hybrid ARM is currently being offered to veterans in a pilot program. When data are available on the results of the current pilot ARM program, the success or failure of this program can be fully assessed to make a determination whether to make the program permanent.

Specially Adapted Housing Program. VA may want to look closely at the rising cost of construction, as that would be a leading factor as to why the maximum grant amount may not be sufficient in the future.

Policy Recommendation P4: Our recommendation is to increase the maximum SAH amount based on annual increases in construction costs. There are several indices available on construction labor and materials measuring the change in construction costs. The increase in the SAH amount should be based on the average annual construction cost increases.

Program Operations Recommendations

Customer inquiries via the VA toll-free telephone number or Web-transmitted inquiries are still being routed to 58 VA Regional Offices, based on the geographic location of the customer. VA staff handling the inquiries are responsible for answering questions that pertain to the several different VA benefit programs, not just the VA Loan Guaranty program. Hence, there is potential for consolidation, efficiency, and consistency gains in this area.

Operations Recommendation O1: Consolidate customer call/email inquiry operations into two centers.

By offering more education opportunities similar to those for lenders and appraisers, VA can improve awareness among real estate personnel. Professionals will also be more likely to endorse VA loans if they are more familiar with VA rules and guidelines. One possibility is to collaborate with National Association of Realtors (NAR) by offering certification programs or participating in annual national and regional conferences. Another option is to develop the current lender portal capabilities to include appraisers and real estate professionals.

Operations Recommendation O2: Provide more training opportunities for real estate professionals.

Real estate professionals indicated that lenders and NAR were their primary sources of information for VA rules and guidelines. VA can coordinate with NAR and make information accessible through its Web site and national and regional offices.

Operations Recommendation O3: Make information more accessible to real estate professionals.

Many lenders and appraisers reported the Lender's Handbook as their primary source of information and the VA Web site as a secondary source of information. By having more detailed information available to lenders, appraisers, and real estate professionals, the less opportunity there will be for noncompliance due to a lack of available information. As mentioned previously, one significant complaint by lenders was the description of the fee schedule in the Lender's Handbook and on the Web. By expanding this description in both the handbook and the Web, there may be less mistakes made by lenders and greater compliance with VA guidelines.

Operations Recommendation O4: Add more detail to handbooks and Web site.

To maximize the effectiveness of audit samples, the Study Team suggests developing a stratified sampling plan. Sampling strata can be defined to minimize the oversampling of certain groups of lenders and incorporate new strata to target groups of lenders who are most likely to be noncompliant. Additionally, the strata should include sampling of loans with a higher risk, such as ARMs.

Operations Recommendation O5: Develop a stratified sampling plan for lender audits.

As VA does with lenders, the Study Team suggests conducting an annual survey of appraisers and real estate professional to better gauge the strengths and weaknesses of the program from their position in the loan process. This is especially important since all of those interviewed by the Study Team suggested specific problems relating to both appraisers and real estate professionals.

Operations Recommendation O6: Conduct an annual satisfaction survey of appraisers and real estate professionals.

Technical Recommendations for Outcome and Performance Measures

The Study Team recommends that the outcome measures listed in Table 2-2 at the end of Chapter 2 of this report be produced annually for ongoing review of program outcomes. These outcomes and measures pertain to home ownership, overall utilization of the program, multiple use, awareness and understanding of the program, foreclosure avoidance, financial benefit for veterans, and cost efficiency. These measures, data sources, methods of analysis are reported in detail throughout the report.

In order to obtain a valid comparison of home ownership rates between veterans and the general population, it is necessary to make adjustments in the demographic composition of the two populations groups. A good source of data for this is the annual Current Population Survey data collected by the Census Bureau. Multivariate statistical analysis at the individual level would be applied.

Technical Recommendation T1: *Statistically analyze differences in home ownership rates between veterans and the general population, controlling for demographic differences.*

One source of information on program participation, awareness, and access is NSV. However, this survey is conducted only once every several years, and because of its comprehensiveness, it is a complex, expensive undertaking.

Relatively small sample sizes and brief questionnaires covering the VA Home Loan program and possibly other VBA programs would insure an economical approach to the measurement effort. The U.S. Census Bureau is using a similar strategy of more frequent surveys that cumulatively replace the long form of the decennial census. The VBA short form questionnaire could be constructed to facilitate comparisons in the level of participation and awareness across programs and over time. Market share information could also be obtained from survey respondents.

Technical Recommendation T2: *Implement a shorter, smaller mini-survey on an annual basis that includes both non-participant and participant veterans.*

VA LGY has resident data systems that can yield information on multiple use, default and foreclosure rates for different population groups, foreclosure avoidance rates, and cost-efficiency indicators. However, except for the FATS ratio, current systems and processes do not readily produce such measures on an ongoing routine basis.

Technical Recommendation T3: More vigorously utilize or enhance VA LGY loan and VBA financial data systems to provide ongoing monitoring of outcome measures.

Technical Recommendation T4: Conduct statistical analysis of default and foreclosure rates and the FATS ratio on a regular recurring basis in order to determine differences in these measures affected by variations in local economic conditions and state laws and regulations on foreclosure.

1. INTRODUCTION

Overview of VA's Home Loan Guaranty Program

The Department of Veterans Affairs (VA) Home Loan Guaranty program provides a permanent benefit that can be used multiple times over a lifetime to a very large and diverse clientele who served or are serving in the Armed Forces of the Nation. Since the inception of the program in 1944, an important objective has been to assist eligible veterans to transition from military to civilian life. VA Home Loan Guaranty program is also intended to provide a benefit to the men and women for their service to the country. It is not designed to fulfill general economic or social objectives.

Table 1-1 gives a brief overview of VA home loan programs. Except for the Direct Loan Program for Native Americans Living on Trust Lands, VA does not directly loan money to veterans; instead, it provides a partial guaranty to the lender against loss if borrowers fail to repay the loan. VA loan guaranties are made to servicemembers, veterans, and reservists, to purchase, construct, repair, or improve a dwelling as their homes. Homes include townhouses or condominium units in projects that VA has approved. Loans may also be made to refinance an existing loan on a home that the veteran owns and occupies. A down payment is generally not required if the purchase price is equal to or less than the reasonable value of the property.

Table 1-1. Overview of Programs

Home Loan Guaranty Program	Direct Loan Program for Native Americans Living on Trust Lands	Specially Adapted Housing (SAH) Grant Program
Purpose		
Assist veterans in becoming homeowners.	Provide direct home loans for Native American veterans to purchase homes on Trust Lands.	Assist disabled veterans with specially adapted housing assistance.
Eligible Populations		
Veterans, active duty military, reservists, and certain surviving spouses.	Native American veterans living on Trust Lands.	Veterans with certain permanent, total, and compensable disabilities.
Number of Participants		
Since inception, 16,797,867 (includes multiple loans)	Since inception, about 350	Since inception, about 32,000

Source: Research by Study Team and VA Officials

The VA Home Loan program offers certain advantages to encourage home ownership by veterans, active duty personnel, certain surviving spouses, and reservists relative to conventional loans, including the following:

- ► No down payment
- ► Limitations on closing costs (less than borrowers would pay for a conventional loan)
- ► No prepayment penalty
- ► Less stringent credit standards to qualify for a loan
- ► Default assistance to avoid foreclosure.

VA Loan Guaranty Service (LGY) is the organization within the Veterans Benefits Administration responsible for administering the VA Home Loan program. Their stated mission is to help veterans and active duty personnel purchase and retain homes in recognition of their service to the Nation. LGY strives to operate as efficiently as possible to minimize costs and ensure the best use of the taxpayer's dollar.

Study Objective

The purpose of this evaluation is to assess the effectiveness and efficiency of the VA Home Loan Guaranty program in assisting eligible veterans, active duty military personnel, and reservists with home ownership. This evaluation fulfills the requirements of P.L. 103-62, the *Government Performance and Results Act of 1993;* Title 38 §527, Evaluation and Data Collection; and 38 C.F.R. §1.15, Standards for Program Evaluation.

Conducted as an objective, third-party evaluation of the VA Home Loan Guaranty program, this study focuses on determining whether the program meets its statutory intent, its intended outcomes, and the expectations of program participants, legislators, program officials, and other stakeholders. In particular, the evaluation—

- ► Assesses the impact of statutes, regulations, significant court decisions, and operations on achieving desired program results
- ► Evaluates the current program outcome measures and recommends revision if necessary
- ► Identifies and reports on comparisons of the VA Home Loan Guaranty program with other similarly sponsored Federal programs
- ► Examines pertinent issues related to the VA Home Loan Guaranty program
- ► Identifies opportunities for the program to better achieve its mission through the development of new loan guaranty products, modification of existing products, and process redesign

► Recommends changes in laws or regulations that should occur to enable the VA Home Loan Guaranty program to more effectively achieve its mission.

VA contracted with Economic Systems Inc. (ESI) in 2002 to conduct an evaluation of the VA Home Loan Guaranty program. VA's Office of Policy, Planning and Preparedness oversaw and coordinated with other VA offices, other Government entities, and Veterans Service Organizations. ESI served as prime contractor with the support of two subcontractors, ORC Macro and The Hay Group.

Study Methods

The study uses diverse methods to address the research questions. They include compiling and analyzing data from several sources, including stakeholders, VA administrative data, a survey of participants in the program,[1] and secondary sources. Stakeholders who were consulted include VA administrators, managers, and policymakers; Veterans Service Organizations; other Federal Agencies (Office of Management and Budget, Department of Housing and Urban Development, General Accounting Office); the House and Senate Veterans Affairs Subcommittees staff; mortgage industry representatives; and minority and special program representatives. Secondary sources include documents from VA, literature, and administrative or survey data from governmental and private sources.

The VA Loan Survey of VA home loan borrowers addresses several research topics such as veterans' access to the loan program, financial assistance that the program provides, participants' views of the application process, and their satisfaction. The VA Loan Survey population consists of participants in the VA Home Loan Guaranty program who originated a VA home loan between fiscal years 1999 and 2003. Participants with refinanced loans are excluded from the home loan population; only loans that were active in VA's administrative files as of June 1, 2003 are included. The VA Loan Survey population consists of four groups: 1) veterans, 2) active duty military personnel, 3) reservists, and 4) borrowers who received default assistance from VA (cured loans). The first three groups in the population are independent and do not overlap. The fourth group—cured loans—is part of the first three groups. A total of 1,755 responses were received.[2]

Table 1-2 lists the principal measurement approach used for each of the study's several research issues.

[1] See Appendix A for survey methods and nonresponse analysis.
[2] Appendix B presents the survey tabulations.

Table 1-2. Research Issue and Measurement Approach

Research Issue	Measurement Approach
1. Statutory Intent	Document Analysis, Stakeholder Interviews
2. Program Outcomes	Document Analysis, Stakeholder Interviews, Survey Data Analysis
3. Outcome Assessment	Logic Modeling, Synthesis of Study Results
4. Profile of Program Participants	Descriptive Statistical Analysis, Survey Data Analysis
5. Multiple Use	Descriptive Statistical Analysis, Survey Data Analysis
6. Participant Satisfaction	Survey Data Analysis
7. Barriers to Home Ownership	Literature Review, Secondary Data Analysis, Survey Data Analysis
8. Maximum Loan Amount	Document Analysis, Survey Data Analysis
9. Remove Barriers to Home Ownership	Literature Review, Secondary Data Analysis
10. Success of Default Intervention	Document Analysis, Stakeholder Interviews, Survey Data Analysis
11. Profile of Defaulted Loans	Administrative and Secondary Data Analysis
12. Certifying Appraisers	Document Analysis, Stakeholder Interviews
13. Adjustable Rate Mortgages	Document Analysis, Stakeholder Interviews, Survey Data Analysis
14. Energy Efficiency Improvements	Document Analysis, Stakeholder Interviews, Survey Data Analysis
15. Adherence to VBA Rules	Document Review, Stakeholder Interviews
16. Program Costs and Benefits	Survey and Administrative Data Analysis, Budget Analysis
17. Native American Loans	Document Review, Administrative Data Analysis
18. SAH Grant Program	Document Analysis, Stakeholder Interviews, SAH Survey Analysis
19. Availability of Housing	Synthesis of Study Results, Stakeholder Interviews, Survey Data Analysis
20. Impact on Program Results	Synthesis of Study Results

Report Organization

This report contains 11 chapters addressing the key study findings, plus appendices containing supporting documentation. The following topics are covered in this report:

- ► Program goals, outcomes, and measures
- ► Program operations
- ► Profile of program participants
- ► Program participation and access
- ► Home ownership rates

- Defaults and foreclosures
- Role of lenders, appraisers, and real estate professionals
- Satisfaction of participants
- Specialty program areas (Specially Adapted Housing grants and Native American Direct Loan program)
- Recommendations.

2. PROGRAM GOALS, OUTCOMES, AND MEASURES

Chapter 2 presents an overview of the legislative history of the VA Loan Guaranty Program and an independent assessment of the goals, outcomes, and performance measures developed by VA Loan Guaranty Service (LGY), as part of the study's broad evaluation of VA Home Loan Guaranty program. It provides an assessment of the extent to which the VA Home Loan Guaranty program outcome measures adequately measure legislated program results consistent with the requirements of PL 103-62. The assessment of outcomes includes suggestions for revisions and the development of new outcome measures.

Legislative Intent

Overview

The program's intent has evolved from its original conception for transition assistance for World War II veterans into the premise that housing assistance can be justified for any period of active service, not just wartime service, because service removes the veteran from civilian life. In addition, Congress has recognized that VA housing benefit provides incentive value for the volunteer military. For these reasons, the program has been made permanent, and benefits have been extended to qualifying members still on active duty, to members serving in the Selected Reserve, and to certain surviving spouses.

Congress has continually sought to expand coverage, to improve features and to maximize the program's appeal and utility to veterans. The initial short-term or one-time benefit program has gradually expanded until it has become a permanent benefit that can be used multiple times over a lifetime. The program was extended to cover special groups such as those needing specially adapted living facilities and Native Americans living on trust lands in recognition that their unique needs should also be served by the program. The definition of a qualifying "veteran" was expanded to include active servicemembers to support the volunteer military and, later, members of the Selected Reserve in recognition of growing active/reserve Total Force mission sharing.

History

The VA Loan Guaranty Program, enacted by Public Law 78-346, June 22, 1944, began as a simple housing assistance benefit, within a larger package of readjustment benefits, to help World War II veterans quickly transition to civilian life following discharge from active service. In its original inception, it was neither evident nor intended that the program would survive as an enduring benefit.

As the Nation moved into the second half of the 20th century, the program grew in complexity and size as housing options, financing markets, and veterans' options and needs for housing expanded. Eligibility was opened to veterans of later periods of conflict including

Korea, Vietnam and the Persian Gulf, and to veterans of the cold war and 'peacetime' periods between those conflicts.

The Veterans' Housing Act, Public Law 91-506, enacted on October 23, 1970, made several fundamental changes in the VA housing benefits for veterans. The most significant change was to permanently restore unused entitlements for all WWII and Korean veterans. The statute accomplished this by deleting the sections of law containing the expiration dates and substituting language stating the benefits are restored and will not expire until used. Another significant expansion in the new law was authority for veterans to use loan guarantees to refinance existing loans. In addition, the law significantly expanded the types of housing and the purposes for which loans could be guaranteed or direct loans approved.

One inference from the statute and the Committee reports at the time of this legislation is that it reflected Congress' view that the readjustment period is not limited to the immediate period following military service. In this 1970 act, the Congress acknowledged that the individual circumstances of the veteran and of the mortgage market may result in exercise of the entitlement long after service is completed. By expanding the types of housing qualifying for assistance, the law made the benefits more flexible and adaptable to veterans' needs, and more reflective of external market trends.

With Public Law 93-569 four years later in 1974, Congress continued the expansion of VA housing benefits for veterans. A far-reaching change was authority for VA to restore the entitlement to a guaranteed, direct or insured loan of any veteran provided the veteran had either: (1) repaid the loan in full and disposed of the property; or (2) another eligible veteran assumed the loan and substituted his or her entitlement. Previously, restoration had been available only in limited cases where the veteran had disposed of the property for a "compelling" reason, or the property had been taken through condemnation or destroyed by fire or other natural hazard.

The impact was to codify the conversion of the loan guaranty and direct loan programs into entitlements that could be reused innumerable times, provided the requirements for repayment or disposal were satisfied. In its report on this provision, the Senate Veterans' Affairs Committee commented:

> "The amendments providing for the restoration of entitlement recognize the fact that we live in a highly mobile society and also that many veterans desire or find the need for a different or larger house for personal reasons. The Committee believes that if prior loans of these veterans have been paid off or properly assumed by another veteran with eligibility, the veteran should have his entitlement restored in full for the purchase of another home."[1]

Although restoration of entitlements had been authorized under special circumstances in previous legislation, the more general restoration provision in this Act essentially converted the housing benefit from a one-time use program to a potentially permanent entitlement that could be used for multiple home purchases.

[1] United States Senate, Veterans' Housing Act of 1974, 93rd Congress, 2nd Session, Report No. 93-1334, December 11, 1974. p.10.

The Veterans Housing Amendments Act of 1976, Public Law 94-324, made additional changes affecting the permanence of the VA housing benefit. Key among these were provisions making the benefit permanent for all veterans serving after January 31, 1955, and permitting use of the program by members still serving on active duty.

The Presidential Proclamation marking the official termination of the Vietnam era on May 5, 1975 raised the question of whether the loan guaranty program should be made permanent.[2] The Senate Veterans' Affairs Committee response referenced the importance of the program for veterans:

> "After careful deliberation, the Committee has concluded that the loan guaranty program should be continued and made permanent.
>
> "Over the past 30 years the VA loan guaranty program has in fact been transformed into a permanent on-going housing program. Through a series of amendments enacted by Congress … the home loan program has been converted to a lifetime housing benefit program for generally all veterans released since September 16, 1940.
>
> "This group of more than 27 million veterans now have their entire life to utilize this home loan benefit and can use the benefit as many times as they wish if the property has been disposed of and the loan has been paid in full.[3]

Making the program permanent was implemented by including language in Chapter 37 of Title 38 that any veteran who served on active duty after January 31, 1955 would be eligible for the benefits in Chapter 37.

The Veterans' Housing Benefits Act of 1978 continued the expansion of VA housing benefits by increasing the covered benefit, adding coverage, and increasing the number of eligible veterans. The House Veterans' Affairs Committee, in describing the purpose of the loan guaranty program, did not attribute to it any transitional features. In its report on the bill to increase the loan guaranty, the House Veterans' Affairs Committee stated its view of the program's purpose:

> "The objective of the loan guaranty program is to facilitate and encourage the extension of credit on favorable terms, by private lenders, to eligible veterans for the purchase, construction, repair, alteration, or improvement of homes to be occupied by veteran purchasers."[4]

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[2] Public Law 91-506, enacted on October 23, 1970, permanently restored unused housing entitlements for WWII and Korean Conflict veterans. This action has been identified as making the loan guaranty "permanent," which it did for these groups of veterans. Public Law 94-324, enacted on June 30, 1976, made the VA housing benefits permanent for all veterans serving on active duty after January 31, 1955, including those still on active duty.

[3] United States Senate, Veterans Housing Amendments Act of 1976, 94th Congress, 2nd Session, Report No. 94-806, May 11, 1976, pp.9-10.

[4] House of Representatives, Veterans' Housing Improvements Act of 1978, 95th Congress, 2nd Session, Report No. 95-1332, June 29, 1978, p.3.

In the Spring of 1991, following cessation of Operation Desert Storm hostilities, Congress passed legislation addressing a number of personnel issues arising from the deployment of the armed forces. Section 332 of Public Law 102-25, enacted on April 6, 1991, included the Persian Gulf War within the meaning of a “period of war”. The law defined the period as beginning on August 2, 1990 and ending on a date as yet to be prescribed by the President. This action placed veterans serving during this period on the same footing as veterans of WWII, the Korean Conflict, and the Vietnam era.

Section 341 of the Act established eligibility for VA-guaranteed home loan benefits to Gulf War veterans who served for at least 90 days and who also met the requirement for veterans entering active service after September 7, 1980. During House consideration of the Conference Report, Rep. Montgomery traced the history of the loan guaranty program from its inception in 1944. His comments were repetitive of similar historical tracings by other Members on other occasions. His comments follow:

> “As World War II drew to a close, Congress sought ways to ease the economic and sociological readjustment of service men and women to civilian life. The program was an innovative means of affording veterans favorable credit that would allow them to purchase a home. Many of these veterans, because of their service in the Armed Forces, had missed an opportunity for establishing personal credit or for accumulating enough money for a substantial down payment on a home. By substituting the guaranty of the United States, with little or no down payment, these veterans were better able to enter the home buying market on a competitive level with their non-veteran counterparts.
>
> “Although the objectives of the legislation were designed to assist in the readjustment of returning veterans, rather than to influence the economy as a whole, the Home Loan Guaranty Program was perceived as a means of stimulating the economy and averting to some degree the possibility of postwar depression.
>
> “Over the years, Congress has enacted many changes to the program to enhance its viability and to respond to developments in the economy and to changes in the needs of veterans. There is now no delimiting date for a veteran to make use of this benefit, and entitlement may be regained once the veteran has paid off the initial loan in full…
>
> “Historically, wartime veterans were eligible for this benefit if they had served at least 90 days. With the advent of the All Volunteer Force during peacetime, eligibility requirements were changed to require completion of 24 months of continuous active duty or the full period – at least 181 days – for which the person was called or ordered to active duty.
>
> “The compromise does not change current law on the amount of time a person must have served on active duty to be considered a veteran; however, it does

> provide ... guaranteed home loan eligibility for service in the Persian Gulf war after 90 days on a similar basis as other wartime veterans."[5]

Public Law 102-547, enacted on October 28, 1992, included significant changes to the loan guaranty program. One outcome was to expand coverage to include qualified members of the reserve components and to provide direct loans to Native Americans.

Congress noted several reasons for extending loan guaranty benefits to the Selected Reserve. First, the reserve components had served well during the Gulf War, and the reserves were carrying out an increasingly large share of the national defense mission. As these members were more frequently serving along side active duty members, and experienced some of the same vicissitudes of service, they should be afforded some of the same benefits. As the House Veterans' Affairs Committee Report indicated:

> "The change to afford home loan entitlement to reservists is needed at this time to recognize the expanded responsibilities of the reserves in this Nation's defense. An overwhelming majority of reservists responded willingly to the call to active duty, but the recent call-up (Gulf War) did disrupt lives and in many cases caused real economic hardship."[6]

As the reserves continued to absorb more of the defense mission, the House Committee also viewed the loan guaranty benefit as a potential recruiting and retention tool for the reserve components. Again quoting from the House report:

> "Whether or not members of the guard and reserve continue to serve in the reserve components depends, in part, on the relief and benefits that are made available to them. With the reduction of the active military forces, the reserve components will be relied on to provide an adequate, cost effective Total Force. Hence, incentives to recruit and retain reservists and national guardsmen may become even more important, particularly in light of the personal sacrifices required of recently recalled reservists."[7]

Coverage of reservists further diluted the transition objective of the loan guaranty program as it was originally established. Since most reservists who would qualify for the benefit were primarily rooted in a private sector occupation with all the stability that that life afforded, their "transition" needs following completion of six year in the Selected Reserve would be, in most cases, minimal compared with those of a veteran ending a full enlistment on active duty. Consequently, the "recognition" factor of the growing defense role of the reserve forces and the need for reserve recruiting and retention incentives were prominent motivators for including reservists.

[5] Congressional Record – House, March 21, 1991, p.H1995.
[6] House of Representatives, Veterans' Housing Amendments of 1991, 102nd Congress, 1st Session, Report No. 102-292, Part I, November 6, 1991, p.6.
[7] Ibid.

Conclusion

Through several legislative actions, Congress modified its original intent of the VA Home Loan program as a one-time transitional benefit for World War II veterans. The current program intent is to provide a permanent benefit for all veterans, reservists and active duty military that is available for multiple use. While it recognizes that veterans are adversely affected by military service in establishing the credit needed to secure a conventional home loan, the intent of the program is NOT to provide a benefit to low-income individuals. It is intended as a benefit to all those in the all-volunteer service, including reservists who have made substantial economic sacrifices during and since the Gulf War era.

A more detailed discussion of the legislative history is provided in Appendix C.

Current Goals, Outcomes, and Measures

Table 2-1 presents the current program goals, outcomes, performance measures, and data sources that VA LGY developed for the VA Home Loan Guaranty program. The current set of goals, outcomes, and measures focuses on home ownership for veterans, decreasing the rate of foreclosed VA loans, improving the quality of life for disabled veterans, and providing financial assistance to veterans who do not qualify for conventional financing to purchase a home. The Study Team generally supports these goals and measures but suggests certain adjustments, refinements, and additions. Additional measures include utilization of the entitlement, awareness, and efficiency-related measures.

Table 2-1. Current Program Outcomes and Performance Measures

Goal	Program Outcome	Performance Measure	Data Source
A. Increase home ownership.	The home ownership rate of veterans will be higher compared to that of the general population.	The home ownership rate of veterans will be 12 percent higher than that of the general population.	Program and Census data
B. Decrease rate of foreclosures.	VA intervention will help veterans avoid termination of home ownership.	Forty-five percent (45%) of veterans who would otherwise face foreclosure will avoid it because of VA intervention activities.	FATS ratio
C. Improve the quality of life for disabled veterans.	Survey respondents report that the Specially Adapted Housing assistance grant has led to an improved quality of life for disabled veterans.	At least 95 percent of disabled veterans surveyed will report an improved quality of life as a result of receiving a Specially Adapted Housing assistance grant.	Special survey and focus groups
D. Provide financial assistance to veterans seeking to purchase a home.	Assist veterans whose limited financial resources would preclude conventional financing.	At least 80 percent of VA loans are to veterans whose limited financial resources preclude conventional financing.	Mortgage loan servicer data

Source: VA LGY

Home Ownership

A stated goal of the VA Home Loan program is to increase home ownership among veterans. The respective program outcome is: "The home ownership rate of veterans will be higher compared to that of the general population." The corresponding performance measure is: "The home ownership rate of veterans will be 12 percent higher than that of the general population." The ensuing implication is that the VA Home Loan program is intended to produce higher home ownership for veterans than would occur otherwise.

VA program officials informed the Study Team that the current measure for home ownership is based on home ownership data obtained through the Department of Housing and Urban Development (HUD) and the National Survey of Veterans (NSV). HUD statements of home ownership rates are based on Bureau of Census data.

However, the performance measure of a 12-percent-higher home ownership rate for veterans compared to that of the general population is problematic because it does not account for demographic differences or shifts in the different population groups. Veteran and non-veteran populations have different characteristics that affect comparisons of their home ownership rates to that of the general population. For example, veterans, on average, are older and have higher household incomes than non-veterans do. Since the groups are not directly comparable, the outcome goal should be based on a measurement that can account for the differences in demographic characteristics between the two groups.

The 12-percent-higher home ownership rate for veterans compared to that of the general population is what it has been in recent years. However, based on the study results, when controlling for the demographic and socioeconomic composition of the general population, a veteran household is only 5 percent more likely to own a home than a comparable general household.

Since differences in home ownership rates between the veteran and general populations are a function of the demographic and socioeconomic makeup of the two populations, it is appropriate to attach the home ownership goal to the relative demographic and socioeconomic composition of the two populations. Statistical analysis, as demonstrated in the study's analysis of home ownership rates, can be used to adjust for the demographic and socioeconomic differences.

In addition, veterans use non-VA lending sources to obtain mortgages; therefore, an overall home ownership rate for veterans does not necessarily reflect the performance or outcome of the VA Home Loan program. Another consideration is that the decision to rent or purchase a home depends on several factors, not just the availability of the VA Home Loan program for veterans. These factors include socioeconomic variables, such as age, race, marital status and household composition; economic variables, such as household income and labor market conditions; financial variables, such as housing prices, mortgage cost, and credit constraints; and geographic variables such as urban and rural locations. Some factors, such as home prices and mortgage interest rates, are out of people's control, yet they play a significant role in the housing purchase decision. For example, mortgage interest rates have dropped from about 8 percent in mid-2000 to under 6 percent at present, thereby increasing the purchasing power of households.

Benefit to Veterans

As stated previously, the VA Home Loan program is intended to provide a benefit to veterans for their service to the country, not to fulfill broad social objectives. In contrast, HUD's loan program is intended to fulfill social objectives, that is, help low-income and minority groups gain access to loan markets that they might not have due to low income or discrimination.

The benefit that veterans gain from VA Home Loan program derives from specific unique features offered by the program. The VA Home Loan program, in particular, offers certain advantages to veterans, active duty personnel, and reservists relative to conventional loans or other available alternatives, including the following:

- No down payment
- Limitations on closing costs (these are less than veterans would pay for a conventional loan)
- No private mortgage insurance (PMI)
- Easier credit standards to qualify for a loan
- Default assistance to avoid foreclosure
- Special housing adaptation assistance for veterans with certain disabilities.

The no down payment and no PMI are unique features of the program and possibly its most attractive benefits. In contrast, HUD's loan program requires a three percent down payment and PMI. While the private sector offers some opportunity for no down payment loans, this is the exception and not the rule and has offsetting disadvantages such as generally requiring an excellent credit history and a higher interest rate. Veterans can obtain a loan without giving a down payment, without having to pay a higher interest rate, and without having to pay private mortgage insurance. In addition to these benefits, the VA Home Loan program offers default assistance to veteran borrowers in financial difficulty through a higher level of service and a greater range of alternatives to avoid foreclosure. Delinquency and foreclosure rates for VA loans are substantially less than for FHA loans.[8]

While the VA Home Loan program may result in a higher homeownership rate for veterans, other significant benefits accrue to veterans. These benefits include the fact that veterans—

- Obtain credit more readily, even with credit-constrained history
- Own a home sooner

[8] The reader is referred to Chapter 6 for additional comparison of VA and FHA loans.

- ► Avoid private mortgage insurance
- ► Use limited financial assets for purposes other than a down payment
- ► Avoid having to borrow money for a down payment from relatives or other sources
- ► Associate the VA Home Loan program with recognition for service to country.

The Study Team analyzed financial information on borrowers contained in the VA Home Loan administrative records to assess what percentage would not qualify for conventional loans. For this analysis, conventional loans are defined as loans that are not insured or guaranteed by a Government agency (i.e., Federal Housing Administration (FHA) and VA). Also, conventional loans are sold on the secondary market if they meet nationally accepted underwriting criteria established by the national secondary market investors, Fannie Mae and Freddie Mac.

A current program goal that VA currently states for the VA Home Loan Guaranty program is: "Provide financial assistance to veterans seeking to purchase a home." The respective performance measure for the goal is: "At least 80 percent of VA loans are to veterans whose limited financial resources preclude conventional financing."

The study analysis of borrower financial records reveals that the percentage of VA loan borrowers who could not qualify for a conventional loan is 82 percent for one-time or first-time users and 76 percent for multiple users. This result meets VA's current 80 percent target for the financial assistance measure. The percentage not qualified for a conventional mortgage is based on typical guidelines issued by the secondary market, that is, a 5 percent down payment or more and an income-to-debt ratio of 36 percent or less.

While the percentage of borrowers who would not qualify for a conventional loan is a very insightful measure, a performance target of 80 percent seems to be an overly arbitrary cutoff point. While the VA Home Loan program certainly is designed to help veterans who are credit-constrained, the program is also available for all veterans. The participation of veterans who qualify for conventional financing should also be viewed as a positive outcome. An alternative measure is to estimate the number of veterans with a VA loan as a percentage of the total population of veterans who do not qualify for conventional financing. However, the Study Team did not find any readily available data sources for this measure.

Study survey results also support the premise that the VA Home Loan program provides significant benefit to veterans. For example, 88 percent of the survey respondents indicate that the no down payment feature was an important reason for using the VA Home Loan program. More than three-fourths of the respondents indicate that they are better off with their VA loan relative to their alternatives without a VA loan. More than three-fourths of the respondents state that the VA Home Loan program helped them catch up with their civilian counterpart and readjust to civilian life after active duty. Eighty-three percent of the respondents indicate that the VA program makes them feel that the Nation recognizes their service.

Program Utilization

The previous discussion assesses the uniqueness of the program and its financial benefit. In addition to this assessment, measures of the utilization of the program further substantiate the value of the program to veterans. Outcomes that reflect a high level of utilization confirm that veterans perceive the program as providing a valuable benefit. Lack of or declining participation in the program would reflect that the program is offering little or declining benefit value to veterans and servicemembers. Since the intent of the legislation is to make the benefit available to all veterans and servicemembers, the level and extent of participation is an important and positive outcome of the program.

Overall Utilization

On the basis of the results of the 2001 NSV, nearly 60 percent of veterans who have ever obtained a loan to purchase a home, make home improvements, or refinance a home loan used a VA loan at some point. Since most veterans use the loan program, it is a valuable benefit. Furthermore, this percentage remains about the same for different age groups of veterans. The important implication is that the program retained its high benefit value over the past decades as we observe the same high participation rate ranging from the youngest age group (less than 35 years) to the oldest age group (75 years or older). Chapter 5 presents this finding in tabular results.

Market Share of VA Loans

The relative share of total VA loans in a Metropolitan Statistical Area (MSA) is another measure of program participation. Market share of VA loans reflects the demand for VA loans relative to the demand for non-VA loans. VA loans compete in the market for their share. The Study Team analyzed the market share of VA loans for 30 selected MSAs where market share is expressed as a percentage of VA loans originated in 2001. It also reports the percentage of veterans in the total population for each MSA as a factor qualifying the relative market share.

Results reveal that market share has a very wide range across the MSAs, varying from only 0.2 percent for the New York MSA to 24.1 percent for the Norfolk, Virginia MSA. Market share for all 30 MSAs is approximately 4 percent. Numerous factors affect market share, including the relative size of the veteran population, maximum VA loan amount, average cost of homes, and demographic composition of the local veteran and active duty population. The market share measure used in this study is based on the number of loans *originated*, as opposed to the actual number of loans for all borrowers. The latter measure, for which data are not readily available, would be a preferred measure because it is a broader, more inclusive measure.

Study analysis of the maximum VA loan amount indicates that it affects participation in high-cost housing versus low-cost housing areas. Analysis of the funding fee that borrowers are required to pay reveals that increases in the funding fee over time have a negative effect on participation. Hence, maximum loan amount and funding fee are two important policy areas that affect the benefit value of the VA Home Loan program and consequently market share.

Multiple Use of the Loan Guaranty Benefit

In measuring utilization of the loan guaranty benefit, we can distinguish between one-time use and multiple use. Multiple use is defined as borrowers reusing their entitlement to obtain a purchase loan, whereas one-time use is defined as not having a previous VA loan.

The legislation gives clear and explicit authority for multiple use. The legislative history of the program shows that it underwent numerous changes to make the use of housing benefits easier and more appealing. One of these changes is that eligible veterans or servicemembers could reuse their entitlement if they paid their previous loan in full and disposed of the property. Veterans were later allowed a one-time entitlement restoration if they paid the loan in full but did not dispose of the property.

Approximately one-third of VA loan borrowers are multiple users, although the estimate varies depending on periods and loan cohorts covered. Multiple users have a favorable foreclosure rate, which is about 40 percent lower than that of one-time borrowers, and they pay a higher funding fee. Hence, the cost is significantly less than for first-time borrowers. Also, the multiple use feature received the highest satisfaction score compared to other features of the program (see Chapter 9 on satisfaction of participants).

Multiple use is another indicator of the value and desirability of the program for veteran borrowers. As such, we recommend that routine reporting of multiple use be conducted annually. VA's primary administrative data file on loans does not contain a data field that reports the number of times participants use their entitlement. We recommend that this feature be added to the database.

Awareness

Awareness of the VA Home Loan program consists of veterans and servicemembers knowing and understanding their entitlement and eligibility for the VA Home Loan benefit. An important element of VA's overall strategic plan is to provide an environment that fosters effective communication about and effective management of its programs. Hence, the veterans' and servicemembers' awareness of the VA Home Loan program is another important outcome or performance of the program.

The VA Loan Survey addresses the awareness of veterans and servicemembers who participate in the program. It does not obtain views from eligible nonparticipants. The Study Team examined results from the 2001 NSV and 1992 NSV to determine the reasons why veterans do not participate in the VA Home Loan program.

On the basis of the 2001 NSV data, 35 percent of the veterans did not participate because they—

- Were not aware of the program (19%)
- Thought they were not eligible (11%)
- Did not know how to apply for a loan (4%).

In comparison, the 2001 NSV source indicates that 17 percent of veterans are not aware of VA health care benefits, 35 percent are not aware of life insurance benefits, and 41 percent are not aware of veterans burial benefits.

Awareness and understanding is an important goal for all VA programs, and as such, VA should have mechanisms in place to measure at least the participants' general awareness of each program on an ongoing basis.

Default Assistance

A significant proportion of VA loan staff resources is devoted to providing assistance to borrowers in default to help them avoid foreclosure. This can be viewed as an operational issue for the Government to minimize foreclosure claims costs, but it provides an important benefit for borrowers as well when the outcome is avoidance of foreclosure. A current VA outcome for the VA Home Loan program is: "VA intervention will help veterans avoid termination of home ownership." The corresponding current performance measure is: "Forty-five percent of veterans who would otherwise face foreclosure will avoid it because of VA intervention activities."

The performance measure of the success of default interventions currently used by VA LGY is the Foreclosure Avoidance Through Servicing (FATS) ratio. The FATS ratio is the number of successful interventions plus other foreclosure avoidance outcomes divided by the number of foreclosures plus the number of successful interventions and other foreclosure avoidance outcomes for a given year or month.

Significant improvement in the FATS ratio occurred between 1996 and 2003 for all of the Regional Loan Centers (RLCs) except one.[9] Explanation for the general improvement relates to the consolidation of RLCs from 45 to 9 during that period. It is better to oversee 9 RLCs than to oversee 45 RLCs. Many new supplemental servicing employees were hired as part of the consolidation. New staff generally require about 3 years of training experience to become fully competent. In addition, renewed emphasis has been placed on the FATS ratio, and the newly implemented policy of rewarding employees with cash awards is an incentive for better performance.

GAO Report 01-610 (May 2001), Improved Measures Needed to Assess Supplemental Loan Servicing Program, was critical of the FATS ratio measure. It concluded that the FATS ratio is not a meaningful measure for the following reasons:

- The measure does not take into account differences in local economies
- The measure is not sensitive to changes in the quality of servicing
- The measure does not include or address cost savings associated with supplemental servicing

[9] Reader is referred to Chapter 7 for detailed analysis of the FATS ratio.

► VA computer system has not been able to generate timely management reports for managing the supplemental servicing program.

The Study Team disagrees with the conclusion of the General Accounting Office (GAO) that the FATS ratio is not a meaningful measure. The FATS ratio, as currently measured, certainly provides useful information to VA management at both the central and the regional loan centers. The FATS ratio is a broad, aggregate measure of foreclosure avoidance, which is certainly an important program outcome. Since GAO's 2001 report, VA has improved on the timeliness of its management reporting. FATS ratio reports are generated monthly with less than a 30-day lag between the occurrence of the results and the dissemination of the reports.

Certain improvements or refinements in the measure could provide additional insights. For example, differences in local economies present an uncontrollable factor in VA's efforts to perform default intervention. Taking this factor into account is not a straightforward exercise and would require more advanced analysis than VA currently performs. By statistically controlling for certain factors such as the conditions of local economies and workload and staffing ratios, separate targets for the FATS ratios for the different RLCs can be set more appropriately.

The FATS ratio is a useful broad measure of servicing effectiveness. Allowance for possible adjustment in the FATS ratio goal of 45 percent could be explicitly stated in VA's statement of goals, outcomes, and measures. Numerous factors that vary over time and across regions—some of which are controllable by management and many that are not—affect default rates, foreclosure rates, and intervention efforts. Statistical analysis of VA loan defaults and foreclosures could be conducted on an ongoing or periodic basis to understand trends, variations, and causal factors.

A general recommendation is to expand the development and application of statistical analysis of VA loan defaults and foreclosures to better inform management and stakeholders of trends, variations, and causal factors on an ongoing basis.

In addition to the FATS performance measure for foreclosures, VA could also introduce outcome measures for default rates. One might argue that VA management has little control over defaults because it does not decide who qualifies for loan origination. However, VA does monitor the lenders participating in VA loan origination. Stakeholders, for example, are particularly interested in default rates for active duty members. Hence, we recommend that VA continuously monitor default regularly for different population groups, including veterans, active duty personnel, and reservists.

Specially Adapted Housing Program

Another key outcome of the VA Home Loan Guaranty program is: "Survey respondents report that the Specially Adapted Housing (SAH) assistance grant has led to an improved quality of life for the disabled veteran." The corresponding current performance measure is: "At least 95 percent of disabled veterans surveyed will report an improved quality of life as a result of receiving a Specially Adapted Housing grant."

The Study Team administered a questionnaire to all current SAH grantees that includes an item pertaining to the program outcome of improved quality of life for disabled veterans. Also included is a question that addresses independent living as a therapeutic or rehabilitative advantage of the program. Key results are that 99 percent of participants say that the adaptations improved their quality of life and 98 percent say that the adaptations help them live more independently.

Cost Efficiency Outcomes

Outcomes for VA programs typically focused on the benefits for the program recipient or beneficiary, not on the efficiency of the program. However, the Program Assessment Rating Tool (PART), of the Office of Management and Budget (OMB),[10] draws more attention to measures that relate to efficiency, budget, and the taxpayer. For example, the following questions related to program results on cost and efficiency are in an extensive list of questions to complete PART:

- Does the program demonstrate improved efficiencies or cost effectiveness in achieving program goals each year?
- Were programmatic goals (and benefits) achieved at the least incremental societal cost and did the program maximize net benefits?
- Were program goals achieved within budgeted costs and established schedules?

A conclusion of the study is that VA successfully and efficiently operates the VA Home Loan program to meet legislative requirements for eligibility determination, lender monitoring, and loss mitigation. Over the past decade, significant consolidation of field operations and technology advances implemented have occurred, allowing for the downsizing of full-time equivalent VA administrative staff from about 1,800 to 900 without a decrease in the services being provided or quality. In addition, during this period private industry has taken on a continually increasing role in the VA Home Loan program.

Within the past few years, dramatic increases in speed of service complement increases in administrative efficiency. For example, for many borrowers, eligibility determination is made online in a matter of a few minutes rather than in 2 weeks or several days as before. Improvements in the VA appraisal process have accelerated the appraisal process by 75 percent. VA notifies lenders electronically within 24 hours that the Government has received the funding fee, in contrast to the previous time lag of 10 to 12 days.

Administrative costs constitute a relatively small portion—less than 10 percent—of the total capital and operating costs. The predominant costs are claims costs and other costs associated with foreclosure and alternatives taken to avoid foreclosure. Each claim costs the Government about $20,000. However, revenues that VA collects from different sources, including the funding fee that borrowers pay, property sales, and proceeds from acquired loans and vendee loans, affect this cost.

[10] http://www.whitehouse.gov/omb/part/index.html

Management of claims losses is so effective now that the loan subsidy rate is nearly zero or *negative* for loan cohorts. While claims costs vary over a given period, the program has been making money for the taxpayer in recent years rather than costing the taxpayer money.

For VA to get credit and recognition for such an achievement, it needs to have a continuous reporting systems in place that measures cost effectiveness and efficiencies achieved that relate to program goals and strategies for improving operations.

Recommended Goals, Outcomes, and Measures

Table 2-2 summarizes the Study Team's recommendations for revised and additional program goals, outcomes, and performance measures, which were discussed in detail throughout this chapter.

The Study Team recommends that the outcome measures listed in Table 2-2 be used annually for ongoing review of program outcomes. These measures and data sources are reported in detail throughout the remainder of this report. VA LGY has resident data systems to produce some of the measures, but not all of them.

One source of information on program participation, awareness, and access is the NSV. However, this survey is only conducted once every several years, and because of its comprehensiveness, it is a complex, expensive undertaking. While it may be too involved and costly to conduct the NSV every year, a shorter, smaller mini-survey could be implemented on an annual basis that would include both nonparticipant and participant veterans. Relatively small sample sizes and questionnaires covering all or several VA programs would insure an economical approach to the measurement effort. The questionnaire could be constructed to facilitate comparisons in the level of participation and awareness across programs and over time. Market share information could also be obtained from survey respondents.

Reporting capabilities of VA LGY and VBA financial data systems could be enhanced to provide more readily certain measures, including multiple use, default and foreclosure rates for different population groups, and cost-effectiveness indicators.

Table 2-2. Revised Program Outcomes and Performance Measures

Goal	Program Outcome	Performance Measure	Definition	Data Source
A. Increase home ownership.	The home ownership rate of veterans will be higher compared to that of the general population.	The home ownership rate of veterans will continue to be higher than that of the general population.	Percent of veterans who own their home compared to general population, adjusted for demographic composition.	Annual Current Population Survey
B. Maintain or increase current participation.	The participation rate for first-time and multiple borrowers will remain the same or be higher.	The participation rate of veterans who ever use the loan program will remain at historical levels or increase.	Percent of veterans owning a home who ever report using VA loan.	Annual mini-survey of participants and non-participants.
C. Increase awareness	Level of awareness among non-participants increases.	Percentage of awareness among non-participants will increase.	Percent of veterans who report not using VA loan program due to lack of awareness of understanding.	Annual mini-survey data of non-participants.
D. Decrease rate of foreclosures.	VA intervention will help veterans avoid termination of home ownership.	Reduce the percentage rate of foreclosure.	FATS ratio adjusted statistically for region and year.	Internal VA data on defaults and foreclosures.
E. Improve the quality of life for disabled veterans.	Survey respondents report that the Specially Adapted Housing assistance grant has led to an improved quality of life for the disabled veteran.	At least 95 percent of disabled veterans surveyed report an improved quality of life due to receiving Specially Adapted Housing assistance.	Percent of veterans receiving SAH who report an improved quality of life.	Ongoing SAH Survey of recent SAH grant recipients.
F. Provide financial benefit to veterans seeking to purchase a home.	Assist veterans whose limited financial resources would preclude conventional financing.	A certain percentage of veterans who do not qualify for conventional mortgage receive a VA loan.	Percent of VA loan borrowers who would not qualify for conventional loan (5% down payment and income-debt ratio of 36% or less).	Mortgage loan servicer data.
G. Improve cost efficiency	Cost efficiency, adjusted for inflation, continues to improve each year.	Reduce cost per loan: (1) administrative cost; and (2) claim cost.	Administrative cost as normally defined for budget. Claim cost are net of offsetting revenues.	VBA financial data and VA LGY output data.

Source: Study Team Analysis

3. PROGRAM OPERATIONS

Chapter 3 describes the operations of VA Loan Guaranty program. It highlights the significant advances made in operations over the past 10 years, and it also describes new initiatives in program operations. Finally, the chapter reviews and recommends certain measures of cost-effectiveness and performance.

Overview of Operations

The VA Home Loan Guaranty program is designed to provide veterans, reservists, and active duty personnel competitive financing terms for home purchases and refinances through private lenders. Eligible veterans[1] who seek to buy a home typically contact a real estate agent or other real estate professional when they are ready to purchase. If the veteran has not already done so, the real estate professional will suggest that the veteran contact a lender who can recommend the best type of loan program for them. Not all veterans who purchase a home opt to take advantage of the VA loan program. In some instances, there are comparable programs offered through private investors and other government sponsored entities (GSEs) that the veteran takes advantage of. VA offers fixed rate financing and has recently introduced a Hybrid Adjustable Rate Mortgage option for veterans to take advantage of in an effort to stay competitive with other conventional financing options. The VA Interest Rate Reduction Refinance Loan (IRRRL) is a popular program used by veterans who already have a VA loan and wish to refinance.

In administering the VA loan program, VA's Loan Guaranty Service (LGY) sets out certain guidelines and standards that lenders and other third party service providers must adhere to in order to participate. Only VA-approved lenders can originate and service VA loans. Appraisers must be VA approved to issue appraisals, and veterans must be eligible to obtain a VA loan. VA performs the administrative functions of eligibility determination of the veterans, collection of the funding fees, monitoring and oversight of lenders and appraisers, and servicing loans that are in default. VA also provides various technical solutions/systems that allow lenders to obtain certain services or information electronically.

Loan Operations

Lenders have primary responsibility for the origination of the mortgage loan. Lenders with automatic authority can underwrite loans without VA's prior approval. Lenders without automatic authority must submit all loans to VA for underwriting except nondelinquent IRRRLs. In addition, there are certain types of unusual loans that require VA's prior approval for underwriting.

Lenders require eligibility determination of military service from the veteran in order to originate a VA loan. In about half the cases, lenders can use VA's online system (referred to as Automated Certification of Eligibility or ACE) to determine eligibility within seconds or

[1] To simplify presentation, we use the term veterans to include all program eligibles including reservists and active duty members.

minutes. The system currently does not handle eligibility determination for National Guard personnel or reservists due to limitations in documentation received from the Department of Defense.

If eligibility cannot be established online, then VA loan candidate applies for a Certificate of Eligibility (COE) for Loan Guaranty Benefits using VA application form VAF 26-1880. The veteran fills out the application form and sends it along with proof of military service (usually the DD214 military record form) to one of two VA eligibility centers. If the applicant is eligible, the eligibility center sends the COE back to the veteran in a few days or less than two weeks. The COE (VA Form 26-8320) establishes the veteran's entitlement and allows him/her to apply for a VA loan with a lender.

After eligibility determination, the lender orders an appraisal from a VA-fee or approved appraiser. The appraiser is assigned to the case according to a rotation system rather than selected by the lender. This appraisal rotation practice is unique to VA and is in contrast to conventional and FHA loan requirements. In the case of Lender Appraisal Processing Program (LAPP) approved lenders, appraisal reports are given directly to lenders for review and approval. The lender's Staff Appraisal Reviewer (SAR) has the responsibility to review the appraisal and determine the reasonable value of the property and any conditions that must be met before VA loan guaranty. In most cases, lenders require any conditions be met before closing to insure the loan can be properly guaranteed. In the case of non-LAPP approved lenders, appraisals are sent directly to VA for review and determination of value and conditions. After review by VA, the appraisal is then forwarded to the lender. This process can result in delays of the loan closing for the veteran.

Within 15 days after closing, the lender deposits the funding fee paid by the borrower into the U.S. Treasury Electronic Transfer Fund, using the on-line VA Funding Fee Payment System. The funding fee was waived for about 15 percent of the cases in 2003 because of the veteran's disability status. This represents an increase of 5 percent from about 10 years ago because more veterans are adjudicated as disabled.

After closing and payment of the funding fee, the lender sends the loan package to the respective Regional Loan Center (RLC) for guaranty. Lenders can also submit loans electronically to VA through VA's Electronic Data Interchange (EDI) system. By using the electronic process, lenders can obtain their guaranty within 48 hours. The electronic process also eliminates the need to send a paper file in for guaranty. This represents a significant time savings over the manual process. Lenders can access the EDI system directly, or through CC Pace's LGXpress™, an independent third party system that provides a Web-based interface to VA's EDI system. The guaranty is required for the lender to sell the closed VA loan to an investor.

Loan Servicing

The loan servicer's primary responsibility is to accept and process payments, report 1098 information, and pay the mortgagor's insurance and taxes. Servicers also perform collection and foreclosure activities when a loan is delinquent. Once the loan is guaranteed, VA is not typically involved in servicing the loan unless the loan has been in default for 105 days.

As in the case of loan origination, VA empowers servicers through its Servicer Loss Mitigation Program (SLMP) to approve alternatives to foreclosure on VA's behalf. VA responds to numerous questions from borrowers and lenders throughout the entire loan process, but more VA staff is concentrated in the loss mitigation area than any other major function performed by VA. After Notice of Default is received from the lender, VA enters the information into the Loan Service and Claims System for supplemental servicing, and a letter is sent to the veteran requesting the veteran to contact VA for help. Although it makes the request, VA does not wait for the veteran to contact them; instead, VA attempts to make contact to assess the situation, determine reasons, and remedy the default.

About 80 percent of the defaults never go to foreclosure. If the loan default cannot be remedied, VA honors the loan guaranty and pays the claim. Different courses of action are taken to avoid foreclosure and prevent or minimize financial loss.

Loan Service Representatives (LSRs) at VA Regional Loan Centers (RLCs) emphasize alternatives to foreclosure when speaking to veterans who are delinquent on their VA-guaranteed loans. They provide counseling to veterans and in appropriate cases intercede directly with loan holders to obtain reasonable repayment plans on behalf of veterans. If a loan holder cannot extend additional forbearance, and VA believes the case warrants additional consideration, VA will buy the loan from the holder and the veteran will make future payments to VA. This is called a refunding. If the veteran's situation reveals that he or she has little, if any, chance of maintaining the loan payments, LSRs encourage a private sale of the home to avoid foreclosure. When a home cannot be sold for enough to pay off the loan, VA considers paying a compromise claim for the difference between the sale price and the loan indebtedness. LSRs also review each default for the possibility of approving a deed in lieu of foreclosure. Each of these alternatives is usually less costly than foreclosure.

VA Offices and Staffing

Regional Loan Centers (RLCs) perform loan production and loan servicing for participants in the VA loan program. There are nine RLCs located throughout the country—Atlanta, Georgia; Cleveland, Ohio; Denver, Colorado; Houston, Texas; Manchester, New Hampshire; Phoenix, Arizona; Roanoke, Virginia; St. Paul, Minnesota; and St. Petersburg, Florida. In addition, two small Regional Offices, Honolulu, Hawaii and San Juan, Puerto Rico, perform a full range of loan functions. RLCs are divided into three areas: Loan Processing (LP), Construction and Valuation (C&V), and Loan Administration (LA). A contractor with VA oversight performs the Property Management (PM) function.

LP handles activities involving home loan origination, including loan guaranty certifications, monitoring, and training of lenders. C&V handles the valuation of properties, manages VA loan fee appraisers, and supervises the construction of Specially Adapted Housing. LA conducts supplemental servicing of loans in default, manages the foreclosure process, and processes claims.

The PM function is management of properties acquired from lenders resulting from foreclosures. PM operations include acquisition, marketing, sale, and settlement of foreclosed properties. An A-76 cost study of the PM function resulted in award of a PM contract to Ocwen Federal Bank FSB (Ocwen) in August 2003. Savings are projected to be $14.25 million over four and a half years.

As of January 2004, 901 full-time equivalent (FTE) staff worked in VA Central Office (VACO) and field offices. Of these staff, 187 FTEs worked in LP, 335 FTEs in LA, and 165 FTEs in C&V. Seventy-four VA staff remain in PM, awaiting their reassignment to other positions. The remainder of the 901 FTEs are in management, files, administration, and other areas, including 98 in VACO LGY, 42 in Office of Chief, and 12 in LG files. Approximately eight staff work in Information Technology (IT) in VACO. VA also has an ongoing IT maintenance contract for its loan operations center in Austin, Texas (annual cost is approximately $2.5 million).

The Property Management Oversight Unit provides oversight of the PM function. It has 18 VACO FTEs and is based in Nashville, Tennessee. The Monitoring Unit, also based in Nashville, audits the lenders and has 14 VACO FTEs. The Quality Control Team, based in Washington, DC, performs internal audits of VA field operations and has 3.5 FTEs. The Portfolio Loan Oversight Unit, based in Indianapolis, Indiana, audits Countrywide servicing of portfolio loans.

Changes in Operations over the Past 10 Years

Over the past several years, the VA loan program has undergone a considerable amount of consolidation and implemented significant technology advances. Program operations place great emphasis on the use of e-commerce. VA has also shifted more responsibility for the loan underwriting and production process to approved lenders. These changes have resulted in great success in terms of increasing speed and accuracy and reducing foreclosures and costs. The number of VA FTEs has decreased dramatically from more than 1,800 ten years ago to about 900 today, while the loan volume, on average, has increased. The changes have occurred mostly during a period of positive economic climate.

Determination of Eligibility

An initial step in VA loan process is the COE, which certifies that the loan applicant is eligible to apply for a VA loan. Two eligibility centers, one in Los Angeles, California, and the other in Winston-Salem, North Carolina, take applications for and issue the COE. VA's recently implemented ACE system provides for online issuance of COEs for simple cases. The two eligibility centers still handle the complex cases. With ACE, certificates can be printed immediately at the lender's office. ACE also provides an online facility for lenders to check on the status of the lender's Loan Guaranty Certificate (LGC).

VA also has a streamlined procedure in place for IRRRLs where a Web-based procedure is used in place of the COE. Participating VA lenders use the Loan Inquiry Internet application to verify veterans' existing VA loans in connection with processing applications for VA refinancing loans. Implemented nationally in January 2003, this application enables the lender to process a loan for refinance without requesting a COE because the lender can submit the Loan Inquiry verification document with the guaranty package. The procedure has a 24-hour turnaround time and frees up the eligibility center for purchases, restorations, and more complex cases.

VA eligibility centers and RLCs use the Guaranteed and Insured Loan System (GIL) to track veteran use of entitlement and verify that loans are guaranteed, have been paid off, or are in some other status. GIL stores data on about 16 million loans dating back to 1944. GI Loans is an enhanced version of GIL that enables access online. The new system eliminated the use of microfiche and clerical or administrative staff at the eligibility centers.

Loan Application and Production Process

The VA loan underwriting function has been transferred almost entirely to the lenders with automatic authority. Automatic processing of a VA loan application occurs in about 99 percent of the cases where lenders underwrite and close the loan without VA involvement. This is an increase from about 92 percent underwritten by the lenders 10 years ago and only 45 percent 20 years ago. This transfer gives control of the underwriting process to the lender and eliminates VA as a potential bottleneck.

VA’s Electronic Lender Folders (ELF) system, started in 2002, tracks lender participation, annual renewal fees, and loan deficiencies. It also generates letters, faxes, and e-mail. Other programs have been put into operation that further move the whole process towards paperless operation, including the Automated Loan Processing System (ALPS), Right-Fax, and E-loans. E-Loans enables RLC employees to scan documents and create electronic files, eliminating the need to set up physical loan files or pull files to review information. It has enabled the electronic recording of lender requests for agent and underwriter approvals and has helped to reduce duplicate funding fee refund payments on old loans.

The old system for lender payment of the funding fee to the government did not communicate with any other system. Evidence that the funding fee had been paid was made only by hard copy communication. The new Web-based funding system, VA’s Funding Fee Payment System (FFPS), enables VA to notify lenders electronically within 24 hours that it received the funding fee, in contrast to the previous time lag of 10 to 12 days. It has also resulted in hundreds of thousands of dollar in savings in terms of mailing costs and associated paper management costs. The new system calculates funding fees based on cohort year of loan, veteran category, and loan amount and is designed to eliminate lender calculation error. VA’s FFPS was launched on a national basis in 2002, resulting in greater consistency and accuracy. The system provides a better tool for VACO and RLCs to exercise oversight of or follow-up on lender payment of funding fees.

Loan Appraisal Process

Lenders and servicers access a VA assignment system in order to obtain a VA appraisal. The system assigns a VA case number to the property and assigns the case to a VA-approved appraiser. VA’s appraisal system for requesting an appraiser was recently transformed into a Web-based production program that allows access by all program participants.

The current VA appraisal system, referred to as The Appraisal System (TAS), was started in 2001 and reached full implementation in 2003. TAS is a centralized Web-based application that replaces the previous region-based system, tracks the status of appraisals, provides online veteran eligibility information for Specially Adapted Housing (SAH), and tracks loans and grants used for SAH. Information is stored in a single national database housed at VA's Austin Automation Center. The new system enables the shifting of workloads across RLCs because all RLCs have access to the same system via the Internet. Many of the VA staff previously involved in the appraisal production process were moved to oversight functions.

LAPP allows the lender to receive appraisals directly from the appraiser and issue the Notice of Value without VA involvement, thereby speeding up the process for loan approval for the veteran. Approximately 90 percent of appraisals are done this way, as opposed to VA first approving the appraisal. VBA's goal is to rely on LAPP in the maximum number of cases possible.

Improvements in VA's appraisal process have speeded the appraisal process by about 75 percent. This is attributable to lenders being able to issue the Notice of Value without VA involvement and the implementation of e-commerce in the process. When e-commerce for the appraisal process was implemented in 2001, mail time and handling of about 12 days was eliminated or drastically reduced. Previously, the customer service standard had been 20 days to complete the appraisal process. Today, there is no uniform national standard, but one that varies according to the local conventional market speed. In Houston, for example, the typical waiting period for the appraisal is five days.

Electronic Loan Guaranty through EDI

VA introduced the Electronic Loan Guaranty program in 1999. Electronic Loan Guaranty allows paperless processing of loans for guaranty. Lenders can directly take advantage of the paperless process with VA if they are EDI capable or through LGXpress™, an independent third party vendor system that allows lenders access to VA EDI process through a secure Web-based system. For 2003, about 25 percent of all loan guaranties were processed through the EDI system.

Consolidation

VA consolidated loan operations in 46 VA Regional Offices (VAROs) into nine Regional Loan Centers. The consolidation took place over a period of 6 years, starting in 1995. The consolidation achieved significant cost savings by decreasing the field staffing level. Previous consolidation of field offices since the early 1990s also resulted in significant reductions in FTEs as well. VA LGY reports a reduction in total FTEs from 1,890 in December 1994 to 912 FTEs in December 2003. The consolidation resulted in greater consistency and accuracy as well as reduction in FTEs. The consolidation of field operations and technology advances allowed for the 50 percent downsizing of full-time equivalent VA administrative staff without a decrease in the services being provided or quality.

The eligibility center in Winston-Salem, started in 1997, and the eligibility center in Los Angeles, started in 1998, as part of the overall consolidation of 46 VAROs into nine RLCs and two eligibility centers. The consolidation of the eligibility determination function resulted in greater consistency, accuracy, and efficiency as many of the original 46 offices had only one or two eligibility clerks.

Management of the C&V function was transferred from VAROs to RLCs in 2002 and 2003, while continuing to deploy fieldwork employees from the VAROs. The number of FTEs in the C&V function has declined from about 230 before consolidation to 165 in January 2004.

The LA function with the largest number of resources experienced the greatest reduction in staff affected by consolidation. As with the other loan functions, its efficiency has increased with the use of certain technology advances, including e-mail communication and Web portals for information dissemination.

Customer inquiries via the VA toll-free telephone number or Web-transmitted inquiries are still being routed to 58 VAROs, based on the geographic location of the customer. VA staff handling the inquiries are responsible for answering questions that pertain to the several different VA benefit programs, not just the VA Loan Guaranty program. Hence, there is potential for further consolidation, efficiency, and consistency gains in this area as well.

Operations are performed similarly in the RLCs, but full standardization has not yet been attained. Consolidation into nine RLCs has followed the trend toward consolidation in the private mortgage industry. For VA to keep pace with the changes in private industry, it needs to operate on a standardized national level.

Ongoing and Future Initiatives

Loan Production

An initiative is currently underway to review, assess, and make recommendations pertaining to the loan production area. The Loan Production Redesign Task Force is conducting a study of legislation, regulations, manuals, and procedures and will make recommendations in the near future. Possible outcomes of the redesign effort in loan production include:

- Increased standardization of procedures among the nine RLCs
- Enhanced attractiveness of a VA loan by eliminating unnecessary differences between VA and other loan programs
- Greater efficiency
- Improved communication with the mortgage industry and the real estate professional industry.

Proactive e-mail communication, consolidation of e-mail listings of lenders at the national level, and giving lenders the ability to design the type of e-mail communication they receive from VA are examples of more effective communication. This is being developed through VA's Web portal.

Redesign Project for Loss Mitigation

VA LGY has a major reengineering initiative underway involving a comprehensive review of policies, procedures, systems, and interactions with industry partners for the loss mitigation function. The general direction of changes in VA loan servicing is to delegate more processes to lenders and for VA to provide more oversight, lender training, and customer service.

The National Loan Administration Redesign Team has documented the current LA environment, identified industry best practices, and designed the to-be LA environment. It has obtained input from mortgage industry leaders (loan servicers, technology providers, attorneys, and other parties) on best practices. Based on this study, VA has drafted a new model for operations in the future, which encourages the mortgage industry to continue trends of the past few years to mitigate losses, while putting VA in more of a role of an overseer to ensure that all alternatives to foreclosure are explored.

Under the new program, LA will delegate more responsibility to the private lenders to service delinquent loans, manage information as a strategic resource, and conduct standardized, ongoing training. In delegating increased responsibility to the private sector servicers, LA will increase decisionmaking authority, provide clear guidelines on program administration, and provide financial incentives to lenders to perform increased servicing. Private servicers will have more authority to facilitate home retention and loss mitigation options and manage the foreclosure process. Servicers will work more vigorously to cure delinquencies early and analyze alternatives for foreclosure. LA will focus on exception cases.

VA expects the new program to begin rollout in 2005. New standards and regulations will be in place for industry to assume more responsibility for loss mitigation. In addition, a new rules-based Web interactive system will be implemented for facilitating and standardizing loss mitigation efforts. The investment in the redesign is relatively small compared to the expected cost savings. Savings will stem primarily from two factors. One is shortening the time to foreclosure and thereby saving on interest costs in cases where foreclosure cannot be avoided. Another source of cost savings is the avoidance of foreclosure in more default cases and consequent claims costs. Each claim costs the government roughly $20,000. Conservative estimates on shortening the time to foreclosure (e.g., reducing the time by only 1 week) and reducing the number of claims (e.g., reducing claims by only 1 percent) reflect significant cost savings such that investment costs are recovered in the first year after implementation.

For private industry to be a full partner in servicing VA delinquent loans, VA loan IT systems need to be modernized and made accessible to the lender servicers. The objective of LA is to operate in an e-Government environment that eliminates manual entries and paper-oriented outputs and makes accurate information available on a timely basis. Its vision for the new system is to have a secure, single repository for LA where data would be accessible for VA staff. At the same time, selected information would be available for servicers and veterans. Most transactions and monitoring of servicer activity and the status of veteran's loans would be done through a Web portal.

Workload Distribution and Standardization

Workload is not distributed evenly among the RLCs, and tasks are not necessarily performed in a standardized manner across RLCs. Staffing levels in relation to workload are not evenly balanced, and staff competency levels vary among RLCs as well. VA managers of the VA Home Loan Guaranty program face constraints on resource levels and reallocations. An objective of the redesign project is to implement standards and processes consistently across RLCs and move and assign work as needed around the country.

Systems

VA LGY has established a systems vision to consolidate redundant functionality, eliminate unnecessary data duplication, improve systems integration, and improve accessibility of both functionality and data. Key elements of the vision include:

- ► Provide centralized access to core business applications through the Veterans Information Portal (VIP)
- ► Consolidate all production data and warehoused data on the VBA Sun computer at the Austin Data Processing Center in Austin, Texas
- ► Eliminate unnecessary functionality and data redundancy
- ► Integrate systems to streamline workflow and processes.

Initiatives stemming from this vision include plans to migrate applications off the mainframe computer in the Austin Data Processing Center and onto the VIP by 2005 and to consolidate loan data in the corporate data warehouse on the VBA Sun Enterprise 10000 computer also located in Austin.

As a result of the VA-initiated Business Process Reengineering (BPR) effort begun in August 2001, a major initiative is underway to replace the Loan Service and Claims (LS&C) system with a Commercial-Off-the-Shelf (COTS) package representing industry best practices. LS&C is a nationwide client/server application used by LA for case management, claim payment tracking, and servicing of guaranteed loans. After 12 years of development and implementation, LS&C still has not reached full functionality, particularly with regard to fulfilling reporting requirements.

The vision for the new system, VA Loan Event Reporting Interface (VALERI), is to have a secure, centralized repository for loan administration data accessible through a Web portal with selected information available to servicers and veterans. This project is intended to support the objectives of VA LGY's vision for the LA Redesign Project described previously, which include:

- ► Promote two-way access with industry, while complying with applicable privacy laws
- ► Provide easy access to timely and reliable reports and data that supports informed decisions
- ► Establish a measurably efficient organization
- ► Ensure financial transactions and accounting events are recorded properly and in a timely manner
- ► Establish an organization with standard processes that operates consistently across RLCs
- ► Maximize internal and external paperless environments
- ► Promote two-way communication within and across VA systems
- ► Be able to move and assign work as needed across the country
- ► Produce all written materials in Reader Focused Writing format.

Currently, VA LGY is responsible for 19 production systems, 16 of which are centrally controlled and 3 of which are field supported. These systems reside in disparate locations with inconsistent or nonexistent interfaces. Some interfaces are manual, and some systems lack functionality to support core functions. Different systems contain varying amounts of data based on go-live dates. All systems must be taken together in order to follow the loan through its lifecycle, from origination through acquisition or liquidation. Applications and data resident in the Austin, TX, Automation Center (AAC) are backed up off site. The Philadelphia, PA, Information Technology Center (ITC) provides disaster recovery capability for AAC IBM mainframe applications. The Hines, IL, ITC provides disaster recovery capability for the AAC SUN applications. Web-based applications resident in the Philadelphia ITC are backed up off site. These web-based applications have high availability features to ensure continuous operations in the event of local hardware/software failures. Full disaster recovery capability for Philadelphia ITC web applications is being developed. An interim disaster recovery solution for Loan Guaranty web applications is expected to be in place by September 2004.

Realization of VA LGY's systems initiatives will result in a reduction of the production systems from 19 to 7. These 7 front-end systems will be accessible from the VIP and include ACE. The target date for completion is the end of 2005.

This reduction of the number of production systems will achieve VA LGY's vision to consolidate redundant functionality. The elimination of unnecessary data duplication will be achieved by the associated collapsing of redundant data feeds and storage into the corporate database on the Sun computer in the Austin center. The major initiative driven by the BPR project to replace LS&C with VALERI is the keystone for improving systems integration and improving accessibility to data. The effective management of these initiatives by VA LGY will be essential to the successful realization of VA LGY's vision.

Appendix D provides summaries of systems and the impact of current initiatives on them.

Communication

Communication between VA and the mortgage industry is critical to the program's success because the program is a collaborative effort among all interested parties to the real estate transaction. Industry understanding of VA program rules and timely communication of changes in rules and guidelines are important. Updates are posted on the "What's New" section of the VA Web site. As there is no notification system or e-mail distribution list, users must continually check the site for updates. To improve communication, VA is developing a Web portal for program participants. This system will have the capability to push e-mail to users and supply lenders with any updated information. Since the portal only has a 100,000-user capability, VA would need to purchase an enterprise-wide license for the portal, costing up to $2 million. Funding for such an endeavor would need to be approved at a VBA-wide management level.

Since the programs offered by VBA are highly dependent on effective communication with program participants, the Study Team believes that this would be a worthwhile investment. The Study Team recommends implementing a subscription-based service where participants could essentially sign up for the types of e-mail updates they are interested in receiving. E-mail communication should occur immediately after changes occur to avoid potentially costly mistakes. (Recommendations on communication with program participants are discussed in greater detail in Chapter 8 of this report.)

Performance Measures

VA LGY currently uses certain measures for monitoring performance of operations. These include the FATS ratio for the loss mitigation program as discussed in the Interim Report on Defaults and Foreclosures and speed and accuracy measures for other parts of the operation.

Cost Measures

OMB's Program Assessment Rating Tool (PART)[2] draws certain attention to measures that relate to efficiency, budget, and the taxpayer. For example, among an extensive list of questions required to complete PART are the following questions relating to program results on cost and efficiency:

- ► Does the program demonstrate improved efficiencies or cost effectiveness in achieving program goals each year?
- ► Were programmatic goals (and benefits) achieved at the least incremental societal cost and did the program maximize net benefits?

[2] http://www.whitehouse.gov/omb/part/index.html

► Were program goals achieved within budgeted costs and established schedules?

VA should have reporting mechanisms in place on an ongoing basis that measure cost-effectiveness and efficiencies achieved that relate to program goals and strategies for improving operations. Measures relating to total program costs, cost per loan, speed of service, and accuracy, for example, would document results and provide a basis for establishing targets for management initiatives in the future.

A cost-effectiveness analysis can be applied to measure the cost of production during a period to determine if costs per unit of output is declining or increasing. It also measures the cost of alternative modes of delivery and determines which mode achieves a desired or optimal level of output for the lowest cost. OMB Circular A-94, *Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs*, defines cost-effectiveness as: a systematic quantitative method for comparing the costs of alternative means of achieving the same stream of benefits or a given objective. If the comparison involves making a particular investment and achieving greater productivity from the investment, net present value analysis may be applied to determine the difference between discounted present value of benefits and costs, particularly if costs and benefits occur over a period of several years.

The cost measure currently used for budgeting purposes is referred to as a subsidy rate. The subsidy rate is the projected cost to the government for a cohort of VA loans over the life of the loans originated in a given budget year. The *Federal Credit Reform Act of 1990* changed the budgetary treatment of credit programs, including the VA Home Loan Guarantee program. VA is required to estimate the net costs to the government of insuring new mortgage loans by cohort year. A cohort year is the fiscal year in which VA loans originate.

To calculate the subsidy rate, VA uses a cash flow model to produce the data that goes into the OMB credit subsidy calculator. OMB's calculator discounts the cash flow data back to the present and produces a subsidy rate. The subsidy rate is the cost to the government for administering these loans for 30 years after loan origination (as required by OMB). The cost includes payments made by the Government for foreclosures and activities to avoid foreclosures, net of payments to the Government including funding fees, penalties, and recoveries.

Table 3-1 reports the subsidy rates for cohort years 1992 to 2003. Original estimates of the subsidy rate were recently revised downwards based on new OMB approved foreclosure rates for the different cohorts. The Variable Default Model uses historical data from VA's Home Loan Guaranty program to forecast default rates for use in budget formulation and reestimates. Through regression analysis, the model evaluates annual default data from 1970 to the present as well as other factors including treasury rates, mortgage rates, and housing market data to produce projections of future loan performance.

For example, the subsidy rate was originally estimated for FY 2003 at 0.81 percent of the dollar volume of VA loans and then reestimated at 0.44 percent, almost half of the original estimate. The original subsidy rate for FY 1994 was 1.36, which was revised to *negative*

0.02. The negative result means that the Government is actually accruing positive cash flow from making VA loans. This is affected by relatively low claims costs and high revenue from funding fees and other sources. The projected rate for FY 2005 is a negative subsidy of -.32 percent. Lower foreclosure rates than expected can be attributed to a strong housing economy (rising property values), interest rates declining to all-time lows, and more effective VA supplemental servicing.

Table 3-1. VA Loan Subsidy Rates, 1992-2003

Cohort	Subsidy Rates		Guaranteed Loan Levels (in thousands)	Initial Subsidy (in thousands)
	Original	FY03 Reestimate		
1992	2.19%	1.72%	$26,473,457	$579,796
1993	2.33%	0.31%	44,040,055	$1,026,133
1994	1.36%	-0.02%	44,630,046	$606,969
1995	1.18%	-0.13%	24,514,642	$289,273
1996	1.56%	0.00%	32,082,686	$500,490
1997	0.74%	-0.25%	27,191,137	$201,214
1998	0.49%	0.01%	44,709,106	$219,075
1999	0.45%	0.01%	47,235,321	$212,559
2000	0.68%	-0.03%	21,799,649	$148,238
2001	0.29%	0.44%	34,064,438	$98,787
2002	0.39%	0.29%	38,871,184	$151,598
2003	0.81%	0.44%	65,790,521	$532,903

Source: VA LGY data

To give readers a general sense of the relative magnitude of the finances involved, Table 3-2 shows revenues and costs by major categories, including funding fees received from borrowers, proceeds from vendee and acquired loans, default claims paid, property acquisition costs, and administrative costs for the past few years. It displays costs on an annual, not cohort, basis. It does not include subsidy payment or VA payments to the general fund account because the subsidy payment is a fund transfer from the U.S. Treasury general account to a VA funding account. The subsidy payment is intended to compensate for non-administrative loan costs, particularly costs arising from loan defaults and foreclosures.

Table 3-2. Annual Revenues and Costs

Revenues						
FY	Net Funding Fees	Property Sales & Other Income	Proceeds from Acquired Loans	Proceeds from Vendee Loans	Interest	Total
2003	$627,581,047	$784,794,597	$132,362,469	$372,659,341	$298,659,199	$2,216,058,656
2002	$487,685,718	$545,307,893	$244,350,183	$700,684,022	$277,412,244	$2,255,442,062
2001	$506,009,589	$614,816,317	$227,331,688	$907,101,695	$283,207,458	$2,538,468,748
2000	$423,246,802	$633,157,392	$255,844,866	$977,191,190	$285,778,000	$2,575,220,250
1999	$612,512,950	$506,528,019	$239,348,737	$1,111,514,622	$245,083,000	$2,714,989,327
Capital & Operating Costs						
FY	Default Claims Paid	Property Acquisitions & Expenses	Acquired Loans	Administrative Costs	Total	
2003	$290,704,110	$1,164,787,010	$158,216,237	$168,280,000	$1,781,989,360	
2002	$298,512,235	$1,293,453,885	$272,368,900	$165,442,000	$2,029,779,022	
2001	$364,796,019	$1,349,612,284	$333,763,646	$162,174,000	$2,210,347,950	
2000	$484,329,583	$1,549,326,188	$235,441,290	$157,478,000	$2,426,577,061	
1999	$518,439,708	$1,554,447,148	$239,348,736	$159,636,000	$2,471,873,591	

Source: VA LGY data

Administrative costs constitute a relatively small portion of the total capital and operating costs, that is, less than 10 percent. The predominant costs are claims costs and other costs associated with foreclosure and alternatives taken to avoid foreclosure. When a VA home loan is foreclosed, VA typically purchases the property from the loan holder and then markets the property to the public through its contractor. VA provides financing for about 75 percent of the properties sold. These types of loans are referred to as vendee loans. The vendee loans are placed in VA's national loan portfolio and then sold under VA's Vendee Mortgage Trust Securitization Program, which usually takes about 6 months.

To avoid foreclosure, VA sometimes purchases VA loans from the lender and works out new terms for the borrower. Two other alternatives incur costs as well, but the costs are less than if foreclosure were to occur, including:

- ► Accepting deeds on the house for borrower to avoid foreclosure
- ► Paying the parts of loans not satisfied from proceeds of private sales, so those sales can be completed and foreclosure avoided.

Offsetting the cost is collection of funding fees, sale of acquired properties, payments on vendee and acquired loans, proceeds from vendee loan sales, and interest. The funding fees and other collections that have been deposited to the guaranteed loan financing account earn interest. VA uses the interest earned to pay for future defaults and other expenses. The total revenues shown in Table 3-2 exceed the total costs for each year from 1999 to 2003 except for 1999. The implication of this is that the funding fees and the fiscal management of the default and foreclosure process have, in recent years, effectively mitigated the need for taxpayer money for VA loan program.

While the claim and related costs dominate the total cost picture, certain measures may be used to examine the cost-effectiveness of different administrative functions of the VA Home Loan Guaranty program. Breaking down administrative cost per unit of functional activity, such as loan certification, appraisal, defaulted loans serviced, and claims, enables the analyst to capture costs per unit of certain outputs being produced and facilitates a basis for comparison.

VBA developed an Activity-Based Costing (ABC) method of calculating the administrative costs of its six business lines (i.e., Compensation, Pension, Education, Loan Guaranty, Vocational Rehabilitation and Employment, and Insurance), which is not used very often. With ABC, resources are assigned to activities, then activities are assigned to cost objects based on their use. Table 3-3 shows the Loan Guaranty Administrative Costs for activities reported in FY 2001. For example, costs associated with loan defaults and foreclosures are Proc3-Loan Service and Claims and Proc4-Property Management. They constitute 43 percent of the total costs. Customer service under Proc13-Provide Information on Benefits constitutes 17 percent of total costs. Reviewing Credit (Activity 22 under the heading of Proc6-Loan Processing) constitutes 10 percent of the total costs.

The ABC tracking of costs does not include measures of output such as COEs generated or defaults serviced, but adding such measures would help to establish a basis for tracking cost-effectiveness on an ongoing basis. Cost per unit of output in a given functional area could then be readily calculated and tracked over time. The ABC data also do not include non-administrative costs such as claim costs, which can be very significant when compared to the administrative costs, as reflected above.

Table 3-3. FY 2001 Loan Guaranty Administrative Costs (Direct and Indirect)

Loan Guaranty Process/Activity	LG Total	LG %
All Activities	$149,620,677	**100.0%**
CORE1—Manage and Award Benefits	**114,120,849**	**76.3%**
PROC1—Process Claims	**4,859,020**	**3.2%**
9—Determine Eligibility (Non-C&P)	4,859,020	3.2%
PROC2—Appellate Review	**222,388**	**0.1%**
11—Process Notice of Disagreement	55,348	0.0%
12—Process Substantive Appeal	37,257	0.0%
13—Schedule/Conduct Hearing	129,783	0.0%
PROC3—Loan Service and Claims	**34,886,271**	**23.3%**
14—Defaults Processed	27,209,182	18.2%
15—Process Claim Against Guaranty	7,677,089	5.1%
PROC4—Property Management	**29,583,607**	**19.8%**
16—Acquire Property	7,779,646	5.2%
17—Prepare Property for Market	10,365,319	6.9%
18—Sell Property	11,438,642	7.6%
PROC5—Construction and Valuation	**23,307,207**	**15.6%**
19—Issue Notification of Value	12,793,574	8.6%
20—Manage LAPP Program	5,808,516	3.9%
21—Assess/Process SAH Grant	4,705,117	3.1%
PROC6—Loan Processing	**16,306,445**	**10.9%**
22—Review Credit	14,811,211	9.9%
23—Conduct Lender Review	1,495,234	1.0%
PROC7—Manage Portfolio Loans	**4,955,911**	**3.3%**
24—Service Portfolio Loans	2,921,232	2.0%
25—Sell Portfolio Loan	2,034,679	1.4%
CORE2—Inform and Educate VBA, Stakeholders, and Beneficiaries	**33,701,042**	**22.5%**
PROC13—Provide Information on Benefits	**24,968,480**	**16.7%**
52—Provide Customer Services—Telephone	16,153,902	10.8%
53—Provide Customer Services—Walk-In	3,301,629	2.2%
54—Provide Customer Services—Correspondence	4,190,014	2.8%
55—Conduct Veterans Outreach	1,322,934	0.9%
PROC14—Training	**8,732,562**	**5.8%**
56—Prepare/Present Training	4,444,701	3.0%
57—Attend Training	4,287,862	2.9%
Other	**1,798,785**	**1.2%**

Source: VBA Program Officials

In the absence of ABC data, one could examine the relation between loan program output and FTEs as a rougher approximation of cost-effectiveness. At the highest level of aggregation, total loan volume and total FTEs can be measured. The Table 3-4 shows total VA loan guarantees issued, total actual FTEs in field offices, and loans per FTE for each year over the past 10 years. While FTEs have steadily declined during this period, the volume of loan guaranties fluctuates widely, neither declining nor increasing significantly over the last 12 years. Hence, we would tend to rely more on the average of loan guaranties over a multi-year period in calculating the ratio of loan guarantees to FTEs. Our conclusion is that field office productivity has more than doubled over the past 12 years.

Table 3-4. Loan Guaranties and FTEs

Fiscal Year	Loan Guaranties	Field Staffing Level	Loans Per FTE
1992	266,021	1,998	133
1993	383,303	1,965	195
1994	602,244	1,861	324
1995	263,130	1,719	153
1996	320,776	1,621	198
1997	258,775	1,426	181
1998	343,954	1,330	259
1999	485,610	1,282	379
2000	199,161	1,237	161
2001	250,009	1,130	221
2002	317,251	1,022	310
2003	508,436	803	633
Average	466,519	1,450	322

Source: VA LGY data

Since VA staffs are actually involved in different stages of the loan process, it would be more insightful to break down the loan volume and FTEs into the different functional areas such as certification of eligibility and supplemental loan servicing. The respective output for a given functional area then would be compared to the respective FTEs in each functional area over time. VA LGY is in the process of developing measures for administrative cost per loan guaranty issued, administrative servicing cost per default processed, and administrative cost per property sold.

Other Performance Measures

Other performance measures used by VA LGY include veteran satisfaction percentage, statistical quality index percentage, percentage of VA loan borrowers who could not have purchased a home without VA assistance, and foreclosure avoidance through servicing. Table 3-5 shows the measurements for 2000 through 2005. The FATS ratio measure receives the most management attention and is the only measure reported in the VBA Annual Performance Report. Chapter 7 (Defaults and Foreclosures) discusses this measure in detail.

Table 3-5. Selected Performance Measures

Performance Measures							
	2000 Actual	2001 Actual	2002 Actual	2003 Actual	2004 Plan	2005 Plan	Strategic Target
Veterans satisfaction %	93	93	93	94	96	96	95
Statistical quality index %	94	96	97	97	97	97	98
Foreclosure avoidance through servicing (FATS) ratio %	30	40	43	45	47	47	47

Source: VA LGY data

The statistical quality control index is a measure of the accuracy of field office cases and affects the bonus awards in field offices. It is based on a Yes/No response of accuracy provided by both field and VACO reviewers. VA examines accuracy in several different quality schedule areas, including COE, underwriting, appraisal, servicing, alternatives to foreclosures, property disposition, and SAH. For example, the reviewer assesses the accuracy of eligibility determination on a Yes/No basis. Statistical sampling is conducted for each schedule with a minimum of ten cases per month and a minimum of 150 cases per month for each eligibility center.

A balanced scorecard approach applies weights to a set of different measures (e.g., 40% for speed, 35% for accuracy, and 25% for customer satisfaction for COE). VA LGY management, however, does not place much emphasis on the aggregation of the measures, only the individual measures. That is, management is focused more on examining the individual measures such as speed or accuracy , as opposed to a single measure that combines the different measures.

Summary

A conclusion of the study is that VA successfully and efficiently operates the VA Home Loan program to meet legislative requirements for eligibility determination, lender monitoring, and loss mitigation. Over the past decade, significant consolidation of field operations and technology advances have decreased full-time equivalent VA administrative staff from about 1,800 to 900. The consolidation resulted in greater consistency and accuracy as well as reduction in FTEs. The consolidation of field operations and technology advances allowed for the 50 percent downsizing of full-time equivalent VA administrative staff without a decrease in the services being provided or quality.

Management of claims losses is so effective that the OMB loan subsidy rate has been virtually zero for loan cohorts over the past ten years.

VA LGY has a major reengineering initiative underway involving a comprehensive review of policies, procedures, systems, and interactions with industry partners for the loss mitigation function. The general direction of changes in VA loan servicing is to delegate more processes to lenders and for VA to provide more oversight, lender training, and customer service. Servicers will work more vigorously to cure delinquencies early and analyze alternatives for foreclosure.

VA expects the new program to begin rollout in 2005. New standards and regulations will be in place for industry to assume more responsibility for loss mitigation. In addition, a new rules-based Web interactive system will be implemented for facilitating and standardizing loss mitigation efforts.

For private industry to be a full partner in servicing VA delinquent loans, VA loan IT systems need to be modernized and made accessible to the lender servicers. A major initiative is now underway to replace the LS&C system with a COTS package representing industry best practices. The vision for the new system, VALERI, is to have a secure, centralized repository for loan administration data accessible through a Web portal with selected information available to servicers and veterans.

Another initiative is currently underway to review, assess, and make recommendations pertaining to the loan production area. The Loan Production Redesign Task Force is focused on: increasing standardization of procedures among the nine RLCs; enhancing the attractiveness of a VA loan by eliminating unnecessary differences between VA and other loan programs; and improved communication with the mortgage industry and the real estate professional industry. Proactive e-mail communication, consolidation of e-mail listings of lenders at the national level, and giving lenders the ability to design the type of e-mail communication they receive from VA are examples of more effective communication.

The Study Team recommends that VA LGY more vigorously utilize their current VA program and financial data systems to routinely report cost-efficiency indicators described in this chapter. These indicators include:

- ► Annual administrative costs per unit of output in the different functional areas such as eligibility determination, property management; loss mitigation; and customer service

- ► Annual average claim costs net of offsetting revenues from sale of acquired properties, proceeds from acquired loans, and proceeds from vendee loans.

- ► Annual OMB loan subsidy rate (this is already required for the budget process, but could be more widely reported as a performance measure).

4. PROFILE OF PROGRAM PARTICIPANTS

This chapter provides a profile of VA Home Loan program participants using both VA administrative records on borrowers and VA Loan Survey data. It describes the population of program participants, including their demographic profile, health status, and military status.

Profile of Program Participants—Administrative Data

We first provide a profile of the program participants for the loans that were originated in October 1, 1999 through June 1, 2003. Our data source is the Guaranteed and Insured Loan (GIL) Master file containing information on Purchase[1] loans and Refinancing loans including Interest Rate Reduction Refinancing Loans (IRRRLs). The Purchase loans are used when a participant wishes to purchase a home and the Refinance loans are used when a participant wants to refinance an existing mortgage. A specific type of refinance loan, IRRRL, does not require any underwriting; therefore, information on finances, such as assets, gross monthly income, residual income, and income-to-debt ratio, are not collected. Some loan and housing information is not collected (i.e., purchase price and type of appraisal). Table 4-1 shows the distribution of loans by type. Almost two out of three (63.9%) loans are Purchase loans.

Table 4-1. Percent Distribution of Loans Originated between 1999-2003, by Loan Type

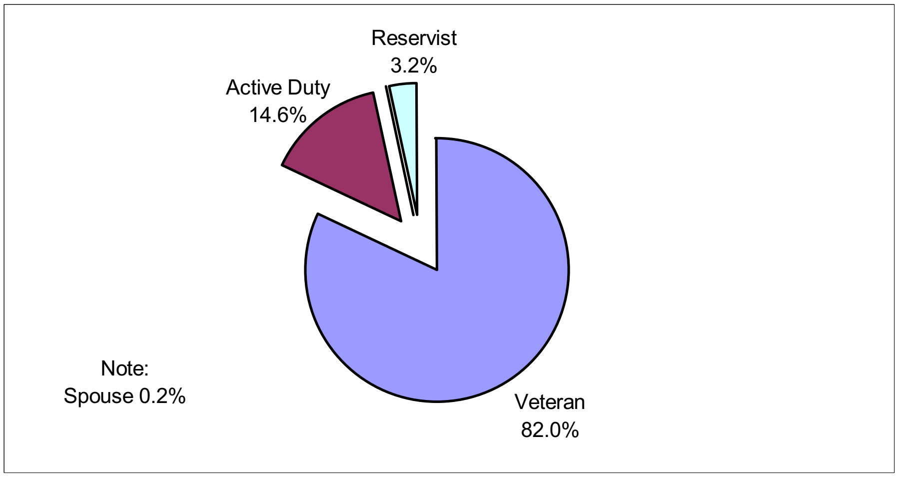
Loan Type	Veterans	Active Duty	Surviving Spouses	Reservists	Total (%)	Total (N)
Purchase loan	60.8%	78.7%	60.4%	75.6%	63.9%	734,938
IRRRL	36.4%	20.5%	33.7%	23.0%	33.7%	387,202
Cash-Out Refinance	2.4%	0.6%	5.5%	1.2%	2.1%	24,556
Refinance under conditions of Public Law	0.3%	0.1%	0.4%	0.3%	0.3%	3,061
Total Number of Records (% & N)	100.0% (942,372)	100.0% (168,016)	100.0% (2,836)	100.0% (36,533)	100.0%	1,149,757
Total of Study Group (%)	82.0%	14.6%	.2%	3.2%	100.0%	

Source: VA LGY GIL Data

The participants in the program were mostly veterans (82.0%), followed by active duty personnel (14.6%), reservists/national guardsmen (3.2%), and surviving spouses (0.2%) as shown in Figure 4-1.

[1] Purchase loans also include Construction loans.

Figure 4-1. Percent Distribution of Loans Originated between 1999 and June 2003, by Entitlement



Source: VA LGY GIL Data

Purchase and Refinance loans have different participant populations, and the data collected by GIL on the two types of loans are different as well. Therefore, we present two profiles: one for Purchase loans and one for Refinanced loans.

For Purchase loans, all data are based on information gathered at the time of the loan. For example, purchase price and gross monthly income are relevant to a person's ability to be approved for a loan at the time of the loan. For IRRRLs, gross monthly income, assets, residual income, income-to-debt ratio, and type of appraisal are not collected as of the refinancing date (these fields have a value of zero or the default value for IRRRLs); however, these fields are current for the other refinancing loans. To present the most accurate information, zeros (in select fields as mentioned above) were recoded as missing for the IRRRLs.

Table 4-2 provides a summary table of the program participants' demographics, financial situation, and home and loan characteristics. A brief overview of the profile of the program participants is presented below.

Profile of Purchase Loan Borrowers

The majority (52.9%) of participants are first-time homebuyers. A large percentage (93.1%) of participants are male. The majority (62.2%) of surviving spouses are female. Active duty personnel and reservists are, on average, younger than veterans and surviving spouses. Overall, the median age for purchase borrowers is 37 years old at the time of loan origination. Veterans have a median age of 38 years old, active duty personnel have a median age of 33 years old, reservists have a median age of 32 years old, and surviving spouses have the oldest median age at 54 years old.

The median gross monthly income for participants is $4,171 and they have a median of $4,995 in assets. Most participants (88.9%) pay a funding fee. Existing conventionally constructed, single-family homes account for most of the loan guaranties (88.7%, 99.8%, and 99.3%, respectively). Most of the loans (93.7%) are based on sole ownership. The median purchase price of a home is $118,900, while the median loan amount is $120,258. This difference indicates that participants could have an upside-down mortgage, meaning that the amount of their loan is greater than the value of their property. This leads to a median loan-to-purchase ratio that is greater than one.

Profile of Refinance Loan Borrowers

Overall, the median age for refinancing borrowers is 43 years old at the time of the refinancing. Veterans have a median age of 44 years old, active duty personnel have a median age of 37 years old, reservists have a median age of 36 years old, and surviving spouses have the oldest median age at 56 years old. Most of the participants are male (94.1%). The majority of surviving spouses are female (55.6%). The median original loan amount of a refinanced loan is $109,923. Existing, conventionally constructed, single-family homes account for the majority of the loan guaranties (99.9%, 100.0%, and 99.8%, respectively). Most of the loans are based on sole ownership (97.6%).

Table 4-2. Summary of Profile of Program Participants

Purchase Loans						Refinanced Loans				
Study Group						Study Group				
Veterans	Active Duty	Surviving Spouses	Reservists	Total	Variables	Veterans	Active Duty	Surviving Spouses	Reservists	Total
					Demographics					
64.4%	57.7%	55.5%	62.2%	63.1%	% White, not Hispanic	62.5%	56.6%	54.9%	60.3%	61.9%
10.5%	13.9%	18.4%	12.0%	11.2%	% African American, not Hispanic	11.3%	15.0%	15.5%	13.8%	11.7%
4.9%	5.5%	4.9%	5.3%	5.0%	% Hispanic	4.5%	4.8%	3.9%	4.2%	4.5%
93.9%	90.6%	37.8%	90.7%	93.1%	% Male	94.6%	92.0%	44.4%	90.6%	94.1%
49.1%	65.9%	57.0%	69.6%	52.9%	% First-Time Homebuyer	0.0%	0.0%	0.0%	0.0%	0.0%
38.0	33.0	54.0	32.0	37.0	Median Age	44.0	37.0	56.0	36.0	43.0
					Financial Condition					
$4,220	$3,993	$2,749	$4,188	$4,171	Median Gross Monthly Income*	$4,355	$4,406	$2,675	$4,236	$4,345
$1,533	$1,570	$1,176	$1,454	$1,536	Median Monthly Residual Income*	$1,791	$1,809	$1,154	$1,622	$1,783
$5,039	$4,763	$6,411	$4,533	$4,995	Median Assets*	$1,933	$1,978	$2,292	$2,290	$1,947
86.3%	98.7%	28.8%	99.0%	88.9%	% Paying Funding Fee	85.7%	95.6%	50.9%	98.4%	86.7%
					Home and Loan Characteristics					
$119,000	$118,500	$98,000	$115,000	$118,900	Median Purchase Price	N/A	N/A	N/A	N/A	N/A
$120,360	$120,360	$97,000	$117,789	$120,258	Median Loan Amount	$109,450	$113,138	$89,330	$117,250	$109,923
7.37%	7.00%	7.37%	7.37%	7.37%	Median Interest Rate	6.50%	6.50%	6.50%	6.62%	6.50%
98.6%	98.2%	97.7%	98.6%	98.5%	% Purchasing a Home	100.0%	100.0%	100.0%	100.0%	100.0%
89.6%	84.3%	89.7%	90.3%	88.7%	% Buying an Existing Home	99.9%	99.9%	99.8%	99.8%	99.9%
99.8%	99.9%	99.6%	99.8%	99.8%	% Buying a Conventional Home	100.0%	100.0%	99.9%	100.0%	100.0%
99.3%	99.6%	99.3%	98.9%	99.3%	% Buying a Single-Family Home (1 unit)	99.8%	99.9%	99.8%	99.8%	99.8%
94.1%	91.6%	92.9%	95.1%	93.7%	% with Sole Ownership	97.7%	97.2%	98.2%	97.6%	97.6%

* Does not include IRRRLs.

Source: VA GIL Data

Profile of Program Participants—VA Loan Survey Data

Demographic Characteristics

Table 4-3 through Table 4-6 contain a demographic profile of the VA Home Loan program borrowers, based on survey responses.[2] In some of these tables, we compare the demographic profile of the program participants to the veteran population overall. Since veterans are the most dominant group of participants, we limit our comparison to the veteran population in the United States only. In general, VA Home Loan program veteran participants are younger; more educated; have more minority group representation, including females, African Americans, and Hispanics; and are in better health than the veteran population overall.

Veterans represent the oldest population, with 33 percent being 50 or older (Figure 4-2). Conversely, active duty personnel are younger, with only 5 percent of the active duty personnel being 50 or older. The average age of all borrowers is 43 (Table 4-3). Overall, 91 percent of borrowers are male. Most (78%) of the participants surveyed identify themselves as White, while 14 percent are African American. Eight percent of the respondents are of Spanish, Hispanic, or Latino descent.

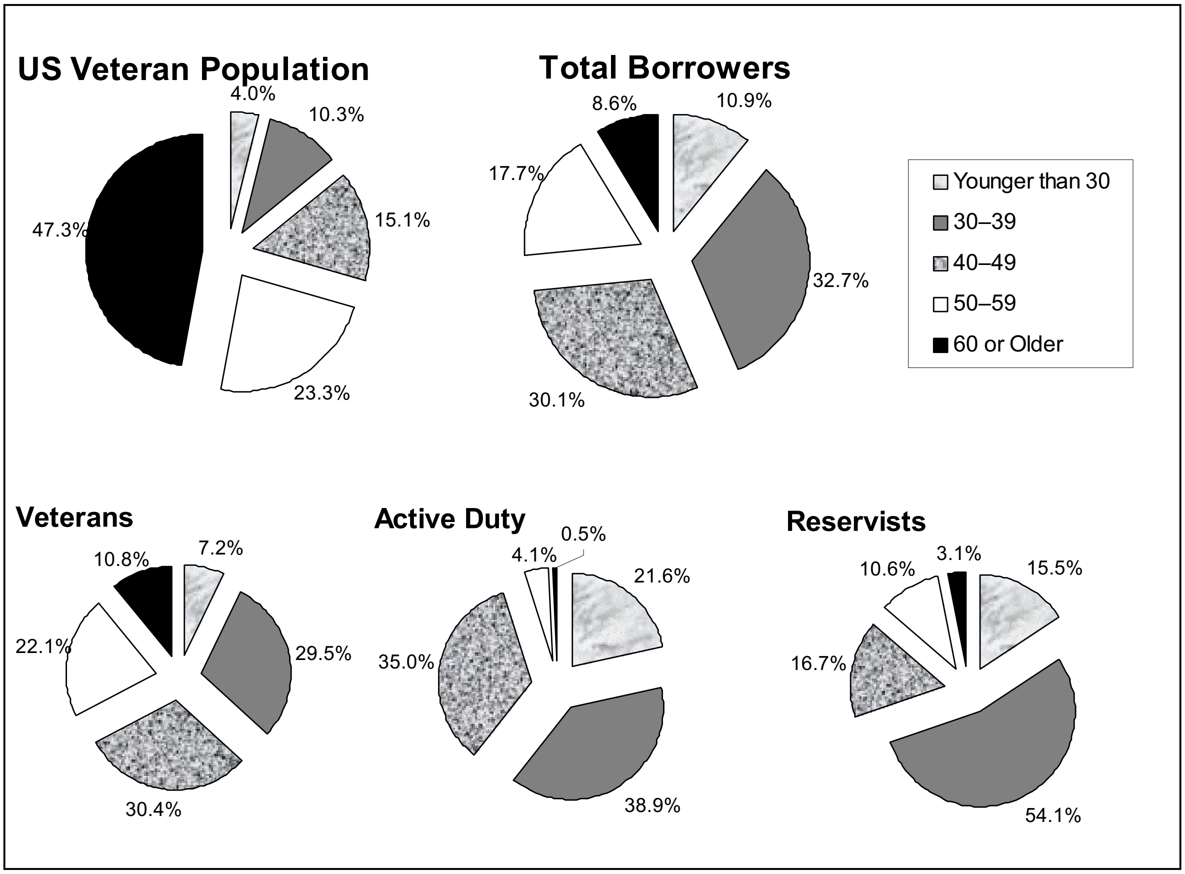
Most (80%) of the respondents are married (Table 4-4). The percentage of reservists who never married is higher (11%) compared to other sample groups. Nearly 1 out of 2 respondents have an associate degree or higher. About a third of veterans with a VA loan have a Bachelor’s degree or higher. Almost all (92.8%) of participants have full time jobs.

Overall, most (86.2%) of the participants rate themselves as being in good or very good health. Among the 13.7 percent of the participants who rate themselves as being in fair, poor, or very poor health, more than 1 out of 3 (68.2%) indicate that they have service-connected disabilities (Table 4-5).

Overall, 41.1 percent of respondents served in the military between 2 and 5 years (Table 4-6). The numbers vary depending on the borrower group. For example, 1 out of 2 veterans served in the military 2–5 years, while 2 out of 3 active duty members served more than 10 years, and 1 out of 2 reservists served more than 5 years. The respondents are predominantly enlisted personnel (86.5%).

[2] Since surviving spouses make up only 0.2% of total borrowers, this group was substituted with the sampling of successful default intervention cases.

Figure 4-2. Age Distribution of VA Loan Borrowers vs. U.S. Veteran Population



Source: VA Loan Survey, Q30 and National Survey of Veterans (NSV), 2001

**Table 4-3. Demographic Characteristics of Respondents—
Age, Gender, Race, and Ethnicity**

	Survey Respondents				
Response	**Veterans**	**Active Duty**	**Reservists**	**Total Borrowers**	**U.S. Veteran Population**
Age (Q30)					
Average Age	*45*	*36*	*38*	*43*	*NA*
Gender (Q31)					
Male	91.3%	88.6%	84.4%	91.1%	93.5%
Female	8.7%	11.4%	15.6%	8.9%	6.5%
Total	100.0% (N=462)	100.0% (N=440)	100.0% (N=429)	100.0% (N=618)	100.0% (N=25.6 million)
Race (Q32) Mark all that apply					
White	80.3%	70.1%	76.6%	78.2%	87.5%
Black or African American	14.7%	19.2%	17.6%	14.1%	9.1%
Asian/Pacific Islander/ Native American/Hawaiian, or Alaskan	0.9%	5.7%	3.3%	2.1%	1.1%
Other	5.7%	7.5%	5.4%	6.1%	2.3%
Total	(N=456)	(N=438)	(N=427)	(N=618)	(N=24.4 million)
Refused to Answer	6	2	2	0	.8 million
Number of Respondents	462	440	429	618	25.6 million
Note: Total percentage is more than 100 percent since respondents were allowed to mark more than one response.					
Ethnicity (Q33)					
Spanish, Hispanic or Latino	7.3%	8.5%	5.9%	8.0%	4.5%
Total	(N=454)	(N=437)	(N=425)	(N=610)	(N=25.1 million)
Refused to Answer	8	3	4	8	75,588
Number of Respondents	462	440	429	618	25.2 million

Source: VA Loan Survey, Q30, Q31, Q32, and Q33; VetPop2001 Adjusted to Census 2000

Table 4-4. Demographic Characteristics of Respondents—Marital Status, Education, and Employment

Response	Survey Respondents: Veterans	Survey Respondents: Active Duty	Survey Respondents: Reservists	Survey Respondents: Total Borrowers	U.S. Veteran Population
Marital Status (Q34) (NSV)					
Never Married	7.2%	6.4%	11.7%	6.8%	7.2%
Married	78.0%	86.1%	77.6%	79.8%	75.1%
Widowed/Separated	1.5%	2.0%	0.9%	1.6%	6.3%
Divorced	13.3%	5.5%	9.8%	11.7%	11.4%
Total	100.0% (N=459)	100.0% (N=440)	100.0% (N=429)	100.0% (N=615)	100.0% 25.2 million
Refused to Answer	3	0	0	3	50,392
Number of Respondents	462	440	429	618	25.2 million
Education (Q36) (CPS)					
Less than some college	27.4%	18.0%	22.1%	25.2%	44.2%
Some college, no degree	29.8%	29.6%	18.8%	29.3%	31.1%
Associate's degree	10.9%	15.5%	11.5%	11.7%	
Bachelor's degree	23.3%	23.9%	34.3%	24.2%	24.7%
Graduate or advanced professional degree	8.7%	13.0%	13.4%	9.6%	
Total	100.0% (N=460)	100.0% (N=439)	100.0% (N=426)	100.0% (N=615)	100.0% (N=23.7 million)
Refused to Answer	2	1	3	3	0
Number of Respondents	462	440	429	618	23.7 million
Current Employment Status (Q40) (CPS)					
Employed full time plus a part-time job	3.1%	3.4%	2.7%	3.4%	95.3%
Employed full time	92.3%	94.7%	94.6%	92.8%	
Looking for work	4.6%	1.9%[3]	2.7%	3.8%	4.7%*
Total	100.0% (N=388)	100.0% (N=414)	100.0% (N=333)	100.0% (N=529)	100.0% (N=25.2 million)
Refused to Answer	74	26	96	89	0
Number of Respondents	462	440	429	618	25.2 million

Source: VA Loan Survey, Q34, Q36, and Q40; Current Population Survey (CPS), March 2002; National Survey of Veterans (NSV), 2001

** Percentage unemployed*

[3] These servicemembers may have been discharged since the sampling of the VA Loan Survey group.

Table 4-5. Health Status of Respondents

Response	Survey Respondents				U.S. Veteran Population
	Veterans	Active Duty	Reservists	Total Borrowers	
Health Status (Q41)					
Very good	39.4%	56.4%	52.6%	44.0%	16.8%
Good	43.9%	35.5%	42.3%	42.2%	28.8%
Fair	11.7%	7.0%	4.7%	10.0%	30.1%
Poor	4.5%	1.1%	0.0%	3.4%	16.3%
Very poor	0.4%	0.0%	0.5%	0.3%	7.9%
Total	100.0% (N=462)	100.0% (N=440)	100.0% (N=428)	100.0% (N=618)	100.0% (N=24.5 million)
Refused to Answer	0	0	1	0	24,510
Number of Respondents	462	440	429	618	24.5 million
Service Connected Disabilities (Q41.1) (Asked if in fair, poor, or very poor health)					
Yes	68.8%	72.2%	13.0%	68.2%	45.5%
No	31.2%	27.8%	87.0%	31.8%	54.6%
Total	100.0% (N=77)	100.0% (N=36)	100.0% (N=23)	100.0% (N=85)	100.0% (N=7.6 million)
Refused to Answer	0	0	0	0	0
Number of Respondents	77	36	23	85	7.6 million

Source: VA Loan Survey, Q41 and Q41.1; National Survey of Veterans (NSV), 2001.

Note: Scale used for health status in NSV is different than the VA Loan Survey; In NSV, respondents were asked of their service-connected disabilities if they indicated that they had a disabling condition.

Table 4-6. Military Status of Respondents

Response	Veterans	Active Duty	Reservists	Total Borrowers
How many years have you served on active duty in the Armed Services? (Q37)				
Less than 2 years	5.6%	0.9%	39.3%	6.1%
2 to 5 years	49.6%	14.1%	10.0%	41.1%
6 to 10 years	15.8%	17.7%	28.7%	17.8%
More than 10 years	29.0%	67.3%	22.0%	35.0%
Total	100.0% (N=462)	100.0% (N=440)	100.0% (N=428)	100.0% (N=618)
Refused to Answer	0	0	1	0
Number of Respondents	462	440	429	618
Military Status (Q50)				
Enlisted	90.8%	70.9%	84.5%	86.5%
Officer	8.6%	25.4%	15.0%	12.0%
Chief Warrant Officer	0.7%	3.7%	0.5%	1.5%
Total	100.0% (N=455)	100.0% (N=437)	100.0% (N=427)	100.0% (N=609)
Refused to Answer	7	3	2	9
Number of Respondents	462	440	429	618
Current/latest military pay grade: Enlisted (Q50)				
E1–E3	15.3%	1.6%	3.9%	12.5%
E4–E6	70.2%	58.1%	83.7%	69.6%
E7–E9	14.5%	40.3%	12.5%	17.8%
Total	100.0% (N=413)	100.0% (N=310)	100.0% (N=361)	100.0% (N=527)
Refused to Answer	7	3	2	9
Number of Respondents	420	313	363	536
Current/latest military pay grade: Officer (Q50)				
O1–O2	15.4%	16.2%	31.3%	15.1%
O3	30.8%	38.7%	39.1%	37.0%
O4	35.9%	29.7%	25.0%	35.6%
O5–O7	17.9%	15.3%	4.7%	12.3%
Total	100.0% (N=39)	100.0% (N=111)	100.0% (N=64)	100.0% (N=82)
Refused to Answer	7	3	2	9
Number of Respondents	46	114	66	91

Source: VA Loan Survey, Q37 and Q50

5. PROGRAM PARTICIPATION AND ACCESS

The Study Team analyzed data that describe and explain program participation to address the following topics:

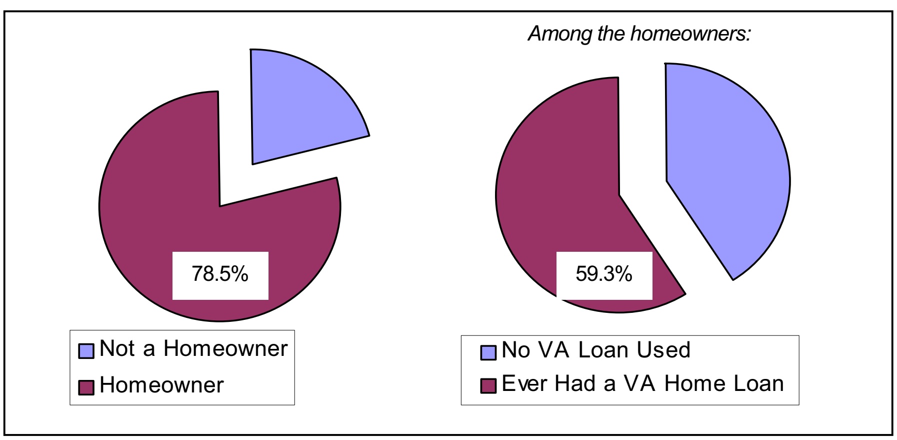
- Participation levels of eligible veterans and other eligible population groups
- Multiple use of the benefit
- Factors influencing access and use, such as VA requirement for an "up-front" funding fee, which is a deterrent to program participation
- Impact of the maximum VA loan amount on participation in the VA Home Loan program in high cost-of-living areas.

Program Utilization

Overall Utilization

As shown in Figure 5-1, 78 percent of veterans responding to the 2001 National Survey of Veterans (NSV) report owning their current residence. The 1992 NSV also reports a 78 percent figure for home ownership. One insightful measure of participation is the percentage of veterans owning a home who ever obtained a VA loan. Based on results of the 2001 NSV, nearly 60 percent of veterans who had ever obtained a loan to purchase a home, make home improvements, or refinance a home loan had used a VA loan at some point (Figure 5-1). This percentage remains about the same for different age groups of veterans. The important implication is that the program has retained its high benefit value over the past several decades as we observe the same high participation rate ranging from the youngest age group (less than 35 years) to the oldest age group (75 years or older), as shown in Table 5-1.

Figure 5-1. Home Ownership and Program Participation of Veterans



Source: National Survey of Veterans, 2001

Table 5-1. Percent Distribution of Veterans, by Use of Loans Obtained through VA Loan Program and Age

Loan Type	Less Than 35 Years	35-44 Years	45-54 Years	55-64 Years	65-74 Years	75 Years or Older	Total
Purchase a home	59.7%	61.5%	62.1%	55.1%	54.0%	57.5%	57.8%
Make home improvements	0.3%	0.1%	1.0%	1.3%	1.3%	1.4%	1.1%
Refinance a home loan	7.7%	8.2%	6.5%	4.7%	2.2%	1.8%	4.7%
No VA loan used	40.3%	38.0%	36.3%	43.5%	44.3%	40.4%	40.7%
Unknown	0.0%	0.4%	0.8%	1.0%	1.0%	1.8%	0.9%
Number of veterans	840,200	1,571,000	3,412,800	3,213,500	3,080,700	2,228,400	14,434,000
% of veterans	5.8%	10.9%	23.6%	22.3%	21.3%	15.4%	100.0%
Note: Percentages add to more than 100 because veterans can have more than one use.							

Source: 2001 NSV, Table 7-21

Table 5-2 reports the numbers of loans originated by loan type and for each fiscal year 1999 to 2002.

Table 5-2. Number of Loans Originated, by Loan Type and Fiscal Year

Study Group	1999	2000	2001	2002
Purchase Loans	224,266	178,618	176,995	155,076
Refinance Loans	179,834	184,691	93,335	135,578
Total	404,100	363,309	270,330	290,654

Source: VA LGY GIL Data

Multiple Use of the Loan Guaranty Benefit

The *Veterans Housing Act of 1974* provided VA the authority to restore the entitlement to a guaranteed, direct, or insured loan of any veteran provided the veteran had paid the prior loan in full and disposed of the property. Previously, restoration had been available only in limited cases where the veteran had disposed of the property for a "compelling" reason, the property had been taken through condemnation, or destroyed by fire or other natural hazard.

This provision was enacted to legislate practices that VA was already following. The impact was to codify the conversion of the loan guaranty and direct loan programs into entitlements that could be reused innumerable times, provided the requirements for repayment and disposal were satisfied. This allowed more than 4 million veterans who paid their loans in full to become potentially eligible for new loans.[1]

The *Veterans' Benefits Improvements Act of 1994* (Section 902) authorized a one-time restoration of entitlement if the veteran repaid the loan but did not dispose of the property. The intention of this change is to address cases in which active duty personnel were

[1] Legislative History of the VA Home Loan Guaranty Program, http://www.homeloans.va.gov/docs/HISTORY.doc

transferred but did not dispose of the property. As stated above, previous legislation required the veteran pay off the loan and dispose of the property before restoration of the loan guaranty entitlement was given.

Although previous legislation authorized restoration of entitlements under special circumstances, the more general restoration provisions converted the housing benefit from a one-use program to an entitlement that could be used for multiple home purchases.

Table 5-3 presents the level of use of multiple and one-time use loans from 1999 to 2002, by category of beneficiary. About one-third (38%) of veterans used the program more than once. The ratio of multiple use to one-time use loans is .38. In our judgment, this reflects a high rate of “repeat” users, implying a high value of the program to many users.

Table 5-3. Total Number of Loan Originations, FY 1999-2002

Loan Type	Veteran	Active Duty	Spouse	Reservist	Total Count
One-time use	396,487	108,516	1,702	27,530	534,235
Multiple Use	176,902	23,706	11	84	200,703

Source: VA LGY GIL data

Using two data sets, the Study Team calculated the percentage of borrowers who have used the VA program more than once to purchase a home: one based on the VA administrative Guaranteed and Insured Loan (GIL) data and the other one based on the VA Loan Survey responses. The results, presented in Table 5-4, vary depending on the data source. It is possible that the survey respondents included the number of times they used the program for refinancing. Table 5-4 shows our estimates, which is somewhere between the two numbers shown for each group. For example, about one-third of total borrowers are multiple users. Veterans have the highest percentage of multiple users, followed by the active duty personnel and reservists. The low percentage of reservist multiple use may be related to the high funding fee they pay for using the program.

The survey asked respondents if loan benefit usage should be limited to a certain number of times. Only 4.4 percent of borrowers reported that the loan benefit should have limited use.

Table 5-4. Multiple Users of VA Home Loan Program

Data Source	Veterans	Active Duty	Reservists	Total Borrowers
GIL Data	30.9%	17.9%	0.6%	27.4%
VA Loan Survey	41.4%	23.7%	4.0%	36.0%

Source: VA Loan Survey, Q18.3 and VA GIL Data

Maximum Loan Amount

The maximum VA loan guaranty is currently set at $60,000. Although VA does not establish a maximum loan amount, the secondary market does by generally not accepting a VA no-down payment loans greater than $240,000. This equates to a 25 percent guaranty by VA for a maximum loan amount of $240,000. The actual amount of the loan guaranty generally ranges from 25 to 50 percent of the total loan depending on the size of the loan. The maximum loan amount has implications for program access and participation. The maximum loan amount, in particular, may affect reduced participation in areas of the country where housing prices are much higher than average.

This study also addresses whether the loan guaranty maximum has kept pace with increases in housing costs and whether veterans have been frozen out of housing markets in high-cost areas. We concluded that the VA Loan Guaranty program enables veterans to purchase homes in both high- and low-cost areas. However, there is a significant difference in the type of housing that veterans can purchase in high- and low-cost areas. In low-cost areas, VA guaranteed loans can be used to finance homes with prices well above the local average housing price. In high-cost areas, veterans who want to purchase more-expensive housing within their Metropolitan Statistical Areas (MSA) may find they are unable to finance their home with a VA loan because the price exceeds the maximum loan limit. This could occur in any MSA, but it is more likely to occur in high-cost areas. In effect, these veterans are frozen out of the housing market price range in which they seek to purchase a home.

The Study Team calculated the ratio of average loan amounts of VA to non-VA loans for each of 30 MSAs, based on 2001 Home Mortgage Disclosure Act data (HMDA). The 30 MSAs selected for analysis are representative of sizeable veteran populations and a broad range of low- to high-cost areas. Analysis revealed that the average VA loans are larger than non-VA loans in low-cost MSAs, and smaller than non-VA loans in high-cost MSAs.

Table 5-5 shows the results of these computations. The second column shows the ratio of the average VA loan amount divided by the average non-VA loan amount for each MSA. The table is in ascending order according to this column. When a ratio is less than 1.0, the VA loan is less than the non-VA loan for that MSA. When a ratio is greater than 1.0, the VA loan is greater than the non-VA loan. If a ratio is 1.0, VA and non-VA loans are the same. Appendix E presents a more extensive analysis of the maximum loan amount.

Table 5-5. Average Loan Amounts for VA and Non-VA Loans, by Metropolitan Statistical Area (MSA)

MSA	Ratio of Average VA Loan to Average Non-VA Loan
All 30 MSAs	0.89
Boston	0.75
Honolulu	0.76
San Diego	0.82
New York-Northern NJ-LI	0.85
Los Angeles-Long Beach	0.87
Chicago	0.88
Washington, DC	0.93
Pittsburgh	0.98
Jacksonville	0.99
Kansas City	1.01
Cleveland-Lorain-Elyria	1.01
Cincinnati	1.01
Indianapolis	1.02
Houston	1.03
Nashville	1.03
Ft. Lauderdale	1.04
Niagara Falls	1.04
Colorado Springs	1.05
Orlando	1.06
Salt Lake City	1.06
Norfolk-VA Beach-Newport News	1.06
St. Louis	1.06
Minneapolis-St. Paul	1.07
Mobile	1.10
Tucson	1.10
Tacoma	1.13
San Bernardino	1.13
San Antonio	1.13
Shreveport	1.14
Oklahoma City	1.14

Source: 2001 Home Mortgage Disclosure Act Data

Based on Table 5-5, average VA loan amounts are less than non-VA loan amounts in high-cost areas. For example, the table shows that in the high-cost areas of Boston, Honolulu, San Diego, New York, and Los Angeles, the average VA loan is smaller than the average non-VA loan. For example, in Boston, the average VA loan is only 75 percent of the average non-VA loan. This contrasts with results in lower cost areas where the average VA loan is larger than the average non-VA loan. The average VA loan in Oklahoma City, for example, is 14 percent larger than the average non-VA loan. Considering all 30 MSAs together, the average VA loan is 89 percent of the average non-VA loan.

We also investigated several indexing alternatives and projected their costs. VA can select from several approaches for indexing the loan maximum. One approach is to adapt the approach used to index the Federal Housing Administration (FHA) maximum insurance amount. Indexing would eliminate the need for Congressional action to change the limit.

We also analyzed VA Loan Survey results (Table 5-6). Among the 70 (11.3%) respondents who reported that they would not use the VA Home Loan program again, 30.4 percent of respondents gave the "loan limit is too low" as the reason for not planning to use the VA program again in the future. A higher percentage (47.2%) of active duty members marked the "loan limit is too low" as the reason for not planning to use the program again in the future, compared to the other survey groups (27.3% for veterans 37.5% for reservists).

Table 5-6. Maximum Loan Amount

Response	Veterans	Active Duty	Reservists	Total Borrowers
(If not likely to use or do not plan to use the VA Home Loan program again) One of the reasons that I would not use VA Home Loan program again is: Loan limit is too low (based on Q51.1)				
Loan limit is too low	27.3%	47.2%	37.5%	30.4%
Total	100.0% (N=55)	100.0% (N=36)	100.0% (N=40)	100.0% (N=69)
Refused to Answer	1	0	0	1
Number of Respondents	56	36	40	70
Should VA keep current program requirements or change the Home Loan program in maximum loan amount? (Q52) Mark all that Apply				
No change needed	46.0%	36.6%	44.9%	44.1%
Tie the maximum amount to area home prices	51.3%	52.4%	41.2%	49.3%
Increase the amount of loan	8.9%	12.1%	11.9%	8.6%
Total	(N=459)	(N=439)	(N=428)	(N=615)
Refused to Answer	3	1	1	3
Number of Respondents	462	440	429	618
Note: Total percentage is more than 100 percent since respondents were allowed to mark more than one response.				
Did the lender-imposed loan limit (i.e., $240,000) affect your decision about how expensive a home to buy? (Q13)				
No-I didn't want to buy a more expensive home	90.9%	88.6%	91.8%	91.2%
No-I did buy a home that exceeded the limit, but put down a bigger payment so that I still qualified for a VA loan	2.4%	1.8%	1.2%	2.0%
Yes-I would have bought a more expensive home if the lender did not limit VA loan	6.7%	9.6%	7.0%	6.8%
Total	100.0% (N=461)	100.0% (N=439)	100.0% (N=427)	100.0% (N=617)
Refused to Answer	1	1	2	1
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q51.1, Q52, and Q13

The respondents were asked whether to keep or change the current program requirements in terms of guaranty amount. Almost half (43.9%) of the respondents said no change is needed in the maximum loan amount, while nearly half (49.0%) suggested tying the maximum loan amount to area home prices. In addition, 8.6 percent said to increase the loan amount. The majority (54%) of those who suggested an increase in the loan amount gave $300,000 to $350,000 as the amount. In another question, the respondents were asked whether the lender-imposed loan limit (i.e., $240,000) affected their decision about how expensive a home to buy.

We caution the reader that the current participants may not be frozen out of certain housing markets, but non-participants may be. The VA Loan Survey covers only the participants of the VA program.

Based on the analysis, we offer the following conclusions:

- Although the $240,000 VA loan limit has kept pace with the cost of housing in most locations, it has not kept pace in high-cost areas.
- A comparison of average and median loan amounts demonstrates that VA loans are larger than non-VA loans in all but high-cost areas.
- Veterans are able to use the VA loan to purchase homes in both low- and high-cost areas. The loan maximum of $240,000 is sufficient to support a home purchase in each of the 30 MSAs we examined.
- However, veterans can be frozen out of some housing markets. By this, we mean they may be unable to obtain VA guaranteed financing to purchase a particular house that they have selected. This outcome is most likely in high-cost areas where up to half of the homes may cost more than can normally be financed with a VA loan. However, this outcome can also occur in less costly areas if the veteran wishes to purchase a high-cost home.
- There are several approaches available to VA to index the loan maximum so that it keeps pace with housing prices. Indexing would eliminate the need for congressional action to increase the limit and add an element of stability to the program.

Awareness and Access

The Study Team examined results from the 2001 NSV and 1992 NSV for reasons veterans do not participate in the VA loan program. The NSV source provides data on several reasons why veterans did not use the VA loan program.

Based on the 2001 NSV data (Table 5-7), about 35 percent of the respondent veterans did not participate because of lack of awareness or understanding. Nineteen percent were not aware of the program, 11 percent thought they were not eligible, and 4 percent did not know how to apply for a loan. According to the 1992 NSV data, 22 percent did not know that they were eligible, and 19 percent did not know how to apply. About 15 percent of them thought that they would not qualify. The 2001 NSV results shows improvement in overall awareness compared to 1992 NSV, although the results are not directly comparable due to differences in the structure of the questionnaire instrument. However, results from both 2001 and 1992 indicate that awareness and/or understanding of the loan program could be improved. By way of comparison, the 2001 NSV source indicates that 17 percent of veterans were not aware of VA health care benefits, 35 percent were not aware of life insurance benefits, and 41 percent were not aware of veteran burial benefits.

Table 5-7. Percent Distribution of Veterans, by Reasons Veterans Did Not Use VA Loan Program and Age

Reason	Percentage
Not aware of the program	19.3%
Did not need or want loan assistance from VA	18.6%
Thinks not eligible for VA loan	11.3%
Thinks applying for VA loan too much trouble or red tape	10.8%
Never considered getting a loan from VA	10.7%
Did not know how to apply for VA loan	4.4%
Thinks VA funding fee too high	3.4%
Thinks other fees or costs too high	2.6%
Applied but not approved for VA loan	2.1%
Thinks amount needed larger than VA maximum	1.9%
Thinks wouldn't qualify for VA loan	1.8%
Thinks VA inspection or appraisal requirements too stringent	1.2%
Thinks seller would not sell if used VA loan	1.2%
Thinks no adjustable rates available	0.4%
Other	27.1%
Unknown	3.3%

Source: 2001 NSV Data

Note: Total percentage is more than 100 percent since respondents were allowed to mark more than one response

In the 1992 NSV, 6.8 percent of veterans did not use a VA loan because the seller would not sell to the buyer intending to use a VA loan. The principal reasons for the seller not selling to a buyer intending to use a VA loan were "would not pay discount points" (42 percent), "VA's loan process too slow" (26 percent), and "too many requirements" (30 percent). VA's loan process is now faster, as explained in Chapter 3 (Program Operations), but the 2001 NSV did not have a similar set of questions on this subject.

The study survey addresses awareness of veterans and active duty personnel who actually participate in the program. Eligible nonparticipants were not surveyed. Table 5-8 presents the most cited information sources for learning about the VA program. Most (75.5%) of the VA Loan Survey respondents became aware of the VA Home Loan program through the military. Nearly one-quarter (23.5%) of the respondents reported that they learned about the VA program through VA, whereas 21.8 percent heard about the program through the real estate agent. One and 0.5 percent of the respondents learned about the VA program from Web sites other than VA's and sellers/builders, respectively.

Table 5-8. From which of the following organizations or individuals did you learn about VA Home Loan program? (Mark all that apply)

Organizations/ Individuals	Veterans	Active Duty	Reservists	Total Borrowers
Military	73.3%	86.1%	76.0%	75.5%
VA	27.2%	13.9%	20.5%	23.5%
Real estate agent	22.8%	18.6%	14.9%	21.8%
Other veterans	15.2%	11.8%	19.3%	14.6%
Lender	13.0%	9.5%	10.3%	11.5%
Family	10.0%	8.6%	11.7%	9.7%
Friends	7.0%	14.3%	10.3%	8.9%
VSOs	6.1%	1.8%	1.4%	5.0%
Web site other than VA's	1.1%	1.1%	0.2%	1.0%
Seller/Builder	0.7%	1.1%	1.4%	0.5%
Other	2.4%	0.7%	0.5%	1.9%
Total	100.0% (N=460)	100.0% (N=440)	100.0% (N=429)	100.0% (N=616)
Refused	2	0	0	2
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q1

The eligibility determination and loan application process affects the borrower's access to the VA loan program. For the sake of comparing the VA loan process with other loan programs, the survey asked respondents whether they ever had a home loan other than a VA home loan. Nearly three-quarters (73.1%) said a VA home loan is the only loan they ever had (Table 5-9). Among the 26.9 percent of respondents who had a home loan other than a VA home loan before, close to half (43%) indicated that compared with other home loans that they had, the VA home loan application process is about the same in terms of ease or difficulty (Table 5-10). Almost 31 percent of respondents who had other loans said it was either much easier or easier to apply for a VA home loan than other loans, whereas 26 percent of respondents said it was harder or much harder.

Table 5-9. Have you ever had a home loan other than VA home loan?

Response	Veterans	Active Duty	Reservists	Total Borrowers
Yes	30.7%	12.3%	33.4%	26.9%
No	69.3%	87.7%	66.6%	73.1%
Total	100.0% (N=462)	100.0% (N=440)	100.0% (N=428)	100.0% (N=618)
Refused to Answer	0	0	1	0
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q6

Table 5-10. (Among those who had a home loan other than VA home loan): Compared with other home loans that you have had, is VA home loan application process easier or harder than other home loans?

Response	Veterans	Active Duty	Reservists	Total Borrowers
Much easier to apply for VA home loan	10.6%	18.5%	12.1%	11.5%
Easier to apply for VA home loan	19.9%	16.7%	13.6%	19.4%
About the same to apply for a VA home loan	44.0%	33.3%	50.0%	43.0%
Harder to apply for a VA home loan	25.5%	27.8%	20.0%	25.5%
Much harder to apply for a VA home loan	0.0%	3.7%	4.3%	0.6%
Total	100.0% (N=141)	100.0% (N=54)	100.0% (N=140)	100.0% (N=165)
Refused	1	0	3	1
Number of Respondents	142	54	143	166

Source: VA Loan Survey, Q6.1

After the application, qualified applicants are issued a certificate of eligibility. As Table 5-11 shows, almost all (93.9%) of the respondents obtained their Certificate of Eligibility (COE) to qualify for a VA loan from one of the three following sources: mail from VA (44.7%), lender/broker (27.6%), and a visit to the VA office (21.6%). We expect the number of borrowers getting their COE by automation (i.e., ACE) to increase in the coming years. Since use of automation is recent, there are currently only a few borrowers using this feature.

One out of three (33.3%) respondents received help in filling out the application for their COE (Table 5-12). As the Table 5-13 shows, the most cited organizations for help were lenders (41.9%), real estate agent/brokers (31.5%), and VA (30.5%), whereas the least cited organizations or individuals were family (0.5%), other veterans (1%), friends (2%), seller/builder (2%), and VSOs (2.5%).

Table 5-11. How did you obtain your Certificate of Eligibility (COE) to qualify for VA loan?

Response	Veterans	Active Duty	Reservists	Total Borrowers
Through the mail from VA	44.0%	40.5%	51.5%	44.7%
From lender or mortgage broker	27.7%	31.3%	15.0%	27.6%
Visit to VA office	22.8%	19.5%	27.2%	21.6%
Military	2.2%	2.5%	2.6%	2.1%
Did not need COE	2.0%	2.8%	1.9%	2.0%
Real estate agent or seller/builder	0.7%	2.1%	1.2%	1.2%
VA Web site	0.4%	0.9%	0.7%	0.5%
Other	0.2%	0.5%	0.0%	0.3%
Total	100.0% (N=452)	100.0% (N=435)	100.0% (N=427)	100.0% (N=606)
Don't know	5	3	1	6
Refused	5	2	1	6
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q2

Table 5-12. Did you get help in filling out the application for your Certificate of Eligibility?

Response	Veterans	Active Duty	Reservists	Total Borrowers
Yes	32.2%	38.6%	36.2%	33.3%
No	49.0%	47.3%	47.9%	48.9%
Did not need help	18.8%	14.1%	15.9%	17.8%
Total	100.0% (N=457)	100.0% (N=440)	100.0% (N=428)	100.0% (N=613)
Refused	5	0	1	5
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q3

Table 5-13. (If received help in filling out the application for COE) Which of the following organizations or individuals helped you? (Mark all that apply.)

Response	Veterans	Active Duty	Reservists	Total Borrowers
Lender	44.5%	38.2%	34.8%	41.9%
Real estate agent/broker	27.4%	31.8%	18.1%	31.5%
VA	34.2%	21.8%	37.4%	30.5%
Military	6.2%	20.6%	22.6%	9.4%
VSOs	3.4%	0.6%	1.9%	2.5%
Seller/Builder	2.7%	1.8%	1.9%	2.0%
Friends	2.1%	2.4%	2.6%	2.0%
Other veterans	1.4%	0.0%	1.9%	1.0%
Family	0.7%	0.6%	1.9%	0.5%
Other	0.0%	0.0%	0.0%	9.4%
Total	(N=146)	(N=170)	(N=155)	(N=203)
Refused	1	0	0	1
Number of Respondents	147	170	155	204

Source: VA Loan Survey, Q3.1

Note: Total percentage is more than 100 percent since respondents were allowed to mark more than one response.

Another measure of access is how easy or difficult it was for applicants to apply for and obtain the benefit. In the VA Loan Survey, respondents reported such experiences as getting information on the program, getting a COE, and finding an authorized lender. Table 5-14 shows the average scores, based on a scale of 1 (=Very Difficult) to 4 (=Very Easy), whereas the percentage distributions of responses are shown in Figure 5-2.

Most respondents had positive experiences with various aspects of the VA Home Loan program. Average scores are above 3 (=Easy) for all aspects except for two: paying the funding fee and paying the closing costs, where the average scores were 2.95 and 2.91, respectively. In addition, for almost all of the aspects of the program (with the exception of "pay the closing costs"), at least 80 percent of respondents had "Easy" or "Very Easy" experiences. "Getting information about the VA Home Loan program" and "finding an authorized VA lender" scored the highest (3.38 and 3.31, on average, respectively.)

Table 5-14. Respondents' Average Ratings of Ease of Various Aspects of VA Home Loan Program

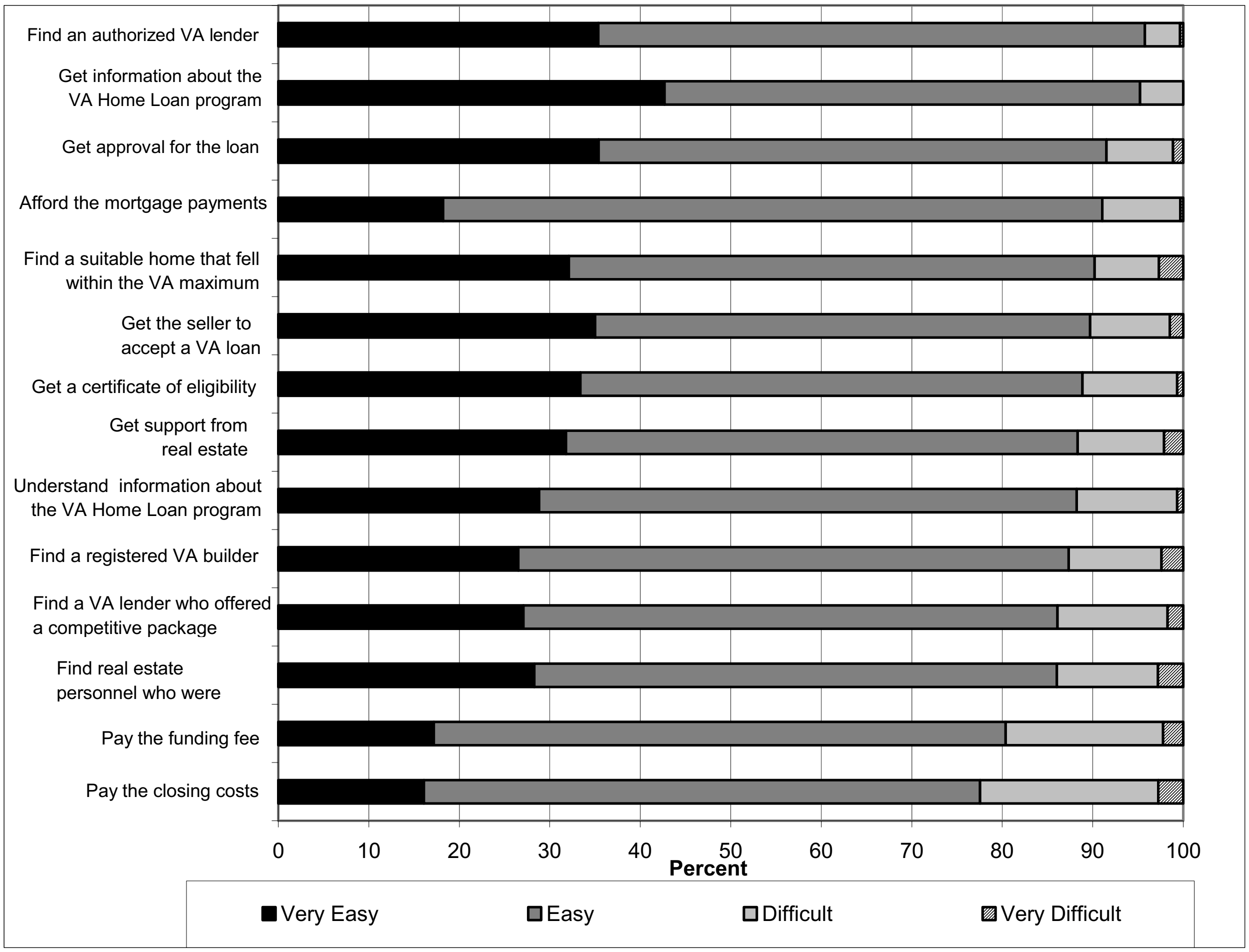
How difficult or easy was it for you to do the following	Veterans	Active Duty	Reservists	Total Borrowers
Get information about VA Home Loan program?	3.38 (N=455)	3.39 (N=435)	3.26 (N=426)	3.38 (N=609)
Find an authorized VA lender?	3.29 (N=441)	3.37 (N=418)	3.27 (N=412)	3.31 (N=591)
Get approval for the loan?	3.25 (N=459)	3.32 (N=437)	3.26 (N=428)	3.26 (N=613)
Get the seller to accept a VA loan?	3.22 (N=396)	3.29 (N=384)	3.20 (N=385)	3.23 (N=534)
Get a Certificate of Eligibility?	3.22 (N=452)	3.20 (N=425)	3.02 (N=421)	3.22 (N=602)
Find a suitable home that fell within VA maximum?	3.19 (N=441)	3.16 (N=422)	3.19 (N=407)	3.20 (N=592)
Get support from real estate personnel?	3.18 (N=420)	3.25 (N=410)	3.12 (N=388)	3.18 (N=566)
Understand the information about VA Home Loan program?	3.17 (N=457)	3.15 (N=436)	3.06 (N=425)	3.16 (N=611)
Find real estate personnel who were knowledgeable and interested in VA loans?	3.11 (N=425)	3.22 (N=418)	3.04 (N=391)	3.12 (N=573)
Find an authorized VA lender that offered a competitive loan package?	3.11 (N=431)	3.15 (N=400)	3.07 (N=394)	3.11 (N=576)
Find a VA registered builder?	3.11 (N=120)	3.21 (N=125)	3.06 (N=101)	3.11 (N=166)
Afford the mortgage payments?	3.10 (N=459)	3.15 (N=439)	3.03 (N=427)	3.10 (N=615)
Pay the funding fee?	2.93 (N=323)	3.04 (N=354)	2.93 (N=316)	2.95 (N=448)
Pay the closing costs?	2.92 (N=356)	2.92 (N=304)	2.85 (N=321)	2.91 (N=472)
Number of Respondents	462	440	429	618

Note: The rating scale used was: 1=Very Difficult; 2=Difficult; 3=Easy; 4=Very Easy.
Average ratings were calculated for those providing a rating.

Source: VA Loan Survey, Q19.1-Q19.14

Note: Number of valid respondents indicated by numbers in parentheses.

Figure 5-2. Distribution of Ratings of Ease for Various Aspects of the VA Home Loan Program (Total Borrowers)



Source: VA Loan Survey, Q19.1-Q19.14

Only 9.7 percent of current borrowers[2] said the difficulties identified in Table 5-14 delayed or prevented them from purchasing a home (Table 5-15). The results of the four sample groups in Table 5-15, however, were not found to be significantly different. Thus, the difficulties identified in Table 5-14 did not prevent participants from owning a home relative to which military group they belonged to. Among those who said “Yes,” about 30 percent reported “getting the seller to accept the VA loan” or “get approval for the loan” as the difficulties that delayed them in owning a home (Figure 5-3). Very few respondents said they had difficulties that prevented them from owning their home.

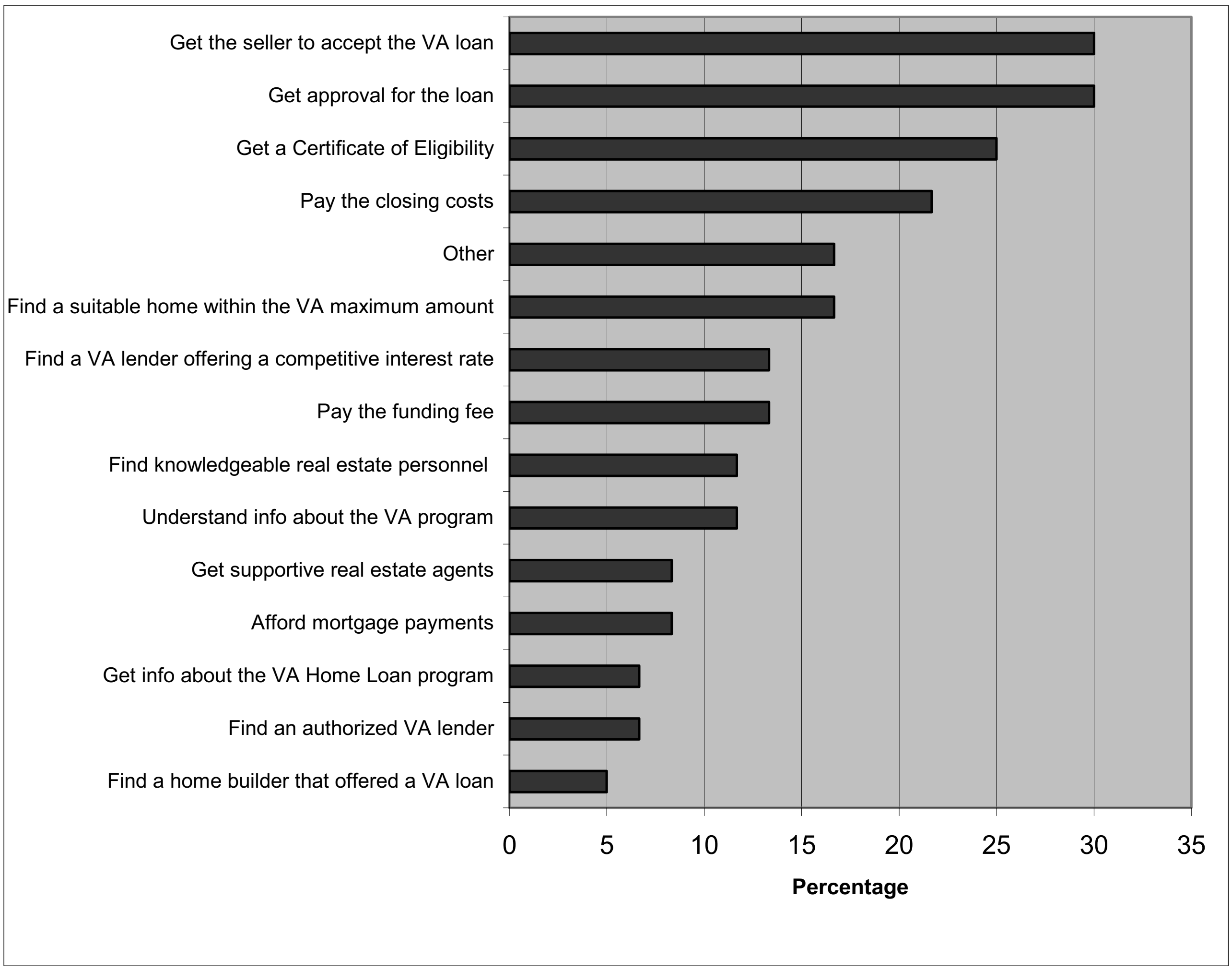
[2] Since nonparticipants were not surveyed, these findings may understate barriers to participation.

Table 5-15. Did any of the difficulties that you identified in Question 19 ever delay or prevent you from owning your home?

Response	Veterans	Active Duty	Reservists	Total Borrowers
Yes	10.2%	8.9%	14.2%	9.7%
No	49.8%	51.6%	51.5%	50.5%
No Difficulties	40.0%	39.5%	34.3%	39.8%
Number of Respondents	100.0% (N=462)	100.0% (N=440)	100.0% (N=429)	100.0% (N=618)

Source: VA Loan Survey, Q20

Figure 5-3. Which of the difficulties identified by the Total Borrowers in Question 19 caused delay in owning a home? (Mark all that apply)



Source: VA Loan Survey, Q20.1

Factors Influencing Access and Use

Funding Fee

The funding fee was first introduced with the Public Law 89-358 (March 3, 1966), *Veterans' Readjustment Benefits Act of 1966*, which required post-Korea veterans to pay a one-time fee of not to exceed one-half of one percent of the amount for a guaranteed or direct loan. In 1970, Public Law 91-506, *Veterans' Housing Act*, terminated funding fee for post-Korea veterans because it believed that the fee was not necessary for the program's solvency and that it created an inequity between post-Korean veterans and WWII and Korean Conflict veterans.

The issue of user fees arose again in 1982. Public Law 97-253, *Omnibus Reconciliation Act of 1982*, reinstituted the loan origination or funding fee revoked in 1970. This time, though, the fee would not apply to veterans in receipt of compensation for a service-connected disability.

The funding fee rate has changed several times. Table 5-16 shows the history of the VA funding fee; whereas, Table 5-17 shows the current funding fee structure.

Table 5-16. History of VA Funding Fee

From	To	Percent of Loan Amount
1966	10/23/1970	0.5%
10/01/1982	8/16/1984	0.5%
8/17/1984	9/30/1987	1.0%
10/01/1987	10/15/1987	0.0%
10/16/1987	11/15/1987	1.0%
11/16/1987	12/20/1987	0.0%
12/21/1987	12/31/1989	1.0%
1/1/1990	10/31/1990	1.25%
11/1/1990	9/30/1991	1.875%[3]
10/01/1991	9/30/1993	1.25%[4]
10/01/1993	12/31/2003	2.00% for active duty/veteran[5] 2.75% for National Guard/Reservist[6] 3.00% for subsequent use[7]

Source: VA officials and legislative history

[3] The fee is reduced to 1.375% if a down payment of 5% is made and to 1.125% for a down payment of at least 10%.
[4] The fee is reduced to 0.75% if a down payment of 5% is made and to 0.5% for a down payment of at least 10%.
[5] The fee is reduced to 1.50% if a down payment of 5% is made and to 1.25% for a down payment of at least 10%.
[6] The fee is reduced to 2.25% if a down payment of 5% is made and to 2.00% for a down payment of at least 10%.
[7] The fee is reduced to 1.50% if a down payment of 5% is made and to 1.25% for a down payment of at least 10%.

Table 5-17. Current Funding Fee Structure

Percent of Base Loan Amount		
Type of Loan	**Veteran/ Active Duty**	**Reservist**
Loan with No Down Payment or with <=5% down payment		
First Time Users		
1/1/2004–9/30/2004	2.20%	2.40%
10/1/2004–9/30/2011	2.15%	2.40%
Multiple Users		
1/1/2004–9/30/2011	3.30%	3.30%
Loan with Down Payment – Loans closed before 10/1/2011		
> 5% and < 10%	1.50%	1.75%
> =10%	1.25%	1.50%
Other Loans		
Interest Rate Reduction (IRRRL)	0.50%	0.50%
Cash-out refinancing	2.20%	2.40%
Assumptions	0.50%	0.50%
NADLP	1.25%	1.25%
Service-connected Veterans	0.00%	NA

Source: VA Circular 26-03-9, December 17, 2003

First-time program participants with loans with no down payment are required to pay a funding fee of 2.20 percent of the loan amount (2.4 percent for reservists) at the time of loan closing. The funding fee is calculated on the basis of whether the borrower is a veteran, active duty personnel, surviving spouse, or reservist; the amount of down payment made (which is not required); loan type; and number of times using their entitlement. This fee may be included in the loan and paid from the loan proceeds. Some program participants are exempt from having to pay the applicable funding fee, including:

- ► Veterans receiving VA compensation for service-connected disabilities
- ► Veterans who, but for the receipt of retirement pay, would be entitled to receive compensation for service-connected disabilities
- ► Surviving spouses of veterans who died in service or from a service-connected disability.

According to the VA Loan Survey results, 18 percent of the respondents who answered the question, “Did you include the funding fee in your VA home loan amount?” indicated that they did not pay a funding fee (Table 5-18). Note that about 29 percent (N=178) of all respondents did not recall whether they paid or included the funding fee in the loan amount.

Table 5-18. Did You Include the funding fee in your VA Home Loan amount?

Response	Veterans	Active Duty	Reservists	Total Borrowers
Did not have to pay a funding fee	22.3%	6.6%	9.9%	18.0%
Yes	71.5%	85.3%	84.0%	74.8%
No	6.3%	8.1%	6.1%	7.3%
Total	100.0% (N=319)	100.0% (N=333)	100.0% (N=294)	100.0% (N=440)
Don't Recall	143	107	135	178
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q12

Since VA loans do not require Private Mortgage Insurance (PMI), a VA Home Loan is less expensive for the participants even though they pay a funding fee. If the down payment is less than 20 percent of the purchase price, the non-VA borrower is generally required to have PMI to cover the risk above 80 percent of the value of the home. PMI is generally 0.5 percent (one-half of one percent) of the loan amount per year. There is generally a $333,700 limit on loans that require PMI if they are to be sold on the secondary market. Most lenders make sure that the loans meet the criteria established by Fannie Mae and Freddie Mac in order to sell the loans on the secondary market. Public Law 105-216, *The Homeowners Protection Act of 1998,* stipulates that lenders must automatically cancel PMI, if it is paid directly to them, when the outstanding loan balance is 78 percent of the original loan balance, (approximately 12 years after loan origination). For example, if a borrower needed PMI on a loan of $100,000, they would pay a total of $6,000 in PMI fees before it was cancelled (($100,000 * .005) * 12 years). In contrast, a veteran would pay a one-time funding fee of 2.2 percent of the loan amount, equaling $2,200. Therefore, a VA loan saves the veteran approximately $3,800.

The VA Loan Survey asked respondents whether to keep the funding fee at the current level, eliminate the funding fee, or change the funding fee to a suggested rate. The majority of the respondents (59.7%) suggested eliminating the funding fee, whereas 35 percent indicated that no change is needed (Table 5-19). Only 5.3 percent suggested lowering the funding fee.

Table 5-19. Should VA keep current program requirements or change the Home Loan program in any of the following ways? (Funding Fee)

Response	Veterans	Active Duty	Reservists	Total Borrowers
No change needed	36.2%	27.3%	39.6%	35.0%
Eliminate the funding fee	59.7%	64.7%	55.7%	59.7%
Change the funding fee	4.3%	8.0%	4.7%	5.3%
Total	100.0% (N=461)	100.0% (N=439)	100.0% (N=429)	100.0% (N=618)
Refused to Answer	1	1	0	0
Number of Respondents	462	440	429	N=618
For those suggesting to change the funding fee: Change it to				
Less than 1%	30.0%	8.6%	8.7%	22.3%
1%	65%	57.1%	69.6%	63.9%
1.5%	0.0%	14.3%	0.0%	2.8%
2%	5.0%	14.3%	17.4%	11.1%
3%	0.0%	0.0%	1.0%	0.0%
5%	0.0%	2.9%	0.0%	0.0%
10%	0.0%	2.9%	0.0%	0.0%
Number of Respondents	100.0% (N=20)	100.0% (N=35)	100.0% (N=23)	100.0% (N=33)

Source: VA Loan Survey, Q52

The FY 1983 reenactment of the funding fee and subsequent increases in the funding fee have effectively made the VA loan program more expensive for veterans and military members and may have discouraged VA loan program participation. We hypothesize that some veterans substituted non-VA loans for VA loans after 1983 in response to increases in the funding fee. To determine the impact of the funding fee on VA loan program participation, we used data from the 1995, 1998, and 2001 Survey of Consumer Finances (SCF) to test the hypothesis through multivariate statistical analysis. Our dependent variable for this analysis is whether a household has a VA home loan for their primary residence. By pooling three years of SCF data, we obtain a larger sample of veteran households with VA loans to test the hypothesis. The independent variables of critical interest are the four time periods of mortgage origination that have different funding fee rates.[8] Table 5-20 below describes the four independent variables:

Table 5-20. Description of Independent Variables

Independent Variable	Period	Corresponding Fee Rate
1	1991 or later than 1994	.5%[9]
2	1985 to 1990 or 1992 to 1993	1 to 1.25%
3	1966 to 1970 or 1983 to 1984	1.875 to 2%
4	All other years (prior to 1966 or 1971 to 1982)	No funding fee[10]

[8] Demographic variables were also included in the regression equation.
[9] These rates change depending on the size of the down payment. The order of the rates does not change however, i.e., rates that are higher in one period without a down payment are still higher with a down payment.
[10] The fourth period serves as the base period in the regression. The results for the other years are relative to this period.

The corresponding funding fee charges for each timeframe, which influence the probability that a veteran household holds a VA loan on their primary residence, determines the impact of the funding fee on VA loan program participation. In particular, we anticipate that mortgages originated during time periods with the largest funding fees will have the smallest probability of being a VA loan.

Table 5-21 reports a summary of the results, controlling for the individual effects of household characteristics. Appendix F shows the complete results of the multivariate statistical analysis.

Table 5-21. Effects of Funding Fee on Whether a Veteran Has a VA Loan

Variable	Change in Probability of Holding a VA Loan
Time Period of Mortgage Purchase	
Mortgage Originated 1966 to 1970 or 1983 to 1984	-18.4%*
Mortgage Originated 1985 to 1990 or 1992 to 1993	-23.3%*
Mortgage Originated 1991 or later than 1994	-31.9%*
** Denotes that the variable is statistically significant at the 95% level.*	

Source: 2001 SCF data file.

Results indicate that the higher the cost of the funding fee, the less likely it is that veteran households hold VA loans on their primary residences. More specifically:

- Mortgages originated during years when the funding fee was .5 percent are 18 percent less likely to be VA loans than mortgages originated during the years when there was no funding fee

- Mortgages originated during years when the funding fee was 1.0 percent or 1.25 percent are 23 percent less likely to be VA loans than mortgages originated during the years when there was no funding fee

- Mortgages originated during years when the funding fee was 1.875 percent or 2.00 percent are 32 percent less likely to be VA loans than mortgages originated during the years when there was no funding fee.

Clearly, funding fee increases adversely affect participation in the VA Home Loan program.

Availability of Military Housing

Active duty personnel may have several housing choices open to them. These include traditional military housing at their assigned installation or military housing managed by a civilian contractor. Alternatively, they may rent or purchase civilian community housing.

Purchasers may finance their homes using a VA guaranteed, conventional, or other type of loan.

DoD has established a system of military housing allowances to assist in meeting the housing expenses of members who reside off-base. The allowances vary by rank, location, and dependency status. That is, there are separate schedules for members with no dependents and members with one or more dependents. The housing allowances are updated each year.

Active duty members who reside in military housing forfeit their monthly housing allowance. Members who reside in privatized housing receive a monthly housing allowance but must pay that amount as rent to the management firm. The amount of housing allowance forfeited for on-base housing or paid to the privatization firm is the total cost for residing in military or privatized housing, including rent and all utilities.

When asked whether military housing was available on base, 82.3 percent of VA Loan Survey respondents said yes. Among those who indicated there was military housing available on their base, 96.6 percent reported that they receive a military housing allowance of $923, on average (Table 5-22).

The Study Team analyzed the nature of relationships between military housing allowances, military housing availability, and the use of VA loans. We used the Military Housing Area (MHA) as the unit of analysis for the study, selecting 30 MHAs as the basis for our analysis. These MHAs are broadly representative of the military population by size, geographic location, and military branch. The Study Team also met with DoD officials to learn about the military housing allowance program and the military housing system. Appendix H reports the full analysis in detail.

Table 5-22. Military Housing of Active Duty Borrowers

Response	Active Duty
(If Active Duty survey group) Is military housing available on your base? (Q49)	
Yes	82.3%
No	17.7%
Total	100.0% (N=322)
Missing	118
Number of Respondents	440
(If military housing available) Do you receive a military housing allowance? (Q49.1)	
Yes	96.6%
No	3.4%
Total	100.0%
Number of Respondents	265
(If received military housing) How much military housing allowance per month? (Q49.1.A)	
Mean	$923
Median	$857
Total	N=247
Refused to Answer	9
Number of Respondents	256

Source: VA Loan Survey, Q49, Q49.1, Q49.1.A

Our analysis of the data led us to the following conclusions:

- We estimate that between 7 and 15 percent of active duty members who do not reside in some form of military housing use a VA loan to purchase a home, but the percentage is lower or higher than this range in some geographic areas.
- No statistically significant relationship occurs between the amount of housing allowance in an MHA and the percentage of active duty personnel who use a VA home loan.
- A positive relationship exists between the amount of the housing allowance and the median housing prices financed by active duty members' VA loans.
- There is no relationship between occupancy rates for military family housing and VA home loan use by active duty personnel.

Our discussions with DoD resulted in additional conclusions. DoD, both the Office of the Secretary and the individual Services, is receptive to disseminating information about VA's Home Loan Guaranty program through housing offices and electronic means. The Homeowner Assistance Program (HAP), operated by the U.S. Army Corps of Engineers, can provide various forms of assistance to VA loan holders who have difficulty selling homes near facilities affected by base realignment and closures.

Financial Assistance

A key program goal of VA's Home Loan Guaranty program is to provide financial assistance to veterans seeking to purchase a home. Financial assistance here does not mean or imply welfare assistance or necessarily support to borrowers with low income. Instead, financial assistance is provided by enabling veterans and active duty personnel to purchase a home without a down payment and qualify with less stringent credit standards than required for a conventional loan.

Conventional loans are loans that are not insured or guaranteed by a government agency (i.e., Federal Housing Authority (FHA) and VA loans), and do not fall into the "Jumbo" loan category (i.e., the loan amount does not exceed $333,700). Conventional loans can be sold on the secondary market if they meet underwriting criteria established by Fannie Mae and Freddie Mac. The criteria address down payment amounts, maximum loan amounts, property specifications, borrower income requirements, and credit guidelines. To sell the loans on the secondary market, lenders must adhere closely to the national guidelines, but they do have some flexibility in their underwriting. Most lenders issue loans that can be sold on the secondary market.

VA's performance measure for the financial goal is that at least 80 percent of the VA loans are to veterans whose limited financial resources preclude conventional financing. The Study Team used VA administrative data on individual borrowers to estimate how many would not qualify for the conventional loan. The percentage not qualified for a conventional mortgage is based on typical guidelines issued by the secondary market, that is, 5 percent down payment or more and income-to-debt ratio of 36 percent or less.[11]

Table 5-23 and Table 5-24 shows the percentage of one-time and multiple use VA borrowers who could not qualify for a conventional mortgage and an FHA mortgage, respectively, for VA loans originated from 1999 to 2003. Substantially more than a majority of VA loan borrowers could not qualify for either a conventional mortgage or an FHA loan. In fact, the performance measure (i.e., at least 80% of VA loans are to veterans whose limited financial resources preclude conventional financing) displayed in Table 5-23 meets VA's program outcome (i.e., assist veterans whose limited financial resources would preclude conventional financing.) More than one-half (61%) of one-time users could not qualify for an FHA loan as Table 5-24 shows. The number of borrowers not qualifying for an FHA loan is based on the 3% down payment and a maximum debt-to-income ratio of 41% requirements.

[11] The income-to-debt ratio information collected by the VA GIL system is a proxy for the total debt-to-income ratio, which divides the total monthly debts (housing expense, installment debts, etc.) by the gross monthly income. Asset amount determines if the borrower has adequate liquid assets available to make the 5 percent minimum down payment required based on the purchase price. This approximation does not take into account other underwriting criteria such as maximum loan limit, property specifications, income requirements, and credit scores.

Table 5-23. Percent VA Loan Borrowers Not Qualified for Conventional Mortgage, FY 1999-FY 2003

	One-Time User	Multiple User	Total Borrowers
Could NOT qualify for a conventional mortgage	82.1%	76.4%	80.6%
Could qualify for a conventional mortgage	17.9%	23.6%	19.4%
Total Percentage (Count)	100.0% (572,695)	100.0% (217,311)	100.0% (790,006)

Source: VA LGY GIL data

Table 5-24. Percent of VA Loan Borrowers Not Qualified for FHA Loan, FY 1999-FY2003

	One-Time User	Multiple User	Total Borrowers
Could NOT qualify for an FHA loan	60.6%	53.7%	58.7%
Could qualify for an FHA loan	39.4%	46.3%	41.3%
Total Percentage (Count)	100.0% (572,695)	100.0% (217,311)	100.0% (790,006)

Source: VA LGY GIL data

While the VA loan program is intended to help veterans who are credit-constrained, the program is also available to all veterans. Participation of veterans who qualify for conventional financing should be viewed as a positive outcome as well. In the study survey results, almost no respondent felt that eligibility should be limited to only those who would not quality for a conventional loan.

Another measure relating to financial assistance would be the estimate of the number of veterans with a VA loan as a percentage of the total population of veterans who do not qualify for conventional financing. However, the Study Team did not find any readily available data sources for this measure.

Table 5-25 presents a financial profile of the survey respondents. Half of the respondents had only $4,904 or less of assets. This result can be compared to a 5 percent down payment of the median price of houses purchased by a VA loan borrower of $5,945 and the median closing cost of $2,350, or total median amount of about $8,300 for both a 5 percent down payment and closing costs. Not having to making a 5 percent down payment or more with a VA loan is critical in this comparison.

A majority (60.9%) of respondents had more than $50,000 in household income in 2002. The assessment of the respondents' current financial situation shows that 17.9 percent of the participants can afford only the basic necessities, with little or no money left, while 79.5 percent of participants indicate that they can take care of living expenses and have some money left over. Among the 61 percent of the respondents who said that they have at least one financial dependent, a majority (52%) indicated a child(ren) as their financial dependent.

Table 5-25. Finances of Borrowers

Response	Veterans	Active Duty	Reservists	Total Borrowers
Financial Dependents (Q35)				
None or Not Applicable	43.6%	24.8%	31.9%	38.9%
At least one Financial Dependent	56.4%	75.2%	68.1%	61.1%
Total	100% (N=461)	100% (N=440)	100% (N=426)	100% (N=617)
Refused to Answer	1	0	3	1
Number of Respondents	462	440	429	618
If has Financial Dependent, Type of Financial Dependents (Mark All That Apply)				
Children	95.4%	97.3%	97.6%	95.8%
Parents	4.6%	3.3%	3.5%	3.5%
Other	3.9%	4.8%	3.5%	4.2%
Total	100% (N=260)	100% (N=331)	100% (N=290)	100% (N=377)
Refused to Answer	1	0	3	1
Number of Respondents	261	331	293	378
Note: Total percentage is more than 100 percent since respondents were allowed to mark more than one response.				
Assets (GIL)				
Mean	$15,849	$12,717	$9,864	$14,440
Median	$5,373	$4,885	$4,281	$4,904
Income to Debt Ratio (GIL)				
Mean	37.1%	38.8%	37.2%	$3,740
Median	38.0%	40.0%	37.0%	$3,800
Gross Income at Time of Loan Application (GIL)				
Mean	$55,858	$53,506	$53,160	$55,080
Median	$51,000	$48,876	$49,968	$50,472
Gross Income in 2002 (Q39)				
$30,000 or less	9.0%	8.3%	6.4%	8.8%
$30,001 to $40,000	14.5%	13.6%	14.4%	13.9%
$40,001 to $50,000	14.7%	21.2%	18.1%	16.4%
$50,001 to $75,000	34.0%	35.1%	36.2%	35.5%
$75,000 to $100,000	17.8%	15.7%	18.4%	16.4%
More than $100,000	10.1%	6.0%	6.6%	9.0%
Total	100% (N=456)	100% (N=433)	100% (N=425)	100% (N=611)
Refused to Answer	6	7	4	7
Number of Respondents	462	440	429	618
Income Adequacy (Q38)				
You can take care of living expenses, and have some money left over	78.5%	84.1%	72.8%	79.5%
You can afford only basic necessities, with little or no money left	18.9%	13.9%	24.4%	17.9%
You have to make major sacrifices and cut back on basic necessities	2.6%	2.1%	2.8%	2.6%
Total	100% (N=461)	100% (N=439)	100% (N=427)	100% (N=616)
Refused to Answer	1	1	2	2
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q35, Q39, Q38, and GIL Data

Nearly all (88.8%) VA borrowers indicated that the no-down-payment feature is an incentive to use the VA loan program, and more than half (56.4%) of VA Loan Survey respondents listed it as the main reason they obtained their current VA loan (Table 5-26). Other reasons for using the VA program included entitlement to a VA home loan (74.6%), lower closing costs (54.9%), good interest rate available with a VA loan (53.1%), and easier to qualify for a VA loan (40.5%).

Table 5-26. Reasons for Getting Current VA Home Loan

Response	Veterans	Active Duty	Reservists	Total Borrowers
All reasons why got current VA home loan (Q8) – Mark all that apply				
No down payment required	87.2%	88.9%	86.2%	88.8%
VA home loan is a benefit that I am entitled to	75.8%	70.7%	70.9%	74.6%
Lower closing costs	54.1%	52.0%	57.8%	54.9%
Good interest rate available with a VA loan	53.0%	48.2%	49.0%	53.1%
Easier to qualify for a VA loan	39.0%	40.5%	38.7%	40.5%
No mortgage insurance	35.1%	33.4%	43.4%	35.3%
No prepayment penalty	34.8%	29.8%	35.9%	33.5%
VA provides assistance to prevent default or foreclosure	21.9%	20.2%	21.2%	21.2%
Recommended by real estate agent or lender	16.9%	19.5%	17.0%	17.0%
Other	1.3%	1.1%	2.6%	1.9%
Number of Respondents	462	440	429	618
Note: Total percentage is more than 100 percent since respondents were allowed to mark more than one response.				
MAIN reason why got current VA home loan (Q9)				
No down payment required	55.2%	59.7%	54.5%	56.4%
VA home loan is a benefit that I am entitled to	15.3%	15.4%	1.2%	15.0%
Good interest rate available with a VA loan	11.1%	7.1%	1.9%	10.8%
Easier to qualify for a VA loan	6.1%	5.3%	0.2%	5.9%
No mortgage insurance	4.6%	4.8%	8.0%	4.9%
Lower closing costs	3.5%	3.7%	4.2%	3.4%
Recommended by real estate agent or lender	2.2%	2.1%	13.2%	2.0%
VA provides assistance to prevent default or foreclosure	0.7%	0.9%	9.9%	0.5%
No prepayment penalty	0.2%	0.2%	6.8%	0.2%
Other	1.1%	0.7%	54.5%	1.0%
Total	100.0% (N=458)	100.0% (N=434)	100.0% (N=424)	100.0% (N=612)
Refused	4	6	5	6
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q8 and Q9

The VA Loan Survey results suggest that the VA Home Loan program provides a significant benefit to the participants who would otherwise have difficulty in obtaining a home loan. Almost half (44.0%) of the VA Loan Survey respondents said it would be either difficult or very difficult to obtain a home loan without the VA Home Loan program (Table 5-27). Furthermore, among the same 44 percent of the respondents, the top three difficulties stated that would prevent from getting a non-VA (FHA, conventional, and nonconforming) home loan were: cannot afford the down payment (84.2%), cannot afford the closing costs (48.9%), and credit record not good enough (30.8%).

When asked what would be their most likely housing situation if they did not have VA loan, a significant percentage (27.7%) reported that they would rent (Table 5-28). This finding emphasizes the importance of this VA benefit to the participants. More than three-quarters (76.1%) of the respondents indicated that they are either much better off or somewhat better off, considering their present housing situation with their VA loan relative to their alternatives without a VA loan (Table 5-29).

Table 5-27. Difficulty in Obtaining a Home Loan without VA Home Loan Program

Response	Veterans	Active Duty	Reservists	Total Borrowers
How easy or difficult would it be for you to obtain a home loan without VA home loan program? (Q22)				
Very easy	14.1%	21.6%	14.5%	14.3%
Easy	42.0%	42.3%	44.1%	41.6%
Difficult	30.6%	26.5%	28.8%	30.9%
Very difficult	13.3%	9.6%	12.7%	13.1%
Total	100.0% (N=369)	100.0% (N=366)	100.0% (N=379)	100.0% (N=502)
Don't know/Refused	93	74	50	116
Number of Respondents	462	440	429	618
For those who said it would be difficult or very difficult to obtain a home loan without VA home loan program: Difficulties that would prevent from getting a non-VA conventional home loan. (Q22.1) Mark All That Apply				
Cannot afford the down payment	82.7%	87.1%	79.0%	84.2%
Cannot afford the closing costs	49.4%	50.0%	51.0%	48.9%
Credit record not good enough	32.1%	22.0%	38.2%	30.8%
Cannot afford the mortgage insurance	23.5%	19.7%	25.5%	22.2%
Too much other debt	19.1%	23.5%	26.1%	19.5%
Cannot afford the interest rate	16.0%	10.6%	12.1%	13.6%
Banks don't want to lend to active duty service members	1.9%	6.1%	2.5%	1.8%
Other	2.5%	0.8%	1.9%	2.3%
Number of Respondents	162	132	157	221
Note: Total percentage is more than 100 percent since respondents were allowed to mark more than one response.				

Source: VA Loan Survey, Q22 and Q22.1

Table 5-28. If you did not have your VA home loan, what would be your most likely housing situation?

Response	Veterans	Active Duty	Reservists	Total Borrowers
Military housing	0.7%	15.1%	24.4%	4.7%
Rent	26.1%	27.5%	24.4%	27.7%
Own home with a conventional, non-VA loan	49.0%	43.8%	46.0%	46.6%
Own home with a FHA loan	21.4%	12.6%	27.2%	18.6%
Share housing with family or friends	2.0%	0.7%	1.4%	1.8%
Other	0.9%	0.2%	0.9%	0.7%
Total	100.0% (N=459)	100.0% (N=436)	100.0% (N=426)	100.0% (N=614)
Refused	3	4	3	4
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q24

Table 5-29. How would you rate your present housing situation with your VA loan relative to your alternatives without a VA loan?

Response	Veterans	Active Duty	Reservists	Total Borrowers
Much better off	49.8%	49.3%	49.2%	51.8%
Somewhat better off	24.9%	24.8%	25.5%	24.3%
About the same	22.9%	24.3%	23.0%	22.0%
Somewhat worse off	1.9%	1.6%	1.9%	1.6%
Much worse off	0.4%	0.0%	0.5%	0.3%
Total	100.0% (N=462)	100.0% (N=440)	100.0% (N=427)	100.0% (N=618)
Refused	0	0	2	0
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q25

In the current mortgage market, private lenders are increasingly offering zero-down payment or low-down payment options to borrowers. This has potential implications for VA because the private sector is serving a segment of the population that used to have limited options for financing, including veterans. However, some lenders still encourage veterans to use a VA loan rather than other financing options because it may be a better deal for both the borrower and the lender. In addition, these zero-down or low-down payment programs in the private sector generally target only households with an excellent credit history. The survey asked participants whether anyone in their household was turned down for credit in the past 5 years, and 28.3 percent said someone was (Table 5-30).

Table 5-30. In the past 5 years, have you or anyone in your household been turned down for credit?

Response	Veterans	Active Duty	Reservists	Total Borrowers
Yes	29.6%	21.1%	30.0%	28.3%
No	70.4%	78.9%	70.0%	71.7%
Total	100% (N=460)	100% (N=437)	100% (N=423)	100% (N=615)
Refused to Answer	2	3	6	3
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q21

6. HOME OWNERSHIP RATES

This chapter compares the home ownership rates of veterans, active duty personnel, and the general population. It identifies barriers to home ownership as cited in the literature, and it reviews how different programs overcome liquidity and lending constraints. It presents the results of multivariate statistical analysis that examines the effects of the VA loan program and other factors on home ownership.

Comparison of Home Ownership Rates

National home ownership rates increased dramatically from 43.6 percent in 1940 to 68.3 percent at the end of 2002.[1] The greatest increase (42%) occurred between 1940 and 1960, raising the home ownership rate from 43.6 to 61.9 percent. Since 1960, home ownership rates have increased, but only 6 percentage points in 42 years. This implies that home ownership rates have reached a plateau and will not go much higher, for veterans or the general population.

Table 6-1 shows the home ownership rates for veterans, active duty personnel, non-veterans/civilians, and the general population as reported by different data sources. We used four secondary data sources (external to VA) to compare home ownership rates of veterans and non-veterans: Survey of Consumer Finances (SCF); Integrated Public Use Microdata Series (IPUMS) from the Census; Current Population Survey (CPS); and National Survey of Veterans (NSV).

One of the outcomes for the VA Home Loan Guaranty program is that the veteran home ownership rate exceeds the rate for the general population. As shown in Table 6-1, veteran home ownership rates exceed the general population home ownership rates by 13 percent or more, depending on the year and data source.

While veteran home ownership rates exceed the general population home ownership rates by 13 percent or more, depending on the year and data source, differences in home ownership rates between the veteran and general populations are partially a function of the demographic and socioeconomic make-up of the two populations. Hence, it is appropriate to "peg" the home ownership goal to the relative demographic and socioeconomic composition of the two populations, and adjust the outcome measures accordingly.

The analysis in the literature suggests that older households and higher income households have a higher probability of home ownership. The ownership rate goal should take into account the relative share of households in different age groups in the general and veteran populations. For example, the percentage of older households in the general population could be adjusted upwards to reflect the higher percentage of older households in the veteran population. This would affect a higher ownership rate in the general population in comparison with the veteran population.

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[1] http://www.colorado.edu/libraries/govpubs/colonumb/ownrtype.htm; http://www.census.gov/hhes/www/housing/hvs/q103tab5.html.

Table 6-1. Comparison of Home Ownership Rates

Population Group	SCF 2001	Census 1990[2]	CPS 2002	NSV 2001
Veteran	80.9%[3]	73.0%	83.6%	78.5%
Active Duty	NA[4]	21.4%	40.0%	NA
Non-Veteran/Civilian	62.9%[5]	53.6%	64.4%	NA
General Population	67.7%	59.9%	68.0%	NA
Difference between Veteran and Non-Veteran	***+18.0%***	***+19.4%***	***+19.2%***	***NA***
Difference between Veteran and General Population	***+13.2%***	***+13.1%***	***+15.6%***	***NA***

Source: Survey of Consumer Finance (SCF), Census IPUMS-1% Sample, Current Population Survey (CPS), and National Survey of Veterans (NSV) data

The study's multivariate statistical analysis of home ownership, reported later in this chapter, adjusts for age, income, and other demographic differences between the veteran and general populations. The result is that the difference in home ownership rates narrows to 5 percent between the two population groups.

VA loan program does not have a program outcome for home ownership rates for military personnel as it does for veterans, even though this group constitutes a significant portion of all users. Reported home ownership rates for active duty personnel vary widely, depending on data source, how military personnel are defined (active duty only and/or reservists on active duty), and how households are counted. For example, a significant number of active duty personnel live in military housing and should be excluded from the denominator in computing the homeownership rates for this group. However, the 1990 Census IPUMS does not provide data separately on military personnel living in group-quarters, preventing such an exclusion. Therefore, the numbers computed from IPUMS for active duty personnel are lower than the actual rates and the rates provided by the other data sources.

A study by Center for Naval Analyses[6] compares the home ownership rates for Navy and Marine Corps personnel who live off-base with the home ownership rates for civilians. They find that although military home ownership rates are much lower than civilian rates, differences between these two groups diminish or disappear as age increases. After controlling for age and other demographic factors that influence home ownership, they find that home ownership in the Navy is not significantly different from the home ownership in the

[2] The complete 2000 Census data was not available through IPUMS at the time of this study.
[3] It may exclude some veteran respondents. The publicly available data set collapses military employment and public administration employment into a single group, which is excluded from this analysis. See Appendix H for more detail.
[4] "NA" means data not available.
[5] It may exclude some civilian non-veteran respondents. The publicly available data set collapses military employment and public administration employment into a single group, which is excluded from this analysis. See Appendix H for more detail.
[6] Heybey, B. (2000). Do Military Families Achieve the American Dream? A Comparison of Navy, Marine Corp and Civilian Home ownership Rates. Center for Naval Analyses.

civilian population. A recent study conducted by the RAND Corporation[7] finds a 63.9 percent home ownership rate for military members and a 64.8 percent home ownership rate for the non-military population. RAND also finds that home ownership rates among military personnel were lower than non-military personnel across all educational and income groups.

Barriers to Home Ownership

Barriers to home ownership can be grouped into three main categories: liquidity constraints (e.g., money available for a down payment), lending/borrowing constraints (e.g., strict mortgage qualifying criteria), and housing affordability.

The most frequently mentioned barrier to home ownership in the literature is a person's ability to procure the down payment for a home. Results from Chicago Title and Trust Corporation's 1999 annual survey of home buyers report that 75.3 percent of first-time buyers use their own savings and investments to make a down payment, and it takes them, on average, 2.2 years to save up the money.[8] Harvard University's Joint Center for Housing Studies[9] research suggests that as many as one in five first-time homebuyers receives funds from a relative or friend to help with the down payment, and this help, on average, is 50 percent of the down payment. Linneman and Wachter[10] find that down payment constraints appear to limit home ownership more often than income.

In 1944, when VA's Home Loan Guaranty program was introduced, it did not require a down payment and the borrower did not have to pay a mortgage insurance premium. A study by Vigdor[11] reveals that eligible veterans were more likely to own their home and that about 20 percent of the increase in veterans' home ownership rates between 1940 and 1970 can be attributed to the VA loan program. Vigdor also shows that the innovations in the mortgage market such as allowing households to borrow more than the value of a home (allowing closing costs to be incorporated into the loan amount) enabled certain households to buy a home, but it did not increase home ownership significantly.

We searched the literature to examine how other government loan programs, particularly the Federal Housing Administration (FHA) loan program, influence home ownership rates. Rosenthal[12] investigated what happens to home ownership rates when all borrowing constraints are removed and how borrowing constraints affect a renter's expectation of becoming a homeowner. Rosenthal used data from the 1998 Survey of Consumer Finances (SCF) to estimate the national home ownership rates if borrowing constraints were

[7] Buddin, R., C. R. Gresenz, S. D. Hosek, M. Elloit, and J. Hawes-Dawson. (1999). An evaluation of housing options for military families, The RAND Corporation.

[8] Chicago Title's 24th Annual Survey of Recent Home Buyers "Who's Buying Homes in America" 1999. http://www.ctic.com/homesurvey/home.pdf

[9] "The State of the Nation's Housing: 2002" Joint Center for Housing Studies of Harvard University, 2002.

[10] Linneman, P. and Wachter, S. (1989). The Impacts of Borrowing Constraints on Home ownership. AREUEA Journal 17, no. 4, 389–402.

[11] Vigdor, J.L. (2002). Liquidity Constraints and Durable Good Prices: Theory and Evidence from the Housing Market. Terry Sanford Institute of Public Policy, Duke University.

[12] Rosenthal, S. S. (2001). Eliminating credit barriers to increase home ownership: How far can we go? Department of Economics, Syracuse University, Working Paper Number 01-01.

lifted entirely. He finds that eliminating all borrowing constraints (and allowing individuals to instantly change their housing tenure if they could) could increase the national home ownership rate by 4 percentage points (from 67.4 to 71.4 percent). The study's author concludes that FHA's ability to increase home ownership rates is limited, but the program has been able to get people into homes sooner than if they had to qualify for a conventional loan.

Housing affordability can be an important barrier to home ownership. A recent study published by the Milken Institute[13] examines housing affordability as a function of housing prices, household incomes, and interest rates and concludes that when one of these variables changes, it has an effect on the other two variables. The authors conclude that housing affordability is satisfactory when these three variables are balanced.

Programs to Overcome Liquidity and Lending Constraints

Understanding the differences between conventional, FHA, and VA loan programs is important in understanding how these programs affect home ownership. Table 6-2 compares VA, FHA, and conventional loans in terms of loan limit, closing costs, qualifying ratios, Private Mortgage Insurance (PMI), and down payment.

Table 6-2. Comparison of VA, FHA, and Conventional Loan Programs

Feature	VA	FHA	Conventional
Maximum loan limit	No loan limit, but lenders typically keep it limited to 4 times the guaranty (currently $240,000)	Depends on the geographic area–in 2003 the range was $154,896 to $280,749.	Over $300,000
Down payment % required	None	3%	3 to 20%; 0% down usually offered with income restrictions
Is PMI required?	Not required, but veteran pays a funding fee (typically 2% of the loan amount)	Required	Required when down payment is less than 20%
Closing costs	Limited	Not limited	Not limited
Qualifying ratios[14]	41% for back-end ratio	29%/41%	28%/36%

Source: Research by Study Team

Lenders, such as banks, savings and loans, and mortgage companies, offer conventional mortgage programs. In the past, conventional loans had stricter qualifying standards, such as a 20 percent down payment. However, most lenders now offer lower down payment options and adjustable rate mortgages (ARMs). If the down payment is less than 20 percent of the purchase price, the borrower is generally required to have PMI to cover the risk above 80 percent of the value of the home. PMI is generally 0.5 percent (one-half of one percent) of the loan amount per year. The limit on loans that require PMI if they are to be sold on the secondary market is now $333,700. Most lenders make sure that the loans meet the criteria

[13] Trimbath, S., and J. Montoya. (2002). Housing affordability in three dimensions: Price, income, and interest rates. The Milken Institute. September.

[14] The first ratio is the "front-end ratio," which is the mortgage payment (principal, interest, taxes, and insurance) divided by the gross monthly income. The second ratio is the "back-end ratio" and is the total minimum debt payments a month (mortgage payment, credit cards, etc.) divided by the gross monthly income.

established by Fannie Mae and Freddie Mac in order to sell the loans on the secondary market.

In today's mortgage market, private lenders are increasingly offering zero-down payment or low-down payment options to borrowers. This has potential implications for VA because the private sector is serving a segment of the population that used to have limited options for financing, including veterans. However, lenders may still encourage veterans to use VA loan rather than other financing options because it may be a better deal for both the borrower and the lender. In addition, these zero-down or low-down payment programs in the private sector generally target households with excellent credit history.

The FHA insures nearly one-fifth of all mortgage loans in a given year, and FHA loans particularly target low-income and minority households. FHA-qualified lenders supply FHA mortgages, while the FHA insures the loans, reducing the risk to the lender. The lender is required to conduct an assessment of the property to make sure the home qualifies under FHA standards. Eligible properties are one- to four-unit houses and condominiums. First-time homebuyers pay a minimum cash down payment of 3 percent of the value of the property. In contrast, conventional lenders can require a down payment anywhere from 3 to 20 percent of the purchase price of the home. FHA has more lenient qualifying standards, which include higher mortgage payment-to-income ratios (29 percent for FHA and 28 percent for conventional lenders). Total debt burden allowed for FHA is 41 percent, while conventional lenders limit it to 36 percent. FHA has maximum loan amounts based on geographic area, with high-cost areas having higher limits. Interest rates for FHA loans tend to be about 0.2 percentage points higher than conventional rates and are not based on the borrowers' credit (unlike conventional loans). FHA requires an up-front payment of a mortgage insurance premium, but it can be added to the amount borrowed. If the mortgage exceeds 90 percent of the home's cost, FHA requires an annual premium as well.

VA guarantees its loans, which VA-qualified private sector lenders provide to eligible veterans, active duty personnel, surviving spouses, and reservists. A VA loan can cover up to 100 percent of the purchase price of a home. VA does not impose loan limits, but the limit for sale on the secondary market is generally four times the guaranty amount (currently at $60,000, which effectively sets a loan limit at $240,000 with no down payment). Borrowers pay a funding fee (between 0.5 and 3 percent, with the majority of borrowers charged 2 percent), which is calculated on the basis of whether the borrower is a veteran, active duty personnel, surviving spouse, or reservist; the amount of down payment made (which is not required); loan type; and number of times using their entitlement. Veterans who receive service-connected disability compensation are exempt from paying a funding fee. VA loans do not require PMI, which is a significant savings for the veteran.[15]

[15] Public Law 105-216, the *Homeowners Protection Act of 1998,* stipulated that lenders must automatically cancel PMI, if it is paid directly to them, when the outstanding loan balance is 78 percent of the original loan balance (approximately 12 years after loan origination).

Factors Affecting VA and Non-VA Home Ownership

To obtain a better understanding of home ownership, the Study Team investigated whether demographics and financial variables influence home ownership. The Study Team's analysis of barriers to home ownership focuses on credit constraints of the veterans. Our analysis suggests that VA's Home Loan Guaranty program mitigates some of the difficulties that veteran households with less than perfect or constrained credit histories would face when trying to obtain conventional mortgages. These variables were selected through a review of the literature. We used data from the 2001 Survey of Consumer Finances (SCF) for multivariate statistical analysis of the relationship of demographic and financial variables to home ownership. The SCF is a particularly rich data set for the purposes of our analysis for two reasons. It allows us to identify households that are credit constrained, which enables us to assess the impact of credit constraints on home ownership rates. The SCF also allows us to identify the veteran participants in the VA loan program.

Among financial variables, the SCF data source defines a household as credit constrained if it had any late payments for the 60 days before the VA Loan Survey or if it had ever filed for bankruptcy. Other financial variables included household income and knowledge of next year's income. For socioeconomic variables, we included age, race, education, number of children, and duration at current job, as possible influences on home ownership.

The results of the analysis of home ownership provide estimates of how much more likely households in a given demographic or financial category are to own a home compared with renting. Table 6-3 presents estimates of the change in probability of home ownership for changes in age, education, income, and other variables.[16] Table 6-3 shows results for two separate analyses, one that includes the general population, and another that includes veterans only.

Table 6-3. Factors Affecting Home Ownership–Multivariate Analysis Results

Variable	Change in Probability of Home Ownership	
	Veteran	General Population
Household Head or Veteran Demographics		
Age	3.4%*	2.7%*
White	15.8%*	13.8%*
Education	7.8%*	6.6%*
Children	18.2%*	26.5%*
Veteran	NA	4.8%*
Household Financial/Economic Characteristics		
Income	0.05%*	0.04%*
Credit Constrained	-14.7%*	-16.4%*
Job Duration	4.0%*	3.4%*
Know Income Next Year	4.6%*	4.4%*
** Denotes that the variable is statistically significant at the 95% level.*		

Source: 2001 SCF data file

[16] See Appendix H for detailed regression results and definitions of variables.

Whether a veteran household is credit constrained (defined as having ever had late payments or a bankruptcy) is a statistically significant negative determinant of home ownership. A veteran household that is credit constrained is about 14.7 percent less likely to own a home than a veteran household that is not credit constrained. The 14.7 percent difference in probability of home ownership for credit-constrained households suggests greater difficulty in obtaining a mortgage.

The financial stability of veteran households has a statistically significant and positive relationship to home ownership. Veteran households that know next year's household income are 5 percent more likely to own a home than those that do not know next year's level of household income. Every additional year of employment in a veteran's current job increases the probability of owning a home by 4 percent.

Among veteran households, age, race, education, income, and number of dependent children have a statistically significant and positive relationship to home ownership. Of these, the number of dependent children and whether a veteran is White are strongly associated with home ownership. An additional dependent child increases the probability of a veteran household owning a home by 18 percent, whereas veteran households that are White are 16 percent more likely to own a home than minority veteran households.

The level of household income also has a statistically significant positive effect on veteran home ownership. The probability of home ownership increases by .5 percent with a $10,000 increase in annual veteran household income.

In comparing results for veterans to all households, the explanatory variables have the same positive or negative effect on home ownership, but the magnitude of the effect differs for certain variables. Whether a household is credit constrained is also a significant determinant of home ownership for the general population. A household that is credit constrained is 16.4 percent less likely to own a home than a household that is not credit constrained, which is notably higher than the 14.7 percent found for veterans only. Our result for the credit-constraint variable means that less than perfect credit history matters less for veteran households when buying a home than for non-veteran households.

The financial stability of households (that is, knows next year's income) has a statistically significant and positive relationship to home ownership. Households who know next year's income are 4 percent more likely to own a home than those that do not know. Every additional year of employment in a current job increases the probability of owning a home by 3 percent.

The summary of the results reported in Table 6-3 is as follows:

- ► Home ownership rates for the general and veteran populations are influenced by the demographic composition of the respective populations. When taking into account the demographic composition of the general population, veteran households are 5 percent more likely to own a home than all households (general population), as opposed to the 13 percent or more difference reported in the tabular results earlier in this chapter.

- ► Good credit history is less important in determining home ownership for veteran households than for non-veteran households. This suggests that the VA loan program mitigates some of the difficulties that veteran households with less than perfect credit history would face getting mortgages that are not VA-backed.

- ► Credit constraints and financial uncertainty about the future are barriers to home ownership among veterans, as well as the general population.

7. DEFAULTS AND FORECLOSURES

This chapter presents results of an analysis of the factors that contribute to defaults and foreclosures of VA-insured loans. In addition, loss mitigation data for years 1996 to 2003 were compared and examined. Reasons for default and foreclosure provided by borrowers were extracted and tabulated. Relevant literature and studies of similar loan programs were reviewed. The Study Team applied advanced statistical techniques to examine the multiple effects of borrower and loan characteristics on the probability of default and foreclosure. We used relevant segments of the mortgage finance research literature and data, General Accounting Office studies, and research and evaluation studies of the Federal Housing Authority (FHA) program of the U.S. Department of Housing and Urban Development (HUD). The Study Team also analyzed survey responses to customer satisfaction questions pertaining to VA supplemental servicing for default interventions where foreclosure was avoided.

Loss Mitigation Program

It has been VA's longstanding policy to encourage mortgage holders to extend forbearance to veteran-borrowers who find themselves in temporary financial difficulties through no fault of their own. In loan default cases, the mortgage holder is responsible for contacting the borrower, determining the reason for the default, and making arrangements for repayment of the delinquency. If this cannot be accomplished by the time that three or four installments are due and payable, the default must be reported to VA, together with the holder's explanation of the reason for the default and a summary of its servicing efforts.[1] Upon receipt of such notice, VA takes an active role in working to protect the interests of the veteran-borrower and the Government by initiating an outreach effort to personally contact the borrower and perform supplemental servicing.

VA closely reviews the holder's servicing of the account and follows up by attempting to contact the borrower by letter or telephone. Once contact has been established and on the basis of facts in the case, VA personnel may offer financial or other counseling to the veteran and/or may intercede with the holder on behalf of the veteran to obtain forbearance or arrange a reasonable repayment schedule in appropriate cases.

When VA efforts to secure additional forbearance are unsuccessful, VA has discretionary authority to "refund" (i.e., to purchase a loan from the mortgage holder). The law providing this authority to VA does not vest borrowers with any right to have their loans refunded or to apply for refunding. Nevertheless, VA considers whether refunding is in the best interests of the veteran and the Government in every case before foreclosure. When VA refunds a loan, it may be reamortized to eliminate a delinquency, and the interest rate may be reduced up to 3 percent below the maximum rate for new GI loans in order to lower the monthly installment payments.

[1] VA regulation 38 C.F.R. 36.4315 requires that a default be reported no later than 45 days after nonpayment on any installment has continued for 60 days. This effectively means that a default must be reported no later than 15 days after the fourth payment is missed.

VA intervention through refunding is exercised in situations where the borrower has the ability to maintain the mortgage obligation or clearly will have that ability in the near future, but the holder has determined it would not be in its best interest to continue to extend forbearance.

When a borrower has no realistic prospects for maintaining even reduced mortgage payments, VA will encourage a private sale of the home to avoid foreclosure. Such a sale can be difficult to arrange if the property is worth less than the total amount owed on the loan, as is sometimes the case in areas that have depressed housing markets. In such a situation, VA may be able to offer assistance by using a procedure that involves a compromise loan guaranty claim. This procedure can be considered if the difference between the loan indebtedness and the purchase price is less than the amount of VA's maximum guaranty. If a veteran finds a buyer who will purchase the property for its fair market value and the proceeds of the sale are applied to the existing indebtedness, a compromise would enable VA to pay a claim for the difference between the sale price and the loan indebtedness.

When a borrower is unable to reinstate the loan (i.e., pay all amounts in default), refunding is not appropriate, and a private sale cannot be arranged, VA considers approving the acceptance of a deed in lieu of foreclosure. If acceptance of the deed will be in the best interests of both the borrower and VA, then VA will approve it. If a deed in lieu of foreclosure is not feasible, the holder will generally proceed with foreclosure.

VA has established the Servicer Loss Mitigation program (SLMP), which authorizes loan holders or their servicing agents (servicers) to perform most of the analyses involved in approving compromise agreements or deeds in lieu of foreclosure. Borrowers may contact the loss mitigation department of their servicer to determine whether the company is authorized to process a compromise or deed; if not, the borrower should contact VA directly.

Termination of the loan is the sole responsibility of the mortgage holder, and it must be accomplished in accordance with State law applicable to all mortgage loans. Prior to the termination, the mortgage holder must notify VA of its intention to foreclose and wait 30 days after VA receives the notice before initiating termination. The holder must then notify VA of the proposed action (e.g., foreclosure sale or a voluntary deed to the holder in lieu of foreclosure), so that VA can take certain actions designed to protect the interests of the veteran-borrower and the Government. An appraisal of the property is obtained, and VA then determines the net value of the property by reducing the appraised value by the estimated costs to VA of acquiring, managing, and reselling the property, including losses sustained on the resale of the property. VA then decides whether or not to specify an amount.

If the sum of the net value of the property plus the maximum amount of claim payable on the loan guaranty amounts to <u>more than</u> the total owed on the loan (unpaid principal, accrued interest, advances for taxes and insurance, liquidation expenses), then VA can reduce the amount of guaranty claim payable by specifying an amount (the net value) for credit to the loan amount. VA only pays a claim for any unpaid balance on the loan account after this credit, and if the mortgage holder acquires the property during the termination process, the holder may transfer the property to VA for the specified amount or net value of the property.

When the sum of the net value plus the maximum amount of claim payable on the loan guaranty amounts to less than the total owed on the loan, VA will not specify an amount. This is called a no-bid. In such a case, even if the loan account were credited with the net value, VA would still have to pay the maximum claim, so there is no advantage to VA in specifying an amount for credit to the loan account. However, this also means that the mortgage holder does not have the option of transferring the property to VA, and the mortgage holder will have to otherwise dispose of the property if it is acquired during the loan termination.

Performance Measure for Loss Mitigation

Veterans Benefits Administration's (VBA's) index of Foreclosure Avoidance Through Servicing (FATS) measures the success of regional offices in arranging alternatives to foreclosure. The index measures the percentage of foreclosures avoided because of successful VA interventions, refunding, compromise claims, and deeds in lieu of foreclosure. To encourage field stations to improve their supplemental servicing, VBA established goals to improve performance measured by the index. The FATS ratio is now a part of VBA's Balanced Scorecard, which contains both strategic objectives and fiscal year targets for the ratio.

Profile of Defaulted Loans and Foreclosures

The Study Team examined VA defaulted loans and foreclosures by—

- Analyzing the different reasons for default, as reported by lenders and documented by VA staff
- Comparing aggregate-level default and foreclosure rates for VA loans to FHA loans and loans in the general population

VA Loan Default Rates

VA Loan Guaranty Service (LGY) default data are generally limited to only those defaults reported by lenders to VA as being seriously late (i.e., more than 105 days late). VA loan data system reports the number of defaults and interventions by RLC and month, but not by category of loan or borrower (such as veterans, active duty, and reservists) or by demographic characteristic (such as age). The latter type of information is not readily available from the tracking system or other source.

VA reports 118,426 defaults for fiscal year (FY) 1999, 132,147 defaults for FY 1998, and 132,534 defaults for FY 1997. Loans in default at the end of the fiscal year as a percentage of loans outstanding was 3.85 percent in FY 1999, 4.14 percent in FY 1998, and 4.00 percent in FY 1997. The average number of loans outstanding has varied from 3.045 million in FY 2001 to 3.315 million in FY 1997.

VA's Office of Inspector General Report No. 9R5-B10-047, *Attributes of Defaulted VA Home Loans*, March 25, 1999, reports higher default rates for active duty members and VA borrowers located in areas with declining home values. This analysis was based on a limited sample of about 500 loans that defaulted between 1995 and 1997 from a universe of about 153,000 loans. The Office of Inspector General found that loans administered to servicemembers accounted for a disproportional number of defaults, as they only represented 18.5 percent of VA loans, yet accounted for 26.3 percent of the defaulted loans.

The report cited several reasons for default. Servicemembers who are first-time home buyers may be more prone to default because they have little or no experience at handling debt. Servicemembers, particularly young members, have little discretionary income. Servicemembers are subject to disruptions due to transfers or discharges. When servicemembers are ordered to other duty stations, they may face difficulty in disposing of properties before transfer or generating enough rental income from the property that they own. The risk of foreclosure is higher where the demand for housing has declined and home values are not appreciating.

In meetings with various stakeholders, the subject of potentially higher default rates for active duty VA loan borrowers came up frequently. Possible solutions or recommendations by VA included providing financial counseling to active duty borrowers, but this suggestion was rejected on the basis that a subgroup of borrowers (i.e., active duty members) cannot be singled out for counseling. As stated above, VA does not track default rates for active duty members separately from other groups. LGY recently compared liquidation rates for active duty versus discharged loan borrowers and found that the liquidation rates are more a function of age rather than military status.

The Study Team examined a sample of 500 administrative loan records containing open-ended (uncoded) explanations of reasons for default. Default reasons are contained in a "Notes" field in the Loan Service and Claims (LS&C) system, which serves as a catchall field for documenting servicing efforts. Of the 500 records, two contained multiple responses, bringing the total number of reasons to 502. For the records with reasons for default, curtailment of income had the highest frequency of response, consisting of 20.7 percent of total responses, as shown in Table 7-1. The next highest frequency of reasons for default was extensive obligations, given by 14.1 percent of participants. For 7.6 percent of the records, improper regard for obligations was stated as reason for default. The reason for default was either unknown or not provided in one third of the records.

Table 7-1. Reasons for Default Breakdown

Reason for Default	Frequency	Percentage	1999 IG Report (Corrected Reason Code)
Unknown/No reason given	167	33.3%	46.8%
Curtailment of Income	104	20.7%	21.6%
Extensive Obligations	71	14.1%	3.6%
Improper Regard for Obligations	38	7.6%	3.6%
Illness of Obligor or family	29	5.8%	5.0%
No contact made	22	4.4%	
Marital Difficulties	20	4.0%	9.4%
Bankruptcy	20	4.0%	
Other	12	2.4%	5.0%
Poor Management/use of credit	9	1.8%	
Death of Obligor	4	0.8%	4.3%
Entered Military Service	3	0.6%	
Job transfer, unable to sell	2	0.4%	
In service, unable to sell	1	0.2%	0.7%
TOTAL	**502**	**100.0%**	**100.0%**

Source: VA loan servicing data, and Inspector General Report, Attributes of Defaulted VA Home Loans, March 1999

In comparison with the inspector general's March 1999 report, *Attributes of Defaulted VA Home Loans*, some differences are noted. The percentage of veterans who defaulted because of extensive obligations increased from 3.6 percent in 1999 to 14.1 percent in 2003. In addition, the percentage of veterans with marital difficulties as their reason for default decreased from 9.4 percent in 1999 to 4 percent in 2003.

Comparison of VA Loan Defaults and Foreclosures to Other Loans

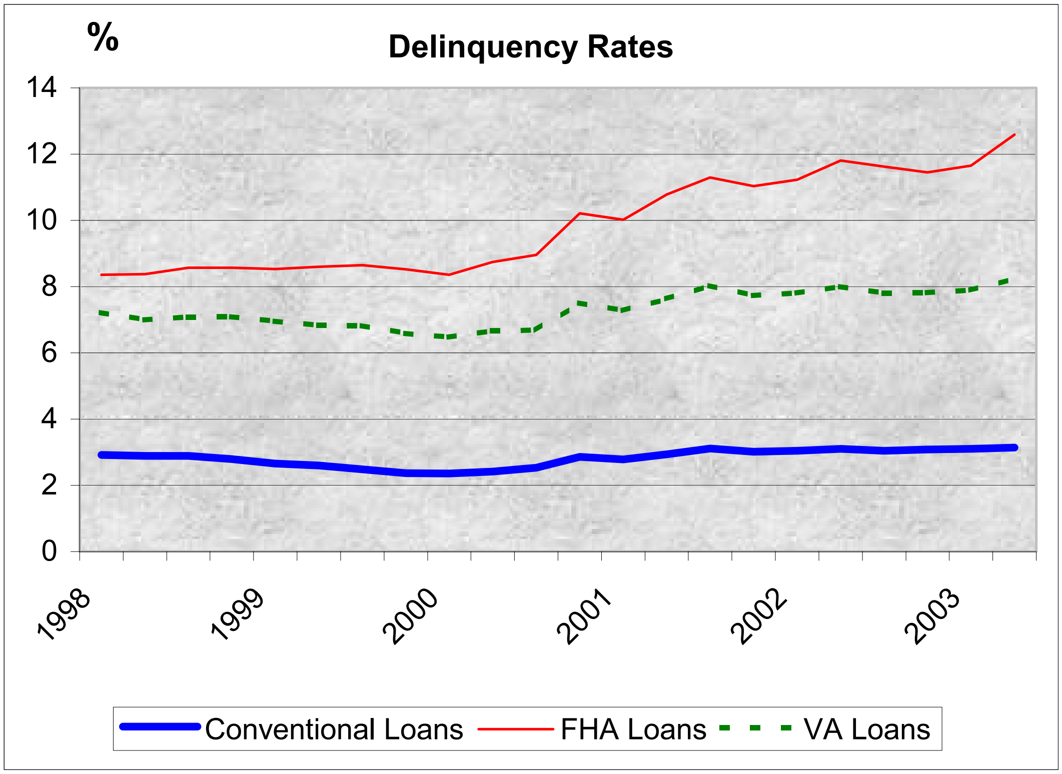
Secondary data from the National Delinquency Survey (NDS) provide quarterly trend data on defaults and foreclosures for different intervals of delinquency (30 days, 60 days, and 90 days) by type of loan, including conventional, FHA, and VA. The NDS, which has been conducted since 1953, currently covers more than 32 million loans on one- to four-unit residential properties, representing about 70 percent of all "first-lien" residential mortgage loans outstanding in the United States. Recent survey results are reported by approximately 180 lenders, including mortgage bankers, commercial banks, thrifts, and life insurance companies. The Mortgage Bankers Association conducts the NDS on a quarterly basis.

In any comparison of VA loan default and foreclosure rates with conventional rates, it must be recognized that VA loans do not require a down payment, whereas most conventional loans do. Loans with no down payment are riskier than conventional loans with a down payment. Additional factors that may affect valid comparisons include income, income-to-loan ratio, the ratio of original loan to home value, and demographic characteristics.

HUD's FHA loan program is a comparable Government program. FHA insures about 18 percent of all mortgage loans on average and encompasses a riskier set of borrowers than those with conventional loans. FHA borrowers tend to be younger and more credit constrained than other borrowers. FHA insures the full amount of selected loans made by private lenders, in contrast to VA loans, which are guaranteed for only a portion of the loan.

Although VA and FHA loans have general similarities, they have distinct differences. In 1998, the percentage of delinquent FHA loans was between 7 and 8 percent. As of the second quarter of 2003, that percentage had risen to nearly 13 percent. In contrast, the percentage of delinquent VA loans was between 6 and 7 percent in 1998 and had only risen slightly in 2003 to between 7 and 9 percent. Thus, as highlighted in Figure 7-1, the percentage of delinquent FHA loans has risen at a greater rate than that of VA loans since 1998. Both Government-subsidized loan programs have much higher loan delinquency rates than those of conventional loans. Conventional loans had a delinquency rate between 2 and 4 percent in 1998, which had only risen a fraction of a percentage point by 2003.

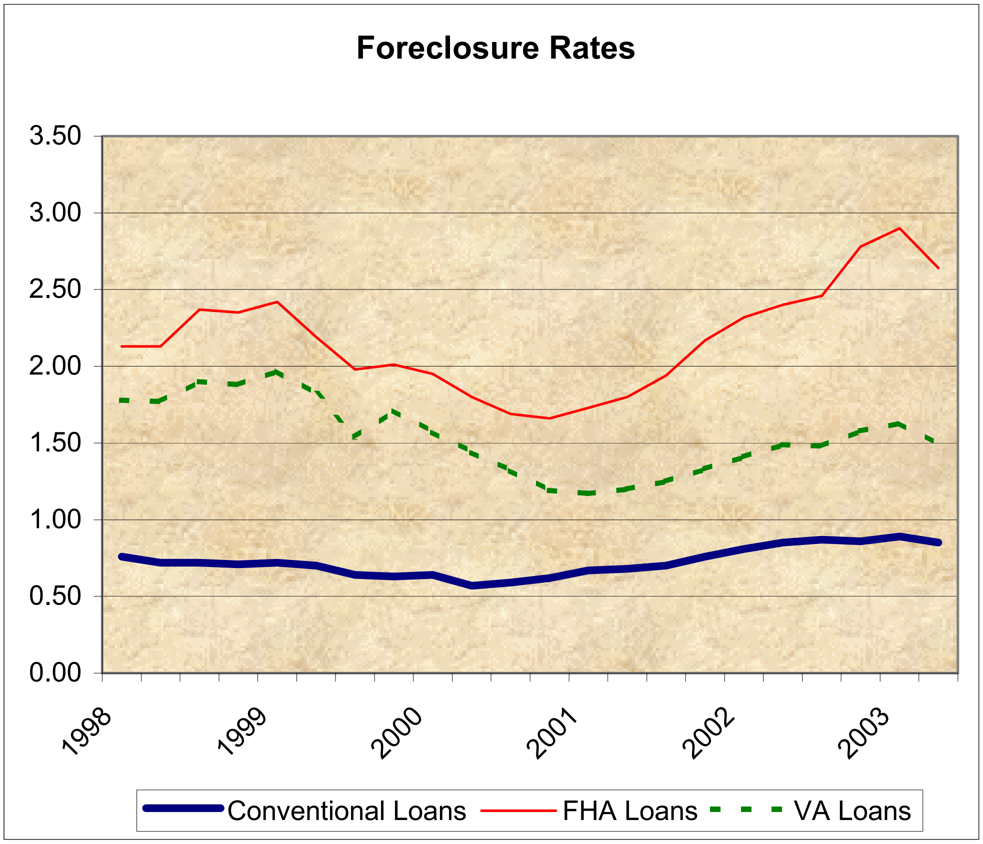
Figure 7-1. VA, FHA, and Conventional Loan Delinquency Rates



Source: Mortgage Bankers Association

An analysis of foreclosure data also reflects higher foreclosure rates of FHA loans. As seen in Figure 7-2, FHA loans foreclosed at a rate between 1.5 and 2 percent in 1998. By 2003, the FHA foreclosure rate had risen a full percentage point. Conversely, VA loan foreclosure rates decreased from 1998 to 2003. In 1998, the rate was slightly under 2 percent, whereas in 2003 it fell to about 1.5 percent. Conventional loans did not have as great a shift in foreclosure rates as did the Government-sponsored programs. In 1998, the percentage of foreclosures was around 0.75 percent, and by 2003, it had increased to around 0.85 percent. Thus, contrary to the FHA and conventional loans, VA loans actually displayed a decrease in foreclosure rates.

Figure 7-2. VA, FHA, and Conventional Loan Foreclosure Rates



Source: Mortgage Bankers Association

Factors Affecting Defaults and Foreclosures

Previous Research

There is a growing body of research at large that attempts to explain differences in the likelihood of default as a function of individual characteristics of the borrower and the loan. A recent study by the Office of Federal Housing Enterprise Oversight (OFHEO)[2] analyzes the probability of default (and prepayment) for prime versus nonprime loans where the interest rate for the nonprime loan is well above the average market rate, typically in cases with greater credit risk. On the basis of econometric analysis, the findings confirm that nonprime borrowers are generally more likely to default and that certain other variables affect the default outcome as well, including the age of the loan, credit scores, down payments, interest rates, house prices, and labor market conditions. One finding of the study is that the probability of default declines as the borrower's credit score increases.

The Study Team notes that VA LGY has started to collect FICO credit scores in its data systems. This may be useful for further research into default patterns for VA loan

[2] OFHEO Working Paper 02-1, Patterns of Default and Prepayment for Prime and Nonprime Mortgages, March 2001.

borrowers. For example, do FICO scores differ between VA loan and FHA loan borrowers? Recent work examining FHA default rates, found that the inclusion of FICO scores was still in its nascent stage. As FICO scores become available in a larger portion of loan files, the differences in scores and their implications can be examined.

The General Accounting Office (GAO) in GAO-02-773 (July 2002), *Mortgage Financing Changes in the Performance of FHA-Insured Loans*, determined factors behind increases in FHA's default and foreclosure rates. GAO described early performance of FHA loans and learned that there were some changes in the mortgage market that contributed to changes in loan performance.

GAO found that newer loans had experienced higher foreclosure rates than rates of older loans. Interestingly, the most recent loans were performing much better than loans made in the 1980s. Loans originated in the late 1990s had higher foreclosure rates than those originated earlier in the decade. Foreclosures were higher in California and for adjustable rate mortgages (ARMs). Loans made on properties in California had a foreclosure rate of 6.4 percent, whereas those made in all other States averaged 2.0 percent. This dramatic difference illustrated a basic economic trend that the increase in the overall foreclosure rate in the 1990s was attributable to the increasing number of loans with higher loan-to-value ratios. This was true to a large extent for loans in California.

Although economic characteristics of borrowers and the dynamics of local and regional housing markets contributed to mortgage foreclosure, other issues contributed to the phenomenon as well. In particular, changes in loan underwriting standards and practices were determined to have played a role in increased rates of foreclosure. These changes were not due to negligence or malfeasance; instead, changes in underwriting standards and practices reflected policy changes designed to increase home ownership. This adjustment of underwriting practices led to significant increases in home ownership, thus meeting the charge of FHA. Still, there was an increase in the rate of foreclosure and, thus, risk associated with FHA's portfolio.

GAO found that, as of the time of its report, FHA had not been collecting individual-level data on variables such as credit scores and debt-to-income ratios for a sufficiently long period to include these types of variable in risk modeling efforts. As we stated above, as the number of observations of both FHA and VA loan records including FICO scores increases, useful analysis yielding insights into probabilities of default associated with particular scores would be possible. Such analysis can examine the extent to which FICO scores serve as a valuable proxy for risk exposure in the case of FHA and VA loans.

In a study sponsored by HUD to analyze FHA default rates,[3] advanced statistical techniques were used to control for certain factors, such as the loan-to-value characteristics of the loan, assets after closing, monthly income, average metropolitan statistical area (MSA) unemployment rate, MSA house price growth, and geographic concentration of defaulted loans. Variables that are proxy for loan risk, such as the loan-to-value ratio, have the expected effect on the default outcome. Average MSA unemployment rate and MSA house

[3] Unicon Corporation, *Assessing Problems of Default in Local Mortgage Markets*, March 2001.

price growth help to control for differences in local economies and housing markets that affect default and foreclosure outcomes. The type of mortgage, such as an ARM, has been shown to contribute to increased rates of foreclosure in FHA loans, when compared with fixed rate mortgage (FRM) loans.[4] Other factors, such as different foreclosure laws among the States and the District of Columbia, contribute to variations in foreclosure and default among different jurisdictions.

As was found by GAO, FHA extends home ownership to borrowers not well served in the conventional market. Although this meets FHA's goal of expanding ownership, there is an increased rate of default. According to the report, by taking actions to reduce the risk of default, FHA will work against extending home ownership.

FHA borrowers in neighborhoods and among lenders with high default rates are more likely to be first-time homebuyers and are often African American. These borrowers also have higher loan-to-value ratios, lower incomes, and smaller values of assets after closing than do borrowers in neighborhoods and among lenders with lower default rates. The analysis showed that atypically high default rates were concentrated among a set of high default neighborhoods and high default rate lenders. Sophisticated analysis was used in efforts to isolate differences between census tracts in default probabilities.

From these reports, certain results or implications are useful to VA. As with all complex programs requiring data to underpin decisionmaking and policy formation—more is better. In particular, as FICO scores become a part of more files, more analysis consistent with that in most other sectors of the financial industry in risk management can be undertaken. Many insights and loss mitigation strategies can be developed from analysis that is more detailed. VA loans, like those of FHA, are designed to increase home ownership to borrowers not well served by conventional lenders. Although not explicit, it can be implied that there is an optimal tradeoff between limiting exposure to default and increasing home ownership.

Results of Multivariate Analysis

The highly aggregated data comparing VA default rates to FHA and conventional loans do not incorporate the effects of age, active duty status, income, qualifying for conventional mortgage, and other variables. Clearly, characteristics of a borrower can influence the rate of default and foreclosure to levels diverging from the simple average rate. The team used multivariate statistical analysis to account and control for the influence of various characteristics on loan outcomes.

The Study Team examined whether economic and demographic factors identified in prior research on non-VA loans affect the probability of VA loan default. Income, gender, race, active duty status, loan-to-income ratio, age, and credit status affect the probability of default. Similarly, the Study Team examined the effect that these same variables have on the probability of a loan foreclosure.

[4] Abt Associates Inc. Analysis of FHA's ARM Program and the Performance of ARMs Relative to Other FHA Insured Single Family Loans. Prepared for HUD, December 2000.

Data

The data used for this analysis are an extract of VA Guaranteed and Insured Loan (GIL) administrative data including defaulted but cured loan data. The GIL data extract includes loans originated between January 1999 and June 2003, whereas the cured data include all loans that were defaulted but cured as of April 2003. The GIL data have an indicator for terminated loans that allowed us to identify foreclosed loans. The GIL data and the cured data were merged in order to attach the data fields available in the GIL data only (such as active duty status) to the cured loan data. The data provide extensive administrative information. The 1999 to 2003 data have over one million records.

Although many variables are included, the number of observations included in the analysis is small, relative to the total sample. The Study Team had over 1.3 million observations, but samples of 20,000 observations were used. This was done to adequately match loans in the GIL database with cured loans. A random sample of the loans was taken and merged with the cured data in order to have a similar number of observations in conducting the multivariate analysis.

Results

Descriptive statistics are presented in Table 7-2 and Table 7-3 for loan default and foreclosure variables, respectively. Multivariate results are presented in Table 7-4 and Table 7-5 for default and foreclosure probability, respectively. The technical information related to the multivariate analysis is included in Appendix I.

Table 7-2. Variables Used for Multivariate Analysis of Loan Defaults

Variable	Definition	Mean	Number of Observations
Cured (Dependent Variable)	**=1 if defaulted but cured; 0 otherwise**	.31	20,452
Active Duty	**=1 if active duty; 0 otherwise**	.13	20,452
Income	**Gross monthly income**	$2,668	20,452
Would Qualify for Conventional Mortgage	**=1 if qualifies for conventional**[5]	.13	20,452
Debt Ratio	**Ratio of Debt: to Monthly Income**	27.04%	20,452
Interest Rate	**Interest Rate**	7.37%	20,452
Down Payment	**Amount of down payment**	$2,030	20,452
Purchase Price	**Purchase price of home**	$106,346	20,452
Guarantee Amount Ratio	**Ratio of Guarantee amount to Loan amount**	33.84%	20,452
Age	**Age of borrower**	39.9	20,452

Source: Study Team analysis and VA loan servicing data on defaulted but cured data

[5] Whether a borrower qualifies for a conventional mortgage is used here as a proxy for lower default/foreclosure risk. Borrowers who qualify for a conventional mortgage have credit and other financial characteristics that create less risk, on average, than those of borrowers who do not qualify for a conventional mortgage.

Table 7-3. Variables Used for Multivariate Analysis of Loan Foreclosure

Variable	Definition	Mean	Number of Observations
Foreclosure (Dependent Variable)	=1 if foreclosed; 0 otherwise	.031	13,361
Active Duty	=1 if active duty; 0 otherwise	.14	13,361
Income	Gross monthly income	$2,745	13,361
Would qualify for Conventional Mortgage	=1 if qualifies for conventional	.12	13,361
Debt Ratio	Ratio of Debt to Monthly Income	22.93%	13,361
Interest Rate	Interest Rate	6.9%	13,361
Purchase Price	Purchase price of home	$121,342	13,361
Guarantee Amount Ratio	Ratio of Guarantee amount to Loan amount	31.74/%	13,361
Age	Age of borrower	37.6	13,361

Source: Study Team analysis and VA GIL data

Table 7-4. Factors Affecting Whether a Loan Defaults

Variable	Change in Probability of Being in Default
Active Duty	10.9%
Income	-2.7%
Would Qualify for a Conventional Mortgage	-21.0%
Debt Ratio	29.0%
Interest Rate	.02%
Purchase Price	9.0%
Guarantee Amount Ratio	.003%
Age	-4.8%

Source: Study Team analysis and VA loan servicing data on defaulted but cured data

Table 7-5. Factors Affecting Whether a Loan Forecloses

Variable	Change in Probability of Being in Foreclosure
Active Duty	9%
Income	-5%
Would Qualify for a Conventional Mortgage	-17%
Debt Ratio	32%
Interest Rate	1.3%
Purchase Price	4%
Guarantee Amount Ratio	.012%
Age	-2.7%

Source: Study Team analysis and VA GIL data

The results in Table 7-3 show that a borrower on active duty is 10.9 percent more likely to be in default than a borrower who is not on active duty. An increase in income decreases the probability of default. A $100 increase in monthly income decreases the probability of default by 2.7 percent. The effect of the $100 increase is estimated at the mean amount of monthly income, which is $2,668 for default loan borrowers. The effect will vary depending on the amount of the monthly income.

Those who qualify for a conventional mortgage are 21 percent less likely to default. This is intuitive, as those who qualify for a conventional mortgage are, on average, less credit constrained than are borrowers who do not qualify for a conventional mortgage. The debt ratio of a borrower has a very strong effect on the probability of default. A 1 percent increase above the average of the debt ratio of borrowers leads to a 2.9 percent increase in the probability of default. Age has a negative effect on the probability of default; that is, older borrowers are less likely to default. These findings are consistent with other similar empirical studies.

Purchase price is found to have a positive effect on default. In other words, homes that are more expensive are more likely to be in default. This result may be less intuitive or counterintuitive and may be attributable to certain regional effects not captured in our model. For instance, California is one of the highest priced areas, and its economy has not been performing as well as much of the rest of the country in recent years. The effect of a poor economy in a local area or State is to increase the occurrence of defaults.

The results also suggest that for the past few years, the mostly stable interest rates have not had a significant impact on defaults. However, when rates are quickly rising, borrowers have difficulty selling or refinancing, whereas dropping rates often help borrowers out of default situations. In the 1980s, when interest rates were in double digits, liquidation rates for VA loans were at their highest level.

In Table 7-5, the variables that contribute to default are significant also in affecting rates of foreclosure. These variables follow those of default with similar orders of magnitude. For example, a VA borrower who is on active duty status is 9 percent more likely to foreclose than a borrower who is not on active duty. This compares similarly to the 10.9 percent higher probability of default for the active duty borrower.

Application of Statistical Analysis to Management

The use of this type of multivariate statistical modeling is common in many financial services organizations as a decision support tool. For example, knowledge of the determinants of foreclosure can be useful in adopting policies that can forestall the loss of a home. Another possible application of this type of analysis is in evaluating the performance of RLCs. The economic and demographic differences that exist across RLCs and over time can have different effects on foreclosure rates and, in turn, on the FATS ratio. Using this type of modeling, one can adjust for the effects of extraneous factors on RLC performance, thereby permitting more accurate assessment of RLC performance. Another potential application is forecasting the workload for supplemental servicing of loans in default.

Analysis of VA Loss Mitigation

As stated previously, the performance measure of success of default intervention or loss mitigation currently used by VBA is the FATS ratio.

The Study Team reviewed the FATS ratio results for different years and regional offices and assessed the reasonableness and accuracy of such data. VA officials were asked to identify factors affecting variations over time and across regional offices. The Study Team also examined practices used for FHA default intervention and measures of such intervention.

Analysis of the FATS Ratio

Table 7-6 provides national summary data for FY 2002 and FY 2003 on successful interventions, foreclosures, and the FATS ratio. The number of foreclosures dropped significantly, from 20,168 in 2002 to 16,084 in 2003. Improvement in the economy, undoubtedly, affected this outcome. The FATS ratio improved from 43 percent to 47 percent as the significant decline in foreclosures outweighed the slight decline in successful interventions. The FATS ratio is the total of successful interventions (SI), refundings (R), voluntary conveyances (VC), and compromises (C), divided by the same total plus foreclosures: FATS ratio = (SI + R + VC + C)/(F+ SI + R + VC + C).

A successful intervention results in the default being cured and the borrower retaining the home. If the loan default cannot be cured, then VA fulfills it guaranty commitment. Different courses of action may be taken to avoid foreclosure and prevent or minimize financial loss, including refunding (VA buys the loan from the lender), voluntary conveyance (VA accepts the voluntary deed from the borrower to avoid foreclosure), and compromise claim (VA pays a claim to the lender to cover the difference between the sale price and loan balance).

Table 7-6. Aggregated FATS Ratios, FY 2002 and FY 2003[6*]

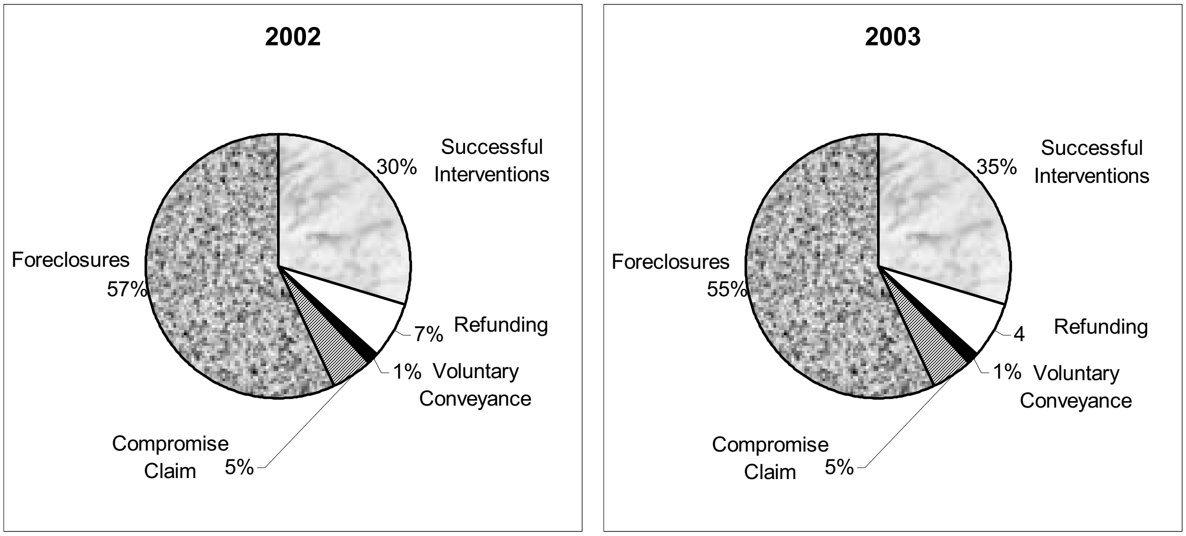
	FY 2002	FY 2003	Percentage Change
Number of Successful Interventions	10,564	10,450	-1%
Number of Refunding	2,486	1,266	-51%
Number of Voluntary Conveyance	460	368	-20%
Number of Compromise Claim	1,792	1,599	-11%
Number of Foreclosures	20,168	16,084	-20%
FY FATS ratio	43%	46%	6%

Source: VA LGY data

Figure 7-3 presents a graph of the percent distribution of the different outcomes of defaulted loans for FY 2002 and FY 2003, including successful interventions, refundings, voluntary conveyances, compromise claims, and foreclosures. The percentage of successful interventions increased from 30 to 35 percent between FY 2002 and FY 2003 while the percentage of foreclosures declined from 57 to 54 percent, reflecting possibly the improving economy and better performance of VA's loan supplemental servicing during this time period. The total percentage of the other outcomes—refunding, voluntary conveyances, and compromise claims—decreased from 13 to 11 percent, also reflecting possibly a better economy and better performance of VA's loan supplemental servicing.

[6] Aggregation of data from RLCs for both years.

Figure 7-3. Percent Distribution of Outcome of Defaulted Loans



Source: VA LGY data

FATS data were provided for each of VA's RLCs or regional offices: Manchester, New Hampshire; Cleveland, Ohio; Roanoke, Virginia; Atlanta, Georgia; St. Petersburg, Florida; San Juan, Puerto Rico; St. Paul, Minnesota; Houston, Texas; Denver, Colorado; Phoenix, Arizona; and Honolulu, Hawaii. Table 7-7 displays the FATS ratios by VA RLCs for FY 1996 through FY 2003 and shows that the ratio varies by RLC and by year. A number of reasons account for this, including but not limited to differences in the health of the various local economies and State foreclosure and lending laws. Differences in State laws, for example, affect the probability of different foreclosure outcomes, particularly in terms of the timing of foreclosures and the occurrence of alternatives to foreclosure. This, in turn, affects the FATS ratio for a given region and year.

Significant improvement in the FATS ratio occurred between 1996 and 2003 for all of the RLCs except for one (Denver). Explanation for the general improvement relates to the consolidation from 45 RLCs to 9 RLCs and 2 Regional Offices (ROs) during this period, because better oversight can be exerted over the smaller number of RLCs. Many new supplemental servicing employees were hired as part of the consolidation. VA officials report that new staff generally require about a 3-year training/experience period to become fully proficient at their job. In addition, renewed emphasis has been placed on the FATS ratio, and the recently implemented cash awards to employees provide an incentive for better performance.

Table 7-7. FATS Ratios for VA Regional Loan Centers, 1996–2003*

VA RLC	1996 (%)	1997 (%)	1998 (%)	1999 (%)	2000 (%)	2002 (%)	2003 (%)	Average (%)
Manchester	39.3	36.7	31.9	31.2	20.3	33.0	41.0	33.3
Cleveland	38.3	40.3	35.0	42.3	35.9	41.0	44.0	39.5
Roanoke	27.9	26.2	19.6	26.8	27.5	51.5	58.0	33.9
Atlanta	30.8	28.3	25.1	25.4	22.3	40.0	44.0	30.8
St. Pete	42.3	39.4	33.2	34.5	30.3	46.5	52.0	32.3
San Juan**						54.5	61.5	58.0
St. Paul	41.9	39.0	26.0	30.4	30.2	48.0	44.0	37.0
Houston	38.9	40.7	42.4	39.4	35.3	36.0	44.5	39.6
Denver	47.7	38.8	37.5	39.6	37.3	38.0	44.0	40.4
Phoenix	38.3	33.5	34.7	32.9	27.5	47.0	52.0	37.9
Honolulu**						39.0	46.5	42.8

*2001 data not available. ** Pre-2002 data not available.

Note that San Juan and Honolulu are Regional Offices, not Regional Loan Centers.

Source: VA LGY data

Differences in the conditions of local economies, State laws and regulations, and the level of workload/staffing ratios affect variations in the FATS ratio across RLCs and years. Workload/staffing ratios are uneven across RLCs, resulting in lower FATS ratios for RLCs with relatively less staff. The Denver RLC, for example, which has relatively fewer supplemental servicing staff, actually experienced degradation in its FATS ratio between 1996 and 2003.

The FATS ratio is strictly an outcome measure and does not account for inputs used in loan servicing or RLC area-specific factors that may affect performance. VA central office management team for the loan program is aware of this issue but has no direct control over the allocation of its staffing resources across RLCs. Higher level management staff within VBA make staffing allocation decisions among the RLCs and across the major VBA programs, including Compensation and Pension.

Survey Analysis of Borrowers with Defaulted Loans

Profile of Borrowers with Defaulted (Cured) Loans

The Study Team conducted a survey of borrowers who received default assistance from their lender or VA and avoided foreclosure. These borrowers are referred to as “cured.” Table 7-8 displays the breakdown of race for the cured borrowers. Almost two out of three (64.1%) of the cured borrowers are White, whereas 27.3 percent are Black. This differs significantly from the overall sample, where 78.2 percent were White and 14.1 percent were Black or African American. Thus, a higher percentage of African American participants and a lower percentage of White participants had cured loans in comparison to the proportion in the overall sample. The breakdown of age and sex of the cured sample did not differ significantly from the overall sample, as the average age was 43.88 and 92.5 percent of the cured participants were male.

Table 7-8. Racial Composition of Cured Respondents

Race	Cured Borrowers	Total Borrowers
White	64.1%	78.2%
Black or African American	27.3%	14.1%
Asian/Pacific Islander /Native American/ Hawaiian, or Alaskan	2.4%	2.1%
Other	8.6%	6.1%
Total	100% (N=418)	100% (N=618)
Refused to Answer	6	0
Number of Respondents	424	618

Source: VA Loan Survey, Q32

Table 7-9 displays the financial breakdown of the cured respondents. The mean asset of the cured participants was close to $7,000 ($6,937), which is more than double the median asset ($2,704). The respondents who had cured loans had fewer assets than the rest of the population of participants. Compared to the total borrowers, the cured participants had only about one half of the mean and median asset levels. The mean income-to-debt ratio for the cured sample is 39.1 percent, and the mean is 40.0 percent. Both of these figures are approximately two percentage points higher than the total borrowers, however they were not found to be significantly different compared to the total borrowers. The mean and median gross incomes at time of loan application are $46,327 and $43,980, respectively. These represent approximately a 15 percent drop from the overall sample results. The breakdown of the gross income in 2002 further displays how the cured sample's participants earn less money than the overall sample. Survey results on income adequacy indicate that the participants with cured loans are in a more serious financial state than the other participants; 13.4 percent of the cured participants, compared with only 2.6 percent of the other survey respondents, indicated that they had to make serious sacrifices and were forced to cut back on basic necessities. In addition, 37.3 percent of the cured respondents, compared with 17.9 percent of the other respondents, answered that they could only afford basic amenities, with little or no money left.

Table 7-9. Finances of Cured Respondents

Response	Cured Borrowers	Overall Sample
Assets (GIL)		
Mean	$6,937	$14,440
Median	$2,704	$4,904
Income to Debt Ratio (GIL)		
Mean	39.1%	37.4%
Median	40.0%	38.0%
Gross Income at time of Loan Application (GIL)		
Mean	$46,327	$55,080
Median	$43,980	$50,472
Gross Income in 2002 (Q39)		
$30,000 or less	18.5%	8.8%
$30,001 to $40,000	15.7%	13.9%
$40,001 to $50,000	19.5%	16.4%
$50,001 to $75,000	30.9%	35.5%
$75,001 to $100,000	11.4%	16.4%
More than $100,000	4.0%	9.0%
Total	100% (N=421)	100% (N=611)
Refused to Answer	3	7
Number of Respondents	424	618
Income Adequacy (Q38)		
You can take care of living expenses, and have some money left over	49.3%	79.5%
You can afford only basic necessities, with little or no money left	37.3%	17.9%
You have to make major sacrifices and cut back on basic necessities	13.4%	2.6%
Total	100% (N=424)	100% (N=616)
Refused to Answer	0	2
Number of Respondents	424	618

Source: VA Loan Survey, Q38 and Q39, and VA LGY GIL data

As shown in Table 7-10, the loan status prior to becoming cured was mostly default servicing (32.9%) and foreclosure initiated, sale date announced, or bidding instructions issued (33.8%). Most of the participants had at least one contact with VA; only 6.1 percent indicated that they did not. Nearly one fifth of the participants indicated that they had more than 10 contacts, and 62.5 percent used the loan toward the purchase of a home, whereas 37.3 percent used it toward a refinance of a previous purchase.

Table 7-10. Loan Status, VA Contacts, and Loan Purpose

Response	Percentage
Loan Status Prior to Becoming Cured	
Defaults: Pending Classification, Payment Plan, Forbearance, Insoluble	20.7%
Default Servicing	32.9%
Foreclosure Initiated, Foreclosure Sale Date Announced, Bidding instructions Issued	33.8%
Intent: Pending Classification, Servicing, Payment Plan, Insoluble, Forbearance	2.7%
Total	100% (N=347)
Missing	77
Number of Respondents	424
Number of VA Contacts	
None	6.1%
1–2	15.4%
3–4	20.9%
4–5	16.7%
6–10	19.6%
Greater than 10	21.2%
Total	100% (N=424)
Refused to Answer	0
Number of Respondents	424
Average	7.34
Purpose of Mortgage	
Condominium	0.2%
Home	62.5%
Refinance	37.3%
Total	100% (N=424)
Refused to Answer	0
Number of Respondents	424

Source: VA LGY data

Service Provided by Lenders and VA

As indicated in Table 7-11, most of the lenders provided information about what the liabilities would be in the event of a default or foreclosure; only 31.1 percent indicated that they did not receive the relevant information.

Table 7-11. Information on Default or Foreclosure

Response	Percentage of Cured Respondents
Did your lender provide information about what your and VA liabilities would be in the event of default or foreclosure on your VA mortgage? (Q26)	
Yes	68.9%
No	31.1%
Total	100% N = 318
Refused/Don't Recall	106
Total Respondents	424

Source: VA Loan Survey, Q26

Table 7-12 indicates that VA contacted a higher percentage of participants than the lender did. Almost 40 percent of respondents indicated that their lender contacted them to offer assistance for late mortgage payments, whereas 45 percent indicated that VA contacted them.

Table 7-12. Lender and VA Contact

Did your lender/VA ever contact you to offer assistance because you were late on mortgage payment(s)? (Q27) and (Q28)		
Response	**Contact by Lender**	**Contact by VA**
Yes	39.7%	45.4%
No	60.3%	54.6%
Total	100.0% N = 423	100.0% N = 423
Refused/Don't Recall	1	1
Total Respondents	424	424

Source: VA Loan Survey, Q27 and Q28

Assistance from Lender

Among the cured participants who were contacted by their lender for mortgage payment assistance, nearly all of them (94.6 percent) received some assistance from a lender (Table 7-13). Of the 94.6 percent who received assistance, 47.6 percent indicated that the lender accepted lower or partial payments to help temporarily solve financial issues. Ninety-six percent of these participants also indicated that the assistance they received on this subject was worthwhile. Borrowers found the lender's adjustment of the term of the loan to lower monthly payments to be worthwhile assistance; 84.6 percent indicated this. Another 90.9 percent of the cured participants found the lender's assistance in reducing the interest to lower the monthly payment to be worthwhile.

Table 7-13. Lender Assistance

Response	Percentage of Cured Borrowers	Number of Valid Respondents
How much assistance did your lender provide? (based on Q27.1)		
None	5.4%	11
Some Assistance: (See below for breakdown)	94.6%	156
Total	100.0%	167
Refused to answer	1	
Number of Respondents	168	
What type of assistance did your lender provide? (Q27.1) Which type(s) of assistance were worthwhile? (Q27.2) Mark all that apply.		
Accepted lower or partial payments temporarily until you solved your problem	47.4%	74
Worthwhile?	95.9%	71
Advised you to consolidate other debt to reduce monthly obligations	22.4%	35
Worthwhile?	60.0%	21
Increased monthly payments to catch up the amount of the late payments	19.9%	31
Worthwhile?	61.3%	19
Adjusted the term of the loan to lower monthly payment	8.3%	13
Worthwhile?	84.6%	11
Reduced the interest to lower the monthly payment	7.1%	11
Worthwhile?	90.9%	10
Accepted lower or no payments until you sold your home	2.6%	4
Worthwhile?	50.0%	2
Other	14.1%	22
Worthwhile?	68.2%	15

Source: VA Loan Survey, Q27.1 and Q27.2

Assistance from VA

Table 7-14 shows that among the cured participants who were contacted by VA for mortgage payment assistance, only a small percentage (12.9%) indicated that they received no help from VA. Of the 87.1 percent who received assistance from VA, 50 percent acknowledged that they received help in working out a repayment plan with the lender, and 39.4 percent indicated that they received financial counseling from VA. In contrast, no one indicated that VA gave assistance in paying off the existing loan so that they could sell their home and remove debt. Similar to the participants' experience with the lender, the assistance from VA was found to be worthwhile in some cases and not in others. All of the participants who received help in the form of purchasing their loan from the lender found the assistance from VA to be worthwhile. In addition, 84.6 percent who were helped by VA to modify the original loan found the help to be worthwhile, and another 83.6 percent who were provided financial counseling from VA found it to be worthwhile.

Table 7-14. VA Assistance

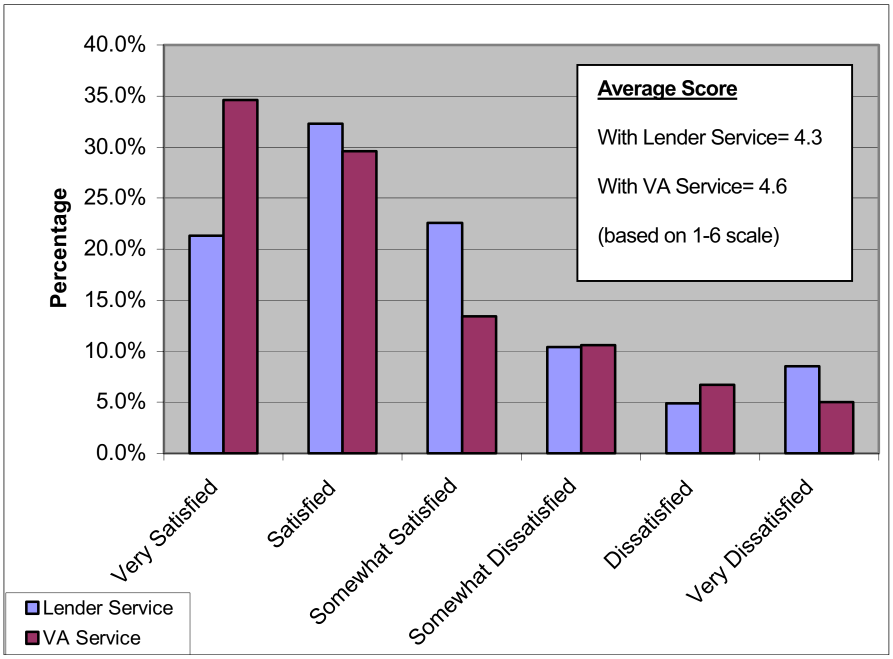
Response	Percentage of Cured Borrowers	Number of Valid Respondents
How much assistance did VA provide? (based on Q28.1)		
None	12.9%	22
Some Assistance: (See below for breakdown)	87.1%	170
Total	100.0%	192
Refused to answer	0	
Respondents	192	
What type of assistance did VA provide? (Q28.1) Which type(s) of assistance were worthwhile? (Q28.2) Mark all that apply.		
Helped you work out a repayment plan with your lender	50.0%	85
Worthwhile?	80.0%	68
Provide financial counseling	39.4%	67
Worthwhile?	83.6%	56
Helped to modify the original loan, e.g., extend the loan period	12.9%	22
Worthwhile?	84.6%	22
Encouraged you to sell your home to avoid foreclosure	8.2%	14
Worthwhile?	42.9%	6
Sent information by mail	4.7%	8
Worthwhile?	50.0%	4
Purchased your loan from your lender and worked out new terms	3.5%	6
Worthwhile?	100.0%	6
Accepted the deed on your house for you to avoid foreclosure	0.6%	1
Worthwhile?	0.0%	0
Paid off existing loan so that you could sell your home and remove your indebtedness	0.0%	0
Worthwhile?	0.0%	0
Other	8.2%	14
Worthwhile?	71.4%	10

Source: VA Loan Survey, Q28.1 and Q28.2

Satisfaction with the Service Provided by Lender and VA

As shown in Figure 7-4, overall, cured participants are more satisfied with the assistance they receive from VA than with the assistance they receive from the lender. Approximately 13 percent more participants were very satisfied with the assistance provided from VA, as compared to satisfaction with lender assistance. A higher percentage (65%) of those who received VA service are satisfied or very satisfied, compared to those who received lender assistance (53%).

Figure 7-4. Overall Satisfaction with Lender and VA Assistance



Source: VA Loan Survey, Q27.3 and Q28.3

Comparison to HUD Program for Loss Mitigation

FHA loan mitigation has been examined and evaluated at different points in time over the past 10 years or so. Comparison of VA and HUD (FHA) loss mitigation yields a number of differences due to history, intent, and other factors. One key difference between the programs is that the FHA loss mitigation program is carried out through loan servicers, not HUD staff, whereas VA staff carries out VA supplemental servicing.

A November 2000 report for HUD, *An Assessment of FHA's Single-Family Mortgage Insurance Loss Mitigation Program: Final Report*, provided an in-depth assessment and recommendations for improving the performance of FHA's loss mitigation efforts. The study shows that 5 percent of default episodes had received loan mitigation treatment as of 1999. This measure is complicated in that the final default rate cannot be calculated until all defaults have occurred or been resolved for a given loan cohort, which can take years to perform.

The FHA study recommended that better communication with loan servicing firms should be implemented. The variability in the rate at which loss mitigation across communities and service providers was found to be due to different rule and policy interpretations, as well as to many reasons related to internal challenges faced by FHA loan default servicers. The report advised that these issues could be reduced through clear and consistent communication.

A range of incentives and penalties was suggested to induce compliance with and adoption of loss mitigation policies. The development of an improved assessment of lender performance was recommended. According to the study, a lender score needed to be tied to an adoption of loss mitigation use. The study concluded that expansion and improvement of data collection were needed to enhance the efficacy of loss mitigation. Change in program rules crafted to improve program performance was also recommended as a performance-enhancing step.

VA supplemental loan servicing program could provide useful lessons for the FHA loss mitigation effort. VA maintains frequent and vigorous communications with its lenders and devotes a significant amount of its own in-house resources to default intervention.

Conclusions

The factors contributing to default and foreclosure are attributable to a number of factors. The leading reason identified for default and/or foreclosure is loss of or reduced income. Many factors causing loss or reduction of income, including but not limited to unemployment, underemployment, change of jobs, change in marital status, and disability, are identified in the economics and finance literature as being significant. Distillation of transcripts of VA staff conversations with VA loan borrowers in default confirms these widely cited reasons for default.

Some of the individual characteristics found to contribute positively to the probability of a VA loan being in default include active duty service status. Borrowers who are on active duty are more likely to default than veterans are. Younger borrowers are also more likely to default. Those who do not qualify for a conventional mortgage are more likely to default. Those with high loan-to-value ratios and lower income are also more likely to be in default.

We compared regional changes in VA's FATS ratio for the years 1996 to 2003. The FATS ratio is basically the number of successful interventions and other default avoidance outcomes divided by the number of foreclosures plus the number of successful interventions and other default avoidance outcomes for a given year or month. Differences between the FATS ratios of the nine VA RLCs are compared for the 1996 to 2003 period. Significant improvement in the FATS ratio occurred between 1996 and 2003 for all of the RLCs except one. Differences in the FATS ratio occur among the RLCs. We also find that VA's default and foreclosure rates are significantly lower than those of FHA, yet remain higher than those of conventional mortgages.

Reasons such as regional variations in housing markets and mortgage laws contribute to differing rates of default and foreclosure among the different RLCs. Situations where there exists an "upside-down mortgage" have also been cited in various studies as contributing to increasing the rate of default and foreclosure. An upside-down mortgage occurs when the loan-to-value ratio is over 100 percent, meaning that the mortgage is greater than the value of the home. A large number of variables contribute to regional variability in housing market characteristics and dynamics, which, in turn, affects the rate of default and foreclosure. This is an area for more research that can contribute to developing better loss mitigation targets and resources. In general, the determination of those factors and issues contributing to a loan being in default is important in developing policies to enhance the effectiveness of VA's loss mitigation efforts.

A general recommendation from our study then is to expand the development and application of statistical analysis of VA loan defaults and foreclosures on an ongoing basis to better inform management and stakeholders of trends, variations, and causal factors. The analysis presented in this chapter is illustrative, but more could be done. Additional variables could be added, such as indicators of the condition of local economies, FICO scores, workload/staffing ratios, and other variables that reflect changes in management policy or differences across RLCs. In addition, there are geographically determined regulatory and legal factors that vary by States, which affect the length and probability of foreclosure versus other outcomes. On the basis of statistical analysis, FATS ratio targets could be adjusted depending on variations in local economic conditions, laws, workload/staffing ratios, and other factors. The advanced multivariate analysis illustrated in this report also neutralizes the effects of certain loan origination characteristics that VA has little or no control over, such as age of borrower and active duty status.

VA LGY default data are generally limited to only those defaults reported by lenders to VA as being seriously late (i.e., more than 105 days late). VA loan data system reports the number of defaults and interventions by RLC and month, but not by category of loan or borrower (such as veterans, active duty, and reservist) or by demographic characteristic (such as age). The Study Team recommends that the VA loan tracking system should routinely report defaults and foreclosures by these categories and for other categories of borrowers who are generally at greater risk of default and foreclosure. In addition, tracking of defaults should be done for loans in default sooner than 105 days. Defaulted loans of less than 105 days late are generally not in the VA loan data system because lenders are not required to report them sooner. However, as part of the effort to seek a greater collaboration with private lenders to provide supplemental servicing, this step should be taken.

The Study Team also conducted a survey of borrowers who received lender or VA default assistance in cases where foreclosure was avoided. Analysis of the survey responses revealed that borrowers are more satisfied with the assistance they receive from VA than with the assistance they receive from the lender. Approximately 13 percent more of the participants were very satisfied with the assistance provided from VA, compared to those who were satisfied with lender assistance. A higher percentage (65%) of those who received VA service are satisfied or very satisfied, compared to those who received lender assistance (53%).

8. ROLE OF LENDERS, APPRAISERS, AND REAL ESTATE PROFESSIONALS

Chapter 8 first addresses whether Government staff, fee personnel, lenders, appraisers, and real estate personnel are aware of and consistently follow Veterans Benefits Administration (VBA) rules and guidelines, and if not, identify best practices and recommend solution strategies. Second, it examines the VA process for obtaining and certifying appraisers, and identify similarities and differences from other institutions that are regularly engaged in making housing loans. Third, Chapter 8 examines the use of adjustable rate mortgages (ARMs) as part of the VA Home Loan Guaranty program. Finally, this chapter determines the extent to which veterans, participating lenders, and interested real estate professionals have been notified and made aware of the availability of loan guarantees under 38 U.S.C., Section 3710, Chapter 37, for energy efficiency improvements to include solar heating and cooling and application of residential energy conservation measures.

The Study Team met with VA officials and staff of the National Association of Home Builders (NAHB), the National Association of Realtors (NAR), and the Mortgage Bankers Association of America (MBAA). The Study Team also conducted interviews with nine VA appraisers, nine VA lenders, and nine real estate professionals (including both real estate brokers and real estate agents).[1] Sources of information include the 2001 and 2002 Lender Satisfaction Surveys, conducted by VA, and the 2003 VA Borrower Survey, conducted by the Study Team. Where appropriate, administrative data were included.

Interviews with appraisers, lenders, and real estate personnel were in the form of open-ended discussions, rather than formal interviews. The meetings and interviews included the discussion of the following topics: VBA rules and guidelines; the Home Loan Guaranty Handbook for Lenders and Appraisers; VBA audit and review procedures; the certification process for appraisers; ARMs; and awareness of energy efficiency improvement loans.

[1] Appendix J provides detailed information on the interviews conducted.

Rules and Regulations

Current Policy

The Lender's Handbook (VA Pamphlet 26-7) contains the rules and guidelines of the VA Home Loan Guaranty program. It is available online through the VA Home Loan Guaranty Web site.[2] This document is VA's primary mechanism for communicating Federal requirements to lenders, and it includes the following sections:

- Lender: Provides definitions and guidelines for the supervised and nonsupervised
- Veterans' Eligibility and Entitlement: Details how a lender can determine a veteran's eligibility, as well as the process and forms that a veteran must submit in order to obtain a certificate of eligibility
- The VA Loan and Guaranty: Presents the basic elements of a VA-guaranteed loan, maximum loan limits, and maximum guaranty amounts
- Credit Underwriting: Presents guidelines for underwriting a VA-guaranteed loan
- How to Process VA Loans: Presents the requirements for processing a VA loan
- Refinancing Loans: Presents the different refinancing options available to veterans
- Loans Requiring Special Underwriting, Guaranty, and Other Considerations: Covers joint loans, construction/permanent home loans, energy efficiency improvement guarantees, and various other loans requiring special underwriting, guaranty, and other considerations
- Borrower Fees and Charges and the VA Funding Fee: Outlines VA's policy on fees and charges paid by the veteran/borrower
- Legal Instruments, Liens, Escrows, and Related Issues: Contains guidelines on various property concerns
- Property Eligibility and Appraisal Requests: Covers everything related to obtaining an appraisal for a VA-guaranteed loan
- Appraiser Requirements: Presents detailed guidelines on appraisal reporting requirements, approaches to value, selection and market of comparable sales, minimum property requirements and repairs, proposed construction, and liquidation appraisals

[2] http://www.homeloans.va.gov.

- ► Minimum Property Requirements (MPRs): Details the guidelines for proposed construction MPRs, basic MPRs, and other issues related to MPRs
- ► Value Notices: Covers the lenders responsibilities in issuing notices of value
- ► Construction Inspections: Presents the guidelines for obtaining an inspection and when an inspection should be scheduled, as well as the lender use of inspection reports
- ► Lender Appraisal Processing Program (LAPP): Details what lenders are eligible to participate in LAPP, the quality control mechanisms that must be in place, SAR (staff appraisal reviewer) training, the lenders' responsibilities under LAPP, and the LAPP processing procedures
- ► Common Interest Communities, Condominiums, and Planned Unit Developments: Presents the requirements for properties in common interest communities, as well as the use of attorney's opinion (that project meets VA requirements)
- ► Sanctions against Program Participants: Outlines who can receive sanctions and what actions qualify for sanctions.

Concerns about Loan Program Guidelines

Maximum Loan Amount

Lenders and real estate personnel residing in areas with a low-cost housing market indicated that the limit had little effect on their business or their industry, stating that the guaranty limit covered most housing costs in the area. Lenders and real estate agents living in higher cost areas or in areas with a mix of housing costs feel that the loan amount should be higher. Lenders suggested that a higher loan limit would encourage a better quality of borrower and help their portfolio of VA loans.

Additionally, many lenders and realtors mentioned the effects of the rising housing costs overall. With an increased loan guaranty amount, VA could increase the number of VA loans and potentially make home ownership easier for some veterans. Many veterans do not win bids since they cannot make up the difference between the guaranty limit and the owner's asking price.

Industry stakeholders told the Study Team that the effective maximum VA loan limit (i.e., four times the amount guaranteed, which is the traditional secondary market requirement for VA loans with no down payment) lags behind the ceiling for conventional loans in the private industry and that they would like to see it indexed similarly to how the Federal Housing Administration (FHA) program indexes its loan limit. The statutory ceiling on FHA-insured loans on a nationwide basis is 87 percent of the Fannie Mae/Freddie Mac conforming limit for conventional loans. The maximum insured loan that can be approved in a particular county is the lesser of the statutory ceiling and 95 percent of the area median house price as measured by the U.S. Department of Housing and Urban Development (HUD). Similarly, VA program officials would like to see the effective limit indexed at 90 percent of the Fannie Mae/Freddie Mac conforming limit for conventional loans.

According to VA program officials, the current guaranty is more than enough, except in high-cost areas. However, Congress does not adjust the guaranty amount every year, so that over time, a significant lag will develop. VA program officials mentioned that members of Congress believe that they are being responsive to increasing housing costs, but the officials think that the limit lags significantly behind for the high-cost areas.

Use of Residual Income Instead of Debt Ratios

Many lenders commented on VA's use of residual income instead of debt ratios. Debt ratios, commonly used by FHA and conventional lenders, include the housing ratio and the total debt ratio. The housing ratio (also known as the front ratio or top ratio) is the total monthly mortgage payment (principal, interest, taxes, and insurance) divided by the borrower's total monthly gross income. The total debt ratio (also known as the back ratio or bottom ratio) is the sum of the borrower's total monthly housing payment plus other monthly debt payments, divided by the total monthly gross income.

VA uses two methods of calculating a borrower's ability to repay a mortgage:

- A maximum total debt ratio of 41 percent (VA does not use a housing ratio)
- A calculation to determine residual income, which is the money remaining after all housing expenses have been paid.

Although some lenders believed that this was a more common sense approach for the purpose of VA loans, many lenders were adamantly against the use of residual income, stating that by moving to debt ratios, VA will be more in line with conventional and FHA loans and will ease lenders' resistance to spending time underwriting VA loans.

Fees

The main suggestion for the improvement of the handbook was for the section "Borrower Fees and Charges and the VA Funding Fee." Most lenders interviewed did not understand what the borrower can and cannot pay at signing. When asked about the explanation provided by the handbook and the Web site, they explained that the language was confusing and the lenders therefore could not discern what the veteran can or cannot pay.

Sources of Information

Industry stakeholders obtain information about the VA Home Loan Guaranty program through three primary sources: the VA Web site, the Lender's Handbook, and annual meetings. All lenders and appraisers interviewed by the Study Group indicated that their primary source of information was the VA Lender's Handbook, which is available on the VA Web site. Supplemental information was obtained from the VA Web site, and annual meetings provided updates. The VA Lender Satisfaction Survey found that 44 percent of lenders in 2002 and 42 percent of lenders in 2001 obtain information on VA policies and procedures from the Web site and approximately 36 percent in 2002 and 39 percent in 2001 obtain information from the Lender's Handbook. Consistent with the results found from the Study Team interviews, the 2002 VA Lender Satisfaction Survey found that 96 percent of lenders reported that in performing their job, the Lender's Handbook was very or somewhat helpful.

All appraisers indicated that information was also obtained at the annual VA meetings. They used these meetings as a way to stay updated on the most recent changes to VA rules and guidelines. These training sessions were unanimously viewed as value-adding experiences.

According to the 2002 VA Lender Satisfaction Survey, only about 4 percent of lenders reported VA-sponsored training events as a method of obtaining information. This is an increase of 1.5 percent from the 2001 survey. Thirty-eight percent of respondents had attended a VA-sponsored training event in the past 12 months. This is a significant increase from 25.9 percent in 2001. However, only 53 percent of respondents were very and somewhat satisfied with how often VA offers these training sessions.

All real estate agents interviewed had not used VA sources for information on the VA Home Loan Guaranty program. They instead obtained information primarily through lenders. The real estate brokers also obtained information primarily through lenders, but they had referenced the VA Web site for additional information.

The general response regarding how VA could perform more effective outreach to real estate professionals was to provide education programs as they do for lenders and appraisers. One solution is for VA to collaborate with NAR by participating in its annual national and regional conferences or offering certification through its professional development courses. Offering free continuing education credits to real estate professionals in as many States and jurisdictions as possible will result in greater awareness and therefore greater compliance with rules and guidelines. The Study Team recommends first pinpointing education efforts in areas with a high VA loan concentration since each location has different standards.

Awareness of VA Loan Rules and Guidelines

Most appraisers and lenders interviewed had been appraising for VA for over 10 years and were therefore very familiar with the loan rules and guidelines. Their extended experience and continuing education (through annual meetings) ensured their awareness of the VBA rules and guidelines and any changes to these standards.

The awareness of VBA rules and guidelines for real estate professionals was weak in comparison to that of appraisers and lenders. The real estate professionals indicated that they had a general idea of the benefits of the loan but had to obtain information for eligibility from lenders or NAR. Since real estate professionals often have the most contact with the veteran (and often suggest financing options), it is important that these professionals be familiar with the rules and regulations of the VA Home Loan Guaranty program. The more familiar the real estate professional is with VA rules and guidelines, the more comfortable they will feel with suggesting the VA loan as a financing option.[3]

Industry stakeholders mentioned that lenders are not always made aware of the latest VA policy or program changes in a timely manner (e.g., assumption fee increases). Lenders and appraisers were concerned with finding updates to VA rules and guidelines on the VA Web site. Currently, updates are posted in the "What's New" section of the VA Web site. Because there is no notification system or e-mail distribution list, users must continually check the site for updates. To help alleviate this problem, VA is developing a Web portal for program participants. This system will have the capability to send push e-mail to users and supply lenders with any updated information. Since the portal only has a 100,000-user capability, VA would need to purchase an enterprise-wide license for the portal, costing up to $2 million. Obtaining funding for such an endeavor would need to be a VBA-wide proposal.

VA needs to optimize the options currently available to notify users of any updates. The most useful option is to continually update the Lender's Handbook, in addition to consistently updating the "What's New" section. However, software problems prevent updates from being made continually to the handbook. When an update is made, a new version should be offered on the Web site. If there are multiple updates, multiple versions will exist on the site. This is a problem that is currently being investigated and remedied by the VA Loan Guaranty Service (LGY).

The Study Team concurs with LGY in its efforts for short-term solutions; that is, the software causing the handbook update problem will be fixed. Additionally, all updates should be continually posted on the Web site in a timely manner so that all new updates are current. The new lender portal will be used to send push e-mails regarding all changes to rules and guidelines to lenders only.

For the longer term, we endorse the LGY proposal for a VBA-wide portal system for users. Since the programs offered by VBA are highly dependent on the education of program participants, this would be a worthwhile investment. The Study Team recommends administering the same push e-mails for updates to lenders, appraisers, and real estate professionals. These push e-mails should be sent immediately after changes occur to avoid potentially costly mistakes by lenders, appraisers, or real estate professionals.

[3] *Evaluation of the Veteran Administration's Housing Assistance Program*, conducted by Carolyn D. J. Wong and G. William Fouts and published in October 1987, recommended continuing to educate those brokers participating in the program. The evaluation noted, "Homebuyers stand to benefit if real estate brokers are familiar with VA program eligibility and qualification requirements, application processes, limitations of VA loans or guaranties, and the loan approval process so that they can better assist the veteran." Since the agent is normally the first in contact with the veteran, education on the program will deter agents from promoting loans that they are more familiar with (i.e., conventional loans) and encourage them to instead promote a VA loan.

Compliance

Compliance and Educating Personnel

Lenders and appraisers are very confident in VA's method of communicating program requirements through annual meetings, handbooks, and the VA Web site. Training is viewed as a method for ensuring compliance among appraisers and lenders, in particular, for staying up to date on changing rules and guidelines. These methods of education and communication promote compliance among lenders and appraisers by maintaining awareness of the guidelines and any updates. All of these participants indicated that their awareness of the rules and guidelines and their years with the program directly affected their high level of adherence to VA rules and guidelines.

There was one distinct exception for adherence to the rules and guidelines for appraisers. Appraisers indicated that they follow the Lender's Handbook rules and guidelines for the appraisal process when possible. Their own judgment was used when the handbook did not provide guidelines. If the handbook does not provide guidance, the appraiser is expected to comply with USPAP.

At the stakeholder meetings conducted early in this study, MBAA raised a question about whether VA applied the rules consistently in all regions or local areas. VA officials indicated that some inconsistency could occur if employees make their own interpretation of rules, but VA strives to implement the same policies everywhere.

Review and Audit Results

The Loan Guaranty Monitoring Unit ensures that loans are processed and closed in accordance with applicable laws, regulations, and policies. Since 1989, this unit performs oversight of VA lender operations through audits both onsite at lenders' offices and at the unit's main office in Nashville, Tennessee. In addition to the 12 full-time auditors in the Nashville Monitoring Unit, there are about 142 regional loan center (RLC) staff conducting the referenced case reviews and about 150 staff monitoring the lenders.

The Monitoring Unit's audit process determines whether lenders meet the requirements in the following areas in closing loans: income, credit worthiness, loan amount, occupancy of property, interest rate, closing costs, VA's credit standards, property eligibility, and appraisal review guidelines. Lenders are selected on the basis of their 2-year loan volume. For lenders with less than 200 but over 74 loans within the 2-year period, fiscal year audits are scheduled at the Nashville office (i.e., in-house), whereas lenders with over 200 loans are audited at the lender's office (i.e., onsite). The audits on lenders with less than 75 loans in a 2-year period are done on a more ad hoc basis.

Delinquent loans (i.e., those identified as 90 days or more delinquent), loans reported as early defaults, and randomly selected loans from the guaranteed insured loan data are selected for audits. For onsite audits, at least 30 loans are requested, and for in-house audits, 10 percent of the lender's 2-year volume, up to 20 loans, are requested.

A typical audit lasts about 1 week. Ten percent of the closed loans are subject to full reviews. Post audits are also performed on 5 percent of all cases reviewed during the audit. A brief discussion of findings, trends, and discrepancies is provided to the lenders at an exit interview, followed by a preliminary report. Lenders must submit their responses to VA within 30 days of receipt of the report. Then VA issues a final report including any recommendations and penalties.

All appraisers interviewed were familiar with the reviewing and auditing processes at VA. All noted that they had been audited by VA and that audits are helpful in pointing out problems. They indicated that VA was fair and thorough in reviewing their work. One appraiser said that the questions from the VA RLC were specific and logical extensions of the appraisal reports.

Many lenders pointed out that, overall, the review process for lenders was fair and also helped to point out errors in underwriting standards. Many lenders indicated that most audits concerned VA's fee schedule. Lenders suggested that this was caused by the lack of explanation in the Lender's Handbook and on the Web site. Most lenders did not understand what the borrower can and cannot pay at signing. They stated that most audits address veterans paying the wrong fees.

The current sampling method for audits is sufficient in sample size. Since compliance is such an important issue for this program, selecting a sample of 10 percent is an effective way to ensure that the audits successfully determine whether there is noncompliance among their participants. Ten percent is well above the sample size needed to reach generally accepted standards of statistical significance for the number of loans being originated.

However, to maximize the efficiency of the sampling plan, the Study Team recommends moving away from simple random sampling and employing a stratified sampling plan. Stratification would group lenders into subgroups before random sampling. By using strata for sampling, audits can target subgroups of lenders that are more likely to be noncompliant (e.g., new lenders or lenders having a high concentration of high-risk loans, such as ARMs). Stratified sampling can also eliminate the oversampling of certain groups, such as large lenders. The private sector uses statistical models called volition prone profiles to cost-efficiently target resources for audits and quality control.

Obtaining and Certifying Appraisers

Appraisal Process

Currently, real estate appraisers are selected by rotation from an approved appraiser list administered by VA, called the VA Fee Panel. The panel is maintained by each RLC covering the area in which the appraisals are performed. Qualified appraisers are added to the panel on an as needed basis. The application form to become a certified VA appraiser is available online. Each RLC processes its own applications.

All appraisers interviewed were positive about the VA appraisal process, citing that the rotational system allows the appraiser to provide a fair market value for the property with the backing of VA, therefore avoiding the pressure placed on appraisers by lenders for higher appraisals. In discussion of the private industry or FHA, appraisers suggested that they were subject to constant pressure for higher appraisals with relatively no backing from HUD. Appraisers indicated that removing the rotational selection will increase predatory lending. In the opinion of the appraisers, the VA Fee Panel and the ability of VA to supervise this independently has been critical to the success and relatively low loss rate. Although this process is supported by appraisers, the rotational system is not readily accepted by lenders and real estate professionals.

The appraisers interviewed noted that VA's system of looking beyond basic certification and putting appraisers on a trial basis was an effective tool for eliminating inadequate appraisers.

In the view of lenders and real estate agents, appraisers for VA loans may undervalue the property, adversely affecting the loan process for veterans in tight housing markets. One industry representative suggested that VA be given the authority to decide how appraisers are chosen, rather than Congress dictating it.

Although three lenders were satisfied with the appraisal process, the remaining six lenders expressed concern about the appraisal process in several areas:

- VA rotational selection of appraisers versus lender selection
- Inability of a lender to directly contact an appraiser, resulting in long wait times for the appraisal and subsequently delayed approval of the loan
- Perceived poor quality of VA appraisals
- Courtesy and professionalism of VA appraisers
- Timeliness of appraisal process
- Selection of VA appraisers and closed VA Fee Panel.

Real estate personnel reported concerns similar to those of the lenders. In particular, seven real estate personnel believed that VA should open the Fee Panel to all appraisers and develop an open system similar to the FHA Single Family Housing loan program, which allows the lender to choose the appraiser. Other real estate personnel suggested that the main problem is that lenders and real estate professionals are not getting a true appraisal of properties from VA appraisers.

Timeliness by VA appraisers was also a concern for participants of the VA Lender Satisfaction Survey. Only 63 percent of lenders in 2001 and 67 percent in 2002 were very or somewhat satisfied with the timeliness of VA appraisers. Additionally, 67 percent of lenders believed that they received appraisal reports in a reasonable amount of time from appraisers, a significant increase from 44.4 percent in 2001. Furthermore, only 64 percent of lenders in 2002 were very or somewhat satisfied with the courtesy and professionalism of VA appraisers. This reinforces comments made by interviewed lenders.

When legislation was offered as a solution to concerns expressed by lenders and real estate professionals for the rotational selection, the appraisal industry reacted in staunch disagreement. In June 2003, the president of the Appraisal Institute (AI) testified against H.R. 1500, the Veterans Appraiser Choice Act of 2003, which would allow veterans to select their own appraiser. He argued that H.R. 1500 would cause improper client pressure or manipulation of the process, which in turn may contribute to mortgage fraud and predatory lending. He added that in comparison of the VA and FHA systems, more than 80 percent of AI's members find the VA appraisal selection process to be more effective than the conventional or FHA process.[4] He stated that contrary to the concerns of the sponsors of the bill, AI's own research indicates that the VA appraisal process is not too slow. He suggested the following to improve VA's system: an increase in the size of the VA Fee Panels, the requirement of periodic recertification of VA appraisers, active disciplining of poorly performing appraisers, and evaluation of VA appraisal assignments by a group such as the General Accounting Office.

AI suggested increasing the size of the VA Fee Panels as a solution, avoiding the removal of rotational selection. In September 2003 at AI's Summit 2003, VA announced that it is recruiting new appraisers to its panels nationwide. The goal is to increase the number of appraisers by about 40 percent. Eight of nine appraisers interviewed, however, were highly concerned about this new VA initiative to hire more appraisers. They noted that the market high is currently on its way down, resulting in a lower number of VA loans and VA appraisals to be done. With a slowing market, the demand for appraisers will decline. As the volume of VA appraisals drops off, appraisers will be forced to find work other than VA appraisals.

In contrast, one appraiser believed that the hiring initiative was a positive effort. He believed that since many appraisers were nearing retirement, the new appraisers would sufficiently make up this gap and possibly bring in a positive outlook on the VA appraisal process, which is to uphold fair market value for the benefit of the veterans.

Overall, there is tension between the views of the appraisal industry and those of the lending and real estate industries. Among appraisers, the VA appraisal process is regarded as effective in preventing predatory lending and undue pressure on appraisers. The rotational basis and closed VA Fee Panels were fully supported by all interviewed appraisers. Most interviewed lenders and real estate personnel, however, found the VA appraisal process flawed. They disagreed with the closed VA Fee Panel and rotational selection and found VA appraisers to be slow and unapproachable.

In an attempt to resolve these opposing views, it may not be necessary to change the VA appraisal process as a whole, but instead modify the existing process to reach common ground among stakeholders. As proposed by AI in response to the Veterans Appraiser Choice Act of 2003, a solution may be to ensure a high-quality VA appraiser. This could include periodic recertifications, active disciplining of appraisers, and an evaluation of the VA

[4] For conventional and FHA guaranteed loans, appraisers are chosen from a list of appraisers by lenders and mortgage brokers.

appraisal process. An evaluation of the appraisal process could assess the timeliness of VA appraisals, the quality of appraisals, and the effects of expanding the VA Fee Panels and eliminating rotational selection.

Appraisal Rules and Guidelines

Among appraisers, the appraisal rules and guidelines were viewed as satisfactory. Two appraisers, however, believed that VA rules and guidelines for appraisers were becoming more vague and that in order to avoid problems faced by conventional or FHA appraisers, it is necessary to keep VA rules more stringent. Two appraisers expressed concern regarding the fees received from VA by appraisers. They indicated that the fees are competitive, but they have not seen an increase in many years. Costs have increased with inflation, such as higher gas prices but they are receiving the same fee with much higher expenses. Since the VA fee is fixed, unlike many conventional fees, they cannot include inflation, travel, or time compensation in their quote. They suggested an index for fees in order to compensate appraisers.

Even though most lenders and real estate professionals were unsatisfied with the appraisal process, they were satisfied overall with the appraisal rules and guidelines. They suggested that, over time, guidelines had become more liberal and often more lenient than those of private sector and FHA loans. Specifically, they indicated that VA was not as particular about mobile home issues, net and gross adjustments, and limits on the size of properties. The primary difference noted by multiple lenders and real estate personnel was VA's emphasis on particular conditions to be in place on the property (e.g., painting). However, VA officials stated that there is a misconception on the part of lenders and real estate personnel concerning the differences in property standards.

VA Appraisal Standards Versus Conventional and FHA Loans

All appraisers follow the Uniform Standards of Professional Appraisal Practice for conducting appraisals. VA differs from other appraisals in two ways:

1) VA does not require appraisers to use a cost approach that estimates the current market value of the home by estimating the cost of reconstructing the home including any improvements, plus the value of the land minus the estimated depreciation of the home since the home was first built. Instead, the appraisers use the market comparison approach, which compares and contrasts the property under appraisal with recent offerings and sales of similar property.

2) The second difference is that VA requires major repairs to be made to the house before closing. VA receives a list of substandard items that need repair, and those items must be fixed or replaced before closing. In some cases, repairs may be made after closing.

Several appraisers commented on the difficulties arising from the second difference, the requirement that repairs must be made to the house prior to closing. They indicated that the criteria were similar up to the point where they needed to report minimum property standards. At this point, VA requires property that is "safe, sound, and sanitary." The requirements under this guideline often lead real estate professionals and lenders to assume that appraisers are overemphasizing certain cosmetic characteristics of the property, when the appraisers are actually following the guidelines set by VA. This conflict was cited as a problem that could be solved by the education of real estate personnel and lenders regarding VA appraisal rules and guidelines and the distinct differences between VA, FHA, and conventional appraisal standards.

Some of the appraisers interviewed suggested that VA appraisal guidelines were perceived as being more strict than conventional rules. Although the standards are higher, they were viewed as beneficial to both VA and appraisers. Higher standards are needed for guaranteed loans, and strict rules and guidelines leave little leeway for VA appraisers to make mistakes in appraisals. This creates less pressure for the appraiser while having VA support their judgments.

Interviews with appraisers revealed two main perceived differences between VA and FHA programs. First, appraisers believed that the role of appraisers in the loan process was different in each program. When conducting appraisals for VA, appraisers filled a narrow role to determining a fair market value of the property for the purpose of the loan. FHA appraisers, however, were turning into home inspectors.

As with appraisers, lenders perceived VA standards and guidelines to be more thorough than FHA or conventional guidelines. Although lenders looked at the basis of the VA home loan as being more lenient (i.e., no cash investment, no documentation for closing cost funds, documentation requirements not as "heavy" as those of FHA), they believed that the rules and guidelines were geared more toward veterans and this type of loan (i.e., no down payment). Many lenders suggested that the main differences came in the appraisal standards, not the underwriting standards, to compensate for the benefits of this loan offered to veterans.

As with appraisers and some lenders, real estate personnel believed that VA loan rules and guidelines were more thorough than FHA and conventional standards. Although they take more time to complete and require more paperwork, all real estate professionals indicated that the strict rules are to the benefit of the veterans because the VA loan is more secure.

Barriers to the Approval of VA Loans

Certain issues between appraisers and lenders and the VA Fee Panel were identified by respondents as barriers to the approval of VA loan applications. Repairs that need to be made before the loan can close can be an impediment, especially in a tight housing market. Although this is meant to protect the veteran and the Government's investment, from the seller's perspective it may be a hassle to make the repairs required by VA.

The most common response to whether there were any barriers to the approval of VA appraisals was the relationship between appraisers and lenders. Five appraisers indicated that some lenders will not make VA loans because they cannot handpick appraisers. The appraisers feel that the lenders and real estate agents try to force their opinions on the appraisers regarding the value that they *want* on the appraisal versus the value that the appraiser deems as the fair market value.

One appraiser noted that the independence of the appraiser VA Fee Panel has caused significant problems with the approval of their appraisals and the strength of the relationships between appraisers, lenders, and real estate agents. This appraiser felt that the lenders were threatened by the independence of the appraisers and their lack of control.

Another appraiser noted the effect of the lenders' emphasis on higher appraised values. When interest rates began falling, the appraisers were using comparative sales within the past 6 months, and therefore estimates were lower. Consequently, the lenders thought the appraisals were too low and were slowing the approval process by continuing to question their estimates.

Other appraisers felt that the LAPP lenders were not necessarily a barrier to the approval of appraisals but that they slowed the process. Several appraisers stated that LAPP lenders are not as knowledgeable of VA rules and guidelines as VA regional office staff members are and that there tends to be more questions on VA underwriting requirements. The consensus was that these LAPP lenders are poorly trained and are trying to make the VA appraisal look like a conventional appraisal.

The primary suggestion was to improve the relationship between appraisers, lenders, and real estate agents. One appraiser stated that lenders and real estate agents need more education on the key differences between conventional and VA appraisal standards to prevent undue pressure on appraisers. Another suggestion was to continue the annual meetings but possibly include the LAPP personnel, lenders, and appraisers so that the entire system of stakeholders receives the same information.

Adjustable Rate Mortgages

Historical Background

In 1992, the VA Home Loan Guaranty program was the only major mortgage market participant without the authority to issue an ARM. During opening statements for the House Committee on Veterans' Affairs hearings on the loan guaranty program, Representative Payne commented that since the ARM had been the "mortgage of choice in the last 5 years," it was time VA followed industry trends.[5] The Veterans Home Loan Program Amendments of 1992, Public Law 102–547, enacted on October 28, 1992, included implementing a 3-year test program for ARMs during fiscal year (FY) 1993, FY 1994, and FY 1995. The VA ARM was to be structured similarly to the FHA ARM. The program had safeguards to prevent a significant escalation in rate from one year to the next (1 percentage point) and an overall limit on the cumulative escalation over the term of the loan (5 percentage points). VA was also directed to establish separate underwriting standards for approving ARMs to minimize the chances of the veteran defaulting on the loan if the interest rate increased.

[5] House Committee on Veterans' Affairs, Oversight Hearings of DVA Loan Guaranty Program, H.R. 939 and H.R. 1384, 102nd Congress, 1st Session, Serial No. 102-10, May 2, 1991, p. 3.

In authorizing the ARM demonstration, both the House and Senate Committees on Veterans' Affairs were diligent in incorporating safeguards to prevent or minimize the potential for default problems. These included a program design similar to the FHA program, strict underwriting requirements for ARM guaranteed loans, and annual reporting requirements so that Congress could monitor experience with the demonstration. The House report expressed the shared concern about helping veterans obtain housing without exposing them to financial difficulties.

Public Law 104–110, enacted on February 13, 1996, allowed the test program for ARMs to lapse. The decision to terminate ARM authority appears to have been entirely outlay driven. In his justification for not extending ARMs, Senator Simpson indicated that he had preferred to extend the program for 2 years and then make it permanent. However, this intention had been reversed by Congressional Budget Office (CBO) cost estimates that indicated that the ARM program would produce additional VA outlays of $36 million in FY 1996 and $33 million in FY 1997.[6] The higher default and foreclosure rates of the VA ARM meant higher losses and costs for VA. Table 8-1 shows the higher foreclosure rates of ARMs versus those of fixed rate loans. Approximately 1.35 million fixed rate loans originated in FY 1993–96, while about 139,000 ARMs originated during this period.

Table 8-1. Comparison of VA Liquidation Rates: ARMs versus Fixed Rate Mortgages

Fiscal Year	Fixed Rate	ARMs	ARMs vs. Fixed
1996	6.46%	10.66%	65.1% Higher
1995	6.71%	8.38%	24.9% Higher
1994	5.46%	10.04%	83.8% Higher
1993*	5.73%	10.58%	84.5% Higher
OVERALL	5.95%	9.52%	60.0% Higher

Source: VA LGY data

**Note: The ARM program was effective from November 1992 through November 1995. Figures for FY 1993 only include 11 months.*

VA introduced a second pilot program in 2002. The Veterans Benefits Act of 2002, Public Law 107–330, enacted on December 6, 2002, implemented a 2-year test of a hybrid interest rate program to run during FY 2004–05. Similar to the pilot program established by Public Law 102–547 in 1992, the new authority places restrictions on the amount of increase in the interest rate from year to year and over the life of the mortgage. For example, the maximum year-to-year increase or decrease is limited to 1 percentage point. Over the term of the mortgage, the maximum increase above the initial contract interest rate is 5 percentage points. The initial rate of interest must remain fixed for a minimum of 3 years, and annual adjustments thereafter will be based on a national interest rate index approved by VA, subject to the 1 percentage point cap on annual adjustments. The provision also requires VA to develop underwriting standards for hybrid mortgages.

[6] Congressional Record—Senate, January 5, 1996, p. S104.

In its report on the bill, the Senate Committee on Veterans' Affairs supported the test of hybrid interest rates, commenting that the loan guaranty program should provide financing options that are competitive with practices in the private mortgage market.

> "The VA Home Mortgage Loan Guarantee program, established in 1944 by Public Law 78–346, was meant to help veterans readjust to civilian life following service in World War II. As private mortgage lending practices have evolved, this VA guaranty program has not kept pace."
>
> "For more than a decade, adjustable rate mortgages (hereinafter "ARMs") have been commonplace in the home loan market…"
>
> "More recently, hybrid adjustable rate mortgages have gained prominence within the home mortgage industry…"
>
> "Currently, VA is the only major mortgage market participant without authority to guarantee ARMs and hybrid ARMs. These options are available under the Federal Housing Administration's loan insurance program. The Committee believes that a pilot program should be established to determine if these loan options would significantly benefit veterans seeking to purchase a home by creating greater flexibility in financing options."[7]

Including ARMs was seen as an important way for the VA Home Loan Guaranty program to keep up with trends in the industry. As this financing option had matured, many of the initial problems in the conventional market that caused higher foreclosure rates had been corrected. These corrections involved limits on rate increases from year to year and better education of borrowers about this type of loan. Once this pilot project is complete, data will show whether the hybrid rate corrected for inherent problems existing in the previous ARM program and whether this ARM program can successfully diversify loan options offered to veterans.

Fixed Rate Versus Adjustable Rate Mortgages

In Figure 8-1, we present the average monthly interest updates for a 1-year ARM and fixed rate mortgages from January 1990 through June 2003. In addition, we present the difference between the amount a veteran could have borrowed using the ARM versus the fixed rate mortgage.[8]

There are two factors affecting how much more a veteran could borrow through an ARM rather than a fixed rate mortgage. The first factor is the difference in the two interest rates. From roughly February 1993 until December 1994, on average, an ARM was 2.96 percentage points lower than a fixed rate mortgage. At this same time, the chart shows that a veteran was able to borrow, on average, $48,000 more when using an ARM versus a fixed

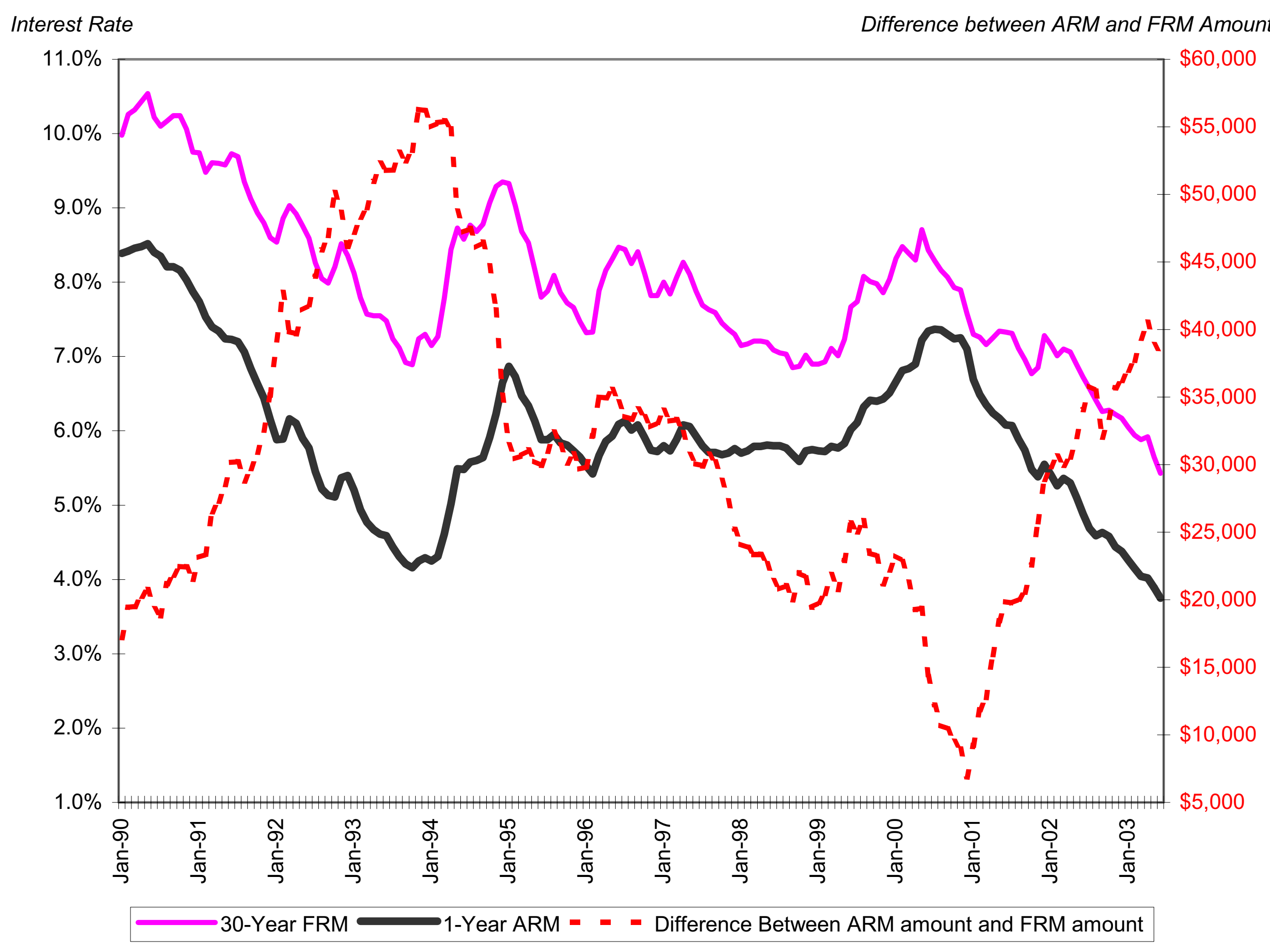
[7] United States Senate, Veterans Hearing Loss Compensation Act of 2002, 107th Congress, 2nd Session, Report 107-234, August 1, 2002, pp. 12–13.

[8] We assumed a gross monthly income of $3,750, other debt payments of $500 per month, a ratio of house payment to income of 28 percent, and a ratio of total house payment to debt of 41 percent. We held the calculations constant in 2003 dollars.

rate mortgage. In 1999, when the interest rates began to increase and the spread between the ARMs and fixed rate mortgages began to decrease, so did the veterans ability to maximize their borrowing through an ARM.

The second factor influencing the veteran's ability to maximize their borrowing potential is the level of the interest rates. From January 1990 until January 1992, the interest rates for both the ARM and fixed rate mortgage were higher (on average, 8% and 10%, respectively), and the spread was about 2.12 percentage points, allowing veterans to borrow roughly $24,000 more through an ARM. In contrast, between January 1996 and January 1998, the spread was 2.04 percentage points, on average, and the ARM and fixed rate mortgage interest rates were lower (6% and 8%, respectively). With these figures, the veteran was able to borrow, on average, $31,000 more through an ARM than a fixed rate mortgage. The level of interest rates, not just the spread between the ARM rate and the fixed rate, impacts the amount a veteran can borrow.

Figure 8-1. ARM and Fixed Rate Mortgage (FRM) Interest Rates
January 1990 through June 2003

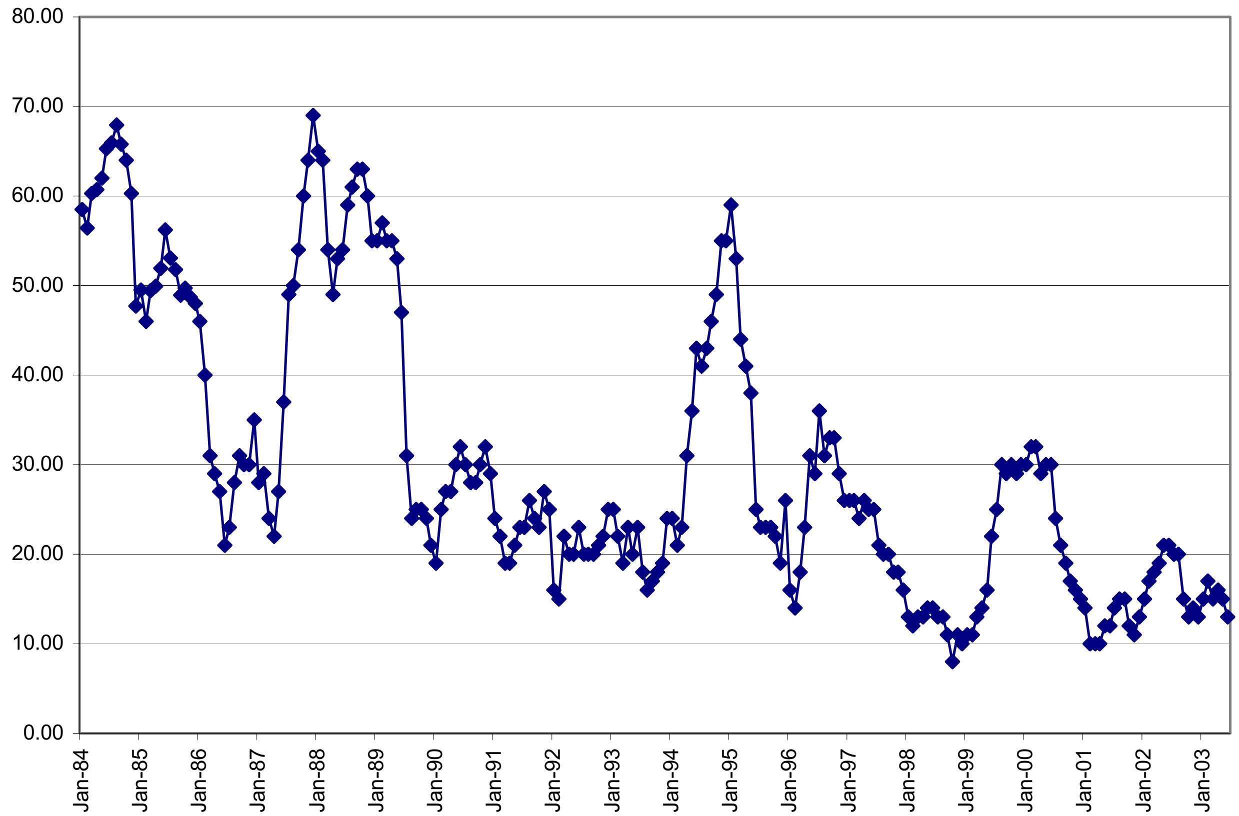


Source: HSH Associates, http://www.hsh.com/mtghst.html

Origination Rates for ARM Loans

As shown in Figure 8-2, the percentage of loans with adjustable rates has been decreasing over the years. They appear to be more popular during the times when the fixed mortgage rates are higher (e.g., late 1980s, 1994/1995, 1999/2000).

Figure 8-2. Conventional Mortgages: All Loans—Percentage with Adjustable Rates



Source: Federal Housing Finance Board: Rates and Terms on Conventional Single-Family Mortgages

Effects of an ARM Option on the VA Loan Program

Lenders believe that offering ARMs to veterans would be a good addition to the VA loan program. They expressed the view that veterans need alternatives to the traditional VA loan and that the lower fixed rate for the first 3 years of the loan would allow veterans, especially first-time homeowners, the ability to get settled into the home at a lower interest rate during the most crucial years. All lenders, however, were highly concerned about their ability to sell this loan on the secondary market. They indicated that their institutions did not have any investors purchasing ARMs and would not push the loan until they found potential investors.

All real estate professionals interviewed indicated that they think that offering ARMs will be beneficial to the VA loan program. All professionals believed that offering a more diverse selection of loans to applicants would allow VA to stay competitive in the market. In addition, this would broaden the narrow set of options for applicants who may not fit into the criteria for the currently offered options.

About one fourth (26.4%) of the VA Loan Survey respondents indicated that they would have been interested in an ARM if it were available at the time they obtained their loan (Table 8-2).

Table 8-2. Would you have been interested in adjustable rate loan if it were available at the time you got your VA loan?

Response	Veterans	Active Duty	Reservists	Total Borrowers
Yes	25.5%	27.7%	31.9%	26.4%
No	74.5%	72.3%	68.1%	73.6%
Total	100.0% (N=458)	100.0% (N=440)	100.0% (N=426)	100.0% (N=614)
Refused	4	0	3	4
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q4

Overall, the Study Team cannot determine whether it is beneficial to VA to continue the ARM program. The opinions of lenders, real estate personnel, and appraisers provide examples of stakeholder opinions and possible issues to address in a future program evaluation. The hybrid ARM was created to alleviate the problems with the original ARM offered in the first pilot program. VA program officials told the Study Team that the previous ARM pilot for VA loans was discontinued by Congress because there were higher default rates and ARMs were viewed as being riskier than conventional loans. The program's success may be dependent on changes in interest rates over the next 2 years. The continuation of the ARM is an important policy issue, and when data are available from the pilot program, this question can be fully addressed.

Energy Efficiency Improvement Loans

Historical Background

The Veterans' Housing Benefits Act of 1978 expanded the types of loans included in the loan guaranty program. First, the law authorized loans for energy-related improvements involving the installation of solar energy systems or other residential energy conservation measures. Terminology defining solar energy systems was based on the Solar Heating and Cooling Demonstration Act of 1974. Covered energy conservation measures were explicitly identified in the 1978 act.[9] The act also clarified in law that VA had authority to prescribe a

[9] Senate Report No. 95-1055, p. 20.

higher interest rate for loans to repair, alter, or improve a home, as compared with the rate for loans to purchase a home.[10]

In 1992, the Senate Committee on Veterans' Affairs considered that the current VA program for energy efficient mortgages (EEMs) was successful but underused because the current

> "procedural requirements have made EEMs … impractical and inconvenient. Many borrowers and lenders are unaware that the lender can consider potential energy savings that would result from energy efficiency improvements financed as part of the original loan. Indeed, very few veterans know that VA EEMs are available, or how to apply for one, before they learn about them in the course of obtaining a VA-guaranteed loan."[11]

Section 9 of the Veterans Home Loan Program Amendments of 1992 added a new EEM program authorizing VA-guaranteed loans for EEMs for improvements to a veteran's current home or to finance the combined cost of acquiring an existing home and making energy efficiency improvements. Veterans could finance the cost of these improvements up to $3,000 (or $6,000 if the increase in the monthly mortgage payment did not exceed the anticipated reduction in monthly utility costs resulting from the improvements). The amount of the EEM financing would not affect the maximum loan guaranty amount.

To overcome the lack of awareness, VA was required to notify eligible veterans, lenders, and realtors about the new program. VA was required to issue annual reports to Congress summarizing experience with the new program.[12] The Veterans' Benefits Improvements Act of 1994 included the cost of energy efficiency improvement in interest rate reduction refinancing loans (IRRRLs). The cost of energy efficiency improvements of up to $6,000 could be included in VA-guaranteed home loans, but they could not be included in IRRRLs. Section 904 permitted these additional costs to be included. In supporting this change, the conferees concluded—

> "We believe that any increased risk from an increase in the loan-to-value ratio would be slight and would be offset to a significant degree by the reduced payments resulting from lower interest rates."[13]

Awareness of Energy Efficiency Improvement Loans

All of the appraisers interviewed were aware of the energy efficiency improvement guarantees in the VA Home Loan program. However, none of them had made an appraisal for energy efficiency improvements. There were various reasons cited by appraisers for the

[10] In its report, the Senate Committee on Veterans' Affairs noted that "the Committee bill is declaratory of existing law on this point, and the Committee specifically affirms its view that the Administrator presently has statutory authority to set different interest rates as appropriate and stresses that the authority in this bill is designed to reflect the Committee's commitment to the importance of energy-related home improvements and to provide appropriate context for coordinated exercise of that authority with respect to home improvement loans for energy-related purposes." Source: Senate Report No. 95-1055, p. 17.
[11] Senate Report No. 102-405, pp. 12–13.
[12] Congressional Record—House, October 5, 1992, p. H11701.
[13] Congressional Record—House, October 7, 1994, p. H11351.

lack of participation (by lenders, appraisers, and borrowers) in the program. The most common reason was education, stating that they were not given enough data or guidelines. They noted that the guidelines had been mentioned previously at annual meetings but were no longer being mentioned.

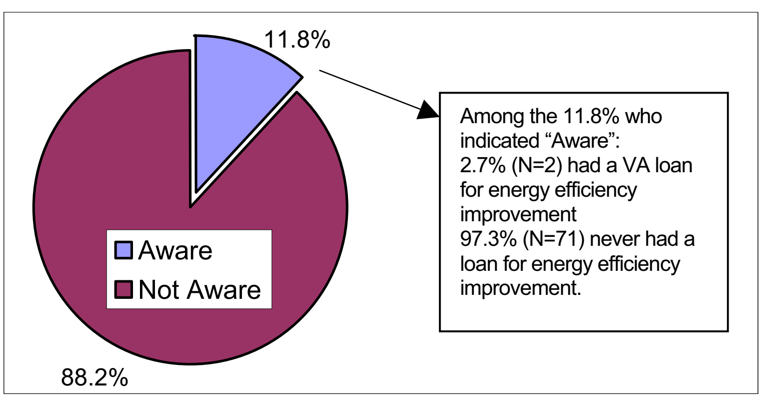
Another appraiser indicated that he cannot find any market comparisons for homes that are energy efficient. Additionally, many mortgage companies do not like to do the detailed work required under this program or do not have enough education about these types of programs.

Most lenders interviewed were aware of the energy efficiency improvement program but had never worked with it. Lenders experienced with this program indicated that their branches typically stayed away from energy efficiency improvement loans because the improvements typically had to be made before the loan closed.

None of the real estate professionals had ever heard of the energy efficiency improvement guarantees and recommended educating the market more on this program.

The lack of awareness of this loan is also prevalent among borrowers (veterans, active duty, and reservists). Only 11.8 percent of the surveyed home loan borrowers indicated that they were aware of the availability of loan guarantees for energy efficiency improvements (Figure 8-3). Among those aware of this benefit, only two (i.e., 2.7%) of the VA Loan Survey respondents said that they had a VA loan for energy efficiency improvements. When asked why they did not obtain a VA loan for this benefit, out of 70 (i.e., 11.8%) VA Loan Survey respondents, almost three fourths (72.9%) said that they did not need the improvements, and 12.9 percent said that they cannot afford the monthly payments (Table 8-3).

Figure 8-3. Energy Efficiency Improvement Loans: Awareness and Participation



Source: VA Loan Survey, Q44 and Q44.1

Table 8-3. If had not ever received a VA loan for energy efficient improvement: Why have you not obtained a VA loan for energy efficiency improvement? (Mark all that apply)

Response	Veterans	Active Duty	Reservists	Total Borrowers
Don't need the improvement	72.9%	73.8%	63.4%	72.9%
Cannot afford the monthly payments	13.6%	6.6%	7.3%	12.9%
Was not aware of the VA loan for energy efficiency improvement	10.2%	13.1%	9.8%	11.4%
Don't need the loan	5.1%	0.0%	0.7%	4.3%
Too much trouble to apply for the loan	3.4%	3.3%	2.4%	2.9%
Available loan amount is not enough	1.7%	0.0%	2.4%	1.4%
Other	3.4%	4.9%	9.8%	2.9%
Total	(N=59)	(N=61)	(N=41)	(N=70)
Refused to Answer	1	0	0	1
Number of Respondents	60	61	41	71

Source: VA Loan Survey, Q44.1.A

Note: Total percentage is more than 100 percent since respondents were allowed to mark more than one response.

Best Practices and Recommendations

Currently, VA includes information on the possibility of adding energy efficiency improvements in each notice of value document created as part of the loan generation process. VA offered preprinted information to lenders. At annual meetings, energy efficiency improvement guarantees are also discussed. VA additionally offers national satellite training broadcasts on this topic.

This practice has been successful in making both lenders and appraisers aware of the improvement guarantees, but it has not increased participation. Real estate professionals are still unfamiliar with this option, which could change if this topic was included in new education initiatives. Currently, there is no direct initiative for outreach to veterans, and this could be improved. VA RLCs will issue releases, and pamphlets are available. Making information more readily available to veterans can potentially stimulate the process of adding this feature to a loan.

The Study Team recommends expanding education initiatives on this topic to increase awareness. Since there seems to be a gap between the awareness of lenders and participation in the program, we also suggest further analysis to determine why there may be a reluctance to participate in EEMs, the demand for energy efficiency improvements, and a cost-benefit analysis of continuing such a program. Newer homes have more energy efficiency built in, and the United States is not currently in an energy crisis; therefore, there may not be a high demand for this type of assistance.

Conclusion

This chapter addressed the following research issues:

1) Determine whether Government staff, fee personnel, lenders, appraisers, and real estate personnel are aware of and consistently follow VBA rules and guidelines, and if not, identify best practices and recommend solution strategies.

2) Examine the VA process for obtaining and certifying appraisers, and identify similarities and differences from other institutions that are regularly engaged in making housing loans. Determine acceptability of the VA appraisal process with real estate professionals, evaluating any perceived barriers to the development of a competitive loan product.

3) Examine the use of ARMs as part of the VA Home Loan Guaranty program. Determine the desirability of restoring this feature.

4) Determine the extent to which veterans, participating lenders, and interested real estate professionals have been notified and made aware of the availability of loan guarantees under 38 U.S.C., Section 3710, Chapter 37, for energy efficiency improvements to include solar heating and cooling and application of residential energy conservation measures.

Rules and Regulations

There were three main concerns addressed by lenders, appraisers, and real estate professionals for VA loan rules and regulations.

1) Maximum loan amount

2) The use of residual income versus debt ratios

3) Description of fees to be paid by borrowers.

The awareness of VA rules and guidelines among lenders and appraisers is high, but it is relatively low among real estate professionals. It is in the best interest of VA to have real estate professionals represent the program accurately to veterans who may benefit from a VA loan, as they are the commonly the gatekeeper for veterans to access VA loans.

In addition to the VA Web site and the Lender's Handbook, appraisers obtain useful information at the VA's annual training meetings, which these professionals view very favorably. Although there are no specific annual meetings for lenders, they reported finding all training opportunities and meetings to be beneficial in promoting awareness of and compliance with VBA rules and guidelines.

VA has a Loan Guaranty Monitoring Unit that works effectively to ensure that loans are processed and closed in accordance with the law, regulations, and policies. Audits are carried out both onsite at lenders' offices and at the unit's main office in Nashville, Tennessee.

Obtaining and Certifying Appraisers

All appraisers interviewed were positive about the VA appraisal process, but lenders and real estate professionals were more critical of the rotational system. Appraisers pointed out that the rotational system allows the appraiser to provide a fair market value for the property with the backing of VA, therefore avoiding the pressure placed on appraisers by lenders for higher appraisals. Some lenders and real estate agents suggested removing the rotational selection, but appraisers suggested that this may result in increased predatory lending. Appraisers were more concerned about the new VA initiative to hire more appraisers. Because of the cyclical nature of the real estate market, they indicated that a slow market may force them to find work other than VA appraisals.

In the view of lenders and real estate agents, appraisers for VA loans may undervalue the property, adversely affecting the loan process for veterans in tight housing markets. One industry representative suggested that VA be given the authority to decide how appraisers are chosen, rather than Congress dictating it.

Adjustable Rate Mortgages

Providing ARMs to the borrowers in the VA Home Loan Guaranty program is viewed positively by lenders, appraisers, and real estate professionals, but lenders were highly concerned about selling this type of loan on the secondary market. They indicated that investors tend not to purchase ARMs, and they would not push the loan until they found potential investors.

Energy Efficiency Improvement Loans

Lenders and appraisers interviewed were aware of the energy efficiency improvement guarantees in the VA Home Loan Guaranty program. There were various reasons cited by appraisers for the lack of participation (by lenders, appraisers, and borrowers) in the program. The most common reason was education, stating that they were not given enough data or guidelines. They noted that the guidelines had been mentioned previously at annual meetings, but they were no longer being mentioned. However, none of them had made an appraisal for energy efficiency improvements. Real estate agents were not aware of the guidelines in this area. The lack of awareness of this loan is also prevalent among borrowers (veterans, active duty, and reservists). Only 11.8 percent of the surveyed home loan borrowers indicated that they were aware of the availability of loan guarantees for energy efficiency improvements.

Best Practices and Solutions

Current best practices and recommended solutions are as follows.

Best Practices

- *Offering continual education opportunities*—The Study Team believes that offering alternative method of education (i.e., annual training meetings, continuing education credits), coupled with consistent communication, detailed handbooks, and a user-friendly Web site, leads to adherence to VA rules and guidelines.

- *Consistent review and audit processes*—Appraisers noted that VA review and audit procedures helped point out problems in their appraisals, which help them avoid making similar mistakes while enhancing their understanding of VA guidelines.

- *Continual communication*—Appraisers and lenders both noted that the continual communication from VA via e-mail or on the Web site was beneficial for maintaining awareness of the program and staying current on any changes in rules and regulations.

- *Annual VA Lender Satisfaction Survey*—This annual survey provides VA with valuable opinions regarding the strengths and weaknesses of the program and potential methods for improving the program.

- *Sample size for audits*—Since compliance is an important issue for this program, selecting a sample of 10 percent is an effective way to ensure that the audits successfully determine whether there is noncompliance among their participants. Ten percent is well above the sample size needed to reach generally accepted standards of statistical significance for the number of loans being originated.

Solution Strategies

- *Education opportunities for real estate professionals*—By offering more education opportunities similar to those for lenders and appraisers, VA can improve awareness among real estate personnel. Professionals will also be more likely to endorse VA loans if they are more familiar with VA rules and guidelines. One possibility is to collaborate with NAR by offering certification programs or participating in annual national and regional conferences. Another option is to develop the current lender portal capabilities to include appraisers and real estate professionals.

- *Make information more accessible to real estate professionals*—Real estate professionals indicated that lenders and NAR were their primary sources of information for VA rules and guidelines. VA can coordinate with NAR and make information accessible through its Web site and national and regional offices.

- *Detailed handbooks and Web site*—Many lenders and appraisers reported the Lender's Handbook as their primary source of information and the VA Web site as a secondary source of information. By having more detailed information available to lenders, appraisers, and real estate professionals, the less opportunity there will be for noncompliance due to a lack of available information. As mentioned previously, one significant complaint by lenders was the description of the fee schedule in the Lender's Handbook and on the Web. By expanding this description in both the handbook and the Web, there may be less mistakes made by lenders and greater compliance with VA guidelines.

- *Development of a stratified sampling plan for lender audits*—To maximize the effectiveness of audit samples, the Study Team suggests developing a stratified sampling plan. Sampling strata can be defined to minimize the oversampling of certain groups of lenders and incorporate new strata to target groups of lenders who are most likely to be noncompliant. Additionally, the strata should include sampling of loans with a higher risk, such as ARMs.

- *Annual satisfaction survey of appraisers and real estate professionals*—As VA does with lenders, the Study Team suggests conducting an annual survey of appraisers and real estate professional to better gauge the strengths and weaknesses of the program from their position in the loan process. This is especially important since all of those interviewed by the Study Team suggested specific problems relating to both appraisers and real estate professionals.

- *Communicate with lenders, real estate professionals, and appraisers to alleviate misconceptions*—Communication with the three groups could be used to alleviate any misconceptions (i.e., homes being undervalued by VA appraisers, VA loans being more difficult to originate) by lenders, appraisers, or real estate professionals.

- *Analysis of data from the ARM pilot program*—The continuation of the ARM is an important policy issue, and when data are available from the pilot program, the success or failure of the program can be fully addressed. VA should further explore the reasons for higher default rates among ARMs if it plans to offer ARMs permanently in the future.

- *Further analysis of energy efficiency improvement guarantees*—There seems to be a large gap between awareness on the part of lenders and participation in the program. The Study Team suggests further analysis to find reasons for this gap and to determine the demand in the industry for such an option.

9. SATISFACTION

VA strives for satisfaction of participants in the VA Home Loan program. This chapter addresses the satisfaction of program participants within three sample groups (Veterans, Active Duty personnel, and Reservists) as well as the satisfaction of the borrowers overall. The Survey Team conducted analysis to determine participants' overall level of satisfaction with the VA Home Loan program as well as satisfaction within key aspects of the program. The objectives of the these analyses are as follows:

- Understand the basic satisfaction level of the borrowers in the program
- Measure the overall satisfaction level of the borrowers in the VA Home Loan program
- Measure the satisfaction level of borrowers with specific program attributes
- Determine who is satisfied and who is dissatisfied among the borrowers
- Determine which program attributes are the most important in determining overall satisfaction
- Identify areas of improvement that will have the greatest impact on overall satisfaction.

We asked respondents to rate their satisfaction with the following items in the VA Home Loan program:

- Information they received about the program
- Length of time it took to get the loan
- Maximum amount of the loan
- Being able to use the loan guaranty benefit to purchase another home in the future
- Amount of funding fee they had to pay
- Service provided by the real estate agent
- Service provided by the lender
- Service provided by VA
- The program overall, including everything.

The Survey Team asked respondents to grade their level of satisfaction based on a six-point scale, ranging from "Very satisfied" (=6) to "Very dissatisfied" (=1). In addition to the six-point scale, respondents were able to choose "Not applicable" as a valid response. Several respondents also "Refused to answer." These two responses were coded but not analyzed.

Average Satisfaction Scores

Table 9-1 shows the average satisfaction score for overall satisfaction and the eight attributes of the VA loan process for four survey groups. On average, program participants were satisfied with the program (5.10 for Veterans, 4.98 for Active Duty personnel, 5.07 for Reservists, and 5.06 for the Total Borrowers). Respondents were consistent in their satisfaction levels throughout most of the attributes, as six of the eight attributes scored between 4.85 and 5.02 for the overall sample. Respondents gave the highest satisfaction scores for being able to use the loan to purchase a home in the future (5.31 by Veterans, 5.16 by Active Duty personnel, 5.18 by Reservists, and 5.28 by the Total Borrowers). The lowest satisfaction rating was for the amount of funding fee, which was the only attribute that had ratings below a 4.00 (4.18 for Veterans, 3.90 for Active Duty personnel, 3.99 for Reservists, and 4.13 for the Total Borrowers). Of the four groups, Veterans reported a higher average score than the other two groups on almost all attributes, indicating that they were generally more satisfied than the other groups surveyed in the study.

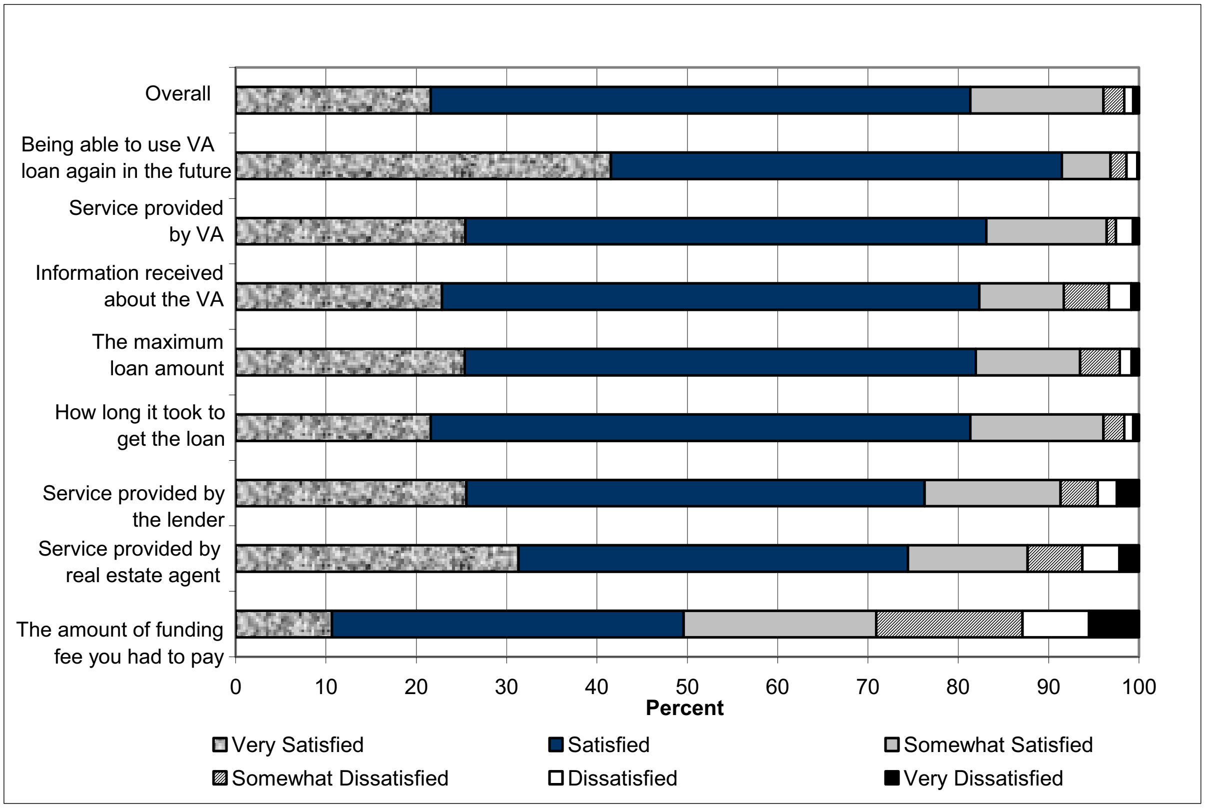
Table 9-1. Average Satisfaction Scores for VA Loan Survey Respondents

Satisfaction with:	Veterans	Active Duty	Reservists	Total Borrowers
Being able to use your VA loan guaranty benefit to purchase another home in the future	5.31 (N=429)	5.16 (N=406)	5.18 (N=380)	5.28 (N=573)
Service provided by VA	5.03 (N=438)	5.07 (N=409)	4.99 (N=423)	5.02 (N=586)
How long it took to get your VA home loan	4.99 (N=459)	5.01 (N=436)	4.88 (N=429)	4.98 (N=615)
With information you got about VA home loan program	5.00 (N=457)	4.94 (N=433)	4.98 (N=426)	4.97 (N=611)
Maximum amount of VA home loan guarantee	4.95 (N=451)	4.82 (N=422)	4.99 (N=418)	4.93 (N=600)
Service provided by your lender	4.88 (N=456)	4.92 (N=431)	4.84 (N=425)	4.86 (N=611)
Service provided by your real estate agent	4.91 (N=410)	4.86 (N=410)	4.68 (N=385)	4.85 (N=559)
Amount of funding fee you had to pay to obtain your VA home loan	4.18 (N=457)	3.90 (N=375)	3.99 (N=350)	4.13 (N=488)
VA Home Loan program overall	5.10 (N=460)	4.98 (N=438)	5.07 (N=27)	5.06 (N=616)
Number of Respondents	462	440	429	618

Source: VA Loan Survey, Q29.1-Q29.9.
Note: Number of valid respondents indicated by numbers in parentheses.

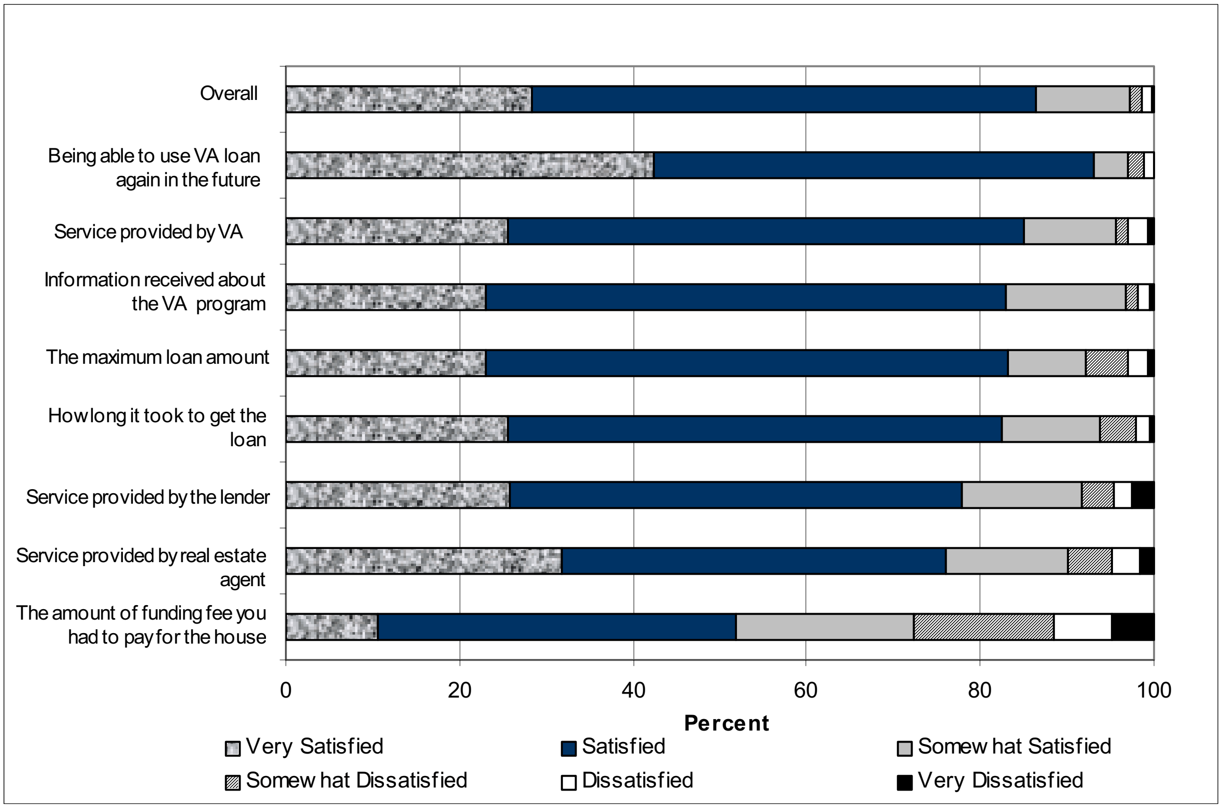
The following four figures present the distribution of responses for total borrowers as well as for each of the three subgroups analyzed in the VA Loan Survey. These figures specify that for most of the attributes for a given group, at least 80 percent of the respondents indicated that they were either satisfied or very satisfied. In addition, a very small percentage of respondents answered that they were dissatisfied or very dissatisfied with the aspects of the program.

Figure 9-1. Distribution of Satisfaction Scores, by Attributes for the Overall Sample



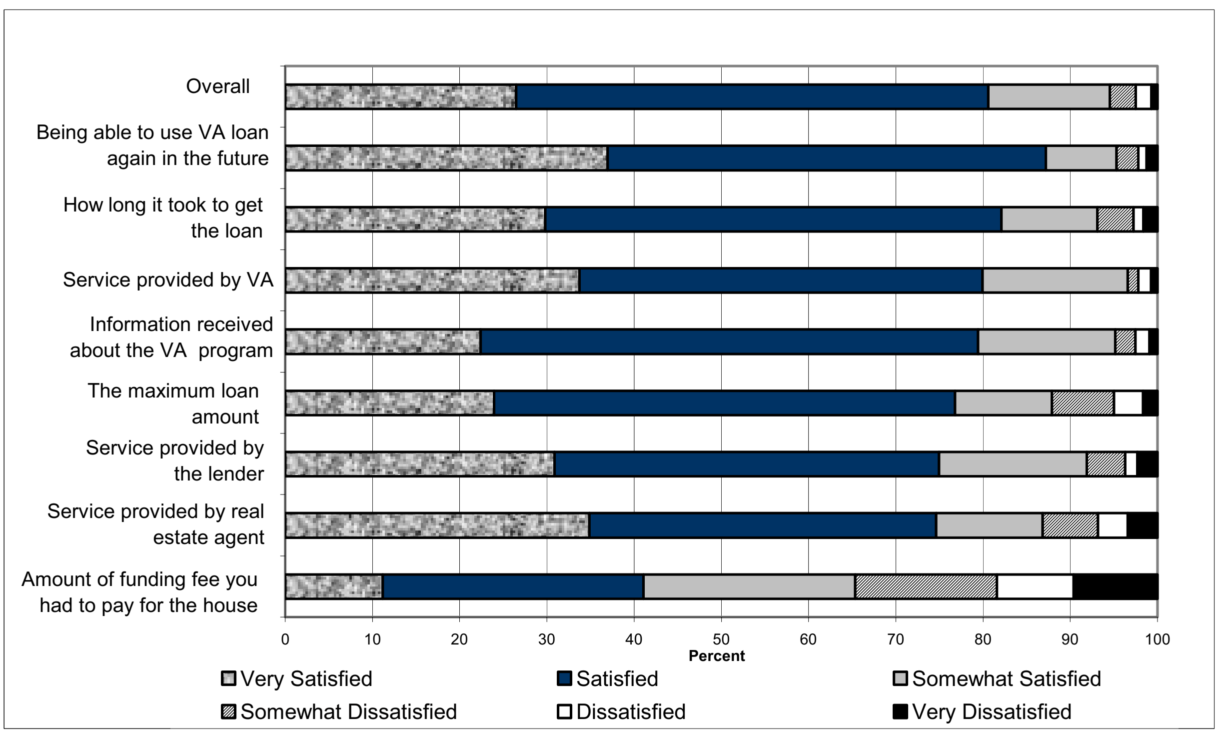
Source: VA Loan Survey, Q29

Figure 9-2. Distribution of Satisfaction Scores, by Attributes for Veterans



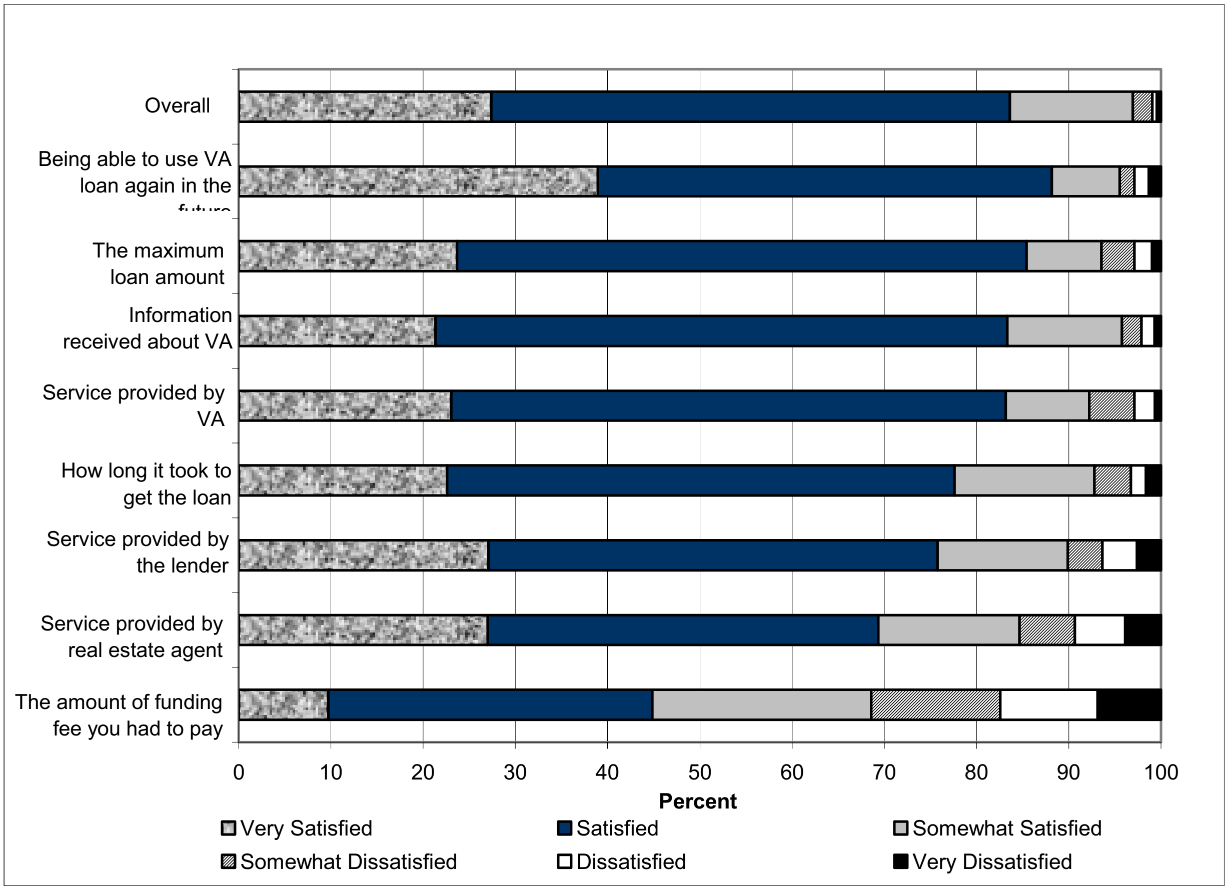
Source: VA Loan Survey, Q29

Figure 9-3. Distribution of Satisfaction Scores, by Attributes for Active Duty



Source: VA Loan Survey, Q29

Figure 9-4. Distribution of Satisfaction Scores, by Attributes for Reservists



Source: VA Loan Survey, Q29

Who is Satisfied and Who is Not?

Table 2 reports the average overall satisfaction scores for each of the four groups. Findings regarding overall satisfaction of borrowers with the VA Home Loan program include the following:

- Participants between ages 30 and 39 are less satisfied than participants of other ages
- Participants age 50 or older are generally more satisfied than other age groups
- Native Hawaiian, American Indian, or Native Alaskan participants are more satisfied than other races.

Table 9-2. Average Overall Satisfaction Scores, by Various Demographic Characteristics

Demographic Characteristics		Veterans	Active Duty	Reservists	Total Borrowers
Ethnicity	Hispanic	5.13	5.05	4.88	5.06
	Not Hispanic	5.10	4.98	5.07	5.06
Age	Younger than 30	5.09	5.10	5.05	5.12
	30 – 39	4.98	4.87	5.04	4.93
	40 – 49	5.12	5.02	5.17	5.07
	50 – 59	5.18	5.06	5.02	5.19
	60 or Older	5.29	5.50	4.92	5.25
Gender	Male	5.10	4.97	5.05	5.06
	Female	5.13	5.12	5.16	5.11
Race	White	5.09	4.94	5.05	5.05
	Black	5.21	5.11	5.11	5.13
	Native Hawaiian, American Indian, or Alaska Native	5.25	5.24	5.21	5.46
	Other	5.08	5.12	5.00	5.11
Education	Less than some college	5.16	5.27	5.07	5.17
	Some college, no degree	5.09	5.05	5.23	5.11
	Associate's degree	4.94	4.84	4.82	4.76
	Bachelor's degree	5.15	5.00	5.06	5.06
	Graduate or advanced degree	5.08	4.60	5.02	5.05
2002 Income	Less than $30,000	4.95	5.25	4.96	5.00
	$30,001 to $40,000	5.13	5.10	4.93	5.11
	$40,001 to $50,000	5.07	4.95	5.00	4.98
	$50,001 to $75,000	5.13	5.00	5.13	5.12
	$75,001 to $100,000	5.14	4.85	5.09	5.02
	More than $100,000	5.17	4.69	5.15	5.13

Source: VA Loan Survey

We performed a more sophisticated statistical technique, regression analysis, to corroborate the results in Table 9-2. This technique allows us to take into account the simultaneous influences of several factors on satisfaction that the simple mean calculation does not. The dependent variable we used for this analysis was the overall satisfaction rating for the loan program.

For all borrowers, the Study Team found five attributes to significantly affect overall satisfaction: age, health, military status, education, and income. The older the borrower, the more satisfied he/she is; borrowers who are in poor health are less satisfied than others; officers are less satisfied than enlisted servicemen; borrowers with at least an associate degree are less satisfied; and those with an annual household income less than $50,000 are less satisfied. For the veteran borrowers, health, military status, and age were again significant attributes, but the year of the loan also significantly affected overall satisfaction. Veteran participants in poor or very poor health are less satisfied compared to those in good, very good, or fair health; veterans who were officers in the military are less satisfied than others, and the older the veteran is, the more satisfied he/she is. For Active Duty personnel borrowers, only two attributes were significant, education and military status. Active Duty personnel who have an associate degree or higher are less satisfied with the overall program than others. For the Reservists, income, level of education, and loan origination year were significant. In each case, the impact was negative. Thus, reservists with an annual household income less than $50,000 are less satisfied than others; reservists who have an associate degree or higher are less satisfied than others.

Table 9-3. Overall Satisfaction with the VA Loan Program – Multivariate Analysis

Factors	Impact	Significance
Total Borrowers		
Age	More satisfied	Significant at 99% level
Health—Poor or Very Poor	Less satisfied	Significant at 99% level
Military Status—Officer	Less satisfied	Significant at 95% level
Level of Education—Associate's Degree or Higher	Less satisfied	Significant at 95% level
Veterans		
Health—Poor or Very Poor	Less satisfied	Significant at 99% level
Age	More satisfied	Significant at 99% level
Active Duty		
Level of Education—Associate's Degree or Higher	Less satisfied	Significant at 95% level
Military Status—Officer	More satisfied	Significant at 95% level
Reservists		
Income—Less than $50,000	Less satisfied	Significant at 99% level
Level of Education—Associate's Degree or Higher	Less satisfied	Significant at 99% level

Source: VA Loan Survey and Study Team Analysis

Key Drivers of Satisfaction

The Study Team identified the attributes that most affect the borrowers' overall satisfaction of the VA Home Loan program. We used a multivariate analysis to identify the key drivers of overall satisfaction and to determine their overall importance. Table 9-4 presents the results for program participants overall, indicating the relative importance of the various attributes on overall satisfaction. "Mean Satisfaction" is the calculated average score of the respective attribute within the given survey group. Six attributes significantly affected the borrowers' overall satisfaction. The service provided by VA affected the borrowers' overall satisfaction the most.

Table 9-4. Importance of Program Attributes for Total Borrowers

Satisfaction	Importance	Mean Satisfaction
Service provided by VA	37.8%	5.02
Maximum amount of VA home loan guarantee	20.4%	4.93
Being able to use your VA loan guarantee benefit to purchase another home in the future	16.1%	5.28
With information you got about VA home loan program	9.8%	4.97
Service provided by lender	8.5%	4.86
Amount of funding fee that had to be paid to obtain the loan	7.5%	4.13
How long it took to get VA loan	0.0%	4.98
Service provided by the real estate agent	0.0%	4.85

Source: VA Loan Survey, Q29

Figure 9-5 combines the rankings of relative importance with the satisfaction scores for each attribute and sorts them into four quadrants of a priority matrix. The quadrant areas are determined by the horizontal line (representing "Importance") and the vertical line (representing "Satisfaction").

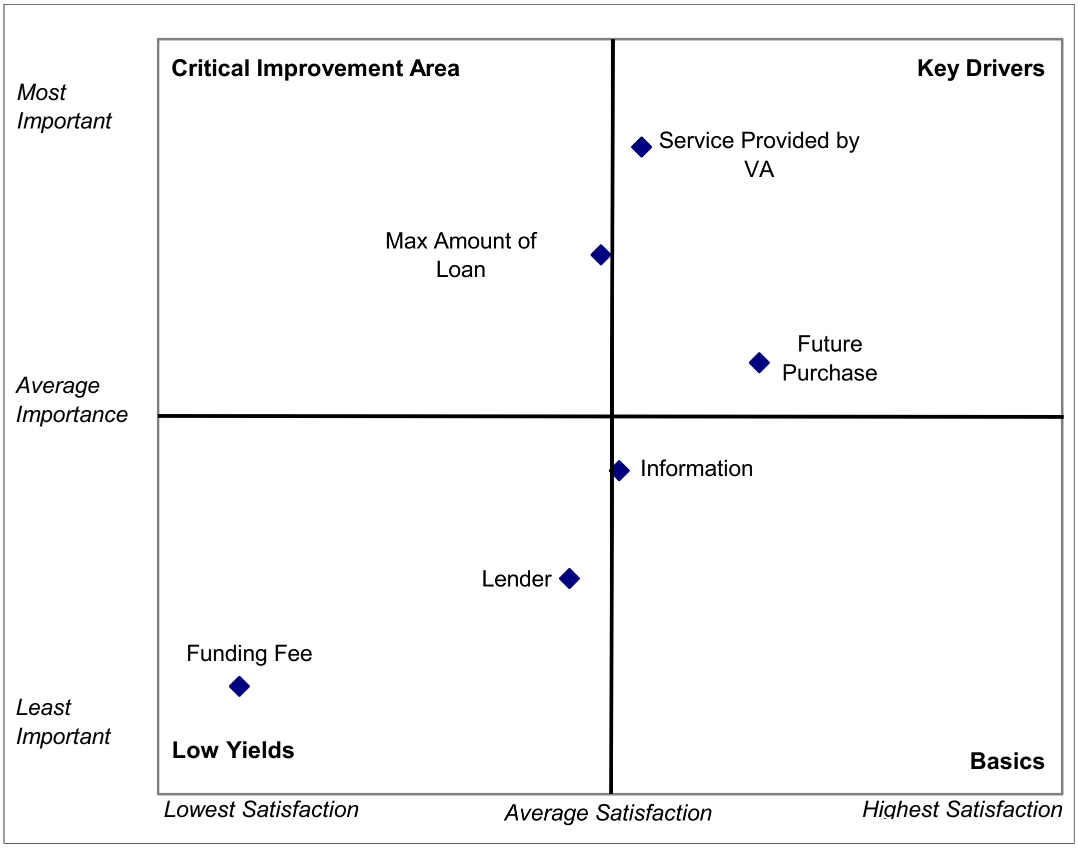
The quadrant labeled "Critical Improvement Area" represents the greatest potential for improvement in overall satisfaction. These attributes need to be addressed for the overall satisfaction score to increase significantly. The "Maximum amount of loan" falls in this area.

The lower-right quadrant, labeled "Basics," contains the attributes that are of low importance for overall satisfaction, but that have high satisfaction scores. This means that VA is meeting the needs of participants and does not need to improve them to increase satisfaction. The analysis for the borrowers overall indicates that the "Information participants received about the program" is located in this quadrant.

The quadrant labeled "Key Drivers" contains attributes that rank high in importance to the customer and in the customer's stated satisfaction score. VA needs to keep the satisfaction results high for the attributes in this quadrant to maintain a high level of overall satisfaction. There are two attributes in this quadrant: "Service provided by VA" and "Ability of future purchase."

The quadrant labeled "Low Yields" contains attributes that rank low in importance to the customer and in the customer's stated satisfaction score. Improving these attributes will not have a large impact on the overall satisfaction of the program. For the Borrowers, "The service provided by the lender" and "The amount of funding fee" were located in this quadrant.

Figure 9-5. Rankings of Importance and Satisfaction for the Total Borrowers



Source: VA Loan Survey, Q29 and Study Team Analysis

Summary

Satisfaction of the borrowers for the VA Home Loan program is slightly higher than "satisfied," 5.06 on a scale of 1 to 6. All of the average satisfaction ratings for the various attributes for the borrowers were above 4.0, or "somewhat satisfied." The amount of funding fee paid to obtain a VA Home Loan was consistently given the lowest score (average was 4.13). However, its average score for the borrowers is .72 lower than the second lowest rated attribute.

The "Service provided by VA" and "Future Purchase (i.e., Multiple Use)" are key drivers of overall satisfaction. Two attributes, "Funding Fee" and "Lender" rate as a Low Yield attribute, indicating that even though the satisfaction level is low, it does not have a large impact on overall satisfaction. Although the average satisfaction scores for the program came up as "satisfied," there is still potential for improvement. "Maximum Amount of Loan" lies in the Critical Improvement Area quadrant, implying that increasing it would increase overall satisfaction.

10. SPECIALLY ADAPTED HOUSING PROGRAM

Veterans who have permanent and total disabilities due to military service may be entitled to a grant for the purpose of constructing an adapted dwelling or modifying an existing home to meet their needs. There are two types of grants available:

- ► Part I: Specially Adapted Housing Grant is for disabled veterans who are entitled a wheelchair accessible home especially adapted for their needs. Currently, the maximum grant amount is $50,000.
- ► Part II: Special Home Adaptations Grant is for disabled veterans who are entitled to adaptations because of blindness in both eyes with 5/200 visual acuity or less, or includes the anatomical loss or loss of both hands. Currently, the maximum grant amount is $10,000.

In this chapter, we analyze the veteran's awareness of the Specially Adapted Housing (SAH) program, the adequacy of the maximum grant amounts, and whether having the grant improved the quality of life of disabled veterans. In our analysis, we primarily rely on the survey administered by VA of the SAH grant recipients.[1] The survey population consists of the entire population of disabled veterans who received a VA SAH grant in fiscal year 2002. We also summarize the informal interviews that the Study Team conducted with construction companies that have done adaptations for veterans to determine whether the grant amounts are adequate.

Legislative History

After World War I, Congress noticed the difficulty that veterans experience in readjusting to civilian life after serving in the military. Thus, during World War II, in 1944, Congress enacted a program to aid veterans financially. The Servicemen's Readjustment Act of 1944 created the VA Loan Guaranty program, which was intended to address many of the issues affecting the large numbers of war veterans soon to reenter civilian life. These issues included physical rehabilitation, education, housing, employment and readjustment allowances, and the proper administration of these benefits.

As years passed, however, the Government quickly realized that the role of VA had to be broadened. For example, "veterans," which originally secluded itself to people who served in World War II, later opened itself to veterans of other wars. It also later included selected reservists, active duty members, and spouses of veterans among those eligible for the program aid.

The Home Loan Guaranty program first recognized specially adaptive housing in 1970, when it added a provision authorizing direct loans for the purchase of specially adapted

[1] VA developed the SAH survey questionnaire, and ESI coordinated the survey collection, including mailing questionnaires, conducting follow up contacts pursuant to the expected response rate, and tabulating the survey responses.

housing, regardless of whether the veteran was in a housing credit shortage area. This marked the first time that VA recognized disabled veterans as a distinct and separate group of veterans who needed individual attention. In order for a veteran to be entitled to the SAH program, an extensive inquiry had to be made by VA in order to determine whether he/she was qualified to receive the loan. However, when the disabled veteran was deemed eligible to receive the loan, a maximum amount of $17,500 was available in order to make life with a handicap more comfortable. The funds could only be used for a specified list of adaptations, such as making ramps for entry or widening hallways to make them wheelchair accessible.

By 1974, VA realized that $17,500 was not sufficient for these types of improvements. Thus, in the Veterans Housing Act of 1974, the maximum SAH grant was increased from $17,500 to $25,000. In addition, in 1978, the maximum SAH grant amount again increased from $25,000 to $30,000.

In 1980, disabled veterans with blindness were recognized with a separate grant. Blind veterans were not originally included in the SAH program, yet they required adaptations like special lighting and sliding doors. In the Veterans Compensation and Housing Benefits Amendments of 1980, a new $5,000 Special Home Adaptations (SHA) grant (Type B) was made for veterans with blindness or anatomical loss, and the original SAH grant became known as Type A.

By 1981, the price of a specially adapted house had increased significantly from the inception of the SAH program. Building a specially adapted house cost approximately $75,700 in 1981, and in the Veterans' Disability Compensation, Housing and Memorial Benefits Amendments of 1981, the maximum grant amount was raised from $30,000 to $32,500. The Veterans' Benefits Improvement Act of 1984 increased the maximum SAH grant further to $35,500 and the maximum grant for veterans suffering from blindness or loss of use of both upper extremities resulting from a service-connected injury to $6,000. The Senate Veterans' Affairs Committee report on its bill justified the increase as necessary to "help ameliorate the erosion in the value of this benefit made by increases in construction costs over the last 3½ years."[2]

The Veterans' Benefits Improvement and Health-Care Authorization Act of 1986 again focused on veterans having service-connected blindness or anatomical loss. Previously, housing grants for these disabled veterans had been authorized only to defer the cost of installing adaptive features in a new home under construction. The Veterans' Benefits Improvement and Health-Care Authorization Act of 1986 expanded this authority by permitting payment of the grant to also offset the "fair market value" of the adaptive features already installed in an existing home.

In 1988, The Veterans' Benefits and Services Act increased the maximum SAH grant by 7.1 percent, from $35,500 to $38,000, and the grant for veterans suffering from blindness or certain anatomical losses by 8.3 percent, from $6,000 to $6,500. Ten years later, Public Law 105–178, Section 2101 (June 9, 1998), increased the SAH grant amount to $43,000 and the SHA grant amount to $8,250.

[2] United States Senate, Veterans' Administration Benefit Rate Increase and Program Improvement Act of 1984, 98th Congress, 2nd Session, Report No. 98-604, September 17, 1984, p. 51.

The Veterans Benefits and Health Care Improvement Act of 2000 repealed regulations that limited the maximum amount of a SAH grant when the disabled veteran co-owned the property with someone other than a spouse. Consequently, if the disabled veteran had joint (50/50) ownership with a nonspouse, such as a sibling, the maximum grant permitted was half of the grant amount, or $21,500. The Veterans Education and Benefits Expansion Act of 2001 increased the SAH grant from $43,000 to $48,000 and the grant for veterans suffering from blindness or anatomical loss from $8,250 to $9,250.

The Veterans Benefits Act of 2003 (December 16, 2003) increased the amounts for the two types of grants to their current levels of $50,000 (SAH Type A) and $10,000 (SAH Type B).

Disabled Veterans' Awareness of the SAH Program

Disabled veterans who seek care at a VA medical facility get a medical determination rating of their disabilities, and those rated permanently and totally disabled are referred to the Veterans Benefits Administration (VBA) for SAH grant eligibility. VA then contacts those disabled veterans and informs them about their entitlement to the SAH program. As shown in Table 10-1, more than two thirds of the SAH grantees learned of the program from VA, 20 percent learned of the program from Veteran Service Organizations (VSOs), and 5 percent learned from other veterans.

Table 10-1. How did you first learn about VA's Specially Adapted Housing (SAH) program?

Source of Information about SAH	Age					Total
	Younger than 50	50–59	60–69	70 or older	Age Unknown	
Veterans Affairs Office (VA pamphlet/brochure)	30.4%	24.7%	46.5%	28.3%	26.9%	30.5%
Letter from VA awarding service-connected disability	17.4%	31.8%	25.6%	26.1%	19.2%	25.6%
Veteran Service Organizations	19.6%	24.7%	11.6%	21.7%	19.2%	20.3%
VA medical facility	17.4%	7.1%	7.0%	13.0%	11.5%	10.6%
Other veterans	6.5%	4.7%	2.3%	6.5%	11.5%	5.7%
Other, specify	2.2%	2.4%	4.7%	0.0%	7.7%	2.8%
Predischarge briefings (TAP/DTAP)	0.0%	1.2%	0.0%	4.3%	3.8%	1.6%
Friends or family	2.2%	2.4%	2.3%	0.0%	0.0%	1.6%
Internet	4.3%	1.2%	0.0%	0.0%	0.0%	1.2%
Lender	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total	100.0% (N = 46)	100.0% (N = 85)	100.0% (N = 43)	100.0% (N = 46)	100.0% (N = 26)	100.0% (N = 246)
Missing	1			2		3
Number of Respondents	47	85	43	48	26	249

Source: SAH Survey, Q1

Table 10-2 shows that almost three out of four (73.6%) of the grant recipients learned most or all of what they needed to know about the program from their initial source (listed in Table 10-1). Almost half of the participants younger than 50 years old (47.8%) received most of the information they needed from their initial source. This percentage is statistically significantly higher than that of the other age groups. Only 5.3 percent of the particiipants received little or no pertinent information from their initial source of the SAH program.

Table 10-2. Looking back, how much of what you NEEDED TO KNOW did you get from the source above?

Amount of Needed Information Obtained from Source	Age					
	Younger than 50	50–59	60–69	70 or older	Age Unknown	Total
Most	47.8%	36.5%	34.9%	34.8%	38.5%	38.2%
All	26.1%	36.5%	41.9%	39.1%	30.8%	35.4%
Some	19.6%	21.2%	16.3%	19.6%	23.1%	19.9%
Little	6.5%	4.7%	4.7%	4.3%	7.7%	5.3%
None	0.0%	1.2%	2.3%	2.2%	0.0%	1.2%
Total	100.0% (N = 46)	100.0% (N = 85)	100.0% (N = 43)	100.0% (N = 46)	100.0% (N = 26)	100.0% (N = 246)
Missing	1	0	0	2	0	3
Number of Respondents	47	85	43	48	26	249

Source: SAH Survey, Q2

Almost all (94.9%) SAH recipients reported that the information they initially received about the SAH program was entirely or mostly accurate (Table 10-3). Only 5.1 percent of the recipients thought that the information they initially received was entirely or mostly inaccurate.

Table 10-3. How accurate was the information that you received from the source above?

	Age					
Accuracy	Younger than 50	50–59	60–69	70 or older	Age Unknown	Total
Mostly Accurate	45.7%	42.0%	51.3%	55.8%	50.0%	47.7%
Entirely Accurate	50.0%	50.6%	46.2%	41.9%	42.3%	47.2%
Mostly Inaccurate	2.2%	6.2%	2.6%	0.0%	0.0%	3.0%
Entirely Inaccurate	2.2%	1.2%	0.0%	2.3%	7.7%	2.1%
Total	100.0% (N = 46)	100.0% (N = 81)	100.0% (N = 39)	100.0% (N = 43)	100.0% (N = 26)	100.0% (N = 235)
Don’t know or not sure	0	3	4	3	0	10
Missing	1	1	0	2	0	4
Number of Respondents	47	85	43	48	26	249

Source: SAH Survey, Q3

The amount of time it took for the grant recipients to learn about the program after receiving a 100 percent disability rating varied: about half (50.7%) said that it took less than 6 months, 10 percent said that it took 7 to 12 months, and a substantial number (39.3%) said that it took more than a year (Table 10-4).

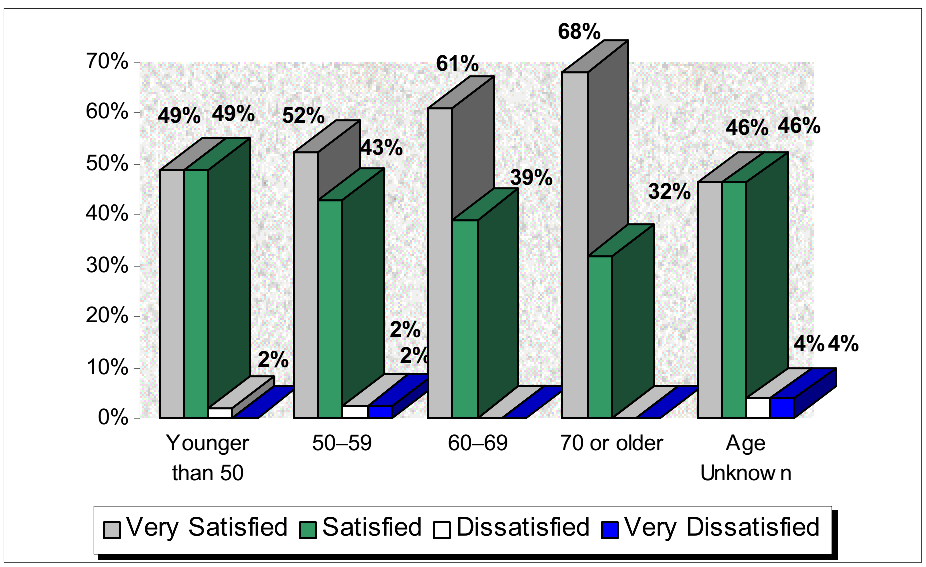
Table 10-4. How long was it between the time that you received your 100 percent disability rating and the time you learned about the SAH program?

Length of Time Between Receiving Disability Rating and SAH Grant	Age					
	Younger than 50	50–59	60–69	70 or older	Age Unknown	Total
Less than 1 month	31.7%	27.7%	18.9%	16.2%	19.0%	23.9%
1–2 Months	14.6%	12.3%	16.2%	10.8%	9.5%	12.9%
3–4 months	4.9%	6.2%	8.1%	5.4%	4.8%	6.0%
5–6 months	2.4%	3.1%	10.8%	8.1%	28.6%	8.0%
7 months to a 1 year	14.6%	7.7%	13.5%	10.8%	0.0%	10.0%
More than a year	31.7%	43.1%	32.4%	48.6%	38.1%	39.3%
Total	100.0% (N = 41)	100.0% (N = 65)	100.0% (N = 37)	100.0% (N = 37)	100.0% (N = 21)	100.0% (N = 201)
Don't know or not sure	4	19	5	9	5	42
Missing	2	1	1	2	0	6
Number of Respondents	47	85	43	48	26	249

Source: SAH Survey, Q4

Satisfaction with the information received about the program is very high. Almost all of the participants (97.2%) were either very satisfied or satisfied with the information they received about the SAH grant. Figure 10-1 shows that there is no significant difference in satisfaction based on age. Also, fewer than 3 percent reported that they were dissatisfied with the information they received about the program.

Figure 10-1. How satisfied are you with the information you got about the SAH program?



Source: SAH Survey, Q46.1

Adequacy of Grant Amounts

Currently, the maximum SAH Type A and SHA Type B grant amounts are $50,000 and $10,000, respectively. At the time of the survey, these amounts were $48,000 and $9,250. Nearly all (92.6%) of the grant recipients reported receiving a Type A grant (Table 10-5). Only 7.4 percent received a Type B grant. In addition, almost all (96.6%) of the respondents received the maximum amount available (Table 10-6). None of the participants 50 years or younger indicated receiving less than the maximum grant amount.

Table 10-5. Which grant did you receive?

	Age					
Type of Grant	Younger than 50	50–59	60–69	70 or older	Age Unknown	Total
Type A . Maximum grant amount is $48,000	97.8%	91.6%	92.9%	91.3%	88.5%	92.6%
Type B. Maximum grant amount is $9,250	2.2%	8.4%	7.1%	8.7%	11.5%	7.4%
Total	100.0% (N = 45)	100.0% (N = 83)	100.0% (N = 42)	100.0% (N = 46)	100.0% (N = 26)	100.0% (N = 242)
Don’t know or not sure	2	1	0	1	0	4
Missing	0	1	1	1	0	3
Number of Respondents	47	85	43	48	26	249

Source: SAH Survey, Q30

Table 10-6. Did you receive the maximum grant amount?

	Age					
Received Maximum Grant	Younger than 50	50–59	60–69	70 or older	Age Unknown	Total
Yes	100.0%	95.0%	97.6%	95.6%	96.2%	96.6%
No	0.0%	5.0%	2.4%	4.4%	3.8%	3.4%
Total	100.0% (N = 45)	100.0% (N = 80)	100.0% (N = 42)	100.0% (N = 45)	100.0% (N = 26)	100.0% (N = 238)
Don’t know or not sure	0	2	0	2	0	4
Missing	2	3	1	1	0	7
Number of Respondents	47	85	43	48	26	249

Source: SAH Survey, Q35

When asked how completely they understood the dollar amount that the grant would provide, 87.2 percent answered that they completely or mostly understood (Table 10-7). Of the 60 to 69 years old who answered this question, almost all of them (97.6%) felt that they understood the grant amount completely or mostly at the beginning of the process, which is significantly higher in comparison with the other age groups.

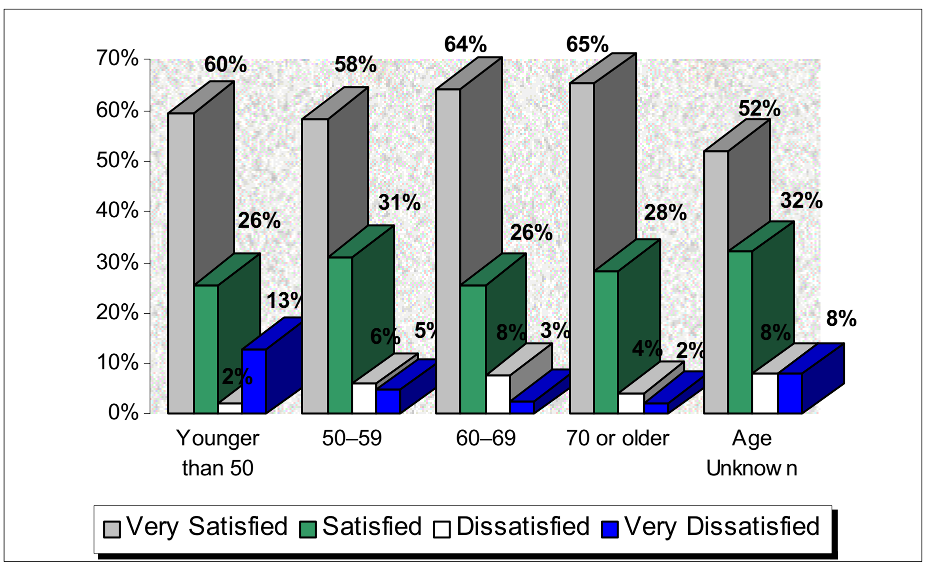
Table 10-7. At the beginning of the grant process, how completely did you understand the dollar amount that the grant would provide?

How Completely SAH Grantees Understood Dollar Amount of Grant	Age					
	Younger than 50	50–59	60–69	70 or older	Age Unknown	Total
Completely	68.1%	72.3%	73.2%	72.3%	72.0%	71.6%
Mostly	17.0%	12.0%	24.4%	12.8%	16.0%	15.6%
Somewhat	8.5%	10.8%	2.4%	12.8%	8.0%	9.1%
Not at all	2.1%	3.6%	0.0%	2.1%	4.0%	2.5%
A little	4.3%	1.2%	0.0%	0.0%	0.0%	1.2%
Total	100.0% (N = 47)	100.0% (N = 83)	100.0% (N = 41)	100.0% (N = 47)	100.0% (N = 25)	100.0% (N = 243)
Don't know or not sure	0	0	0	1	1	2
Missing	0	2	2	0	0	4
Number of Respondents	47	85	43	48	26	249

Source: SAH Survey, Q36

Almost 90 percent of the veterans studied thought that the grant amount was very or somewhat adequate. Figure 10-2 shows that those participants younger than 50 found the grant amount to be inadequate (13%), as compared with older recipients.

Figure 10-2. How would you rate the adequacy of the grant amount provided by the Specially Adapted Housing program?



Source: SAH Survey, Q37

SAH grant recipients may either adapt an existing home or build a new home with adaptations. Whether a grant recipient bought a new home or adapted/remodeled a previously owned one did not affect their rating of the adequacy of the grant amount (Table 10-8).

Table 10-8. Adequacy of Grant Amount with a New or Remodeled Home

Adequacy of Grant Amount	New Home	Remodeled/Adapted Home	Total
Very adequate	57.7%	60.0%	59.2%
Somewhat adequate	30.8%	28.4%	29.2%
Somewhat inadequate	5.1%	5.8%	5.6%
Very inadequate	6.4%	5.8%	6.0%
Total	100.0% (N=78)	100.0% (N=155)	100.0% (N=233)
Don't know or not sure	1	3	4
Refused to Answer	1	1	2
Number of Respondents	80	159	239

Source: SAH Survey, Q37, 33 & 31

Of the 27 people who thought that the grant amount was somewhat or very inadequate, 25 gave explanations as to why the amount was insufficient. Ten respondents, or 40 percent, who found the grant amount inadequate said that it cost more than the given grant amount to build or adapt their homes. An additional 20 percent indicated that they had to pay additional out-of-pocket money for the adaptations. Eight percent thought that the area they lived in was very expensive and that this limited their renovations. Another 8 percent found it hard to find a contractor who was willing to do the work. The remaining respondents found the items to be very expensive, found that unsatisfactory work was done by the contractor, thought that too much grant money was delegated for unnecessary items, or had a situation where there was unapproved work.

Analysis of Construction Costs

To get a better idea of the cost of adaptations in different parts of the country, VA's SAH office chose six cities to analyze: two in a low-cost area; two in a medium-cost area; and two from a high-cost area. For the high-cost area, Oakland, California, and Waco, Texas, were chosen. Seattle, Washington, and Pittsburgh, Pennsylvania, were selected for the medium-cost area, and Des Moines, Iowa, and Louisville, Kentucky, were selected for the low-cost area.

SAH agents from these six cities provided the names and phone numbers of contractors who successfully made SAH adaptations in the past. The Study Team contacted these contractors by phone to identify the various costs of construction and to get an understanding of their experience in dealing with SAH grant adaptations.

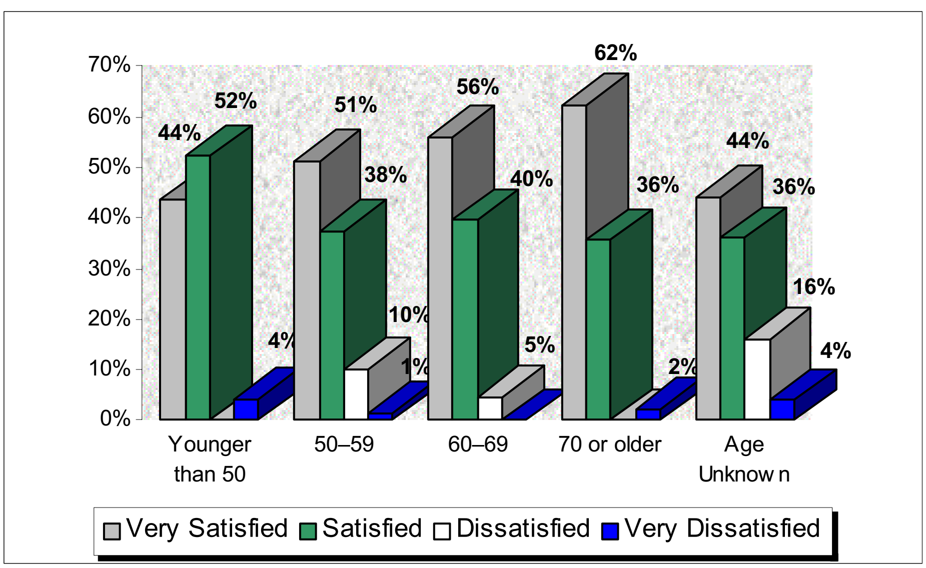
On the basis of these interviews, we conclude that the maximum grant amount of $50,000 is generally sufficient to adapt a house according to the SAH adaptation requirements. In cases where grant recipients need all of the adaptations, the maximum grant amount may not be sufficient. Some contractors indicated that a few grant recipients were forced to fund some of the project themselves, but it was mainly because they wanted the adaptations to stay up to par with the quality of their home. The bathroom adaptations cost the most, so in some instances, building an entirely new bathroom unit was more cost-effective for the disabled veteran. All of the contractors also indicated significant increases in the cost of construction. One contractor from a low-cost area reported a 20 percent increase in construction costs in the past few years, which may make the grant amount insufficient. Thus, VA may want to look closely at the rising cost of construction, as that would be a leading factor as to why the maximum grant amount may not be sufficient in the future.

Our recommendation is to increase the maximum SAH amount based on annual increases in construction costs. There are several indices available on construction labor and materials measuring the change in construction costs. Among them include: Construction Materials Producer Price Index by Bureau of Census, Turner Construction Co.'s Building Construction Index, Engineering News-Record's Building And Construction Index, and E.H. Boeckh's Residential Building Cost Index. For example, between 2001 and 2002, the increase in construction cost according to the indices mentioned above was, on average, 2.4%. Then the SAH amount would have been increased from $48,000 (the maximum amount in 2001) to $49,152.

Satisfaction with Grant Amount

Overall, 92.1 percent are satisfied or very satisfied with the SAH grant amount. A majority (52%) of participants are very satisfied, and another 40 percent are satisfied. Figure 10-3 shows that participants between 50 and 60 years old were the most dissatisfied—11 percent responded that they were dissatisfied or very dissatisfied. On the other hand, only 2 percent of participants older than 70 said that they were dissatisfied or very dissatisfied with the amount, which is statistically significantly lower than that of the other age groups.

Figure 10-3. How satisfied are you with the maximum amount of the SAH grant?



Source: SAH Survey, Q46.4

Quality of Life

The SAH grant enables disabled veterans to live at home comfortably. Using the grant for adaptations, disabled veterans have the opportunity to live with an improved quality of life. The grant can have an extremely positive effect on a disabled person's independence and quality of life. For example, an article by McNeil[3] discusses the transition a soldier in the late stages of multiple sclerosis had to make moving from a hospital to a home. With the help of the SAH grant, a soldier was able to go home again after experts had predicted he would spend the rest of his life in a hospital. To him and his family, being able to go home again because of the SAH grant was a "blessing." An article by Lynch[4] details the story of how a paraplegic child with a spinal cord injury was able to gain independence and freedom in his everyday life through housing adaptations. An article by Nowak[5] discusses the need for handicapped accessibility in order to make life comfortable in an adapted home. The article gives details as to how the minimum wheelchair turning radius is acceptable in a public bathroom stall, whereas in a home, the minimum radius would not suffice, as one would like to be relaxed as possible. Ingraham[6] wrote an article detailing how a handicapped person achieved a better quality of life when he was given money for adaptation.

These studies conclude that, with the help of the funded adaptations, the SAH grant could have a profoundly positive effect on a disabled person's independence and quality of life.

The next series of tables addresses the following current performance measure of a disabled veteran's improved quality of life after receiving a grant: "At least 95 percent of disabled veterans surveyed will report an improved quality of life as a result of receiving a SAH grant."

Table 10-9 shows that 98.3 percent of respondents found that the housing adaptations helped in making them more independent. The percentage of grant recipients who agreed that housing adaptations help them live more independently increases as their age increases. All of the participants 60 or older responded that the adaptations helped them live more independently.

[3] McNeil, J. (October 10, 2002). Resting at Home. Roanoke Times & World News.
[4] Lynch, R.D. (Fall 1993). Karl's House. Technology and Disability, 2(4), pp. 30–39.
[5] Nowak, M. (August 10, 1998). Removing Barriers—Making Homes Handicapped-Accessible Is a Challenge. The Sunday Gazette (Schenectady, NY).
[6] Ingraham, F. (January 31 ,1993). Barrier Free. Times Union (Albany, NY).

Table 10-9. Do the housing adaptations help you live more independently?

Help Disabled Veterans Live More Independently	Age					Total
	Younger than 50	50–59	60–69	70 or older	Age Unknown	
Yes	95.7%	98.7%	100.0%	100.0%	95.8%	98.3%
No	4.3%	1.3%	0.0%	0.0%	4.2%	1.7%
Total	100.0% (N = 46)	100.0% (N = 79)	100.0% (N = 41)	100.0% (N = 47)	100.0% (N = 24)	100.0% (N = 237)
Don't know or not sure	0	2	1	0	1	4
Missing	1	4	1	1	1	8
Number of Respondents	47	85	43	48	26	249

Source: SAH Survey, Q58

Almost all (99.2%) of the SAH grantees who responded thought that the adaptations improved their quality of life (Table 10-10). The few disabled veterans who said that the SAH adaptations did not improve their quality of life were younger than 50 years old. Consequently, the program meets and exceeds the outcome established by VA—95 percent of veterans will report an improved quality of life as a result of the SAH grant.

Table 10-10. Have the housing adaptations improved your quality of life?

Grant Improved Quality of Live	Age					Total
	Younger than 50	50–59	60–69	70 or older	Age Unknown	
Yes	95.7%	100.0%	100.0%	100.0%	100.0%	99.2%
No	4.3%	0.0%	0.0%	0.0%	0.0%	0.8%
Total	100.0% (N = 46)	100.0% (N = 79)	100.0% (N = 41)	100.0% (N = 46)	100.0% (N = 24)	100.0% (N = 236)
Don't know or not sure	0	2	1	1	2	6
Missing	1	4	1	1	0	7
Number of Respondents	47	85	43	48	26	249

Source: SAH Survey, Q59

Seventy percent of the veterans who responded to the SAH Survey would have continued to live in the same house without adaptations if the SAH program did not exist (Table 10-11). A higher percentage (20.6%) in the younger than 50 age group, compared with those in the other age groups, indicated that they would live in a nursing home if the SAH program did not exist. A higher percentage of veterans older than 50 reported that they would live in the same house without adaptations, implying a lower quality of life.

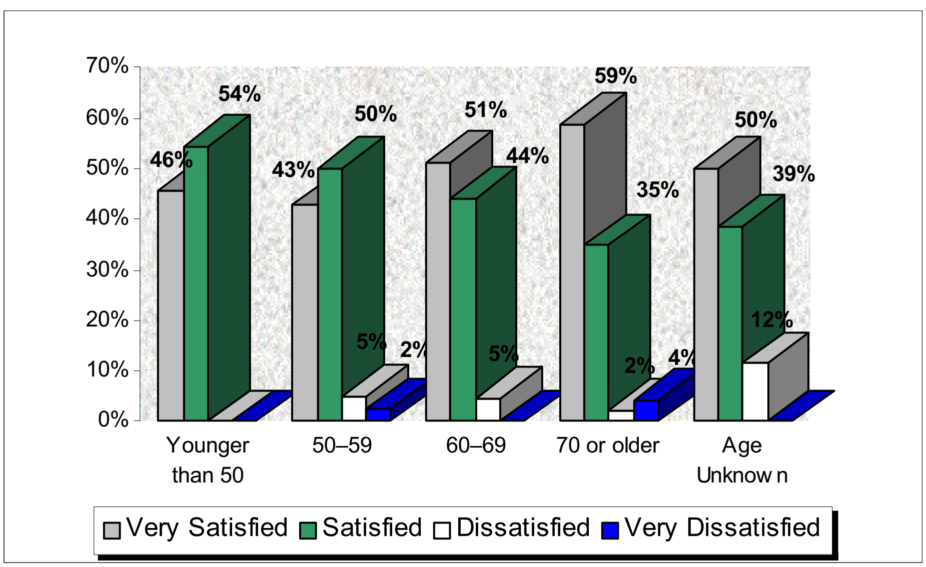
Table 10-11. If the SAH grant program did not exist, what would be your most likely housing situation?

Living Situation without SAH Grant	Age					
	Younger than 50	50–59	60–69	70 or older	Age Unknown	Total
Live in the same house without adaptations	55.9%	73.0%	87.5%	75.7%	50.0%	70.2%
Other living situation	8.8%	9.5%	6.3%	13.5%	18.2%	10.6%
Living in a nursing home	20.6%	12.7%	6.3%	2.7%	9.1%	10.6%
Live with a family member or friend	14.7%	4.8%	0.0%	8.1%	22.7%	8.5%
Total	100.0% (N = 34)	100.0% (N = 63)	100.0% (N = 32)	100.0% (N = 37)	100.0% (N = 22)	100.0% (N = 188)
Don't know or not sure	12	14	8	10	4	48
Missing	1	8	3	1	0	13
Number of Respondents	47	85	43	48	26	249

Source: SAH Survey, Q59.1

Overall, veterans indicated that they were happy with the SAH program. Nearly all (94.3%) SAH recipients indicated that they were satisfied or very satisfied with their grant. Figure 10-4 displays that no participant younger than 50 was dissatisfied or very dissatisfied with the program.

Figure 10-4. How satisfied are you with the SAH program overall, including everything: application process, maximum loan amount, services and so on?



Source: SAH Survey, Q46.5

Summary

Overall, survey responses indicate that the SAH program offers a needed benefit to disabled veterans. Participants are generally satisfied with the program, but they feel that the amount of the grant is insufficient in some cases where they need all of the adaptations. VA may want to look closely at the rising cost of construction, as that would be a leading factor as to why the maximum grant amount may not be sufficient in the future. Our recommendation is to increase the maximum SAH amount based on annual increases in construction costs. The quality of life of disabled veterans increased after receiving a SAH grant. Only a small number of veterans indicated that their life was not improved. For example, in Table 10-10, which shows responses to the question of whether the grant improved the recipients' quality of life, only 2 people answered "no" out of the 249 surveyed. In addition, 98.3 percent of the veterans surveyed responded that the adaptations helped them live more independently. These results indicate a successful program that is exceeding its performance standard.

11. NATIVE AMERICAN DIRECT LOAN PROGRAM

Legislative History and Program Description

VA's direct home loan program to Native American veterans living on Trust Lands was established by Congress in 1992 as a 5-year pilot initiative to assist those veterans in obtaining mortgage financing and home ownership. It has been extended twice and is currently authorized through 2005. In FY 2003 this program experienced unprecedented participation, due to historically low interest rates. This coincided with a $5 million loan cap. As a result, the program had to shut down from May 2003 through the end of the fiscal year. On September 30, 2003, the President signed P.L. 108-87, which retroactively lifted the cap.

The1992 law identified the following program eligibility requirements for veterans to receive loans under the Native American Direct Loan program (NADL):

- Character of Service
  - If eligibility is based on regular active duty service, the veteran must have been discharged or released under conditions other than dishonorable
  - If eligibility is based upon service as a member of the Selected Reserves, including National Guard, the veteran must have served the required length of time and such service must have been honorable
- A satisfactory credit risk with stable and sufficient income to meet mortgage payments
- Holders of a meaningful interest[1] in the Trust or equivalent land on which their homes will be located that entitles them to use and occupy the land
- A member of a Federally recognized tribe or the equivalent (e.g., Native Hawaiians or other Pacific Islanders) that has signed a memorandum of understanding (MOU) with VA.

Native American veterans are required to pay a funding fee of 1.25 percent unless they receive compensation for a service-connected disability, or military retirement pay, in lieu thereof. Veterans who were in the Reserves or National Guard are required to pay a funding fee of 2 percent of the loan amount. Veterans can pay the funding fee in cash or include it in the loan principal.

Three Federal agencies—VA, the U.S. Department of Housing and Urban Development (HUD), and the U.S. Department of Agriculture (USDA)—each with their own statutorily-mandated home loan programs for Native Americans, came together, under the auspices of

[1] This can be a long-term lease, allotment, or other interest conveyed by the tribe or entity with jurisdiction over the land. This interest must be transferable in the event of a foreclosure.

the One-Stop Mortgage Initiative, to try to simplify the home buying process on Trust Lands. The Department of the Interior's Bureau of Indian Affairs was also involved and helped craft the model documents for the One-Stop Mortgage Initiative. Since the first step to home buying on trust territory is participation by the tribal governments, the Federal agencies decided to develop a series of model documents, including an MOU, which met the requirements of all three Federal programs. VA agreed that if a tribe wished to use these model documents the tribe would need only to sign the MOU with one of these participating agencies. If a tribe chose not to use the model documents, it must enter into a separate agreement with each Federal agency and would not automatically be eligible for participation in all programs.

The principal amount of a NADL may not exceed $80,000. However, the law permits VA to increase this loan limit if housing costs in an area are significantly higher than average housing costs nationwide.

In March 2003, the House of Representatives[2] introduced a bill that would make non-Native American veterans married to Native Americans eligible for the direct loan program. This bill was referred to the Committee on Veterans' Affairs and has not come up for a vote as of the date of this report.

The Study Team visited the VA Phoenix Regional Loan Center, met with stakeholders, and interviewed staff at National American Indian Housing Council. More information on meetings and interviews are presented in Appendix K. We also reviewed the literature on the subject and analyzed the NADL data provided by VA.

NADL Volume

From 1993 through the end of June 2003, the NADL program issued 266 loans. As seen in Table 11-1, out of the 68 signed MOUs , only 27 (39.7%) of them were active as of June 30, 2003. About 60 percent of the tribes with signed MOUs do not take advantage of the loan program. The increase in the number of tribes using the NADL program has slowed in recent years. For example, between 1993 and 1998, there were a total of 53 tribes that signed an MOU, and of these, 18 had a loan under NADL. In contrast, from 1999 to 2003, there were 15 MOUs signed, and only nine new MOUs used the NADL program. The percentage of tribes with MOUs participating in the program was 40 percent in 1998 and stayed at about the same level since then. Figure 11-1 displays how the number of MOUs has gradually increased to 68 since 1993, but in comparison, use of the NADL program has been relatively low. The difference between the number of signed MOUs and the number of active MOUs has steadily increased since the program's inception.

Appendix K, Table K-2 shows the number of loans by tribe, State/Territory, and year of origination as well as amount of loans by MOUs and State/Territory

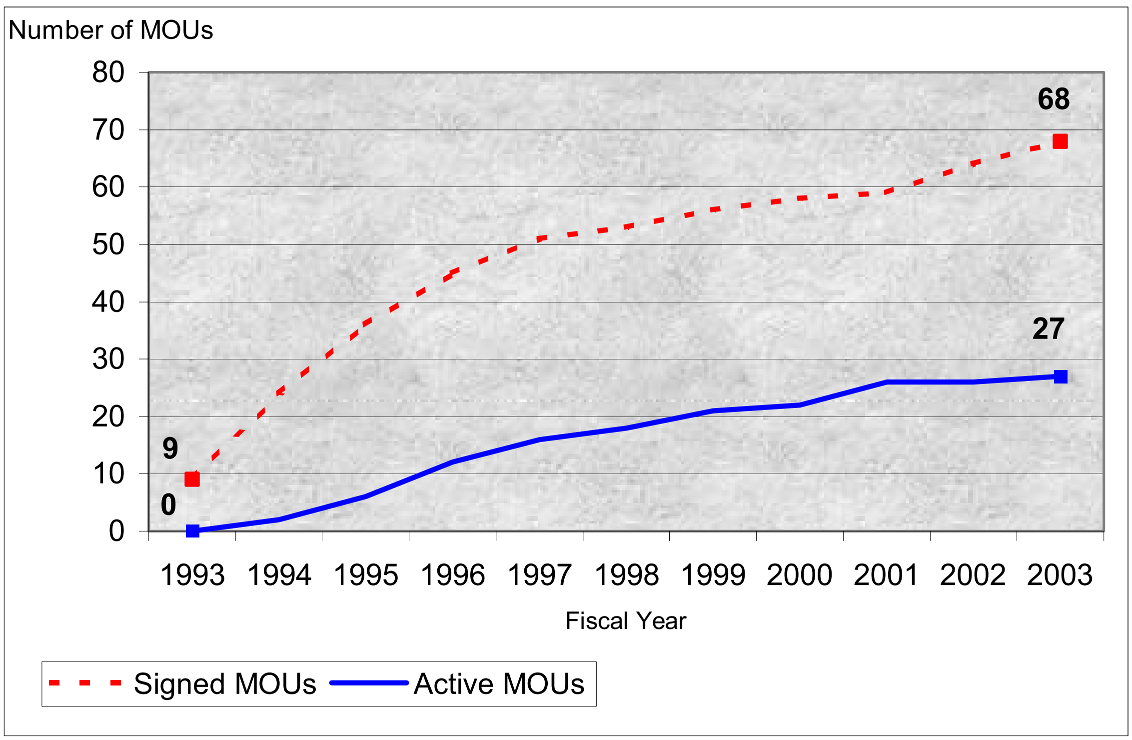
[2] H.R. 1190

Table 11-1. Distribution of MOUs by Year

Year	(1) Number of MOUs signed	(2) Number of MOUs signed, Cumulative Total	(3) Number of Tribes Using the NADL Program for the 1st Time	(4) Number of Tribes Using the NADL Program, Cumulative Total	(4)/(2) % of MOUs Used the NADL Program
1993	9	9	0	0	0.0%
1994	15	24	2	2	8.3%
1995	12	36	4	6	16.7%
1996	9	45	6	12	26.7%
1997	6	51	4	16	31.4%
1998	2	53	2	18	40.0%
1999	3	56	3	21	37.5%
2000	2	58	1	22	37.9%
2001	1	59	4	26	44.1%
2002	5	64	0	26	40.6%
2003	4	68	1	27	39.7%
Total	68	68	27	27	39.7%

Source: VA LGY Data

Figure 11-1. Number of Signed MOUs and Active MOUs from 1993 to 2003



Source: VA LGY Data

Home Ownership Rates of Veterans Living on Trust Lands

A more detailed discussion of home ownership rates of veterans living on trust lands can be found in Appendix K. According to Census data[3] there are 98,037 veterans living on the Trust Lands of those tribes for which VA currently has an MOU. This figure does not include the number of veterans living on Hawaiian Home Lands because we were unable to find a data source reporting this information.

Of the publicly available data, we were able to analyze home ownership by:

- ► Race at the Trust Land level (Source: Census Summary File 3)
- ► Race and veteran status at the State level (Source: Integrated Public Use Microdata Sample-IPUMS)
- ► Race and veteran status at the county level (Source: Current Population Survey, 2002)

The average home ownership rate is 69.0 percent for all those living on Trust Lands, and 70.1 percent for Native Americans/Alaskan Natives living on Trust Lands, according to Census 2000. This compares favorably with the home ownership rate of 68 percent for the general population. Data are not available for veteran home ownership on Trust Lands. While the home ownership rate is relatively high, housing conditions on Trust Lands are of poor quality, due to overcrowded conditions, lack of infrastructure, and related problems.

NADL Volume as a Percent of Veterans Living on Trust Lands

The number of veterans living on the Trust Lands of those tribes for which VA currently has an MOU is approximately 98,037, according to Census 2000 (Appendix K). This figure does not include the number of veterans living on Hawaiian Home Lands because we were unable to find a data source reporting this information. Census numbers may be underestimated because of the remoteness of the Trust Lands and because the tribal culture is not supportive of reporting their population figures. We acknowledge this and recommend that the number presented above be viewed as an estimate rather than actual figure. Based on the 121 NADLs made on Trust Lands (not including Hawaii) between 1994 and 2003, only 1.2 percent (=121/98,037) of veterans living on Trust Lands have NADL.

[3] http://factfinder.census.gov/home/aian/aian_aff2000.html

Impediments to Greater Program Usage

The most frequently cited reasons in the literature[4] for the lack of home ownership on Trust Lands are: Native Americans not meeting the income requirements, the unique problems regarding tribal land status, tribal sovereignty, and getting a clear title from the Bureau of Indian Affairs. These same reasons for the lack of home ownership are impediments to higher use of VA's NADL program.

In 1989, Congress mandated[5] that VA and the Department of the Interior conduct a study on the use of VA's Home Loan Guaranty program benefit by Native American veterans. The study's report[6] listed certain impediments to program usage, which were the same impediments listed in a recent 2002 GAO report.[7] In the 12 years between the two studies, it appears that little has changed in terms of the reasons why Native American veterans living on Trust Lands do not use the VA Home Loan Guaranty program or the NADL program.

Interviews with Native American veterans during the 1990 VA study provided three groups of reasons why a Native American veteran living on Trust Lands might not use the VA loan program:

- ► Independent Reasons: These include a veteran using other Federal housing programs, using tribal funding sources, building a home from personal funding sources, acquiring a home on non-Trust Land, acquiring a home without purchasing it, having no current need for a VA home loan, and using conventional financing.
- ► Structural Reasons: These include a veteran having insufficient income, applying for a VA loan and being refused, having an inappropriate site for home, and having unstable income.
- ► Operational Reasons: These include a veteran misunderstanding the nature of the benefit, not knowing where to obtain information, not being able to complete

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[4] Manchester, P. B. (2001). Mortgage Lending on the Pine Ridge Indian Reservation. *Cityscape: A Journal of Policy Development and Research*, 5, 317-325.
Case Studies on Lending in Indian Country. Housing Assistance Council, 1996.
Barriers to the Development of Housing for Native Americans. Housing Assistance Council.
Abariotes, A., Myers, S., & Poupart, J. (1995). American Indians and Home Ownership. *The American Indian Research and Policy Institute*.
Assessment of the Utilization of VA Home Loan Benefit by Native American Veterans Living on Trust Land – Final Report. November 28, 1990. Department of Veterans Affairs Contract Number V101(93)P-1203.
Native American Housing: VA Could Address Some Barriers to Participation in Direct Loan Program (GAO 02-654).
Rumbelow, H. (2002, October 13). *Washington Post,* p. A03.

[5] Public Law 101-237, Section 312.

[6] Assessment of the Utilization of VA Home Loan Benefit by Native American Veterans Living on Trust Land – Final Report. (November 28, 1990). Department of Veterans Affairs Contract Number V101(93)P-1203.

[7] Native American Housing: VA Could Address Some Barriers to Participation in Direct Loan Program (GAO 02-654).

the application package, not being able to obtain a Certificate of Eligibility, feeling it took too long to process a VA home loan, and not knowing how to apply.

Another important reason was that Trust Land status does not allow the land to be used as security for the loan. Because of this, private lenders see Trust Land mortgages as riskier since they cannot use the land as security for the loan and may think they will not get their investment back in the event of a foreclosure. Additionally, lenders do not have the policies and structures in place to work with the intricacies of lending to tribal or community ownership. Due to these factors, the lenders view lending on Trust Lands as higher risk, with costlier and more time-consuming foreclosure processes to deal with. The lender and veteran can experience additional problems with the time involved in making the loans, from visiting the tribal area to gaining approval for the transaction from the Secretary of the Department of the Interior.

The 1990 VA study concluded that the most significant reason that the VA loan program was not being used more on Trust Lands was the high risk nature of the loan because the land could not be used as security and the lender would not have any way to foreclose on the property should default occur. The study offered alternatives for restructuring the VA loan program to better meet the needs of the veterans and lenders. These alternatives were different based on the study group of Native Americans (i.e., American Indians, Alaska Natives, Native Hawaiians, and American Samoans) and type of Trust Lands involved. After evaluating the alternatives, the study provided program recommendations for each study group:

- For American Indian veterans, the study recommended that the tribal government provide a guaranty to supplement VA guaranty, thus creating a 100-percent guarantied loan.

- For Alaska Natives, the study recommended VA work with Alaska's Department of Community and Regional Affairs to improve access to VA loan program by veterans living on Trust Lands.

- For Native Hawaiians, the study recommended VA work with Hawaii's Department of Hawaiian Home Lands.

- For American Samoans, the study recommended that VA monitor HUD's efforts to institute lending in the islands and then modify VA's program based on HUD's working model.

The 2002 GAO report cited above provided a review of VA's Direct Home Loans for Native American Veterans Living on Trust Lands in response to a request from Congress, which has a potential interest in making the program permanent when it is up for reauthorization in 2005. The final report addressed these questions:

- Does a disparity exist in participation in the program between Native American veterans and Native Hawaiian and Pacific Islander veterans, and if there is a disparity, what is the reason for it?

- ► What actions has VA taken to meet outreach, assessment, and reporting requirements specified in the direct loan program's authorizing legislation?

GAO reports that Native Hawaiians and Pacific Islanders have received five times as many loans as Native Americans since the program began. The reasons for the disparity stem from problems with Native Americans obtaining a meaningful interest in the land, a lack of infrastructure on the Trust Land, and insufficient income and credit histories to qualify for a loan. Native Hawaiians do not have these problems because they are able to lease the land, they receive assistance with infrastructure from the Department of Hawaiian Home Lands, and the economy supports incomes that are sufficient to qualify for a loan.

Native American veterans often have had problems obtaining a meaningful interest in the land they wish to use for their home because of fractionated allotments. Land fractionation is a problem on many Trust Lands and occurs when ownership interest passes through generations of heirs, resulting in a large number of people owning smaller shares of the original land. When this occurs, the veteran has to get all parties with an ownership interest in the property to give him an undivided interest in a portion of the property. In contrast, veterans who have obtained leases rarely have this problem because leases rarely involve fractionated interests.

The lack of infrastructure is another significant problem in obtaining a loan on Trust Lands. Since most of the land is remote, often no basic infrastructure exists, and it can cost more than $20,000 per home to provide the necessary systems. Native Hawaiian veterans do not experience problems related to infrastructure, since the Department of Hawaiian Home Lands provides eligible Native Hawaiians with infrastructure funding. In one case, the funding was as much as $50,000 per lot for sewer, water, and electrical services.

As with any loan, the veteran is required to meet basic income and credit requirements, with the individual or household income sufficient to make the mortgage payment on the home. Using 1990 Census data, GAO found that Native Americans had an average annual income of $16,800 and Native Hawaiians had an average annual income of $26,600. The combination of insufficient income and unacceptable credit history appears to be more of a barrier for Native American veterans than for Native Hawaiian veterans.

Another of the barriers that GAO found was the $80,000 loan limit set by the legislation. VA has the authority to raise the limit for a geographic area if it is determined that the average housing cost in the area is higher than the national average. VA increased the loan limit in Hawaii, the Pacific Islands, and Washington to $120,000, and to $100,000 for one tribe in New Mexico. VA has issued increases in loan limits wherever it has been necessary to do so, based upon submitted loan applications. The negative impact of this is that many people do not know that the loan limit can be increased, and therefore, if they cannot find a home for under $80,000 they use another program. Other Federal programs (such as two administered by HUD and two administered by Department of Agriculture through its Rural Housing Service) providing mortgage assistance on Trust Lands had loan limits between $144,000 and $278,000, and the average guaranteed loan was $102,000 in 2001.

GAO reports that another barrier could be the veterans' lack of understanding about the home buying process. The Director of VA's Honolulu field office partners with local housing authorities who provide assistance in the mortgage and home buying process through counseling and education. There are similar organizations on the Trust Lands in the Continental United States, such as HUD's One-Stop Mortgage Center, but VA Regional Loan Centers have not partnered with them. The Phoenix and St. Paul Regional Loan Centers have had little contact with the One-Stop Centers and have not used them to identify, educate, and assist prospective buyers. GAO reports that an official at a One-Stop Mortgage Center in Arizona estimated that as many as 200 Navajo veterans had visited the Center for information on home ownership, but they did not receive complete information about the VA loan program because the Center's staff was not familiar with it.

GAO concludes that barriers exist in the use of the program. Some are out of VA's control and others are not. Barriers within VA's ability to control are the $80,000 loan limit, which may be inhibiting use on some Trust Lands; partnering with local housing organizations to provide information to veterans; and assessing the outreach efforts to make sure that they are effectively reaching the target audience. Barriers outside of VA's control are problems with obtaining meaningful interest; lack of infrastructure; and insufficient income and credit histories.

Appropriateness of $80,000 Ceiling

The median home value for American Indian and Alaska Natives was $81,000 according to the 2000 Census,[8] whereas it was $110,000 for American Indian and Alaska Native veterans according to the 2001 National Survey of Veterans (NSV) data. These figures are for the nation as a whole, not just Trust Lands. Native Hawaiian and Other Pacific Islanders had a median home value of $160,500 in 2000[9] per Census data, whereas the Native Hawaiian and Other Pacific Islander veterans had a median home value of $200,000 in 2001 NSV data. Again, this is for the nation as a whole and does not reflect only Trust Lands.

Veterans who purchase homes on Trust Land do not have the expense of purchasing the land. Therefore, these loan amounts should be lower than loans to veterans who are purchasing homes not located on Federal Trust Land.

The median as well as mean loan amounts and median home values for the Trust Lands with MOUs are presented in Appendix K, Table K-4. The median home value for all the tribes with signed MOUs, on average, was $72,730 (with a range of $25,300 to $171,900), somewhat under the $80,000 maximum loan limit. However, this also means that close to half of the home values are above the $80,000 loan limit. This fact alone makes it apparent that the $80,000 maximum loan limit may not be sufficient for some of the tribes. Tribes have too many homes with market values that are well above this limit. This finding warrants a need for a formal analysis to be undertaken to determine what the appropriate maximum loan amount should be, based on local housing and home construction costs. A

[8] Bennefield, R. (May 2003). Home Values: 2000. Census 2000 Brief, United States Census Bureau, C2KBR-20.
[9] Ibid.

new maximum loan amount could be set on a regional or tribe-by-tribe basis based upon the findings.

Conclusion

Home ownership among natives living on Trust Lands is about the same as that of the non-Native Americans living on Trust Lands. Home ownership data on veterans living on Trust Lands are not available. Home ownership among Native Americans is largely affected by their relatively low income, which is a systemic problem on the largely rural Tribal Lands that lack an economic base. This problem requires a broad range of interventions that are beyond VA's scope in its NADL program. Other Federal housing programs assist Native Americans living on Trust Lands, but these programs all face the same barriers. The One-Stop Mortgage Initiative to simplify the home buying process on Trust Lands was a previous inter-agency task force effort.

It appears that barriers to increased use of the VA direct loan program are deeply entrenched in the Trust Lands. The barriers are not unique to VA's loan program. Increasing program use and home ownership will probably have to stem from programs designed to facilitate economic development on the Trust Lands, instead of relying principally on lending programs.

The Millennial Housing Commission (MHC), established by Congress in 2000, made several recommendations to address the broader systemic problems on Trust Lands that adversely affect home ownership and housing conditions in general.[10] One recommendation is to increase funding for capacity-building, technical assistance, and training to help tribes understand how best to use housing block grants and other financial resources available to them. There is a critical need for institutions on Trust Lands to manage the financing for housing construction, rehabilitation, and home improvement loans. The MHC also recommended that Congress provide funding for the Land Title Report Commission to analyze and improve the current system for maintaining ownership records and title documents. The MHC recommended increased funding for housing-related infrastructure needs through the Indian Health Service and the Rural Utility Service.

[10] *Meeting Our Nation's Housing Challenges: Report of the Bipartisan Millennial Housing Commission*, Washington, D.C., May 30, 2002 (available at www.mhc.gov).