Department of
Veterans Affairs

Office of Inspector General

ATTRIBUTES OF
DEFAULTED VA HOME LOANS

Prepurchase counseling would benefit active duty service members who are first-time homebuyers and may help to reduce VA home loan defaults.

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Office of Inspector General
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DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
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Memorandum to the Under Secretary for Benefits (20)

Attributes of Defaulted VA Home Loans

1. The purpose of the audit was to review the effect of the implementation of Department of Veterans Affairs (VA) Housing Credit Assistance program policies on loan defaults. Also, we assessed the reliability, accuracy, and completeness of information contained in two of VA's loan guaranty data systems: (i) Guaranteed & Insured Loan, which contains loan origination data; and (ii) the Liquidation and Claims System, which is used for operational control, servicing and reporting of defaults, claims, and liquidation of loans.

2. We reviewed 499 loans from a universe of 152,561 loans that defaulted between July 1, 1995, and June 30, 1997. The universe of defaulted loans had a total loan value of $11.4 billion and a guarantee value of $4 billion.

3. Loans made to active duty service members defaulted more often than loans made to veterans and also tended to default earlier in the loan period. Service members may be more prone to default on loans due to several factors, including: inexperience at handling debt and difficulty in coping with mortgages when transferred to other duty stations or after being discharged.

4. Loan defaults were also higher in vicinities with declining home values. Borrowers in those vicinities were having difficulty dealing successfully with mortgages or disposing of properties when their income was curtailed. For properties we reviewed, the average loss in value from the original appraisal to the liquidation appraisal was about 19 percent. There is little that VA can do to prevent losses and reduce defaults in vicinities with declining home values.

5. In one vicinity, 40 percent of the defaulted loans were for interest rate reduction refinancing loans (IRRRLs), a substantially higher default rate than the 18 percent nationwide average for IRRRLs. In that vicinity, Veterans Benefits Administration (VBA) staff inappropriately approved IRRRLs to cure seriously defaulted loans, even in instances where the refinance increased the monthly mortgage payment. Loan Guaranty

Service policy staff proposed regulatory changes to prevent future occurrences of this condition by generally limiting IRRRLs to instances where the veteran's monthly mortgage payment will decrease, and by requiring that the loans being refinanced either be current in their payments or meet certain credit standard provisions.

6. Our review of VBA's process of entering information about loan originations and defaults into its data systems disclosed that processing steps were time-consuming and duplicative for VA loan guaranty staff and lenders. In addition, VBA routinely distributed numerous data reports to field station staff, but loan guaranty staff often did not use them or used them infrequently. Also, staff could have improved their performance if they had additional information such as "help" screens in automated systems and a better understanding of the data systems' capabilities. VBA has been working to replace antiquated data systems, but progress has been slow.

7. Most of the data fields (84 percent) we reviewed contained accurate data or were left blank appropriately. However, data were often not accurate for names of lenders who made the loans, reasons for default, and borrower financial information such as assets and income. Inaccuracy and inexactness of data were caused by the need for additional codes, coding errors, and changes in data reporting requirements for loans made after October 1992. As a result, data for those items may be statistically inadequate as a basis for making program changes or for providing to parties who request program data. As VA progresses toward its Electronic Data Interchange (EDI) system, currently being tested, coding accuracy should improve. EDI is similar to a system used by the Department of Housing and Urban Development (HUD) for the Federal Housing Administration (FHA). HUD allows authorized lenders to enter loan origination data directly into its computer systems via the FHA connection on the Internet. This eliminates the need for HUD staff to manually input data into their computer system. Like HUD's system, EDI would reduce duplicative tasks and eliminate the need for regional office staff to input origination information for every loan.

8. We recommended that the Under Secretary for Benefits counsel service members about VA home loan benefits, the management of mortgage payments and other debts, purchasing and selling a home, and the consequences of having a mortgage when transferred to another duty station or deciding to leave active duty. Counseling should be geared toward service members who are in their first enlistment or are first-time homebuyers. In addition, we recommended that coding options for "reasons for liquidation" be broadened to allow staff to more appropriately categorize the reason. We also suggested that additional features be included in automated loan guaranty information systems, and that regional office management and staff be surveyed to determine whether reports should be discontinued or their distribution reduced.

9. The Deputy Under Secretary for Management agreed that a more formal counseling program will benefit many veteran-homebuyers, especially first-time homebuyers, and proposed establishing a prepurchase counseling requirement for all first-time homebuyers. This requirement may require a regulatory change. The Deputy Under Secretary also agreed to revisit codes for reasons for default and liquidation, and to consider our remarks in developing the new Loan Servicing and Claims System. We consider the recommendations resolved, and we will follow up on the implementation.

For the Assistant Inspector General for Auditing

(Original signed by)

WILLIAM D. MILLER
Director, Kansas City Audit Operations Division

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RESULTS AND RECOMMENDATIONS

1. VA Should Take Action to Reduce Defaults of Loans Made to Active Duty Service Members

VA home loans defaulted at a higher rate in areas where there was high use of VA's program by active duty service members and/or where housing markets were declining. Service members who are first-time homebuyers may be more prone to default because they may have little or no experience at handling debt or budgeting monthly income. In addition, they had marginal income and were subject to complications brought about by being transferred or discharged. A higher number of defaults heightens the amount of default servicing and monetary losses to the government, and, if foreclosure occurs, results in the veteran's loss of further use of the VA home loan benefit.

The default rate in some vicinities exceeded the national average

We reviewed a nationwide statistical sample of defaulted home loans to identify their characteristics. We also sampled and identified the characteristics of defaulted home loans in 12 selected vicinities where default rates were higher than the national average. When we compared the characteristics of the national sample to those of the vicinities, we identified two major factors that contributed to the higher default rates.

- The nearby presence of large military bases affected 7 of the 12 vicinities. In five vicinities, the majority of the loans that defaulted were originally obtained by active duty service members. These vicinities included Virginia Beach, VA; Fayetteville, NC; Hinesville, GA; Lawton, OK; and Killeen, TX. The default rates in two other vicinities–Sanford, NC, and Jacksonville, FL–were also affected by nearby military bases but to a lesser extent.

- Property values were rapidly declining in all four of the California vicinities that we reviewed: Victorville, Antioch, Vacaville, and Sacramento.

The risk of default is higher for lending to active duty service members

Loans acquired by service members were more likely to default than loans acquired by veterans. Loans to service members accounted for 26.3 percent of the defaulted loans ($3 billion of the loan amounts) in our national sample. However, service members accounted for only 18.5 percent of VA-guaranteed home loans.

Service members also tended to default earlier in the loan period. Of those who defaulted within the first 5 years, the default rate for service members was much higher than for veterans. Our sample showed that 48.3 percent of the defaults for service members' loans occurred in the first 5 years of the loans, compared to 31.7 percent for borrowers who were not on active duty.

The majority of defaults on service members' loans occurred while they were still on active duty or shortly after they were discharged. A review of active duty status for the service members showed that 45.3 percent were still on active duty when their loans defaulted and another 15.9 percent defaulted within 2 years after discharge from active duty. Of the loans made to active duty service members in all our samples, 90 percent were still in active default.

Causes for Service Members' Defaults - Service members may be more prone to default on loans due to several factors. Service members may have little or no experience at handling debt or budgeting monthly income, and they do not receive any formal counseling in this area. In addition, they had marginal discretionary income and were subject to complications brought about by being transferred or discharged.

Credit Standards - Unlike veterans, service members were not required to demonstrate a 2-year history of acceptable credit and income. Our sample showed that as a group, service members were also younger than other borrowers. Their residual incomes were low, and many barely met underwriting requirements. Spouses of younger borrowers were usually not employed, which resulted in limited income for family support and monthly expenses.

> To illustrate, one 19-year-old married borrower with one child had not completed the required eligibility period of 180 days of service when loan processing began. Prior to his enlistment, the borrower had been in high school. The borrower was not required to demonstrate a 2-year history of acceptable credit and income. In addition, the borrower's spouse was not employed, and the loan analysis showed that the borrower did not meet the residual income guideline by $24. The borrower was stationed in Korea at the time the loan was closed. The loan defaulted after only five payments.

Debt Management - Our review of servicing records and credit reports disclosed that service members who were first-time homebuyers tended to increase their debt immediately following loan closing, buying furnishings and automobiles. Since they had marginal income at the outset, the increased debt heightened the risk of default.

> Another example illustrates poor debt management. A 20-year-old married borrower with one child had not completed the required eligibility period of 180 days of service when loan processing began. The borrower was not required to

> demonstrate a 2-year history of acceptable credit and income. The borrower's spouse was unemployed. The loan analysis showed that at the time of closing, the borrower's residual income exceeded the guideline by $167. Immediately after purchasing the home, the borrower purchased an automobile, which increased his monthly debt by $394. After purchasing the automobile, his residual income was under the guideline by $227. The loan defaulted after only three payments.

Transfer of Duty Station - Our review of service members' reasons for default showed that they had difficulty in coping with transfers to other duty stations. When ordered to other duty stations, service members cited an inability to dispose of the properties before transfer or to generate sufficient rental income from them to make loan payments. According to VA Loan Guaranty staff, contributing factors could include an undesirable property location or a limited pool of potential buyers. Since many service members defaulted within 5 years and their property values had not appreciated, they had not accumulated enough equity to absorb the cost of selling the property. In addition, selling could be complicated by limited advance notice of the transfer and short lengths of tour.

Prior to transfer to another installation, individuals are given advance notice that could be as little as 120 days. The length of tour varies but can be short, depending on the service member's military occupation specialty (MOS). If an individual has a critical MOS, the individual may be at one duty station for several years. The average length of tour for those without a critical MOS was cited as 12 to 24 months.

> In two separate examples from our review, borrowers were transferred from Oklahoma to Washington. Although both defaulted, one defaulted and let the loan foreclose; the other tried unsuccessfully to rent the home, and VA accepted the deed in lieu of foreclosure.

Post-Service Employment - Failure to find local employment after discharge was cited by servicers as a routine reason for default. Borrowers who were discharged cited an inability to find immediate employment with sufficient income to continue mortgage payments. Our review found that defaulters who separated from active duty tended to leave the community and could not be located by loan servicers.

Counseling - Service members do not receive formal counseling to offset the lack of an adequate credit history. Base housing officials informed us that incoming service members are only counseled on the availability of base housing and off-base rentals.

Since 1990, VBA has required lenders to complete VA Form 26-0592, Counseling Checklist for Military Homebuyers. The form contains space for the service member and lender to certify that counseling has been provided. We found that the use of this checklist is ineffective. In fact, all the borrowers we interviewed could not recall ever receiving counseling in these areas or signing the form. We also found that the lenders and borrowers signed the form at the time of loan closing, when the borrower had to sign numerous other closing documents. In our view, counseling is not appropriate at the time of loan closing because at that point, the emphasis is more on finishing the loan process and signing all the documents. In addition, lenders and borrowers have already invested a considerable amount of time and effort, which further detracts from the effectiveness of the checklist. Also, lenders often included the checklist in loan documents for veterans as well as service members. This further illustrates the minimal amount of emphasis given to the form.

VA also provides VA Pamphlet 26-5, Pointers for the Veteran Homeowner, to all veterans who have obtained a VA home loan. The pamphlet contains advice about being a responsible homeowner and what to do in case of difficulty in making the mortgage payments. Although we believe the pamphlet contains good advice, providing the advice after the loan has been closed would not be as effective as providing it earlier in the process. Our review of subsequent credit reports (and interviews with the defaulters) showed that some borrowers who had marginal residual incomes immediately went out to make major purchases on credit.

Summary - Base housing officials do not counsel the service members regarding VA home loan benefits, purchasing and selling a home, and the management of mortgage payments and other debts. In addition, they are not counseled regarding the consequences of having a mortgage when transferred to another duty station. According to a military source in one vicinity we reviewed, real estate expenses are the responsibility of the service member. In our view, counseling would provide helpful information to first-time homebuyers or to those who have an inadequate credit history. We believe that VA should take the lead on providing counseling and work with the Department of Defense in establishing a counseling program where appropriate.

Vicinities with rapidly declining property values increase the risk of default

Four of the vicinities in our review had higher default rates due to declining property values. The vicinities were in California, which experienced a housing boom that peaked in the mid-1990s. During the boom, housing prices soared, then began to fall when the boom ended. Borrowers who purchased homes during the period of high prices, from about 1988 through 1995, had properties that were worth thousands less than the principal remaining on their home loans. For properties in our sample, the average loss in value from the original appraisal to the liquidation appraisal was about $17,000, ranging from about $2,000 to $55,000.

When the home values declined, borrowers who could not meet their mortgage obligations could not sell their homes for a price that would allow them to pay off the remaining loan principal. Loss of the home was inevitable. Available outcomes included foreclosure, a compromise sale, refunding, or a deed-in-lieu of foreclosure. In a compromise sale, the house is sold for less than the full amount of the debt and VA agrees to pay the lender the difference between the principal owed and the proceeds of the sale. The difference cannot exceed the guarantee amount. VA may choose to refund the loan or accept a deed-in-lieu, but will do so only if the property has enough equity to make these alternatives advantageous to the government.

Conclusion

VA home loans that pose a higher risk for default heighten the amount of default servicing, monetary losses to the government, and, if foreclosure occurs, loss of further use of the VA home loan benefit. In particular, the risk is higher where the demand for housing has declined and home values are not appreciating, and when homeowners have curtailed income or are subject to periodic job relocation. In such circumstances, homeowners may not have accumulated equity or assets to enable them to absorb the costs of keeping or selling the homes.

In instances of declining property values, there is little that VA can do to prevent losses and reduce defaults except to ensure that, prior to approving loans, lenders ensure that loan applicants have an adequate credit history and the ability to meet mortgage obligations. We believe that active duty service members, who tend to have a higher default rate, should receive counseling for questions about VA home loans, particularly when deciding to purchase housing, being notified of an impending transfer, or deciding to leave active duty. Counseling should include information about the reasoning behind meeting credit standards, cautions about increasing debt when approval is based on marginal credit, the disposition of housing and assets when transfers occur, and guidance on actions to take if income becomes curtailed. In our view, VA should ensure that service members are adequately informed.

Recommendation 1

We recommend that the Under Secretary for Benefits:

Counsel service members about VA home loan benefits, the management of mortgage payments and other debts, purchasing and selling a home, and the consequences of having a mortgage when transferred to another duty station or deciding to leave active duty. Counseling should be geared toward service members who are in their first enlistment or are first-time homebuyers.

Under Secretary for Benefits Comments

Appendix IV on pages 31-34 contains the full text of the Under Secretary for Benefits' comments.

The Deputy Under Secretary for Management, responding for the Under Secretary for Benefits, agreed that a more formal counseling program needs to be established for all first-time homebuyers. The Deputy Under Secretary stated that there are numerous nonprofit counseling entities that offer prepurchase counseling aimed at the first-time homebuyer. The Office of General Counsel will be consulted to determine whether the establishment of a counseling requirement can be done administratively or if a regulatory change will be necessary.

The Deputy Under Secretary also stated that the basic thrust of VA credit standards for all veterans is to establish that the veteran is a satisfactory risk and has sufficient stable and reliable income. The credit standards are clear that the absence of credit is not to be viewed as bad credit. Consequently, any applicant, on active duty or not, who had not established a credit history can still be approved as a satisfactory credit risk. However, the Deputy Secretary also agreed that prepurchase counseling would more likely benefit first-enlistment active duty members, who were less experienced in handling financial obligations than already discharged veterans.

Office of Inspector General Comments

The Deputy Under Secretary for Management's plan to begin the process of establishing a prepurchase counseling program aimed at all first-time homebuyers satisfactorily addresses our concern for providing such counseling to service members who are in their first enlistment or are first-time homebuyers. We will follow up on the process as it is implemented.

2. Data Accuracy Could Be Improved in Loan Guaranty Information Systems

Our analysis of selected data fields in Loan Guaranty data systems for defaulted loans found that data were often not valid for lender names, reasons for default, and borrower financial information such as assets and income. Inaccuracy and inexactness of data were caused by the need for additional codes, coding errors, and changes in data reporting requirements for loans made after October 1992. As a result, data fields with invalid data may be statistically inadequate as a basis for making program changes or providing to parties who request program data.

Reliable Data Is Needed To Prepare Special Reports

VBA periodically uses information contained in its Guaranteed and Insured Loan (GIL) and Liquidation and Claims System (LCS) data systems to prepare special reports requested by Congress, government agencies, and private organizations. At the time housing credit assistance loans are guaranteed, staff at VA Regional Offices input a "snapshot" of information in the GIL system, generally data regarding the borrower's financial status and the loan details. Loan information is not updated unless a default occurs. When loans default, staff input information in LCS for use in operational control, servicing and reporting of defaults, claims, and liquidation of loans.

Our review of defaulted loans included an analysis of documented support for data in GIL and LCS. We found that most of the data fields (84 percent) contained valid data or were left blank appropriately. Data were generally valid for VA Regional Office identifiers and loan details such as loan numbers, interest rates, loan terms, loan purposes, amounts of guarantee, and mortgage types. Our analysis showed that:

- 71.6 percent of the data was accurate.
- 12.6 percent of the data fields was left blank appropriately.
- 5.9 percent of the data was not accurate.
- 9.8 percent of the data did not have any support in VA files or other data systems.

Types of Inaccurate Data

Several types of incorrect or inexact data were found:

- For loans we reviewed that were made prior to October 1992, GIL contained incorrect or incomplete data for certain data fields that showed the borrowers' financial status at loan origination.
- GIL contained incorrect names for the lenders who originated the loans.

- Reasons for default had no support in servicing records.
- Some data had minor input errors.

Pre-1992 Financial Information for Borrowers - Loans originated prior to October 1992 contained incorrect financial information pertaining to the borrowers. For example, the amount listed on the loan analysis form for “net income” was in the data field "balance available for family support," and the “estimated monthly shelter expense” was in the data field "guideline balance available for family support." Also, some loans prior to 1992 had no data. We attributed this to coding errors and to system reporting changes that were made in 1992. Prior to that time, some data was reported only for prior approval loans[1]. In October 1992, additional data fields were added and lenders were instructed to supply the information on every automatic loan[2] (except interest rate reduction refinancing loans). As a result, financial information pertaining to the borrowers may be incomplete and statistically inadequate as a basis for making program changes or providing to parties who request program data.

Loans With Incorrect Lender Names - The lender's name was incorrect for 17 percent of the loans reviewed. For some of those loans, the data system showed "Lender Not on File," but loan approval documents showed the lenders’ names. For the remainder of those loans, the name did not depict the lender’s name shown on loan approval documents. We attributed the incorrectness to system programming that allowed substitution when lenders subsequently changed names or were purchased by other lenders. There is little effect from the lender’s name being incorrect, except for the lack of an audit trail for conducting periodic quality reviews of lenders.

Loans with Incorrect Holder's Reason for Default - The “holder's reason for default” data field was incorrect for 75 percent of the loans. For 42 percent of the loans, the holder’s reason for default was not supported by data in the loan folder and the reason for default was incorrect. For 33 percent of the loans, LCS did not show a reason for default. For 47 percent of the defaults, servicing staff could not contact the veteran or determine the reason for the default. Therefore, the reason was unknown.

The following table shows the “reason for default” codes, the percentage each code was input to LCS, and the code supported by our file review. We considered missing codes incorrect because at least one code (including “unknown”) was appropriate and should have been entered.

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[1] Prior approval loans are those submitted to VA for approval before guarantee is granted.
[2] Automatic loans are those underwritten and approved by lenders who have been granted authority to approve loans without VA staff involvement.

"Reason for Default" Codes	Percentage Coded in LCS	Correct Reason Code
01 Death of obligor	2.2	4.3
02 Illness of obligor or family	1.4	5.0
03 Marital difficulties	2.2	9.4
04 Curtailment of income	12.9	21.6
05 Extensive obligations	13.7	3.6
06 Improper regard for obligations	27.3	3.6
07 Unsatisfactory property		
08 Poor management		
09 Entered military service		
10 In service, unable to sell		0.7
11 Other	3.6	5.0
12 Job transfer, unable to sell		
13 Unknown	3.6	46.8
No reason code entered in LCS	33.1	
Total	100.0	100.0

As shown in the table, staff input "unknown" for only 3.6 percent and did not input a code for 33.1 percent although at least one of the codes was appropriate. The reason for no input for the 33.1 percent was unclear because field and headquarters staff provided different descriptions of input procedures. Field staff showed us that the coding was input when the notice of default was received from the servicer. However, headquarters staff informed us that coding procedures had been changed for this data field and that coding was not input until the notice of intention to foreclose is filed. Thus, headquarters staff explained, the codes may not yet have been input at the time of our review.

In accordance with public law, VA Annual Reports include the reasons for home loan foreclosures and the percentage attributed to each reason. VA reported the following reasons for foreclosure for Fiscal Years 1995-1997 and the percentage attributed to each reason:

Reasons	FY 1995	FY 1996	FY 1997	Average
Extensive Obligations	74.2	75.6	78.4	76.1
Curtailment of Income	16.5	14.9	13.5	15.0
Marital Difficulties	6.4	7.0	6.4	6.6
Illness or Death of Borrower	2.7	2.3	1.6	2.2
Dissatisfaction with the Property	0.2	0.2	0.1	0.2

In order to provide this information to Congress, after a loan termination has been completed, VA codes into LCS a “VA reason for liquidation.” As shown in the table, the Annual Reports do not show a percentage attributed to instances where the reason was unknown, that there was improper regard for obligations, or that the borrower had abandoned the mortgage obligation. Based on our review, which was for the period from July 1, 1995, through June 30, 1997, we believe that the Annual Report should have presented these categories because in many instances, the servicers and VA staff had either been unable to contact the borrowers or had determined that the reason for default was an improper regard for obligations. Although our audit only evaluated the support for reasons for default coded into LCS, and not the reasons for liquidation, 55 of the loans in our sample have subsequently been terminated and another 31 were still in default and could be terminated. For 24 of the 55 loans (43.6 percent), the reason was unknown.

The LCS codes for “reasons for default” are not the same as those for “reasons for liquidation,” although, in our opinion, the reasons available to coders should be the same for both data fields. There are 15 codes for “reasons for default,” including a code for “unknown” and “improper regard for obligations.” Only 8 of those 15 codes are “reasons for liquidation,” but there are no codes for “unknown” or “improper regard for obligations.” The other five codes that are omitted are:

- poor management
- obligor entered military service
- other
- obligor in service, base closing
- obligor is former military, reduction in force

We believe that this inconsistency in coding causes confusion and inaccuracy. For that reason, we believe that Loan Guaranty Service should revisit the codes and assure that they reflect the actual reasons.

Loans With Minor Errors in Data Input - For 24 percent of the loans we reviewed, data systems contained incorrect data in one or more data fields. These errors occurred because minor errors were made when inputting data, for example, minor errors in Social Security Numbers, dates of birth, and other data. *See Appendix III-A, page 23, for a list of data elements in which minor errors were made when inputting data.*

Conclusion

Data for defaulted loans in Loan Guaranty data systems are generally valid or are left blank appropriately. However, data for loans made prior to October 1992 may be incomplete and statistically inadequate as a basis for making program changes or providing to parties who request program data. Data were inaccurate because of the need for additional codes, coding errors, and changes made in data reporting requirements. VBA should revisit the codes and assure that they reflect the actual reasons. As VA progresses toward its Electronic Data Interchange (EDI) system, currently being tested, coding accuracy should improve. EDI would allow lenders to submit data electronically and substantially reduce the need for regional office staff to input data manually. *For additional information about EDI, see Appendix II, page 22. For additional information about loan attributes, see Appendix III-B, page 24, for graphs and additional details.*

Recommendation 2

We recommend that the Under Secretary for Veterans Benefits improve the accuracy of data input by revisiting codes for reasons for default and liquidation.

Under Secretary for Benefits Comments

Appendix IV on pages 31-34 contains the full text of the Under Secretary for Benefits' comments.

The Deputy Under Secretary for Management, responding for the Under Secretary for Benefits, agreed with the recommendation to revisit codes for reasons for default and liquidation. The process has already begun as part of VA's efforts to develop EDI reporting of defaults, and to install a new Loan Servicing and Claims (LS&C) System.

The Deputy Under Secretary was not sure that these efforts would improve the accuracy of data input, as reasons for default and liquidation are subjective and open to interpretation by servicers. The Deputy Under Secretary also believed that some defaulted loans were justifiably uncoded when our review was conducted, because recent LCS system changes deferred coding requirements for defaults until the notice of intention to foreclose is filed.

Office of Inspector General Comments

The Deputy Under Secretary for Management's plan to revisit coding and make it more consistent satisfactorily addresses our concern for reducing confusion and inaccuracy. Although external input to EDI may never be consistent, VA staff must use it for servicing VA loans, avoiding foreclosures, and claims. We believe that EDI and the replacement of LCS in the near future will be a significant improvement, and that providing clear reporting guidance to servicers will help. We will follow up on the process as it is implemented.

3. Proposed VA Regulatory Changes Would Reduce Losses and Servicing Costs for Refinancing Loans in Serious Default

Eighteen percent of the defaulted loans in our statistical sample were for interest rate reduction refinancing loans (IRRRLs). In one specific vicinity, 40 percent of the defaulted loans were for IRRRLs, substantially higher than the percentage in the statistical sample. This area also exhibited the highest default rate in the nation, for vicinities with significant loan activity. Some IRRRLs in that area were in serious default before being refinanced and defaulted again immediately or soon after refinancing was approved. They defaulted primarily because the refinancing costs and accumulated interest and penalties from their old loans were included in the principal of the new loan, which increased the loan payments in some instances. VA regional office staff approved refinancing of these loans although refinancing did not benefit either the veteran or the government. As a result, the borrowers did not improve their ability to make mortgage payments and the additional handling of the loans incurred additional costs.

Refinancing Should Benefit the Borrower and the Government

VA Pamphlet 26-7, the Lender’s Handbook, states that veterans may refinance VA-guaranteed loans at a lesser rate of interest without use of additional loan entitlement under Section 3710(a)(8) of Title 38, U.S. Code. However, if the existing loan is in serious default, VA will determine the veteran's capability to make the loan payments to preclude approval of a refinancing loan that would be of no real benefit to the interests of either the veteran or the government.

We found that 67 percent of the loans being refinanced in the sample’s high-default vicinity were 2 or more months in arrears when the IRRRL was approved and that 42 percent were at least 3 months in arrears, thus requiring prior approval from VA. However, VA regional office staff disregarded the Lender’s Handbook guidance and approved loans that were no real benefit to either the veteran or the government. For example:

> One loan was 5 monthly payments in arrears. The borrowers wanted to refinance the loan, bring the loan current, and reduce their monthly payment to enable them to make needed repairs on the home. Although refinancing decreased the interest rate by 0.5 percent, the mortgage payment actually increased by $45 per month. This occurred because the accumulated interest and penalty amounts from their old loan were included in the principal of the new loan. Regional office staff approved the new loan with the higher mortgage payment even though the veteran had not shown the ability to pay the lower mortgage payment. No payments were made on the new IRRRL.

> One loan was 12 monthly payments in arrears. When the borrowers bought the home in October 1993, both were employed, but in 1996, they could not meet the mortgage payments because their only income came from social security and a disability pension. Regional office staff approved a new IRRRL that decreased the interest rate by 0.5 percent, but the mortgage payment increased by $116 per month. The increased mortgage payment, combined with other debt payments, would have consumed over 95 percent of the couple's net income, leaving them with only $61 per month for family support. VA's guideline was $710 per month for a minimum balance for family support for the couple. No payments were made on the new IRRRL.

The high rate of IRRRL defaults in the sample vicinity occurred because VA regional office loan guaranty staff approved such refinancing to "cure" seriously defaulted loans. They usually approved such IRRRLs because they believed that it benefited the borrowers to get a fresh start, free of added interest and penalties, and it did not increase the claim amount to VA. However, their belief was not accurate. The debt from penalties and interest were merely incorporated into the IRRRL and a funding fee was added. This, in turn, increased the overall mortgage payment. Since the IRRRL did not improve the borrower's ability to make loan payments, the borrowers eventually defaulted again. The additional default activity on the new loan required additional servicing intervention by VA and lender staff, which increased the overall cost for handling the loan. After defaulting, the new loan incurred unpaid interest and penalties, which ultimately increased the claim amount.

During the audit, VBA's Loan Guaranty Service identified the regional office's practice and took corrective action to discontinue it. As an additional measure, VA proposed legislation to limit IRRRLs "to instances where the veteran's monthly mortgage payment will decrease, and by requiring that the loans being refinanced either be current in their payments or meet certain credit standard provisions." The proposed regulation was posted in the Federal Register of June 3, 1998. In our view, the regulation would reduce program costs and ensure that IRRRLs improve borrowers' ability to make loan payments.

Conclusion

Refinancing is not a proper cure for a loan in serious default unless it is foreseeable that the borrower is better able to repay the loan. To reduce the risk of excessive monetary loss and additional unnecessary servicing, loan guaranty staff should discontinue the practice of approving IRRRLs when refinancing would not increase the borrower's ability to repay the loan. VA proposed regulations to ensure that IRRRLs do not impair borrowers' ability to make loan payments. We believe that VA's proposal will be an adequate corrective measure. Therefore, we are not making any recommendations for this issue.

4. Management Advisory: Data Systems Enhancements

Our review disclosed that VBA routinely distributed numerous data reports to field station staff, but loan guaranty staff often did not use them or used them infrequently. Also, staff could have improved their performance if they had additional useful information and a better understanding of the data systems' capabilities. VBA has been working to replace antiquated data systems with on-line processing and reporting capabilities, but progress has been slow. We identified additional enhancements that would speed up processing time and improve staff performance.

Distribution of Periodic Management Reports Could Be More Efficient

VBA distributes periodic management reports that display loan guaranty system data to field offices for their use. However, we found that many of these reports are used infrequently or are distributed to staff but are only used by management. For instance, at one regional office we visited, Loan Servicing and Claims staff received 30 different system reports on a regular basis, but only used 12 of them. Thirty-four reports were provided for the Property Management (PM) section, but PM staff only used 12 of the reports regularly. The remaining reports were used on an as needed basis but not as often as they were distributed. Many of the reports provided to PM staff were summaries that were not used by PM staff but were used by management to measure section activities and compare station activities with other stations.

VBA's plan to switch to an online system could eliminate much of the distribution of hardcopy reports furnished to regional offices. Once the online system is in place, management and staff could access the reports online. The system could keep track of report usage and eventually discontinue those that are not used. Until the online system is in place, however, unnecessary distribution of reports should be reduced. We suggest that VBA determine the necessary distribution by surveying its regional office management and staff and reduce distribution according to the survey results.

Staff Could Improve Their Performance If They Had a Better Understanding of the Data Systems' Capabilities

As VBA is moving towards advanced data systems, some additional training features should be considered for inclusion. We found that regional office staff could have enhanced their performance if they were provided information and training regarding the capabilities of the current data systems. For example, Loan Production staff informed us that they were not trained in using the Automated Appraisal Assignment Process (AAAP) system and that they experienced problems in obtaining management reports from the system. According to headquarters and regional office staff, VBA provided AAAP training for one or two staff from each regional office, but many were Information Resources Management staff, not loan guaranty staff. Also, some of the staff who

training for one or two staff from each regional office, but many were Information Resources Management staff, not loan guaranty staff. Also, some of the staff who
attended training were no longer employed at the regional offices. Knowledge of the system's capabilities would have enabled staff to identify out-of-line situations and take corrective actions.

In addition, the Loan Production System (LPS) contains some information that would be useful to field level managers; however, not all managers were aware of the system's capabilities. As an illustration, OIG recently needed to review loan underwriting practices for a specific housing subdivision that was experiencing a high default rate. To accomplish the review, OIG needed to identify the universe of loans originated during a specific time period. Although regional office staff were aware of defaults in the subdivision, they were not aware that they could query the current data system to identify the universe of loans involved. According to Loan Guaranty Service headquarters staff, this information was available from LPS, but field staff were not trained to retrieve it.

At one regional office we visited, a supervisor explained that LPS reports provided a considerable amount of information for program oversight. The supervisor stated that headquarters staff had provided her with information and a data dictionary. However, this information had not been disseminated to all offices nor had formal training been offered.

VBA is moving in the right direction in creating new systems that passively update information in its main data system. However, information should be added to the systems to ensure that staff has all of the technical knowledge and skills needed to effectively perform their duties. Also, all staff should be provided training to ensure they are aware of the capabilities of the systems available to them. We believe that VBA should consider programming "help" screens in the systems to enable staff to learn helpful system features.

OBJECTIVES, SCOPE AND METHODOLOGY

Objectives

The audit had two objectives: (i) to review the effectiveness of VA Housing Credit Assistance program policies toward loan defaults, particularly those occurring in vicinities where default rates are higher; and (ii) to assess the reliability, accuracy, and completeness of VA loan data input in VA's loan guaranty data systems.

Scope and Methodology

Our audit included an examination of national and local policies, procedures, and information regarding VA home loan defaults. The audit was performed in accordance with generally accepted government auditing standards and included such tests of the procedures as were deemed appropriate under the circumstances. We used the following methodology to evaluate program practices and to verify the accuracy and support for information in VA's loan guaranty data systems:

1. We developed a nationwide statistical profile of the characteristics of 139 VA-guaranteed loans that were in serious default nationwide during the period from July 1, 1995, through June 30, 1997. The loans were statistically sampled from a universe of 152,561 loans that defaulted during that period, obtained from the LCS active and terminated files. These loans had a total loan value of $11.4 billion and a guarantee value of $4 billion. We reviewed VA loan files and identified trends and characteristics of defaulted loans. We validated the reliability, accuracy, and completeness of default information contained in VA data collection systems.

2. We reviewed 360 VA-guaranteed loans that were in serious default in 12 geographic vicinities that had higher-than-average default rates during the period from July 1, 1995, through June 30, 1997. We reviewed a discovery sample of 30 loans from each of the regions. We reviewed VA loan files and identified trends and characteristics of defaulted loans within those vicinities. We validated the reliability, accuracy, and completeness of default information contained in VA data collection systems. The regions reviewed were:

Antioch, CA	Sacramento, CA
Fayetteville, NC	Sanford, NC
Hinesville, GA	Upper Marlboro, MD
Jacksonville, FL	Vacaville, CA
Killeen, TX	Victorville, CA
Lawton, OK	Virginia Beach, VA

3. We compared nationwide and regional profiles, trends, and characteristics of loan defaults.

4. We discussed national and local policies relative to loan defaults and data systems with Loan Guaranty Service officials at VA Central Office and VA Regional Offices.

BACKGROUND

The VA home loan guaranty program provides housing credit assistance to veterans and service members. Assistance is provided by the government's partial guaranty of loans made by private lenders in lieu of the substantial down payment and other investment safeguards applicable to conventional mortgage transactions.

The overall health of VA's guaranteed loan portfolio is measured by the percentage of outstanding guaranteed loans reported to VA as being in default, including those in early default. Loans in early default are those which were originated in the previous 2 fiscal years.

VA's goal is to keep early defaults below 1.5 percent. The actual percentage will vary depending on interest rates and economic conditions, but anything over 1.5 percent may indicate a problem in the underwriting of VA guaranteed loans. The early default measure is affected by factors beyond VA's control–especially economic variables such as interest rates, other housing appreciation rates, and unemployment. The percentage has been less than 1.5% since the revised credit standards were put into effect in FY 1986 and interest rates declined.

Since the program's inception in 1944, VA has guaranteed more than 15.2 million loans, totaling over $533 billion. In FY 1996, VA guaranteed 320,776 loans. The following chart shows the number of defaults, percentage of all loans in default, and percentage of early defaults for fiscal years 1991-1997. As shown in the chart, the number of loans in default has increased over the last 2 fiscal years, reaching four percent in FY 1997. The percentage of early defaults has also been increasing since 1993.

Fiscal Year	Loans in Default-End of Fiscal Year	Percentage of All Loans Defaulted	Percentage of Early Defaults
1991	122,775	3.1	1.1
1992	113,654	3.2	0.7
1993	110,792	3.2	0.7
1994	106,717	3.1	0.8
1995	102,137	3.0	1.2
1996	113,799	3.4	1.4
1997	132,245	4.0	N/A

VA has a Lender Monitoring Unit (LMU), which monitors default information to target and audit lenders that have above average default rates. Some vicinities have early default percentages of over 7 percent. Also, some lenders have early default percentages of over 20 percent.

VA's home loan guaranty program is supported by computer systems at the Austin Automation Center. The Loan Guaranty System (LGY) has the following subsystems:

> GIL system contains a detailed statistical master record for each VA guaranteed or insured loan. Also, the system is available on-line through the LGY Index system.
>
> LCS contains information on the operational control, servicing and reporting of defaults, claims and liquidation of loans.
>
> The Property Management System (PMS) contains information associated with the acquisition, maintenance and disposition of VA acquired properties.
>
> The General Ledger System (GLS) contains financial information on VA guaranteed or insured loans.
>
> The Portfolio Loan Accounting Control and Evaluation (PLACE) contains a complete history of financial and statistical information on each outstanding loan.
>
> The Loan Guaranty System Rapid Access (LRA) is an on-line system that provides access to the PMS and LCS.

Each system is interfaced or linked to one or more other systems within the LGY. Also, the systems have various standard reports that are available through the Extended Reports Distribution system. These reports vary in production frequency from daily to annually.

VBA Has Been Working to Improve Its Data Systems

In 1991, Loan Guaranty Service began using the LPS and Code Sheet Elimination system to update how information is input into the data systems. LPS monthly inputs some, but not all, collected data into GIL. For example, the property address is input into LPS but is not input into GIL. Currently, the LPS database is maintained on servers and tape backup equipment at 46 regional offices. LPS uses local networks on Wang computer systems. The Code Sheet Elimination system enables direct on-line input into the Liquidation and Claims System (for defaults, foreclosures, and claims) and the Property Management System (for managing and selling acquired properties).

VBA Modernization

VBA is developing and updating its automated information systems in a project called VBA Modernization. The purpose of the VBA Modernization project is to have an on-line production system. The project would eventually integrate all the major VBA systems, including Compensation & Pension and Loan Guaranty, into one "corporate" database system. Progress on developing and implementing VBA Modernization has been slow, reportedly 11 years thus far. The loan guaranty subsystem of the database, called the Automated Loan Production System (ALPS), is designed to support regional office staff and help them perform their jobs. Also, it is designed to provide program information for VA Central Office program managers.

The new loan guaranty systems are currently being tested and will operate on desktop personal computers. Approval for nationwide use will follow testing, which is nearing completion. The systems will be connected by modems or servers to mainframe systems at Hines, Illinois, and Austin, Texas. In the new systems, standard reports would no longer be printed and distributed but would be automated and available on-line. The reports would provide program management information and operational information for regional office staff. Systems that have been improved include the Expanded Lender Information (ELI), AAAP, and Loan Processing.

Expanded Lender Information - This lender file shows each originator's and servicer's name and VA identification (ID) number. The system has the ability to search for a lender's name, ID number, underwriter's name, and location by state or county. The system will also show the prior name of the lender, if applicable, and the history of any disciplinary actions or audit information.

The system allows VA to maintain data about underwriters and appraisers who move from one lender to another. This feature enables VA to track persons who have been disbarred or who have been known to submit or approve poor quality or questionable loans. In instances when one lender merges with another–for example, ABC buys out XYZ–the system automatically transfers the former lender's outstanding loans and staff to the new company.

Automated Appraisal Assignment Process - The subsystem for assigning fee appraisers and loan numbers would be moved from regional office servers to a server located at VA Central Office. It would be a nationwide system with controls to protect the information and to limit access. Lenders would access the Internet to call into the AAAP system.

Loan Processing - Automatic lenders approve and close VA loans and then submit the loans to VA for guaranty. The LP subsystem provides the information needed for regional office staff to review and approve the loan guaranty. Loan origination data is entered from a VA Loan Summary Sheet prepared by the lender or is electronically submitted by the lender. LP has information about the veteran and the property, including appraisal information. Before a loan could be entered into LP, the veteran's Social Security Number (SSN) must match a SSN in VBA's corporate database and the funding fee must be paid.

Electronic Data Interchange - In addition to VBA Modernization, EDI system is scheduled to begin testing in August 1998. One of the components of this new system is the Loan Origination/Application for and Issuance of Guaranty. This component would allow lenders to electronically submit the same information that is currently on the Loan Summary Sheet. EDI would process this information with the same edit checks that the current LP system has and would check to ensure that the funding fee has been paid. If everything were correct, the system would send the lender an electronic certificate of guaranty.

EDI is similar to the system used by the Department of Housing and Urban Development (HUD) for the Federal Housing Administration (FHA). HUD allows authorized lenders to enter loan origination data directly into its computer systems via the FHA connection on the Internet. This eliminates the need for HUD staff to manually input data into their computer system. HUD uses this information at a local level to track first-time homebuyers. Like HUD's system, EDI would reduce duplicative tasks and eliminate the need for regional office staff to input origination information into LPS for every loan.

In our view, on-line processing of loan origination and default information is a "best practices" example. Lenders' staffs would no longer be required to prepare and submit paper documentation, and VA staff would not have to manually input the information.

DETAILS OF AUDIT

LOANS WITH MINOR ERRORS IN DATA INPUT

Number of Loans with Input Errors*	Type of Input Error
8	Lender identification number (incorrect)
1	Veteran's first name (incorrect or misspelled)
4	Veteran's middle initial (omitted)
4	Veteran's last name (incorrect or misspelled)
4	Social security number (incorrect)
7	Date of birth (month omitted)
2	Interest rate (incorrect)
2	Military status (incorrect code used)
1	Date of first uncured default (incorrect)
1	Name of present owner (original buyer shown instead of assumer)
9	Address Lines 1 and 2 and ZIP Code (incorrect)
1	Servicer code (incorrect code used)

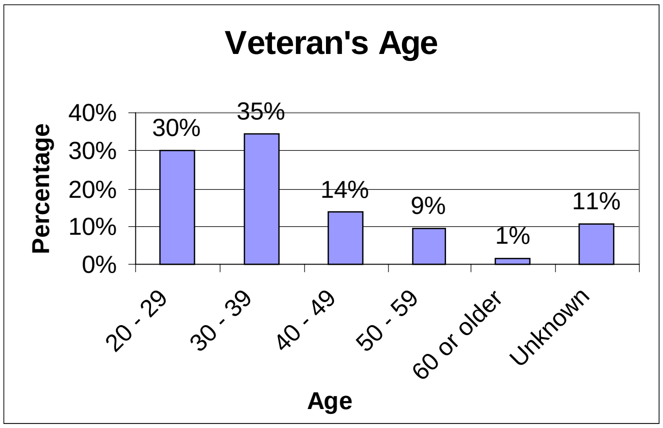
*Errors based on statistical sample of 139 loans.

DETAILS OF AUDIT

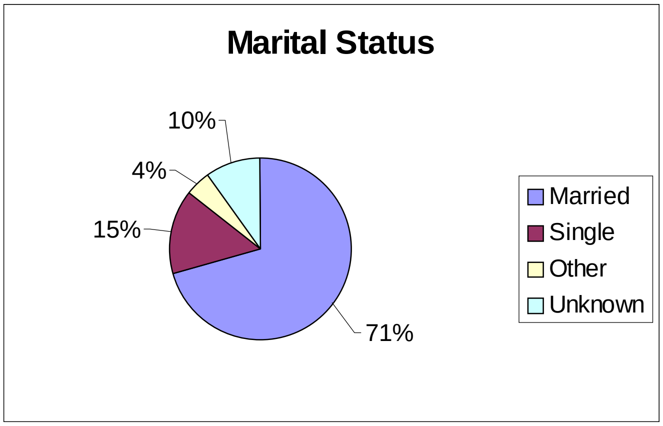
NATIONAL PROFILE OF DEFAULTED LOANS

The following profile shows statistical data for the national sample of defaulted loans. This profile provides an analysis of loan progression from origination through default and is intended to enhance the information available for use by program management. Although some of the information provided is obtainable by analyzing system data, some is only obtainable through a review of the loan file and information acquired during default servicing.

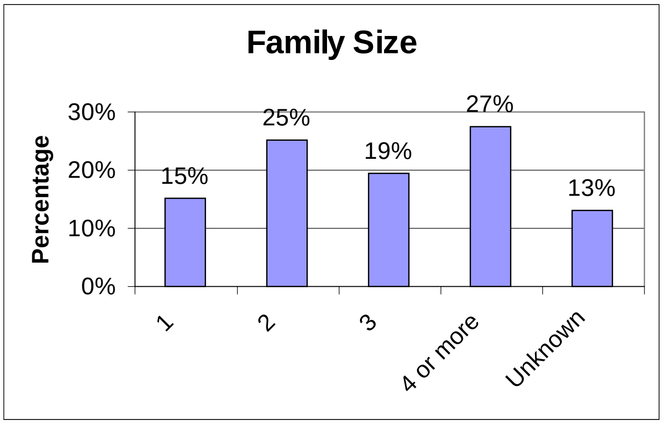
At Loan Origination



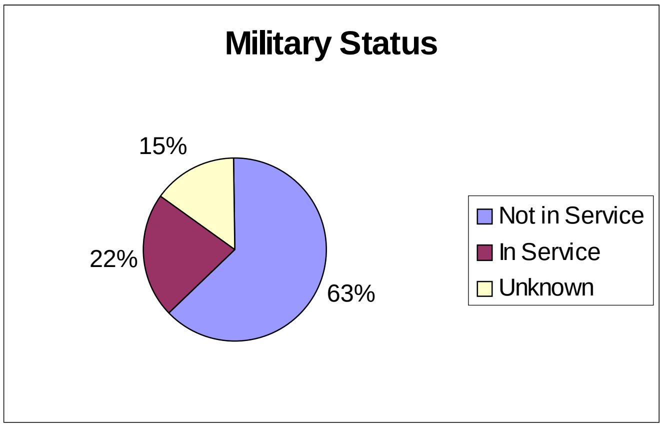
The average age of the veterans who originated the loans was 35.3 years, and the range was 21 to 68 years. Almost 54 percent were under 35 years old. For the unknowns, 9 percent were IRRRLs (which do not require underwriting information) and 2 percent did not show the veteran's age.



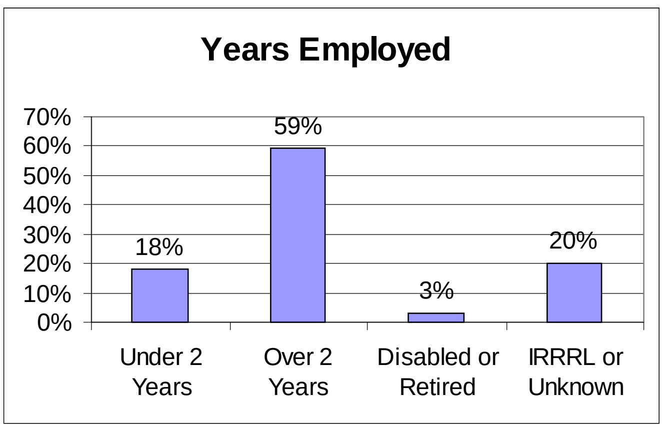
At loan origination, 71 percent of the veterans were married, 15 percent were single, and 4 percent were separated, widowed, or divorced. We were not able to determine the marital status for 10 percent of the veteran's loans (IRRRLs, vendee loans, or loan files that did not show the marital status).



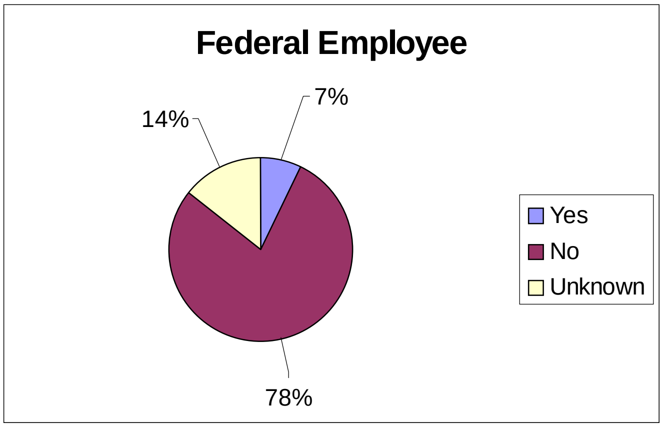
The average family size was 2.8 members, and the range was 1 to 9 household members. We were unable to determine family size for IRRRLs, vendee loans, or loans in which the loan file did not show the family size.



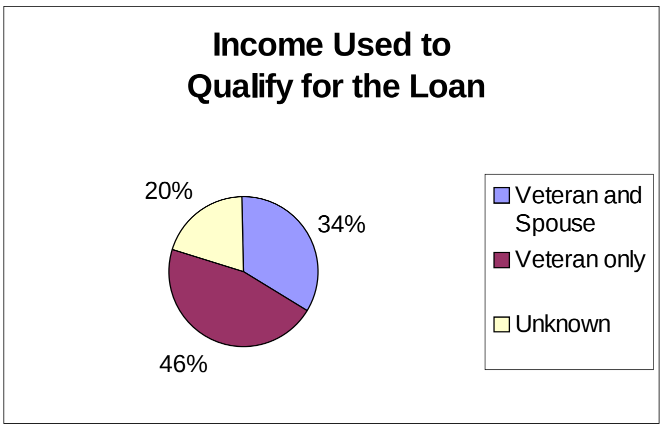
The majority of the borrowers were not in the military. Sixty-three percent of the borrowers were not on active duty, and 22 percent were still in the service. We were unable to determine the military status for 15 percent of the loans (IRRRLs, vendee loans, or loans in which the loan file did not show military status).



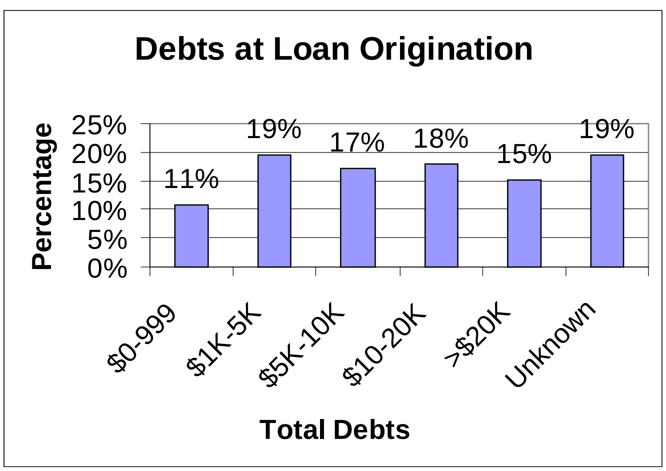
The borrowers were employed in their current job an average of 5.6 years, and the range was 0 to 31 years. Eighteen percent were employed less than 2 years at their current or prior jobs.



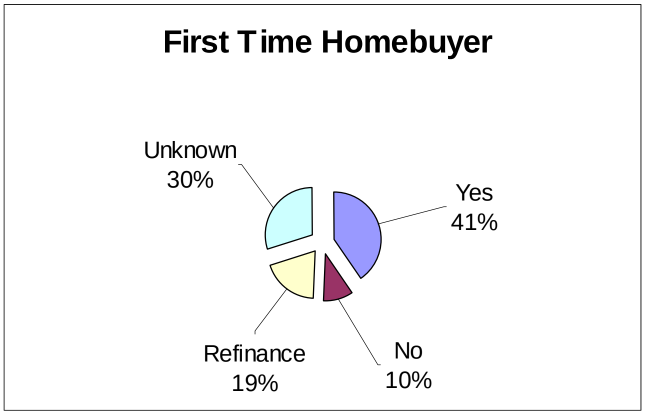
Only 7 percent of the borrowers were federal employees, and 79 percent were not federal employees. We were unable to determine employment status for 14 percent of the borrowers (IRRRLs, vendee loans, or loans with insufficient data in the loan file).



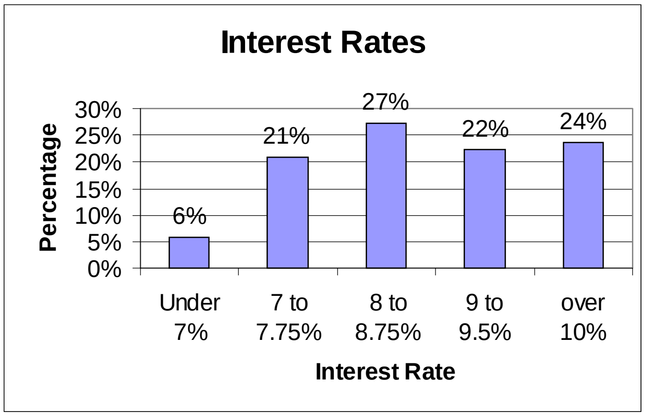
Both the veteran's and spouse's incomes were used to qualify for the loan in 34 percent of the loan originations, but one income was used to qualify for 46 percent. For 20 percent, the loan was an IRRRL or data was not available.



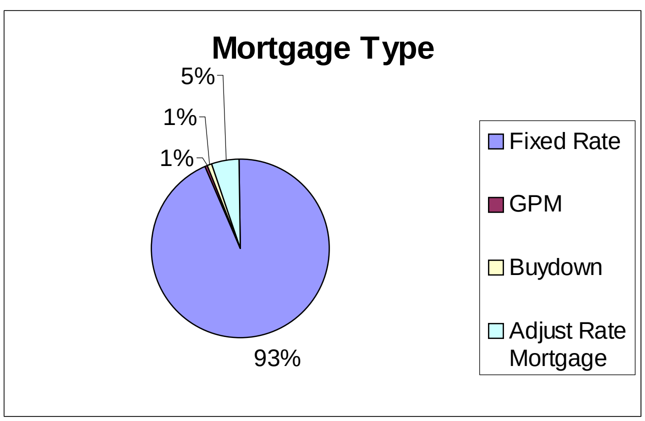
Veterans' debts averaged $13,287, and the range was $0 to $126,947. For the unknowns, 12 percent were IRRRLs and 7 percent did not show the amount of debts in the loan file.



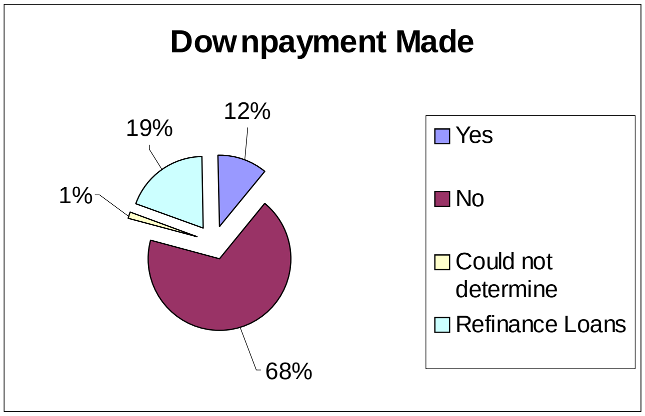
Forty-one percent of the loans were to first time homebuyers, and 10 percent were not. For 49 percent we were unable to determine because they were either refinanced loans (19 percent) or the loan files had insufficient data to determine if the borrower was a first time homebuyer (30 percent).



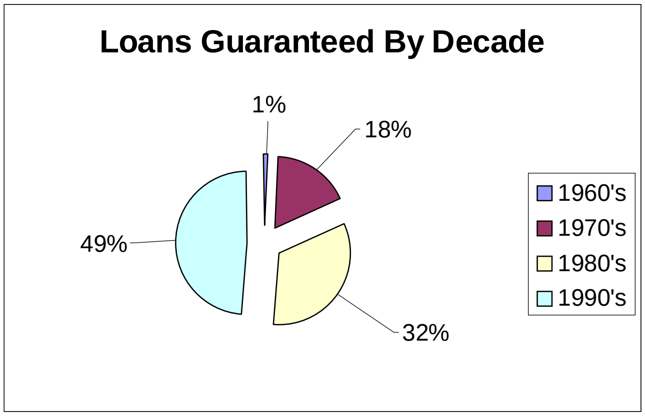
At loan origination, the median interest rate was 8.5 percent, and the interest rate range was 5.5 percent to 14.5 percent. Our analysis of the loans with interest rates over 10 percent showed 91 percent were guaranteed prior to 1990 and the borrower should have refinanced but did not. For 45 percent of the loans with interest rates over 10 percent, refinancing may not have prevented the default, which was caused by death, illness, marital difficulties, income curtailment, or the home was destroyed by fire.



Fixed rate mortgages were the predominant type of mortgage (93 percent) at the time of default. The other types of mortgages were adjustable rate mortgages (5 percent), graduated payment mortgages (1 percent), and temporary buydowns (1 percent).

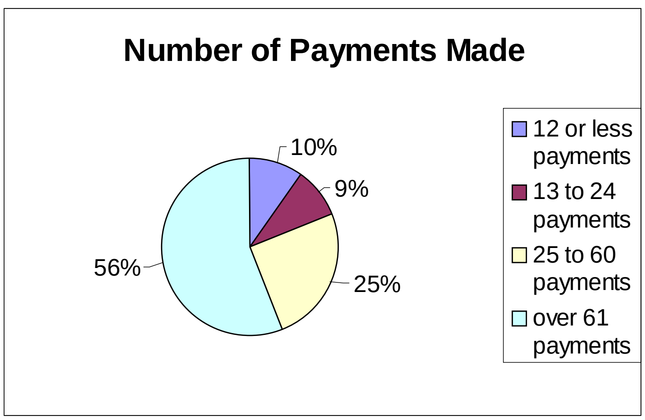


Borrowers made downpayments on only 12 percent of the loans. Downpayments were not made on 68 percent, and 19 percent of the defaulted loans had been refinanced. For 1 percent of the loans, we could not determine if there was a downpayment.

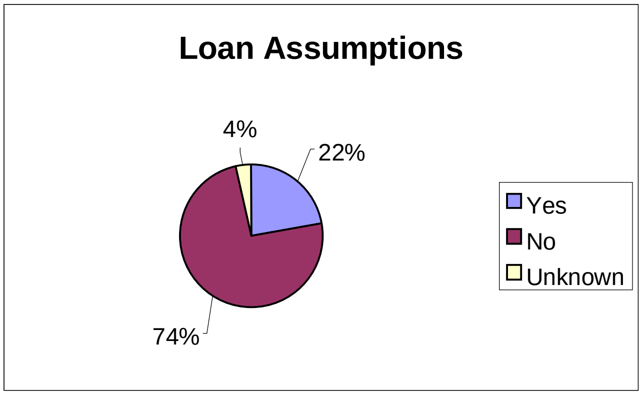


Nearly half of the defaulted loans (49 percent) were guaranteed during the 1990's, and 32 percent were guaranteed during the 1980's. Nearly one-fifth of the loans were guaranteed prior to the 1980's. The range of the guarantee dates was from October 1969 through May 1997.

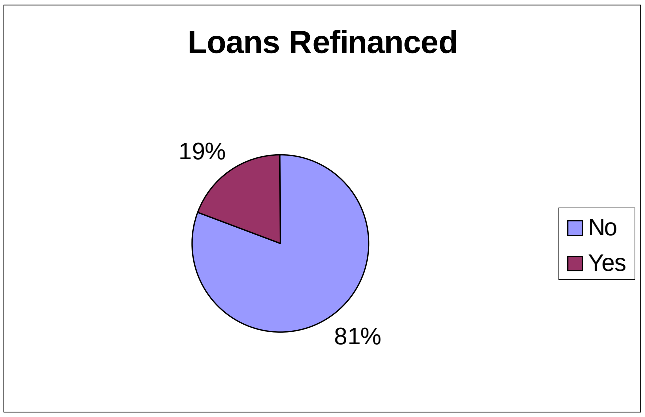
At Loan Default



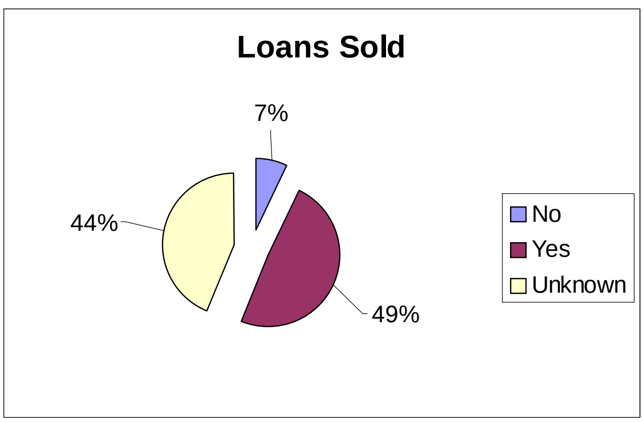
The average number of payments made before loan default was 106 payments, and the range was 0 to 330 payments. The median was 88 payments. Almost 19 percent defaulted with 24 or fewer payments. For loans with 12 or fewer payments, 43 percent were refinanced loans. The majority (57 percent) of the loans that defaulted with 12 or fewer payments were due to marital difficulties or curtailed income.



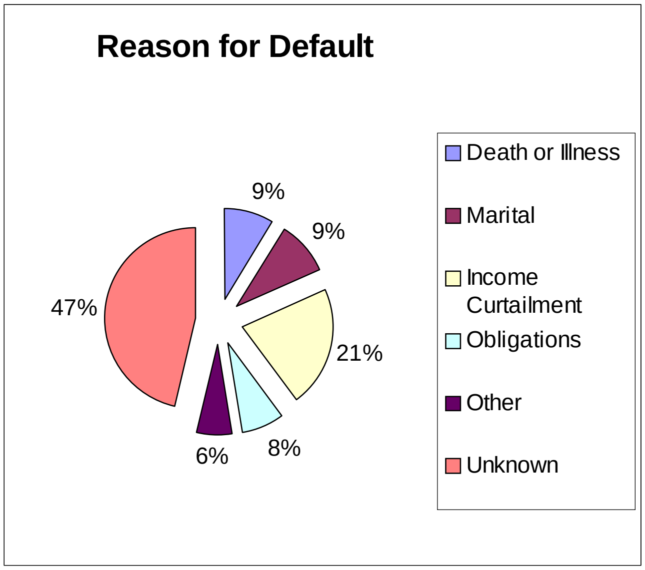
The majority of loans reviewed in the sample were retained by the original borrowers. Of the loans reviewed, 74 percent were not assumed and 22 percent were assumed. Due to a lack of servicing data, we could not determine if 4 percent of the loans were assumed.



The majority of defaulted loans reviewed in the sample were not refinanced. Of the loans reviewed, 81 percent were not refinanced and 19 percent were refinanced. For the refinanced loans, 93 percent were IRRRLs and 7 percent were not.



For most of the defaulted loans sampled with sufficient servicing records, the servicer was not the original lender. Of the loans reviewed, the originator sold 49 percent and 7 percent were not sold. Servicing records were not sufficient to make a determination for 44 percent of the loans.



We reviewed the servicing notes to determine why the borrower defaulted. For 47 percent of the defaults, servicing staff either could not contact the borrower or the borrower did not provide a reason for default. For the remaining 53 percent, servicing staff obtained information from the borrowers, and the most common reasons for the default were death/illness, marital difficulties, and income curtailment. Also, servicing staff found 8 percent had a disregard for obligations.

MEMORANDUM FROM THE UNDER SECRETARY FOR BENEFITS

Department of
Veterans Affairs

Memorandum

Date: FEB 19 1999

From: Deputy Under Secretary for Management (20)

Subj: Draft Report, Audit of Attributes of Defaulted VA Home Loans

To: Assistant Inspector General for Auditing (52)

We address the recommendations of the subject audit below.

1. Counsel service members about VA home loan benefits, the management of mortgage payments and other debts, purchasing and selling a home, and the consequences of having a mortgage when transferring to another duty station or deciding to leave active duty. Counseling should be geared toward service members who are in their first enlistment or are first-time homebuyers.

We agree that counseling has value. It is for that reason that we have required lenders to provide counseling to all military homebuyers since 1990. The specific items to be covered in the counseling are contained on VA Form 26-0592, Counseling Checklist for Military Homebuyers. The form contains space for the military member to certify that he/she has been counseled and for the lender to also certify that the member has been counseled. The counseling checklist, (copy attached) addresses most of the specific topics included in the recommendation, and we will review the form for any appropriate additions when it is next up for replenishment/revision. However, we also agree that it is likely that the Counseling Checklist is frequently handled in a purely administrative ("Here's another form you have to sign") manner, and its content is not truly conveyed to the military homebuyer, making its counseling value minimal.

With respect to the suggestion contained in the report that VA ought to take the lead on providing counseling and work with DOD in establishing a counseling program where appropriate, we agree that a more formal counseling program will benefit many veteran-homebuyers, especially first-time homebuyers. However, there are counseling programs already available which generally focus on first-time homebuyers. We believe it would be more appropriate to establish a formal counseling requirement for all first-time homebuyers and not just for those who are also members of the active duty military. Therefore, we have begun the process of establishing a prepurchase counseling requirement for **all** first time homebuyers.

Our research shows that there are numerous nonprofit counseling entities that offer prepurchase counseling aimed at the first time homebuyer. We have begun the process of

MEMORANDUM FROM THE UNDER SECRETARY FOR BENEFITS

identifying counseling agencies in order to provide a list of available counselors. We have to determine in consultation with the Office of General Counsel whether the establishment of the counseling requirement can be done administratively or if a regulatory change will be necessary. If the requirement can be established administratively, we can publish a change to VA Pamphlet 26-7, Lenders Handbook, relatively quickly; if a regulation will be required the process will take substantially longer. (Based on an informal conversation with the Office of General Counsel, it appears likely that it will require a regulatory change to establish a requirement of counseling.)

We would be remiss if we did not clarify a matter which has clearly led to a misunderstanding. The basic thrust of the credit standards for **all** veterans is to establish that the veteran is a satisfactory risk and has sufficient stable and reliable income. Generally, a two-year employment history up to the present is considered necessary to establish the stability and reliability of the income, but there are instances in which a two-year history is not needed. Such instances would include a circumstance in which the veteran has recently completed specialized training or education and is currently working in the field for which the training or education was obtained. Another means of establishing the stability of employment is the assurance that it is going to continue for the foreseeable future, as in the case of a member of the military who is early in an enlistment period of three or four years. In such a case, it is reasonable to conclude that the income is established as stable and reliable. Likewise, in establishing that a veteran is a satisfactory credit risk, it is necessary to review at least the past two years. However, in **all** cases, our credit standards are very clear that the absence of credit is not to be viewed as bad credit. Consequently, any applicant, on active duty or not, who has not established a credit history can still be approved as a satisfactory credit risk. We agree that the likelihood that an active-duty member who is early in a first enlistment right out of high school will have both a very short employment history and a meager or nonexistent credit history is a greater than a veteran who has completed a term of enlistment in the military. Likewise, we agree that the first-enlistment active duty member is generally going to be younger and less experienced in handling financial obligations than an already discharged veteran and more likely to benefit from prepurchase counseling.

2. We recommend that the Under Secretary for Veterans Benefits improve the accuracy of data input by revisiting codes for reasons for default and liquidation.

We share the OIG's desire for accuracy in coding and agree with their recommendation to revisit codes for reasons for default and liquidation. This process has already begun as part of VA's efforts to develop EDI reporting of defaults, and to install a new Loan Servicing and Claims (LS&C) System.

MEMORANDUM FROM THE UNDER SECRETARY FOR BENEFITS

We are not sure that these efforts will improve the accuracy of data input as proposed by the OIG, however, as reasons for default and liquidation are subjective, and open to interpretation. If a borrower fails to respond to the servicer's collection efforts, the servicer could report the reason for default as unknown. A different servicer might advise that the reason in that case was an improper regard for obligations, since the borrower had failed to respond to collections efforts by the servicer. Even if a servicer talks with a borrower and learns that a family member's serious illness led to extensive medical bills, the servicer could report family illness as a reason for default, or the servicer could interpret the reason for default as being the result of excessive bills due to the illness, or even poor money management for failure to have adequate health insurance to cover such an occurrence. The possibilities for different interpretations are quite extensive.

The differences noted by the OIG between reasons reported by servicers and those coded by VA may also be the result of interpretations. The differences could, however, by attributable to changes during the time between reporting of defaults by servicers and when they advise VA of notice of intention to foreclose. We believe that the OIG may be misinterpreting the requirements of VA's present Liquidation and Claims System (LCS), which is to be replaced in the near future by the Loan Servicing and Claims (LS&C) System. The OIG report indicates that "Field staff showed us that the coding was input when the notice of default was received from the servicer." The OIG was probably viewing the entry of data from a combined notice of default and intention to foreclose. LCS does not accept reason for default coding when only a default is entered into the system. However, if a joint notice of default and intention to foreclose is received by VA, then LCS requires that a reason for default be coded. The OIG apparently extrapolated this process to include all default reporting and erroneously concluded that the lack of a reason for default indicated inaccurate coding, when this is not the can if VA has received only a notice of default, without having received notice of intention to foreclose.

In order to address missing reasons for default via EDI, VA is considering allowing servicers to use numbers 001-044 of the 641 – Status Reason Codes in the ANSI X12 format when reporting defaults to VA. Servicers could also use the 1307 – Loan Status Code to provide additional information on loans being reported in default. This data should be helpful to VA in analyzing defaults to determine appropriate action. However, it will be still be incumbent upon VA employees to establish the real reason for liquidation upon termination of a VA-guaranteed loan. The new LS&C System is still in development and the remarks from the OIG will be considered in establishing these reasons.

(Original signed by:)

Nora Egan

Attachment

MEMORANDUM FROM THE UNDER SECRETARY FOR BENEFITS

Department of Veterans Affairs

COUNSELING CHECKLIST FOR MILITARY VENDEE HOMEBUYERS

1. Failure on the part of a borrower on active duty to disclose that he/she expects to leave the area within 12 months due to transfer orders or completion of his/her enlistment period may constitute “bad faith.” If your loan is foreclosed under circumstances which include such bad faith, you may be required to repay VA for any loss suffered by the Government. (In any case in which VA suffers a loss as a result of foreclosure, the loss must be repaid or suitable repayment arrangements made before you can use your Loan Guaranty benefits or purchase another VA – acquired property with vendee financing.)

2. Although real estate values have historically risen in most areas, there is no assurance that the property for which you are seeking financing will increase in value or even retain its present value.

3. It is possible that you may encounter difficulty in selling your house, recovering you investment or making any profit, particularly if there is an active new home market in the area.

4. Receiving military orders for a permanent change of duty station or an unexpected early discharge due to a reduction in force will not relieve you of your obligation to make your mortgage payments on the first of each month.

5. “Letting the house go back” is not an acceptable option. A decision to do so may be considered “bad faith.” A foreclosure will result in a bad credit record, a possible debt you will owe to the Government and difficulty in getting more credit in the future.

6. If unexpected circumstances lead to difficulty in making your payments, contact the servicer of you loan promptly. It will be easier to resolve any problems if you act quickly and are open and honest.

7. YOUR LOAN MAY NOT BE ASSUMED WITHOUT THE PRIOR APPROVAL OF VA.

8. VA does NOT guarantee the house and its condition. You are buying a previously occupied house, in it “as is” condition, without any warranties, and must satisfy yourself that its condition is satisfactory.

I HEREBY CERTIFY THAT I have been counseled and I fully understand the counseling items set forth above.

____________________________ ____________________________

BORROWER’S SIGNATURE DATE

I HEREBY CERTIFY THAT the borrower has been counseled regarding the counseling items set forth above.

____________________________ ____________________________

VA REPRESENTATIVE’S SIGNATURE DATE

VA FORM 26-0160
Oct 1990

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