

Statement of  
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before the

Subcommittee on Housing and Memorial Affairs  
of the  
Committee on **Veterans'** Affairs  
United States House of Representatives

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Mr. Chairman, I am pleased to appear before your Committee today to discuss the current condition of the Veterans Administration (VA) loan guaranty program and the outlook for the coming years. As you know, the main function of the VA's Loan Guaranty Revolving Fund (Guaranty Fund) is to guarantee **veterans'** residential mortgages for 60 percent of their principal value up to \$27,500. As of the end of fiscal year 1983, the VA had guaranteed some 11.5 million loans with an aggregate value of \$200 **billion**.

#### A FUNDING PROBLEM

The Congressional Budget Office projects that, under current policies, the Guaranty Fund will have a negative balance of \$127 million by the end of this fiscal year. By the end of 1989, shortfalls are projected to exceed \$1 billion. Two main problems account for this poor prospect for the Guaranty Fund:

- o Unprecedented default rates on VA mortgage loans in the wake of the recent recession, and
- o Loss of the external support that has traditionally helped to keep the Guaranty Fund **afloat**.

## Defaults

The costs of a VA loan default fall to the Guaranty Fund, whose role it is to provide restitution to the lender (commonly some private lending institution) either by paying off the guaranty or by purchasing the property. When the VA purchases a property, it then attempts to resell it, offering the new purchaser a direct mortgage, or "vendee loan." Receipts from the property sale or from the subsequent sale of the vendee loan are deposited in the fund. In general, the VA loses money as a result of property acquisitions and subsequent resales. The current record-high defaults, a consequence of the recent recession, are thus one source of extreme pressure on the Guaranty Fund.

## Loss of Past Subsidization

In the past, when shortfalls occurred in the Guaranty Fund, another VA account—the Direct Loan Revolving Fund (Direct Fund)—has provided the cash needed. Thus far, the Direct Fund has contributed nearly \$2 billion toward the support of the Guaranty Fund. Now, however, this recourse is no longer available. Partly as a result of recent administrative budget-cutting measures, the Direct Fund is radically reduced in scale and purpose. Past transfers to the Guaranty Fund and liquidation of assets have depleted the Direct Fund. The VA therefore expects further subsidization by the Direct Fund to be impossible, at least for the near future.

## FUNDING OPTIONS FOR FISCAL YEAR 1984

The immediate situation indicates that prompt action is necessary to assure the Guaranty Fund's ability to keep its 1984 commitments. The VA has indicated that it may request a special supplemental appropriation to cover the Guaranty Fund's 1984 obligations. In addition, the Senate Committee on Veterans' Affairs has ordered reported S.2391, a bill that would increase the fee charged for home loans made or guaranteed by the VA. Under S.2391, this so-called "origination fee"--first implemented in 1983 and scheduled to end in 1985--would rise from one-half of 1 percent of the loan principal to a full 1 percent. The bill would also require that origination fees be deposited in the Guaranty Fund between March 31, 1984 and September 1985; under current law, fees are returned to the Treasury. If the Congress enacted S.2391 immediately, the Guaranty Fund's 1984 shortfall would be decreased by \$90 million. Together with a small supplemental appropriation, this would alleviate 1984 funding problems.

## OPTIONS FOR 1985-1989

The prospect for an accumulated deficit of \$1 billion in the Guaranty Fund by 1989 clearly signals a need for farther-reaching solutions. One approach would entail changes to reduce the Guaranty Fund's future operating costs or increase its collections through improved operating efficiency. Two operating strategies CBO has examined are:

- o The Administration proposals, and
- o An approach that would improve financial comparisons underlying individual VA decisions.

A principal distinction between these approaches is that the Administration's plan, like current policy, would have all default cases handled in a single, uniform manner, whereas an improved case-by-case determination basis would accommodate the often pronounced **differences** among cases.

Neither of these operating strategies would entirely eliminate the Guaranty **Fund's** deficits, however. So I will also discuss other options for financing the Guaranty Fund's **deficits**.

#### Possible Operating Changes

The Administration's Proposals. In its budgetary request for fiscal year 1985, the Administration proposed a number of changes in the operating procedures of the VA's mortgage program. Two major features would provide:

- o That the VA no longer acquire a property at foreclosure but instead pay the lender the amount of the guaranty applicable to the foreclosed loan, and
- o That the VA would no longer offer its own financing (vendee loans) for the resale of properties acquired from foreclosures.

In addition, the Administration proposes that the VA stop offering repurchase agreements on sales of vendee loans already in its portfolio, and that the VA no longer purchase from the lender a guaranteed loan in ~~default--a~~ provision designed to grant the veteran-homebuyer special forbearance.

The changes proposed by the ~~Administration--though~~ they would result in an outlay savings of about \$500 million over the ~~1984-1989 period--would~~ merely substitute one single course of action for another. Moreover, while conferring some immediate benefits, this plan might have undesirable long-run characteristics. Paying the guaranty in all VA foreclosure cases would ultimately cost the revolving fund more than the current policy of acquiring properties. Historically, the average amount payable under a VA guaranty is larger than the average net loss experienced by the VA on an acquisition and resale. Initial reduction in outlays would thus be more than offset in later years by the subsequent elimination of collections from the sale of the properties and related vendee loans.

Improved Financial Comparisons. The CBO analysis indicates that the major inefficiency in the VA loan guaranty program's current operating procedures is that all loans under foreclosure and all real property available for sale by the VA are handled in a like manner. CBO has concluded that the VA can only maximize its financial position on transactions of this program if it makes a case-by-case comparison of the full financial consequences of all alternative actions. CBO estimates that this approach could reduce the VA's 1984-1989 outlays by \$635 million--\$128 million more than the Administration's plan.

In the past, the cost comparisons made by the VA have virtually always led it to conclude that it should acquire a property. But these comparisons have been based on estimates of acquisition costs that are systematically underestimated. With more complete cost accounting, two effects could reasonably be expected: the VA would pay the guaranty instead of offering to acquire the property in about 10 percent of all foreclosure cases; and in those cases in which the VA did offer to acquire, the price it specified to the lender would be lowered. CBO has estimated that this relatively minor change in VA procedures could reduce 1984 outlays by about \$110 million. From 1985 through 1989, outlays would be further reduced by more than \$200 million.

CBO has examined a sample of 65 recent cases in which the VA had acquired a property as the result of a foreclosure. (Details and analysis of

this study will be provided in a forthcoming CBO paper.) Among these cases was one in which the appraised value of the property at the time of foreclosure was less than 80 percent of the amount the VA had paid the lender to acquire it. In a contrasting case, one property had an appraised value 20 percent higher than the VA's initial cost of acquisition. In such discrepant cases, no single approach--neither acquiring the property nor paying the guaranty--would minimize the cost of satisfying the VA's guaranty.

Similarly, no single approach is appropriate for decisions about disposing of properties acquired at foreclosure. The properties in CBO's sample ranged from a \$15,000 two-bedroom detached house in an economically depressed neighborhood in Detroit to a \$90,000 high-rise condominium apartment in Los Angeles. While a vendee loan would probably not significantly increase the selling price of the Los Angeles condominium, whether the Detroit property could be sold at all without a vendee loan is doubtful. CBO's analysis indicates that larger net savings could be obtained by offering for sale without vendee financing those properties likely to sell for cash and by tightening the credit standards applied to those vendee loans that are needed to sell the remaining properties at a reasonable price. If the VA limited vendee financing to those properties that would not be expected to qualify for other mortgages, CBO estimates that \$280 million could probably be saved between now and 1989. Tightening credit standards on vendee loans would bring the estimated savings associated with these improvements



in the financial management of the Guaranty Fund to \$635 million through 1989.

Clearly, however, none of these **options--including** the Administration's proposed **changes--promises** to put the Guaranty Fund on a sound and self-sufficient footing permanently. As Table 1 shows, with any of these measures in effect, the fund would again be in a deficit position before the end of the **1984-1989** projection period. **CBO** has therefore considered strategies for funding the recurring shortfalls.

#### FUNDING OPTIONS TO CLOSE REMAINING DEFICITS

Remaining deficits in the Guaranty Fund could be financed either by:

- o Extending and crediting loan origination fees to the Guaranty Fund rather than to the Treasury, or
- o Appropriating the money needed directly or indirectly to the Guaranty Fund.

In considering the merits of these choices, the Congress would confront a necessary choice between general taxpayer financing and specific user financing. The appropriation approach would continue general taxpayer support for the VA mortgage program. Relying on income from origination

TABLE 1. FUNDING REQUIREMENTS OF THE VA LOAN GUARANTY REVOLVING FUND UNDER ALTERNATIVE APPROACHES, 1984-1989 (In millions of dollars)

	1984	1985	1986	1987	1988	1989	1984-1989
Funding Requirements Under Current Policies (Baseline)	127	109	9	180	301	384	1,110
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Cost Impact of Administration's Proposals (Savings (-)/Costs (+))	-360	-264	161	63	-38	-90	-528
Remaining Funding Needed	0	0	0	25	263	294	582
Cost Impact of Improved Financial Comparisons (Savings (-)/Costs (+))	-207	-193	-18	-46	-80	-103	-647
Remaining Funding Needed	0	0	0	0	182	281	463

fees would alter the program fundamentally, making it a user-supported service. The current imposition of origination fees represents a temporary partial step in this direction. The choice between these alternative approaches would be influenced largely by whether the Congress continues to regard homeownership assistance for veterans as an aspect of compensation for military service that is properly supported out of general tax collections.

#### Origination Fees

As I noted earlier, S.2391 would increase the origination fee to 1 percent of the loan principal and would deposit the fees in the Guaranty Fund as of April 1, 1984. This measure would reduce the 1984 fund deficit to \$37 million and would eliminate the deficits expected in 1985 and 1986 (see Table 2). Without an extension of the termination date, however, the fee hike would not affect the Guaranty Fund's deficits after 1987.

Alternatively, the Congress could extend the collection of fees beyond the 1985 termination date at the current one-half percent level or at the increased 1 percent level suggested by S.2391. The collections that would be expected under these options are also shown on Table 2. Crediting a permanent 1 percent origination fee to the Guaranty Fund would bring in sufficient collections to ensure the fund's solvency through 1989 with no other change in law or program operations. After 1987, however, the annual

TABLE 2. EFFECTS OF ORIGINATION FEE OPTIONS ON REQUIREMENTS OF THE VA LOAN GUARANTY REVOLVING FUND, 1984-1989 (In millions of dollars)

	1984	1985	1986	1987	1988	1989	1984-1989
Funding Requirements Under Current Policies (Baseline)	127	109	9	180	301	384	1,110
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Extended Collections of Fees at 0.5 Percent	90 <u>a/</u>	111	126	143	159	171	800
Extended Collections of Fees at 1 Percent	180 <u>a/</u>	222	252	286	318	342	1,600
Collections of Fees Under S.2391	90 <u>b/</u>	222	0	0	0	0	312

a. Full-year impact.

b. A total of \$135 million in fees would be expected in 1984 under S.2391, but only the \$90 million collected after April 1, 1984 would be credited to the Fund.

fee collections would fall below the annual fund deficits, and excess collections from prior years would have to be used to make up the difference. CBO projects that the operating deficits under current policies will be so large after 1990 that appropriations will be required in addition to the higher fees. Only if the permanent 1 percent origination fee is credited to the fund, in combination with improvements in the operating efficiency of the program, could this approach be expected to maintain the fund's solvency permanently. A drawback in any scheme involving automatic financing by origination fees, however, is a potential loss of Congressional control.

#### Appropriations

A measure of Congressional control could be restored by resorting to financing the Guaranty Fund's deficits through the annual appropriations process. Indeed, if the monies needed were appropriated to the VA's Readjustment Benefit Account and then transferred to the Guaranty Fund, no change in authorizing legislation would be needed.

Mr. Chairman, this concludes my remarks. I will be happy to respond to any questions the Committee may have.