**STATEMENT OF**
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**DEPARTMENT OF VETERANS AFFAIRS**
**BEFORE THE**
**SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY**
**HOUSE COMMITTEE ON FINANCIAL SERVICES**

**APRIL 16, 2008**

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Ms. Chairwoman and members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the underwriting standards used by the Department of Veterans Affairs (VA) Loan Guaranty Program at time of loan origination, the loss mitigation tools available to our borrowers over the course of their loans, including guidance given to loan servicers, and performance data of loans guaranteed by VA over the past ten (10) years.

First, I would like to describe VA's underwriting standards. Lenders underwriting VA loans must ensure that the contemplated terms of repayment bear a proper relation to the veteran's present and anticipated income and expenses, and that the veteran is a satisfactory credit risk. VA's credit standards employ the use of residual income guidelines and debt-to-income ratios in determining the adequacy of the veteran's income.

Residual income is the amount of net income remaining (after deduction of debts and obligations and monthly shelter expenses) to cover family living expenses such as food, health care, clothing, and gasoline. VA considers

minimum residual income (balance available for family support) as a guide. Minimum residual income does not automatically trigger approval or rejection of a loan. Instead, underwriters should consider residual income in conjunction with all other credit factors. If residual income is marginal, underwriters should look to other indicators, such as the applicant's credit history, and, in particular, whether and how the applicant has previously handled similar housing expenses. However, an obviously inadequate residual income alone can be a basis for disapproving a loan.

VA uses the borrower's debt-to-income ratio to compare total monthly debt payments (housing expense, installment debts, and so on) to gross monthly income. In our program, a ratio greater than 41 percent generally would require close scrutiny of the loan package. The debt-to-income ratio is also a guide and lenders should consider the debt-to-income ratio in conjunction with all other credit factors. In practice, it is a secondary underwriting factor to residual income.

Lenders are expected to use good judgment and flexibility in applying these guidelines, and the underwriting decisions must be based on the sound application of the underwriting standards. VA seeks to give veterans the benefit of the doubt with regard to credit and instructs lenders to examine compensating factors when making an underwriting decision.

The Committee also requested that I describe VA's guidance given to mortgage servicers regarding loss mitigation for loans guaranteed under the VA Loan Guaranty program. VA published guidance to mortgage servicers in February 1994 in the VA Servicing Guide, Handbook H26-94-1, in Chapter 3, titled Alternatives to Foreclosure. As an introduction, the guide states "VA … expects every realistic alternative to foreclosure which may be appropriate in light of the facts in each case to be explored before a loan is terminated by foreclosure…. Alternatives to foreclosure should be discussed with borrowers by the holder as soon as possible in the course of the default, preferably before legal action is initiated…." The guide provides specific information on extended repayment plans, forbearance, loan modifications, "short" sales (with VA paying a compromise claim for the mortgage balance not satisfied by proceeds of a private sale), and deeds in lieu of foreclosure.

In 1995, VA established a Servicer Loss Mitigation Program to provide specific guidelines on processing short sales and deeds in lieu of foreclosure without VA prior approval. VA also began paying incentives for the successful completion of those alternatives for servicers, which had agreed to comply with the program guidelines.

Over the years, VA has also taken an active role in supplementing the servicing of private loan holders by attempting to contact veteran borrowers when their loans are reported as being seriously delinquent. VA has provided financial

counseling and assistance in developing reasonable repayment plans, which could be proposed to the private loan servicers.  VA’s efforts in fiscal year 2007 resulted in foreclosure avoidance of more than 57% of seriously delinquent cases.  VA representatives helped arrange 8,453 repayment plans or other forbearance agreements on such cases that eventually reinstated, thereby avoiding claim payments estimated at more than $181 million.

In February of this year, VA published an extensive regulatory package that was the result of a business re-engineering effort to assess the servicing of VA-guaranteed home loans.  The project goal was to improve service to veterans by standardizing internal operations, while also recognizing best practices within the mortgage servicing industry.  VA developed procedures to ensure that servicers would utilize the full range of alternatives previously considered by VA in its supplemental servicing in order to help veterans mitigate potential losses. The new environment utilizes the latest information technology to assist VA in gaining greater oversight of efforts to help veterans retain their homes during financial difficulties.  The new environment is called VALERI, which stands for the VA Loan Electronic Reporting Interface.

VALERI is being phased in during the remainder of this calendar year and presently covers about 30% of the delinquent VA home loans.  Under VALERI, VA has provided regulatory definitions for repayment plans and special forbearance assistance, and has prescribed conditions for consideration of loan

modifications, short sales, and deeds in lieu of foreclosure. VA also has established a system of incentive payments for completion of loss mitigation alternatives, that will vary in part based on servicer performance on criteria that will be determined over the next two years. Those criteria will factor into servicer tier rankings, with all servicers entering into VALERI in Tier two of the ranking system, with rankings to be adjusted based on performance in servicing loans.

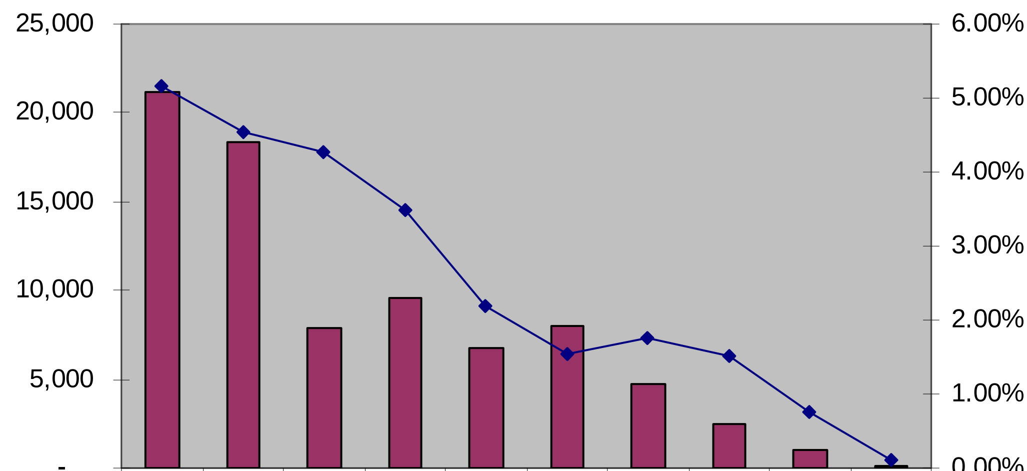
Lastly, the Committee asked that I describe the performance of loans guaranteed under the VA Loan Guaranty program under recent (last 10 years) standards, including the number and percentage of loans ending in foreclosure. The VA program has fared well in recent years with regard to foreclosure rates. According to data from the Mortgage Bankers Association, the quarterly delinquency rate for VA loans during the past five years declined from 7.81% to 6.49% as compared to prime loans, which increased from 2.69% to 3.24%. Over that same time period, delinquency rates for subprime loans increased from 14.74% to 17.31% and, for FHA loans, the rates increased from 11.23% to 13.05%. Similarly, during that same period, the percentage of VA foreclosures started in the first quarter of 2002 was .47% and decreased to .39% in the fourth quarter of 2007. In comparison, the rates increased from .20% to .41% for prime loans, 2.18% to 3.44% for subprime loans, and .81% to .91% for FHA loans.

The MBA data is obtained from members that report information on a voluntary basis, and is considered to be the best measure of outstanding

delinquencies at the present time. Once VA has the new VALERI environment fully operational, we will be able to easily track delinquencies on all outstanding VA loans. Until that time, VA relies on actual defaults and terminations reported to determine the rate of liquidation by cohort year.

Looking back ten years, for loans originated in 1998, 5.16% have been liquidated. Since that time, there has been an overall decline in the liquidation percentage as displayed in the chart below.[1]

**Liquidations by Cohort Year**




| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|---|---|---|---|
| Number of Liquidations | 21,16 | 18,40 | 7,923 | 9,527 | 6,734 | 7,973 | 4,716 | 2,513 | 1,068 | 132 |
| Percent of Liquidations | 5.16% | 4.55% | 4.28% | 3.50% | 2.20% | 1.54% | 1.75% | 1.52% | 0.77% | 0.10% |

This concludes my testimony. I appreciate the opportunity to speak before you today. I will be pleased to answer any questions you may have at this time.

[1] Liquidations generally peak between year 3-5 of the loan, so the actual liquidations for cohort years 2002 and later are likely to increase, however, total liquidations have been declining along the same path as foreclosures since 1998.