



**Testimony of James H. Danis II, CMB, AMP**

**President**

**Residential Mortgage Corporation**

**Before the**

**House Veterans Affairs**

**Subcommittee on Economic Opportunity**

**Hearing on**

**“The Status of the Loan Guaranty Program”**

**May 20, 2010**

Chairwoman Herseth Sandlin, Ranking Member Boozman, and members of the subcommittee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA)<sup>1</sup> on the status of the U.S. Department of Veterans Affairs (VA) loan guaranty program. I am James H. Danis II, and President of Residential Mortgage in Fayetteville, North Carolina, a Certified Mortgage Banker, and MBA member.

I have been in the mortgage business for 17 years and have worked with the VA Home Loan Guaranty Program since 1993. Approximately 70 percent of the loans my company closes are VA loans. In North Carolina, loans guaranteed by VA are an important part of our market and their use is increasing. During fiscal year (FY) 2008, 13,152 VA loans were originated in our state and in fiscal year 2009, 20,548 loans were closed. On a personal note, I am a beneficiary of the VA Home Loan Guaranty Program. The homes my parents purchased to raise me and my siblings were bought with VA loans. In keeping with our family tradition, my first home was financed with a VA loan. For many reasons, I am a strong advocate of this guaranty program.

Congress established the VA Home Loan Guaranty Program, under which an eligible veteran could obtain a low-interest, 100 percent loan-to-value (LTV) mortgage loan to buy a house, in 1944. The program was one of the major innovations and an important part of the original Servicemen's Readjustment Act of 1944, commonly known as the "GI Bill." Since its inception, the objective of the program has been to assist eligible veterans and active duty service members in becoming homeowners. The VA program is designed to benefit men and women because of their service to the United States, and is not intended to fulfill general economic or social objectives.

MBA has always been a staunch supporter of the VA Loan Guaranty Program and we believe it remains an important and viable program for veterans and active duty military personnel. As credit markets have tightened and loan underwriting has become stricter, finding zero-downpayment mortgages has become increasingly difficult. Providing 100 percent LTV loans is a tremendous benefit to our veterans who have dedicated their lives to serving our country, and is crucial in military communities.

Through FY 2009, VA has guaranteed more than 18.7 million mortgages, totaling over \$1 trillion, to purchase or construct a home, or refinance an existing home loan. Constituting 4.2 percent of all originations in 2008 (the most recent data available), VA lending is still a relatively small percentage of the overall housing market, although the number of eligible borrowers who take advantage of the benefit is steadily increasing. In FY 2008, VA loans totaled 179,648, but in 2009, that number nearly doubled to 325,673 home loans. The borrowers who use the VA program for their homeownership financing are as varied as the U.S. population. According to VA's Annual Benefits Report FY 2009, African Americans comprised 13.5 percent of VA loans, Hispanics comprised 8.2 percent, and Asians comprised 1.9 percent. The homeownership rate

---

<sup>1</sup>The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: [www.mortgagebankers.org](http://www.mortgagebankers.org).

among veterans is astounding; according to Census data published in 2009, the veteran homeownership rate was 82 percent, compared to 67 percent for the general population.

VA guaranteed loans are made by private lenders to eligible veterans for the purchase of owner-occupied homes. These loans are comprised of both fixed- and adjustable-rate mortgages and can be used for purchase or refinance. If the loan is approved, and the veteran is eligible, VA will guaranty a portion of the loan to the lender. The basic guaranty is \$36,000, although for loans that exceed \$144,000, a guaranty of 25 percent of the particular county loan limit is possible. The VA loan limits are 125 percent of the area median price for a single family residence. This guaranty protects the lender against losses up to the amount guaranteed and allows a veteran to obtain favorable financing terms.

### **I. VA Loan Performance**

Despite most of these borrowers not having “skin in the game,” VA loans have outperformed their counterparts throughout the recent housing crisis (see chart below, based on MBA data). Although serious delinquencies have risen from 2.88 percent in the first quarter of 2008 to 5.42 percent in the fourth quarter of 2009, the VA portfolio has been able to weather the turbulent market, largely due to its historically conservative underwriting standards. VA mortgages have always been fully documented and fully underwritten loans on owner-occupied properties.

	Seriously Delinquent 4 <sup>th</sup> Quarter 2009	Foreclosure Starts 4 <sup>th</sup> Quarter 2009
VA	5.42	0.81
FHA	9.42	1.28
Subprime	30.56	3.66
Prime	7.01	0.86
<i>U.S. Total</i>	<i>9.67</i>	<i>1.20</i>

Although VA does not require private mortgage insurance, there is a funding fee that most borrowers finance into the loan. The fee ranges from 2.15 to 3.3 percent of the loan amount on purchases and 0.5 to 3.3 percent of the loan amount on refinances. The fee depends on the borrowers’ type of military service (regular versus Reserves or National Guard) and if the borrower makes a downpayment. If a borrower is refinancing to lower the rate, the fee is 0.5 percent. First time users’ fees are less than subsequent users. If a borrower receives service-connected disability payments each month, then he or she is exempt from the fee. This fee is a critical part of the VA loan guaranty program; it helps the program have a negative credit subsidy and allows it to maintain funding for future generations of military families.

### **II. Concerns**

Although the VA Guaranty Loan Program has had an excellent track record of providing benefits to veterans and active duty military personnel, MBA would like to recommend four ways to further improve this important program:

1. Congress should avoid mandating new risk retention requirements, which could cripple the VA loan program and harm our economic recovery.
2. VA’s higher loan limits need to be extended until the housing crisis has subsided.

3. The VA loan program should be reviewed and updated to be better aligned with prudent, industry standards. VA management should have the flexibility to make programmatic changes that keep the program competitive, current, and relevant for future generations.
4. The VA loan program needs servicing enhancements to keep it effective and relevant in the marketplace today. Servicers encounter programmatic challenges unique to servicing VA loans. Changes that would simplify processes and be cost-effective would encourage more lenders to participate in the VA program, which would directly benefit military families.

### **1. Risk Retention**

One of the most harmful proposals pending in Congress is the requirement that mortgagees and securitizers retain a five percent (or other percentage) interest in any mortgage they originate, sell or securitize. Both the House and Senate financial regulatory reform bills would apply such a risk retention requirement to VA (and FHA) loans, despite their underlying government guaranty. In the Senate, Senators Mary Landrieu and Johnny Isakson successfully offered an amendment to S. 3217, the Restoring American Financial Stability Act, that would exempt a class of prudently underwritten (or “qualified”) mortgages from these requirements. The House, meanwhile, passed an amendment offered by Representatives Walter Minnick and Gary Miller that would give federal regulators greater discretion to reduce or eliminate such risk retention requirements. While both amendments were significant improvements over the more onerous provisions in the underlying bills, MBA continues to believe that all loans insured or guaranteed by the government or sold to a government-sponsored enterprise (GSE) should be specifically exempt from the bill’s risk retention mandate.

Congress should retain the Landrieu/Isakson amendment that provides an exemption for risk retention requirement for prudently underwritten mortgages with low-risk characteristics. The exemption should be expanded to include government loan programs, including VA. Such an exemption is critical to ensure the continued availability and flow of VA’s program to veterans. Failure to exclude the VA and other safe and properly underwritten loans will negatively affect the housing recovery and veterans’ opportunities to secure affordable home mortgages.

### **2. Loan Limits**

The VA program does not impose a specific maximum limit on VA loans. Rather, these “limits” are established as a result of the maximum guaranty the VA will provide for a VA home loan in a particular location. Generally, a qualified borrower with full entitlement may borrow up to the loan limit with no downpayment. The word “limit” denotes the maximum loan amount on a zero-down VA loan.

The Veterans Benefits Improvement Act of 2008 provided, among other things, a temporary increase in the maximum guaranty for loans closed through December 31, 2011. Without this bill, borrowers living in relatively high-cost areas would have had to make a large downpayment for higher priced loans. This bill also allows borrowers to refinance 100 percent of the value of their home. Prior to this legislation, refinances were generally limited to 90 percent of the established value. MBA supports these changes and we thank this subcommittee and Congress for supporting the extension of these loan limits, so that veterans who reside in high-

cost areas can enjoy their much deserved housing benefits. We would ask that Congress consider extending these limits until the housing crisis has subsided.

### **3. Alignment with Industry Origination Standards and Programmatic Flexibility**

MBA urges Congress and the VA to consider the following recommendations to ensure the competitiveness and continued success of the guaranty home loan program.

VA's standard policies are inconsistent with other industry programs in ways that add complexity and cost to the origination of VA products. These differences deter some lenders from participating in the program, thus limiting veterans' access to mortgage financing. MBA urges Congress and the VA to consider changes that would allow VA to align its policies and procedures to industry standards, thus making the program friendlier to both lenders and consumers. MBA and its members are willing and eager to work with VA staff to develop recommendations and implement changes that would increase the attractiveness of the VA program.

#### **Closing Costs**

VA should review all of its fees and charges and align them with FHA and conventional products. The closing fee policy, in particular, is complex and inconsistent with what is customary in today's mortgage industry. VA needs to simplify its policy to allow borrowers to pay reasonable and customary fees in order to make VA loans more competitive in the marketplace. Currently, VA limits the amount veterans can be charged for closing costs. Anecdotally, a common rejection of VA financing *by a veteran* is because VA will not allow certain closing costs to be paid by the veteran, when the seller is not willing to pay these costs. Although the intent is to protect the veteran, this structure ultimately puts the veteran at a disadvantage in the homebuying process and may cause these borrowers to lose bids when a seller is unwilling to pay the additional fees. Moreover, the fee itemization that VA requires is not aligned with new RESPA standards. VA should review all of its fee policies to ensure that they are current and in sync with current regulations and expectations of the market.

#### **Appraisals**

An example where greater alignment would be helpful is how appraisers are assigned to VA loans. VA does not allow mortgage companies to assign appraisers to VA cases. Appraisers are randomly assigned through The Appraisal System (TAS), which is a VA computer-generated program that randomly assigns appraisers to loan cases. This method was developed to discourage collusion among appraisers, realtor estate brokers, mortgage companies, and/or borrowers, and was quite ahead of its time. New appraisal standards (specifically dictated by the Home Valuation Code of Conduct), however, have "raised the bar" for the entire industry and now mandate procedures that limit undue influence of the appraiser and greatly minimizes the risk that the VA was trying to prevent. Standard industry practices in place today, for all loan products, control more for the highest risk transactions (high LTVs); thus, it may be unnecessary for VA to so tightly manage its appraisal process. The current VA process negatively impacts lender efficiencies and can negatively impact borrowers by increasing their costs. VA should consider reevaluating its appraisal process.

### Programmatic Updating

VA qualifies veterans based on net income and not gross income, as is the case with FHA and conventional loans. VA requires that the veteran meet residual income guidelines *and* acceptable ratios; FHA and conventional loan programs do not impose residual income requirements. Residual income is the amount of net income remaining – after the deduction of debts, obligations and monthly shelter expenses – to cover other family living expenses, such as food, health care, clothing and gasoline. VA's residual income guidelines vary according to loan size, family size and geography. The VA program is the only loan program that requires the calculation of residual income.

The tables that guide lenders on acceptable residual income amounts have not been updated since 1997 and are outdated. VA should update its tables to reflect new economic realities. Some of those figures need to be adjusted up or down depending on family size.

### Programmatic Flexibility

The laws and regulations governing the VA program are very prescriptive. Many changes that make the VA loan program competitive and current must be congressionally approved. For example, it was only with the enactment of the Veterans Benefits Improvement Act of 2008 that veterans were able to take advantage of the "extra" entitlement available for loans in excess of \$144,000. Prior to that, refinance loans were limited to a \$36,000 guaranty which meant that refinance loans in excess of \$144,000 would not have the 25 percent backing typically required in the secondary market. That same law also removed the 90 percent limit on refinances, by authorizing VA to guaranty the loans up to 100 percent of the value. These changes make it easier for veterans to combine a first and second mortgage and payoff the loan. When rates came down, a veteran with a loan amount above \$144,000 was not able to take advantage of the lower rates and refinance. Until the law was changed, VA was unable to permit its borrowers from reaping the benefits that the typical, non-VA borrower could enjoy.

Similarly, VA has temporary authority for adjustable rate and hybrid ARMs through 2012. MBA encourages Congress to authorize VA adjustable-rate products permanently. ARMs are especially useful loans for active duty military, since these families move often. The VA does not allow lenders to charge borrowers a prepayment penalty, and so the risk is low for the veterans if they move or choose to refinance. Programmatic flexibility within its product offerings is crucial for helping VA maintain its relevancy.

Lastly, VA introduced a very large regulation change in 2008 when it created the VA Loan Electronic Reporting Interface (VALERI) system. This reporting system was a significant improvement in VA reporting system and continues to be extremely valuable to lenders originating VA loans. VA, however, was unable to make these systems changes in a more timely and flexible manner because so much of the reporting was codified in regulation. We recommend that VA managers be given the flexibility to modify their loan programs and reporting guidelines without the need for new laws or regulation changes. This flexibility is crucial in helping VA to be relevant and competitive in a fast-changing market.

#### **4. Servicing VA Loans**

MBA appreciates VA's continued support of veterans through its servicing guidance. VA maintains a close relationship with veteran borrowers and serves as an effective advocate for them. The following are several features of the VA loan program that are positive for both servicers and borrowers.

*Streamlined processes:* Our members find, as a general rule, VA has more streamlined processes for servicing, loss mitigation and property conveyance than other loan programs. This benefits the program by creating efficiencies within key processes.

*Refunding authority:* The VA has the unique authority to purchase a loan from the lender in an effort to assist a borrower who is severely delinquent. When a purchase occurs, the VA takes over full service of the loan and the remaining mortgage payments. This option is not often used in part due to the servicer's preference for utilizing existing workout options, where appropriate, and retaining servicing rights, but also because of reluctance on the part of VA to purchase seriously delinquent loans from servicers. Our recommendation for partial refunding are discussed below.

MBA offers the following servicing recommendations needed to keep the loan program effective and relevant in the market place today.

- *Modernize the VA Loan Guaranty Program to Provide a Full Guaranty to Ensure the Availability and Affordability of the VA Loan Program for our Nation's Veterans*

Despite VA's lower delinquency rate, the VA's loan guaranty program is the most expensive program for lenders to administer, especially during periods of declining real estate prices. This is because a VA loan carries the highest level of credit risk exposure of any government-related loan program. The VA partial guaranty exposes servicers who administer the loans to principal losses that can range up to 50 percent or more. Conversely, the FHA program provides insurance for 100 percent of the outstanding principal amount. Under Fannie Mae and Freddie Mac programs, the GSEs purchase the loans and retain 100 percent of the principal risk associated with such ownership.

To illustrate the impact of the VA partial guaranty, when a VA loan goes through the default process, and the servicer transfers custody of the property to the VA after foreclosure sale, VA pays the servicer an amount that reflects VA's current appraised value plus the guaranty amount – which in many cases is significantly less than the amount of the veteran's indebtedness. VA requires any remaining indebtedness above the claim payment to be written off and for the servicer to waive the right to seek a deficiency judgment. This write-off results in a principal loss for the servicer that averages between \$25,000 and \$40,000 per instance and in many cases exceeds 50 percent of the loan amount. Our members indicate that 35 to 40 percent of all recent foreclosures on VA guaranteed loans result in a principal loss.

We believe the risk of principal loss is a major reason why the VA program is far less vibrant than other government and private programs. Not all lenders are capable of originating and servicing VA products because it is almost impossible to guard against credit losses during large cyclical economic downturns. The implications of VA principal losses discourage lender participation and result in increased costs and/or reduced availability of affordable home financing to veterans. Changes to underwriting and program requirements cannot fully compensate for the risk of default and certainly cannot do so without extremely limiting access

of this important veteran benefit or destroying the very essence of the program, namely the zero percent downpayment feature that our veterans have earned.

Absent modernization of the VA Loan Guaranty, lenders will be forced to react to the increased risk of principal losses and the growing cost of the program through price adjustments. While VA pricing varies, historically VA loans have priced approximately 25 basis points higher than FHA-insured loans in part to offset the risk of principal loss. In addition, purchases of Ginnie Mae servicing that include material levels of VA loans in the pools price far worse than pools with less VA servicing. Clearly, such pricing is imprecise and based on historical losses, which fail to recognize the current magnitude of the decline in home values across the country. As lenders and servicers continue to accumulate losses in this program, we believe pricing will be adversely affected and some originators and servicers will be forced to limit or discontinue VA loan production and servicing altogether. Realistic pricing adjustments and further tightening of the credit market for VA products will result in higher interest rates or costs and reduce the availability and affordability of home financing options for many veterans.

Now, more than ever, it is critical to modernize the VA Loan Guaranty program to ensure that the VA loan remains a financially relevant option and a true benefit for active duty and veteran families. The loan guaranty should be revised to eliminate the risk of principal loss to lenders so that the VA Loan Guaranty program will provide the same high-quality government backing as other government-sponsored loan programs. Such changes can be made with no disruption of VA's operations, systems, or employment base. With these recommended changes to VA's Loan Guaranty Program, the VA loan will be transformed from the least attractive loan product to the most attractive. Lenders will be encouraged to utilize the program and veterans will derive a true benefit from the VA loan program and be assured lasting access to affordable, low downpayment home financing.

- *Increased Guaranty Ensures Improved Loan Modification Sustainability*

Increasing the VA guaranty will also facilitate and promote increased modification options for veterans experiencing financial hardship. VA currently allows servicers to modify loans to help delinquent borrowers retain their homes. MBA and our members support such modifications, especially given the entitlement to our veterans. Most, if not all, modifications involve some level of "capitalization" of arrearages,<sup>2</sup> which allows the loan to be brought current. Capitalization increases the principal balance of the loan and, unfortunately, the risk of principal loss to the servicer. We appreciate VA's current policy to increase the guaranty to reflect the increased principal amount. Such capitalizations nonetheless increase the risk of loss to the servicer by 75 percent of the arrearage (assuming a 25 percent guaranty) should the borrower re-default. In the current housing climate, these types of losses make the modification more risky to servicers. Congress should authorize higher guaranty amounts as recommended to promote and facilitate increased loan modifications for veterans.

- *Grant the VA "Partial Refunding" Authority*

---

<sup>2</sup> Capitalization of arrearages allows the borrower to add the delinquent amount to the balance of the loan to bring it immediately current. Under current VA rules, the new principal balance is reamortized over the remaining term of the loan or the maturity date can be extended to the earliest of: 1) 360 months from the due date of the first installment required under the modification or 1) 120 months after the original maturity date. 38 CFR §36.4815. Capitalization and reamortization benefits the borrower, who would otherwise have to cure the delinquency through a lump sum reinstatement or repay the arrearage over a shorter period of time.

MBA believes that the VA should expand its loss mitigation options to be consistent with other government programs. Specifically, the VA should be granted authority to make “partial refundings” similar to FHA’s partial claim authority. A partial refunding would allow the VA to use its refunding authority without having to purchase the entire loan. The process could work similarly to FHA’s partial claim in that a servicer would advance funds on behalf of a borrower in an amount necessary to reinstate a delinquent loan. The borrower, upon acceptance of the advance, would execute a promissory note and subordinate mortgage payable to the VA. Identical to the FHA program, the promissory note could carry no interest and not be due and payable until the borrower pays off the first mortgage or no longer owns the property.

A partial claim or refunding option is an attractive loss mitigation option for veterans and ensures robust usage. The borrower’s delinquency is cured without the servicer having to purchase the loan out of a Ginnie Mae pool, which is often prohibitive for servicers that must bear the interest rate risk, have secondary market authority and capacity to redeliver to Ginnie Mae, and have the capital or warehouse capacity to fund the repurchases.

For the partial refunding to be successful, it is critical that VA’s guaranty not be reduced by the amount of the refunded amount; otherwise the servicer suffers significant financial detriment for helping a veteran who later redefaults. A partial refunding option would eliminate a gap in VA’s loss mitigation program and ensure that veteran borrowers have the same loss mitigation assistance that is available in other loan programs.

- *Enhancements to VA’s Loss Mitigation Programs*

*Forbearances:* The VA should consider eliminating the requirement that borrowers must be 61 days delinquent in order to qualify for a special forbearance.<sup>3</sup> The VA should consider adopting an imminent default standard similar to FHA’s. FHA defines imminent default as a “borrower that is current or less than 30 days past due on the mortgage obligation and is experiencing a significant reduction in income or some other hardship that will prevent him or her from making the next required payment on the mortgage during the month that it is due.”<sup>4</sup> The elimination of the 61-day wait time would especially assist veterans who become unemployed, have wages cut, or have other hardships such as illness or death in the family.

*Modification of the Maturity Date:* VA regulations currently provide that the maturity date of a modified loan cannot be extended to exceed 360 months from the due date of the first installment required under the modification or 120 months past the original maturity date, whichever comes earliest.<sup>5</sup> In some cases, therefore, the term cannot be extended to 30 years to improve affordability. MBA recommends that the VA remove the 120-month restriction and allow servicers to reset the maturity date to 360 months from the first modified installment. This change is consistent with current FHA policies.<sup>6</sup>

---

<sup>3</sup> 38 CFR §36.4801 (2009).

<sup>4</sup> FHA Mortgagee Letter 2010-04 “Loss Mitigation for Imminent Default” (Jan 22, 2010).

<sup>5</sup> 38 CFR §36.4815(d) (2009).

<sup>6</sup> FHA Mortgagee Letter 2009-35 “Loan Modifications: FHA Loss Mitigation Incentives – Update” (Sept. 23, 2009).

*Capitalization of Foreclosure Fees:* VA should allow foreclosure fees incurred by the borrower to be capitalized as part of a modification<sup>7</sup> as is permitted by FHA. Today, such foreclosure fees must be paid by the veteran prior to modification, which can create an unnecessary hardship for the veteran. FHA currently permits legal fees and related foreclosure costs related to a canceled foreclosure action to be capitalized into the loan modification or partial claim.<sup>8</sup>

*Relocation Assistance:* The VA should consider developing a “cash for keys” program that provides the borrower with funds to cover relocation expenses in connection with a compromise sale (short sale) or deed in lieu. Such programs provide the veteran borrower a graceful and organized exit from the home if he or she is unable to retain it. FHA provides such incentives for pre-foreclosure sales (short sales) and deeds-in-lieu of foreclosure.<sup>9</sup>

### **III. Conclusion**

We thank this subcommittee for giving MBA the opportunity to voice our appreciation and dedication to the VA Home Loan Guaranty Program. This program is invaluable to the brave men and women who have sacrificed so much for this country, and the enhancements suggested here would make it even more attractive and beneficial to veterans and their families. We look forward to working with you and the VA to help sustain the VA Home Loan Guaranty Program for many generations of veterans to come.

---

<sup>7</sup> 38 CFR §36.4815(f) (2009).

<sup>8</sup> FHA Mortgagee Letter 2008-21 “FHA Loss Mitigation Program Updates” (Aug. 14, 2008).

<sup>9</sup> FHA Mortgagee Letter 2008-43 “Pre-Foreclosure Sale (PFS) Program – Utilizing the PFS Loss Mitigation Option to Assist Families Facing Foreclosure” (Dec. 24, 2008); FHA Mortgagee Letter 2000-05 “Loss Mitigation Program - Comprehensive Clarification of Policy and Notice of Procedural Changes” (Jan. 19, 2000).