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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

VA And HUD Can Improve Service And Reduce Processing Costs In Insuring Home Mortgage Loans

VA and HUD can provide more timely service to home buyers and save at least $4 million annually by following the private mortgage insurers' practice of relying on approved commercial lenders for certain underwriting activities involved in guaranteeing and insuring single family home mortgage loans. This would reduce duplication of effort between the agencies and lenders and reduce the number of times applications are reviewed by the agencies. VA and HUD rely somewhat on lenders now, but not to the extent possible.

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GAO/AFMD-82-15
JUNE 11, 1982

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To the President of the Senate and the
Speaker of the House of Representatives

This report points out that the Veterans Administration and the Department of Housing and Urban Development could, in their single family home mortgage insurance programs, not only reduce their administrative costs but also provide more timely service to home buyers by relying more on commercial lenders--where practicable--to perform certain underwriting activities when granting and insuring mortgage loans. We estimate that the agencies could reduce their costs by at least $4 million, and perhaps up to $8 million, by adopting this insurance approach.

We are sending copies of this report to the Director of the Office of Management and Budget, the Administrator of Veterans Affairs, and the Secretary of Housing and Urban Development.

Charles A. Bowsher
Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

VA AND HUD CAN IMPROVE SERVICE AND REDUCE PROCESSING COSTS IN INSURING HOME MORTGAGE LOANS

D I G E S T

By adopting practices and procedures similar to those used by private mortgage insurance firms, the Veterans Administration (VA) and the Department of Housing and Urban Development (HUD) can save several million dollars annually and improve service to their borrowers without increasing the agencies' insurance risk. This can be done by relying more on approved lenders when practical, as private mortgage insurers do, to perform the required underwriting activities of establishing property values and determining borrowers' ability to pay.

Under their single family housing mortgage guaranty and insurance programs, VA and HUD insure mortgage loans for houses, mobile homes, and condominiums. The money is loaned to home buyers by private firms. The guarantee or insurance protects the lender against loss if the borrower does not repay the loan. In 1980, VA guaranteed 327,896 home mortgage loans and HUD insured 394,582.

A large portion of the processing costs incurred by VA and HUD in insuring loans involves underwriting--determining the condition and value of the property through inspection and appraisal and determining a prospective buyer's ability to pay by assessing his or her income, assets, indebtedness, employment, and credit history. Underwriting is a standard process for protecting against the risks in both making home mortgage loans and in insuring them. VA and HUD procedures provide either for their employees to make the underwriting determinations or for approved commercial lenders to make one or both determinations.

VA by law has an "automatic lender" program which delegates to approved lenders the authority for determining borrowers' ability to pay, but not for determining property values. HUD, on the other hand, has been pilot testing at about one-fourth of its offices an approach which delegates both borrower-ability-to-pay and property valuation

AFMD-82-15
JUNE 11, 1982

Tear Sheet

determinations. The agency's delegated authority procedures parallel commercial insurance practices in which lenders are relied on for underwriting. (See p. 6.)

Both agencies are underutilizing commercial lenders in that they mostly rely on their own staffs for underwriting rather than on lenders. In 1980, approved lenders performed the underwriting for less than 1 percent of HUD's insured loans and only part of the underwriting for just 22 percent of VA's insured loans. For VA loans, lenders only determined the borrowers' ability to pay. Lender participation in HUD's test may be limited by HUD's requirement that they provide "outreach" loan service to outlying areas. (See pp. 6 and 7.)

An estimated 40 percent of insured loans potentially could be processed under delegated authority procedures. VA and HUD cannot fully rely on lenders because, among other reasons, many lenders may not meet agency qualifications for approval or may process too few loans to make approval cost effective. (See p. 7.)

By achieving 40 percent participation and extending the use of delegated underwriting authority--by VA to include property valuations and by HUD to include all its offices--GAO estimates that the agencies could save between $4 million and $8 million annually in personnel costs, based on 1980 costs and loan volume. The amount saved would depend on the method used in processing. VA and HUD could also improve service to borrowers because chronic processing delays that occur at the agencies during peak workload periods would be avoided. (See p. 8.)

Both agencies recognize the potential cost savings from greater reliance on approved lenders for underwriting but are concerned with the added risk, particularly in delegating property value determinations. The key concern is that lenders and appraisers may tend to overvalue property, thus decreasing the agency's ability to recover full value from the property if the borrower defaults. This would be protected against by having the agencies select the appraisers and make a field review of a sample of appraisals, as is done under their regular procedures. (See p. 9.)

GAO believes that the agencies' control systems over lender underwriting activities, if properly adhered to, are adequate to minimize the risk of relying on approved lenders to perform the entire underwriting function. Their control procedures are similar to those private mortgage insurers use in relying on commercial lenders for underwriting. (See p. 10.)

VA's legislation states that VA determines property values. Accordingly, VA should seek an appropriate statutory amendment authorizing property values to be determined following standards and procedures established by the Administrator.

RECOMMENDATIONS

GAO recommends that:

--The Administrator of Veterans Affairs (1) obtain participation from more lenders in its automatic lender procedure and (2) extend coverage to include determination of property values based on appraisals by VA-approved appraisers. VA should seek appropriate statutory changes for this purpose.

--The Secretary of Housing and Urban Development (1) extend HUD's delegated processing authority nationwide and encourage qualified lenders to participate by eliminating the outreach requirement and (2) establish a system for assessing and reporting on the quality of lender performance.

AGENCY COMMENTS AND GAO'S EVALUATION

HUD stated that GAO's recommendations supported efforts it had recently undertaken to move forward with a delegated program. VA agreed with the recommendation to expand its automatic loan underwriting procedure (giving approved lenders authority to determine borrowers' ability to pay), but did not agree with the recommendation to extend its automatic lender procedure to include determination of property values, maintaining it would make the loan guarantee program more susceptible to abuse. GAO disagrees. As pointed out in the report, property values would be determined by a VA approved appraiser that VA could select, just as is done under its regular procedure. GAO believes that this procedure, along with other controls applied by VA, provides adequate protection against the abuse both GAO and VA are concerned with.

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GAO performed this review to assess whether VA and HUD could increase productivity and reduce administrative costs in one of their main activities--single family house mortgage guaranty and insurance program.

Contents

ABBREVIATIONS

GAO	General Accounting Office
HUD	Housing and Urban Development
VA	Veterans Administration

CHAPTER 1

INTRODUCTION

We made this review to assess the potential for the Veterans Administration (VA) and the Department of Housing and Urban Development (HUD) to improve productivity and reduce administrative costs in one of their main functions--single family housing mortgage guarantee and insurance programs.

Improving productivity involves (1) using fewer resources to obtain the same or more output without sacrificing quality or timeliness or (2) obtaining more output and/or increased quality or timeliness with the same resources. Assessing productivity involves not only identifying the current productivity level, but analyzing methods to improve productivity. We identified the potential improvements this report discusses by comparing the procedures VA, HUD, and private mortgage insurance firms use to process housing loan guaranty and insurance applications. This report is one of a series of productivity studies of common Federal functions we have made using a similar comparative approach.

NATURE OF MORTGAGE LOANS AND MORTGAGE INSURANCE

Unless a buyer can pay cash for a home, he or she must borrow to finance the difference between the purchase price and the down payment. This debt plus interest, typically repaid in monthly installments for as many as 30 years, is referred to as a mortgage loan. The lender is generally a bank, savings and loan association, mortgage company, mortgage banker, or insurance company. The home is the collateral for the mortgage.

Lenders considering a home buyer's request for a mortgage loan face two kinds of risk. The first relates to the ability of the buyer (borrower) to meet monthly payments on the mortgage loan. The second relates to the amount of the owner's (borrower's) equity--the amount by which the selling price or value of the property exceeds the amount owed on the mortgage loan. The higher an owner's equity (or borrower's down payment), the lower the risk because the owner has an incentive to continue making monthly payments or to sell the house and pay off the mortgage.

These two risks are addressed by a process called underwriting. The equity risk is addressed by determining the reasonable value of the property through appraisal and limiting the loan to the difference between the appraised value and the down payment. The expectation is that in the event of foreclosure, the property can be sold for the amount of the mortgage, thus precluding a loss. The ability to pay risk is addressed by assessing a buyer's income, assets, indebtedness, employment, and credit history.

However, some equity and ability to pay risks cannot be addressed by underwriting. Changing market conditions and the potential for the owner to abuse the property and reduce its value cannot be easily assessed. Also, a person's ability to pay can be affected by a multitude of unpredeterminable factors such as sickness, loss of job, reduction in income due to divorce, added credit purchases after loan approval, and death. These unpredictable events along with small down payments are two reasons lenders seek mortgage insurance.

Lenders have four mortgage insurance sources depending on the prospective borrower's qualifications and down payment.

--VA, if the borrower is a veteran.

--HUD, if the down payment is at least 3 percent (with some exceptions).

--Department of Agriculture, Farmers Home Administration, if the borrower lives in a rural area and meets certain requirements.

--One of about 15 private mortgage insurance companies if the down payment is at least 5 percent.

According to the Mortgage Insurance Companies of America, there was $960 billion in outstanding single family mortgages in 1980. Of that amount, $660 billion was not covered by mortgage insurance, $105 billion was insured by private sector insurers, and $195 billion was insured by the Federal Government.

PURPOSE AND AUTHORITY OF VA'S AND HUD'S INSURANCE PROGRAMS

Helping people finance home purchases is the primary objective of VA's and HUD's mortgage loan guaranty 1/ and insurance programs. Under their programs, the buyer applies for a mortgage loan from an approved lender and the lender has all or a portion of the loan insured by VA or HUD. The insurance protects the lender against loss if the borrower defaults. The insurance is intended to encourage lenders to provide financing to people who might not otherwise become home buyers, and to make it easier to buy a home by reducing the required down payment.

1/VA's program usually is referred to as a guaranty program and sometimes an insurance program. In this report, we will refer to it as an insurance program. Although VA does not assess an insurance fee to cover losses (as HUD and private insurance firms do), it has a revolving fund to cover the expenses incurred in loan foreclosures which to date has been self-sufficient.

Authority for VA's program

The authority for VA's mortgage loan insurance program is set forth in 38 U.S.C., chapter 37. VA is authorized to insure mortgages for qualified veterans who buy new and existing houses (of up to 4 separate units), mobile homes, and condominiums. It insures the first 60 percent of the mortgage loan or $27,500--whichever is less. No down payment is normally required. During fiscal 1980, VA processed 613,671 property valuation applications and 267,421 insurance approval applications (borrower-ability-to-pay determinations) and insured 327,896 loans including 68,740 for which lenders approved the loans for insurance under special procedures. Direct program costs for the entire loan insurance program 1/ were $49.9 million. These funds are congressionally appropriated as part of VA's budget.

Authority for HUD's program

HUD operates its single family mortgage insurance program under title II of the National Housing Act of 1934, as amended (12 U.S.C. 1707, et seq.). HUD is authorized to insure mortgages for any qualified buyers who purchase new and existing houses (of up to four separate units), mobile homes, or condominiums. It insures these loans for up to 97 percent of the first $25,000 of appraised value and up to 95 percent above that (for veterans, 100 percent and 95 percent) for up to 35 years. Limits on the amount of the loan--appraised property value--that can be insured vary depending on the type of home and the location, e.g., $90,000 for a single family house in a high cost area. The buyer must make a down payment to cover the difference between the loan amount and the sales price or appraised value.

During fiscal 1980, HUD processed 541,472 property valuation applications and 433,012 insurance approval applications (borrower-ability-to-pay determinations), and insured 394,582 loans. The field staff personnel cost for HUD's entire mortgage insurance program 1/ was $38.8 million. The program is self-supporting with funding from HUD's mutual mortgage insurance fund. Borrowers pay a premium of one-half of a percent for HUD mortgage insurance.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this review was to determine whether opportunities existed for improving productivity and reducing costs in VA and HUD administration of their single family loan mortgage insurance programs.

1/VA's and HUD's insurance programs involve three functions: (1) underwriting, (2) loan servicing, and (3) property management and disposition. Our review was limited to the first--the underwriting function involving property valuation and borrower credit activities.

We performed our review at the headquarters of VA and HUD and at four VA and four HUD field offices. The four VA field offices were: Chicago, Illinois; Minneapolis, Minnesota; Philadelphia, Pennsylvania; and Roanoke, Virginia. The four HUD field offices were: Chicago, Illinois; Minneapolis, Minnesota; Philadelphia, Pennsylvania; and Richmond, Virginia. We selected these field offices to obtain geographical coverage of program activities.

We discussed VA guaranty and HUD insurance programs with the Mortgage Insurance Companies of America, Federal National Mortgage Association, Mortgage Bankers Association, U.S. League of Saving Associations, and several lenders. We also obtained information on the insurance practices of private mortgage insurance companies from these sources.

Our basic audit approach was to compare the procedures used by VA, HUD, and private mortgage insurance firms. We interviewed headquarters and field office officials, analyzed agency reports of workload, timeliness, backlogs, and personnel utilization, and reviewed the legislation and regulations pertaining to these programs. We reviewed and analyzed operating procedures involved in insuring mortgage loans at VA and HUD. The financial, operational, and performance data used in this report was obtained mostly from agency records. We believe the data we used is reasonably reliable. We noted any qualifications in the text where the data is used.

We limited our HUD analysis to unsubsidized activities and our analysis of both HUD and VA to the underwriting function involving property valuation and borrower credit activity. We did not review the agencies' loan servicing, property management, or property disposition activities.

This review was made in accordance with our current "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

CHAPTER 2

GREATER RELIANCE ON COMMERCIAL LENDERS FOR UNDERWRITING WOULD REDUCE AGENCY PROCESSING COSTS AND IMPROVE SERVICE

VA and HUD could substantially reduce their costs while improving service to home buyers by relying more on approved commercial lenders to determine property values and borrowers' ability to pay--underwriting activities required in obtaining mortgage insurance. This insurance approach parallels commercial insurance practice where lenders are relied on for underwriting.

--VA has procedures for delegating underwriting authority to approved lenders, but only for borrower-ability-to-pay determinations. VA underutilized this procedure with only 22 percent of the loans processed by this means in 1980.

--HUD, for two years, has had delegated procedures authorizing approved lenders to determine both property values and borrowers' ability to pay. HUD is testing this procedure at about one-fourth of its offices; during the first year only about 1 percent of the loans were processed by this means.

An estimated 40 percent of insured loans could be processed under delegated procedures. Participation is limited because, among other reasons, many lenders do not meet agency qualifications for approval or process too few loans to make approval cost effective. If VA would extend its use of delegated underwriting authority to include property valuation and if HUD would extend its delegated authority to all its offices, we estimate that the agencies could not only save at least $4 million annually in personnel costs, but could also improve service to borrowers because delays in processing these loans would be avoided.

The agencies recognize the potential cost savings from relying on approved lenders for underwriting but are concerned with the added risk, particularly in delegating property value determinations. We believe the agencies' control systems over lender underwriting, if properly adhered to, are adequate to minimize the risk. Private mortgage insurers reportedly use similar controls when relying on lenders for underwriting.

AGENCIES UNDERUTILIZE COMMERCIAL LENDERS FOR UNDERWRITING

Sound management dictates that, in insuring home loans, VA and HUD keep their processing costs low while providing prompt service and minimizing their insuring risk--to a level consistent with their overall program objectives. A large portion of the processing costs involves underwriting--determining property value and a borrower's ability to pay. For making these underwriting determinations, the agencies have two procedures:

--In-house processing in which their employees arrange appraisals, determine property values based on these appraisals, and determine the prospective borrower's ability to pay.

--Delegated processing in which, under close monitoring, approved lenders perform one or both underwriting activities.

Under both in-house and delegated processing, lenders obtain and verify information for determining a borrower's ability to pay, and independent appraisers approved by VA or HUD make the appraisal on which the property value is based.

VA, since inception of its program, has been required by law to have an "automatic lender" program which delegates to approved commercial lenders the authority for determining borrowers' ability to pay, but not for determining property values. HUD, on the other hand, has for two years been testing an approach which delegates both borrower-ability-to-pay and property value determinations. 1/

The agencies' delegated authority procedures parallel commercial insurance practices in which lenders arrange appraisals, establish property values, and determine borrowers' ability to pay before submitting the package to a private mortgage insurer.

VA and HUD are both underutilizing commercial lenders for underwriting in two ways: (1) they have needlessly limited lender participation by restricting what lenders are authorized to do or the localities where lenders can be approved and (2) they are not obtaining full participation from lenders they have approved.

At VA, only 22 percent of the insured loans were processed by lenders in 1980. This is up from 9 percent in 1978. Moreover, lenders only determined the borrowers' ability to pay; VA employees determined the property values (based on appraisals by their approved appraisers). One factor limiting participation has

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1/VA is required by 38 U.S.C., chapter 37 to give qualifying lenders "automatic lender" authority to determine borrowers' ability to pay and also to approve loans which VA must insure. However, under 38 U.S.C. 1810 (b)(5), the final responsibility for making the property value determination belongs to VA. Lenders subject to Federal and State examinations, such as federally chartered banks, qualify as automatic lenders. Others, such as mortgage bankers, can qualify by meeting VA criteria. HUD's delegated procedures are used only in a test program started in 1980 at 18 of its field offices. HUD's criteria for approving lenders is similar to VA's but lenders also must provide "outreach" mortgage loan service to designated localities having a low volume of HUD loans. In contrast to VA, HUD can refuse to insure loans that lenders have approved.

been the tendency of approved lenders to submit for agency determination questionable cases where the prospective borrower's ability to pay is marginal. VA officials expressed the belief that they could obtain greater lender participation by thorough training of both lenders and VA field staff as well as promoting lender participation.

At HUD, the pilot program for delegated procedures is conducted at only about one-fourth of its field offices, and in 1980 only about one percent of the loans insured nationally were processed under delegated procedures. HUD officials stated that participation in its test was limited because of the requirement for lenders to provide outreach loan service which is costly, and perhaps by the provision which allows HUD to refuse to insure loans that lenders have approved. HUD officials are considering eliminating the outreach requirement.

Potentially about 40 percent of loans could be insured using delegated authority

It is not considered feasible to rely on lenders for underwriting of all insured loans for the following major reasons.

--Many lenders, particularly mortgage bankers who are VA's and HUD's major clients, may not meet the agencies' qualifications. They may not have the required financing or experience, for example.

--Many lenders insure such a small number of loans through VA and HUD that approval would not be cost effective for the lenders or the agencies.

We believe, however, that it should be possible to insure at least 40 percent of VA and HUD loans under delegated processing procedures. VA officials acknowledge that they could make greater use of their "automatic lender" procedure. They estimated that with proper promotion and additional training of their employees and lenders, from 40 to 50 percent of their loans could be insured this way. HUD officials estimated that, if its pilot program were extended, loan insurance processed under delegated authority would increase from 1 to 30 or 40 percent. It appears that delegation of about 40 percent could be achieved by working only with a relatively small number of lenders that account for much of both agencies' business. For example, in 1980 just 157 lenders accounted for 58 percent of the loans HUD insured.

SUBSTANTIAL COST REDUCTIONS AND IMPROVED TIMELINESS CAN BE REALIZED BY RELYING MORE ON LENDERS

By extending the use of delegated underwriting authority--VA to include property valuation and HUD to include all its offices--the agencies could make substantial reductions in personnel costs. Assuming that 40 percent of their loan volume could be insured under delegated processing, we estimate that VA and HUD could save between $4 million and $8 million in personnel costs, based on the mortgages insured during fiscal 1980. Of the savings, about one-third would accrue from borrower-ability-to-pay processing and two-thirds from property valuation processing. The amount saved would depend on the method used in processing. VA's procedure is to review each loan package as a check on lender performance. HUD's procedure is to review thoroughly all loans only until confident of the lender's capability; after that only a percentage of the loans are reviewed in such depth. Our savings are calculated applying VA's process. (Savings would be greater if HUD's approach were used.) 1/

The cost reductions would be realized in two ways. First, the agencies' processing effort would be reduced. It takes considerably less time to simply review lenders' determinations and completed packages than to prepare them initially. For example, in determining a borrower's ability to pay, it takes about one-half as much staff time to review an automatic lender package as to do the related work of calculating a borrower's net income, checking his or her credit record, and performing the related paperwork, according to VA's work measurement standards used in determining staffing requirements. Also, agencies would receive and process the paperwork once rather than three times--for both property and ability-to-pay determinations and insurance endorsement.

Secondly, the number of applications being sent to the agencies would be reduced. VA and HUD now receive many applications for both property valuation and credit worthiness determinations that do not result in an insurance endorsement. For example, in 1980 VA processed nearly twice as many property value determinations as

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1/Savings were calculated basically as follows using 1980 loan volumes. Borrower ability to pay - We determined the processing time per loan required by VA and HUD under delegated procedures, using VA's time standard for processing applications under its automatic lender procedure. We applied this time standard to the loans that could be insured using automatic procedures (40 percent of total loans). We then subtracted this estimated time from the current time used and multiplied the time savings by the average salary rate of persons performing this function at each agency.

Property value appraisal - We determined the required processing time per loan using HUD's time standards by deducting the time for inspection and clerical tasks that would not be performed with appraisals sent directly to lenders. (We used HUD's standards because they were more detailed.) We allowed the standard time for technical review assuming a desk review would be made of the appraisal for each insured loan. To determine the total time saved, we multiplied the time saved per loan by the number of loans that could be insured using automatic procedures (40 percent). We then multiplied the total time saved by the average salary rate of persons performing this function at each agency.

insurance endorsements. Under delegatd procedures, many applications that do not result in insured loans would be screened out by lenders. Had 40 percent of VA's and HUD's underwriting workload been processed under delegated procedures in fiscal 1980, they might not have had to handle about 194,000 applications for property valuation and 40,000 applications for borrower credit determinations.

Lenders' costs may be somewhat higher under delegated processing since they perform activities otherwise performed by VA and HUD. These increases would be borne by the borrower as they are under a commercial mortgage loan. On the other hand, lenders at a minimum, assess a borrower's ability to pay and may check the property appraisal before submitting loans for insurance. Hence, they may not have to do a lot more work than they would when VA and HUD perform the underwriting.

Having commercial lenders perform the underwriting will also improve service to borrowers by avoiding processing delays that occur at VA and HUD during peak periods when the workload exceeds staff capability. Delays in processing property valuation and borrower-ability-to-pay applications during workload peaks is a chronic problem for VA and HUD. Delays were experienced in varying degrees at all field offices we reviewed. Delays in granting insurance would be avoided under delegated processing since lenders would grant the loan before sending the paperwork to either agency. Unlike VA, HUD, under its current legislation, has authority to refuse to insure a loan.

AGENCIES ARE CONCERNED WITH ADDED RISK IN FULLY EXTENDING DELEGATED PROCESSING

The agencies recognize the potential cost savings from relying on approved lenders for underwriting, but are concerned with what they view as the added risk--to some an unacceptable risk--in doing so. In view of VA's years of experience in delegating borrower-ability-to-pay determinations, its key concern is with delegating property valuation. VA officials consider this as more of a problem than do HUD officials.

VA officials stated that its delegated process for borrower-ability-to-pay determinations saves money and that they should make greater use of it, but believe extending the process to property valuation activities is too risky. We do not agree. VA already has taken the most critical steps in this process by (1) having property appraised and checked by approved independent appraisers and inspectors and (2) having its field staff select the appraiser for each property appraisal request. 1/ This provides for a separation of duties to protect against improper activities and

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1/Property is inspected to ensure that construction conforms to VA and HUD standards and that repairs or alterations that are required to meet VA and HUD standards are properly performed.

overstatement of property values by lenders. Further, as in VA's own "inhouse" procedure, 10 percent of each appraiser's work would be checked for reasonableness by VA field staff. Thus, property values would be set in essentially the same way under both inhouse and delegated procedures. The difference would be that under delegated procedures appraisals would be given directly to lenders. Under its inhouse procedures, appraisals are given to VA, and after desk review VA issues lenders a resonable value determination. In our opinion, desk reviews of appraisals provide very little added quality assurance. While the procedures and arithmetic can be verified, an on-site observation is necessary to truly assess an appraisal. In this regard, we found that VA seldom substantially adjusts the appraised value.

VA's legislation states that it is VA's responsibility to make the property value determination. In this respect, 38 U.S.C. 1810 (b)(5) provides as follows:

> "* * *that the price paid or to be paid by the veteran for such property, or for the cost of construction, repairs, or alterations, does not exceed the reasonable value thereof as determined by the Administrator."

Accordingly, a change in the statutory language would appear necessary to permit VA to have appraisals sent directly to lenders. Wording such as the following would suffice.

> "* * *that the price paid or to be paid by the veteran for such property, or for the cost of construction, repairs, or alterations, does not exceed the reasonable value thereof as determined in accordance with standards and procedures established by the Administrator."

HUD officials advised us that its delegated processing test was working well, and that no significant lender performance problems were encountered. While favoring expansion of delegated processing, the officials thought quality could drop because of insufficient monitoring and conflict of interest when lenders do their own underwriting. Thus far, this has not been the case according to test office reports. At the time of our review, HUD had not set a date for completing its test. However, a task force was established in December 1981 to begin work on expanding the delegated processing approach nationwide. Several alternatives were being considered, some of which might require statutory authority.

VA and HUD have adequate private-sector-type controls to address risk

The agencies have control systems similar to private insurers which we believe are adequate to minimize their risk in relying on lenders to perform the entire underwriting function. In addition to the two basic risks in making home mortgage loans (see p. 1), mortgage loan insurers who rely on lenders for underwriting face a third risk. This risk arises from the potential for default and loss on foreclosure due to the lender's carelessness or questionable underwriting practices. Private mortgage insurers, who normally rely on lenders for underwriting, protect against this risk as follows.

The private mortgage insurance firms and lenders dealing with private insurers that we talked with said that private insurers scrutinize the lender's capability, expertise, and reputation before issuing the lender a master policy. Some of them further monitor lender performance through various quality control measures including

--spot checking appraisals and borrower credit determinations and

--keeping aging and exception reports which "flag" defaults, servicing problems, and delinquencies.

When private insurers note poor quality lender work they may temporarily suspend their business with that lender or even revoke the lender's master policy.

VA and HUD employ similar controls in their delegatd processing procedures to protect against poor lender performance. Both agencies

--have stringent criteria for firms to qualify as delegated lenders (for example, 5 years experience in originating and servicing HUD and VA insured mortgages) and equally stringent requirements for their chief underwriter,

--have due process procedures to remove lenders that do not meet agency performance standards,

--list approved appraisers who meet their criteria and performance standards,

--select the appraisers for individual property appraisals, and

--conduct a quality control evaluation of 10 percent of each appraiser's valuations.

Also, HUD field offices conduct a quality control evaluation of 10 percent of loans approved by each lender and may reject, with headquarters' approval, questionable loans approved by lenders. VA field offices review each approved loan and rate lender performance. VA cannot refuse to guarantee a mortgage submitted under its automatic lender procedure but it can suspend or expel the lender from further participation because of poor underwriting.

CONCLUSION

We believe an acceptable quality level on mortgages insured under delegated processing can result if VA and HUD diligently perform their monitoring functions and aggressively enforce existing procedures for removing lenders and appraisers who do not satisfy VA and HUD performance standards. Accordingly, and because relying on commercial lenders will improve service to home buyers and reduce VA's and HUD's costs, we believe that VA and HUD both should adopt as policy the private mortgage insurers' practice of relying to the extent practicable on commercial lenders for underwriting. Specifically, commercial lenders should determine property values (based on appraisals by agency-selected appraisers) and borrowers' ability to pay. The agencies should seek those amendments to their respective statues that could be required for this purpose. The agencies could continue to underwrite in particular circumstances in which they believe doing so is necessary to provide adequate service or protect the Government's interest. For example, VA could continue to determine property values for appraisals requested by home sellers. (HUD accepts appraisal requests only from lenders.)

We generally favor testing significant process or system changes to assure their workability before implementation. In this case, however, we believe that VA's long experience in relying on commercial lenders to determine borrowers' ability to pay and the long experience of private mortgage insurance firms in relying on commercial lenders, not only to determine borrowers' ability to pay but also to arrange appraisals and determine property values, sufficiently demonstrates the merits and reliability of depending on commercial lenders for underwriting. Moreover, HUD's test should by now have provided sufficient experience for HUD to assess and decide on the adequacy of its controls. Thus, while not totally opposed, we believe additional testing by the agencies, except to facilitate phased implementation, would be superfluous.

RECOMMENDATIONS

The Administrator of Veterans Affairs should:

--Obtain participation from more lenders in its automatic lender procedure.

--Extend coverage of its automatic lender procedures to include determination of property values based on appraisals by VA approved appraisers, and apply appropriate quality control procedures to the expanded delegated activity. VA should seek those amendments to its statutory authority that are required for this purpose.

The Secretary of Housing and Urban Development should:

--Extend HUD's delegated processing authority nationwide and encourage qualified lenders to participate by eliminating the outreach requirement.

--Establish a system for assessing and reporting on the quality of lender performance.

AGENCY COMMENTS

VA and HUD provided written comments on a draft of this report. (See apps. I and II.) HUD, in its comments, stated that our recommendations supported efforts it had undertaken to move forward with a delegated program. VA agreed with our recommendation to make greater use of its automatic lender underwriting procedure giving approved lenders authority to determine borrowers' ability to pay. But, in contrast with HUD, VA did not agree with our recommendation to extend its automatic lender procedure to include determination of property values, maintaining it would make the loan guarantee program more susceptible to abuse. VA based its objection on two premises. First, VA stated that by allowing lenders to choose an appraiser from VA's approved list there would be a strong tendency for lenders to select appraisers who place the highest values on properties. Because higher realty values mean higher loan amounts, unscrupulous lenders and appraisers could take advantage of veterans and VA. Second, VA stated that a sample of field reviews of appraisals, by themselves, would not provide sufficient protection for veterans or the VA.

As is made clear in our report, we disagree with VA, and believe that in objecting it overlooked some important points.

First, property appraisals would continue to be prepared by appraisers VA has checked and approved. Also, rather than have lenders select the appraiser (which we did not suggest), VA could also select the appraiser as it does now and as HUD has been doing. To provide further protection, we would expect VA to continue to perform field reviews of a percentage of appraisals as a check on the performance of their approved appraisers. It could also desk review for accuracy each appraisal. (As stated on p. 8, the amount of cost savings would vary depending on the review method used.) Any appraiser found making poor or unscrupulous appraisals could be removed from VA's approved list. We believe these controls are adequate to protect both veterans and the taxpayer.

Second, Veterans would be provided faster service if appraisals were given directly to lenders because periodic delays in processing at VA field offices would be avoided. We believe that veterans are at least as concerned with getting fast service from the Government as they are in being protected.

In sending our report to the Administrator of Veterans Affairs we urged him to reconsider VA's objection and at least test our recommended approach.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

OFFICE OF THE ASSISTANT SECRETARY FOR
HOUSING - FEDERAL HOUSING COMMISSIONER

March 22, 1982

Mr. W. D. Campbell
Acting Director
Accounting and Financial Management
Division
General Accounting Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Campbell:

Secretary Pierce has asked me to respond to Mr. Eschwege's letter of February 16, 1982, transmitting a proposed report to the Congress entitled "VA and HUD Can Improve Service and Reduce Processing Costs in Insuring Home Mortgage Loans" (assignment code 910317).

The two recommendations set forth in the study support efforts which were undertaken by the Department over the last several months. Specifically, a task force was established within the Department during late 1981 to begin work on expanding HUD's delegated single-family program nationwide. As a part of this effort, a system for monitoring the quality of the lender's delegated performance is being developed and will be implemented as standing procedures for field offices to utilize under delegated processing procedures.

We appreciate the opportunity to comment on this study and are extremely pleased that it supports our decisions to move forward with a strong delegated program.

Very truly yours,

Philip Abrams
General Deputy Assistant Secretary-
Deputy Federal Housing Commissioner

APPENDIX II

Office of the
Administrator
of Veterans Affairs

Washington, D.C. 20420

Veterans
Administration

MARCH 17 1982

Mr. Gregory J. Ahart
Director, Human Resources Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Ahart:

The February 16, 1982, draft report, "VA and HUD Can Improve Service and Reduce Processing Costs in Insuring Home Mortgage Loans," has been reviewed and my comments on the report findings, conclusions, and recommendations are enclosed.

Thank you for the opportunity to comment on this report.

Sincerely,

ROBERT P. NIMMO
Administrator

Enclosure

Enclosure

VETERANS ADMINISTRATION RESPONSE TO THE FEBRUARY 16, 1982 GAO DRAFT REPORT, "VA AND HUD CAN IMPROVE SERVICE AND REDUCE PROCESSING COSTS IN INSURING HOME MORTGAGE LOANS"

GENERAL COMMENTS

I agree with GAO's conclusions concerning increased program promotion and Veterans Administration (VA) personnel and lender training. Field office personnel are required to make frequent and regular visits to lenders and lenders associations in order to provide advice, assistance, and training on program matters. The VA's Loan Guaranty Service has made an effort in recent years to assure that personnel making these visits stress the advantages of automatic processing by authorized lenders. To the extent staffing and travel fund limitations allow, VA will continue to conduct training sessions and promote more use of automatic loan processing.

With respect to the report findings regarding aggressive enforcement of suspension procedures, the VA has mechanisms for removing or withdrawing automatic processing authority if lenders' performance is unsatisfactory. However, removal has proven to be extremely difficult, time consuming, and expensive. Title 38, United States Code section 1802(3), gives me the authority to require a lender to submit loans on the prior approval basis upon 30 days' notice. The authority to close loans automatically, once granted, is considered a proprietary right and as such, it is necessary to prove cause before it can be removed. The proof must be objective and credit underwriting is, by nature, a subjective decision. Therefore, in the absence of the most flagrant abuses, it has been very difficult to remove automatic processing authority.

RECOMMENDATIONS

The Administrator of Veterans Affairs should:

--Obtain participation from more lenders in its automatic lender procedure and extend coverage to include determination of property values based on appraisals by appraisers designated by VA.

--Ensure that appropriate quality control procedures are applied to the expanded delegated activities.

RESPONSE TO THE RECOMMENDATIONS:

I agree that an expansion of the automatic loan underwriting program is desirable. Approval criteria for nonsupervised lender participation are under constant review to see if any requirements may be relaxed, allowing more lenders to participate but still assuring adequate protection of veterans' and the Government's interests. In 1975, VA gave nonsupervised lenders authority to close VA loans on the automatic basis. On three occasions since 1975, significant aspects of the approval criteria have been modified to make it easier for more lenders to qualify. The requirement that lenders must maintain a minimum loan servicing portfolio of 1,000 VA-guaranteed loans was reviewed shortly after the program began and the requirement was reduced to 500 VA loans. Subsequently, the minimum number was further reduced to a total of 500 loans, of which only 250 had to be guaranteed by VA.

I do not concur in the recommendation that authority to determine property values be delegated to lenders. Undoubtedly, personnel costs could be reduced if lenders were permitted to obtain appraisal reports directly from the fee appraisers but the Loan Guaranty Program would become much more susceptible to abuse. The VA maintains a list of approved appraisers in each state and the lender would be free to chose any appraiser on the list. This would not be in the best interest of veterans or the Government because there would be a strong tendency to select appraisers who place the highest values on properties. Higher realty values mean higher loan amounts; therefore, unscrupulous lenders and appraisers could take advantage of veterans and the VA.

The law requires that the amount of a Government Insured (GI) loan not exceed the reasonable value of property, and in turn, VA's guarantee is set as a fixed percentage of the loan amount. VA's liability under the guaranty agreement is directly related to the soundness of the appraisal report. In the event of foreclosure, the direct costs to the Government are primarily determined by the outstanding loan balance, unpaid interest, and property value at the time of liquidation. If the property value is overstated at loan origination, most likely the Government's outlays and the veteran's indebtedness will be greater than necessary. Therefore, it is imperative that VA review the appraisal to verify the valuation before loan closing. In addition, we are doing a disservice to veterans if we permit them to use their GI loan benefit to acquire homes for more than reasonable value without first advising them of the fair market value.

I do not believe that a sample of field reviews of appraisals, by themselves, would be sufficient protection for veterans or the VA if lenders had authority to obtain appraisals and determine property values.

OTHER COMMENTS

I suggest two technical corrections be made in the report. For convenience, the report refers to VA's program as an insurance program, rather than a guaranty program. (See footnote 1 on page 2 of the draft report.) I have no objection to this terminology as long as it is adequately explained. The footnote should include a statement that, unlike both private and HUD insurance programs, VA collects no insurance fee with the monthly payment. The insurance fund created by these fees enables both private insurers and HUD to take certain commercial risks that VA's guaranty program cannot afford to take.

My other comment pertains to the statutory authority for VA's Loan Guaranty Program. On page 2, the draft report cites the "Serviceman's Readjustment Act (1944)." Although that statute, which is actually entitled "Servicemen's Readjustment Act of 1944," created the program, it was repealed by Public Law 85-857, section 14(87), 72 Stat. 1105 (1958). The correct authority for the VA home Loan Guaranty Program is chapter 37 of title 38, United States Code.

(910317)

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