Testimony of
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United States Senate Committee on Veterans' Affairs

Hearing to Consider Pending Legislation
April 17, 2024

Introduction

Chairman Tester, Ranking Member Moran, Members of the Committee: Thank you for the invitation to participate in today's hearing. I am here on behalf of the Housing Policy Council (HPC), a trade association comprised of the leading national mortgage lenders and servicers; mortgage, property, and title insurers; and technology and data companies. HPC's members share a common interest in the success and sustainability of the VA Home Loan Guaranty Program.

HPC and HPC members have a long history supporting active duty servicemembers and Veterans who have served our country. HPC's first president, John Dalton, was the Secretary of the Navy during the Clinton Administration and established within HPC a commitment to working with the Department of Defense (DoD), the Department of Veterans Affairs (VA), and the Consumer Financial Protection Bureau's (CFPB) Office of Servicemembers Affairs to promote access to safe and affordable lending programs and services for military families and veterans.

We have an active working group that coordinates with the DoD to advance policies that facilitate compliance with the Military Lending Act and Servicemembers' Civil Relief Act. We also manage working groups that focus on ways to enhance and expand home lending for Veterans through the VA Home Loan Guaranty Program, the subject of this hearing.

The Committee's decision to focus on providing the VA Home Loan Program with additional legislative authority is timely. The program has undergone remarkable growth over the last 10 or so years. In the decade between 2011 and 2021, the number of VA originations quadrupled, growing from just over 350,000 loans to over 1.4 million.

In the wake of this incredible growth, it is appropriate to assess whether the VA has the resources and authority the agency needs to operate the program effectively, fulfilling its mission to those who served our nation and managing the associated mortgage credit risk. Our own informal assessment of the situation leads us to conclude that VA does, in fact, need additional authorities and resources to continue to fulfill the critical mission of the agency.

In my testimony, I will present HPC's perspective on S. 3728, the Veterans Housing Stability Act of 2024, which is intended to authorize the VA to administer a "partial claim" program. <u>HPC supports this</u>

objective but offers suggestions to strengthen the legislation and make the VA's powers more like those of the FHA.

Background: What is an FHA Partial Claim?

Before discussing how a partial claim could be used for the VA Home Loan Program, it is helpful to analyze how and why the tool works so well for the Federal Housing Administration (FHA).

As is well known, FHA is a government mortgage insurance agency that provides coverage on 100 percent of a mortgage balance (up to the FHA loan limit). To be clear, FHA accepts the credit risk for the loan in its entirety. In exchange for taking that risk, however, FHA establishes specific parameters for the amount of risk the agency is willing to accept. It does this through loan underwriting requirements *and* mandating standards for how the loan is to be managed over time to reduce the severity of losses should the borrower stop paying – through FHA loss mitigation requirements. For the risk that FHA is absorbing, the agency collects a mortgage insurance premium and the revenue generated by these charges are ultimately used to pay claims.

When a loan completes foreclosure, FHA pays a *full* claim, satisfying the loan balance in full and, selling the property to recover against the loss. Prior to a foreclosure, however, as part of FHA's loss mitigation efforts, FHA can pay a *partial* claim, up to 30 percent of the maximum claimable amount, in order to reduce the remaining loan balance in a way that will permit a borrower to remain in their home and resume making loan payments. When FHA permits a partial claim, the lender sets up a subordinate lien to secure the partial claim amount (up to the full 30 percent permitted by law), behind the FHA-insured primary mortgage. This subordinate lien is to be repaid by the borrower upon sale of the property or payoff of the primary loan. Typically, the partial claim is used to cover arrearages accumulated after a borrower has been delinquent or in forbearance for an extended period yet is in a position to resume their monthly payments at their previous level.[1]

The partial claim arrangement has been very successful for FHA, serving as an effective loss mitigation tool that does, in fact, lead to loan reperformance that reduces FHA's overall losses. FHA can do this because it has the authority to access a portion, rather than the entirety of the insurance coverage.

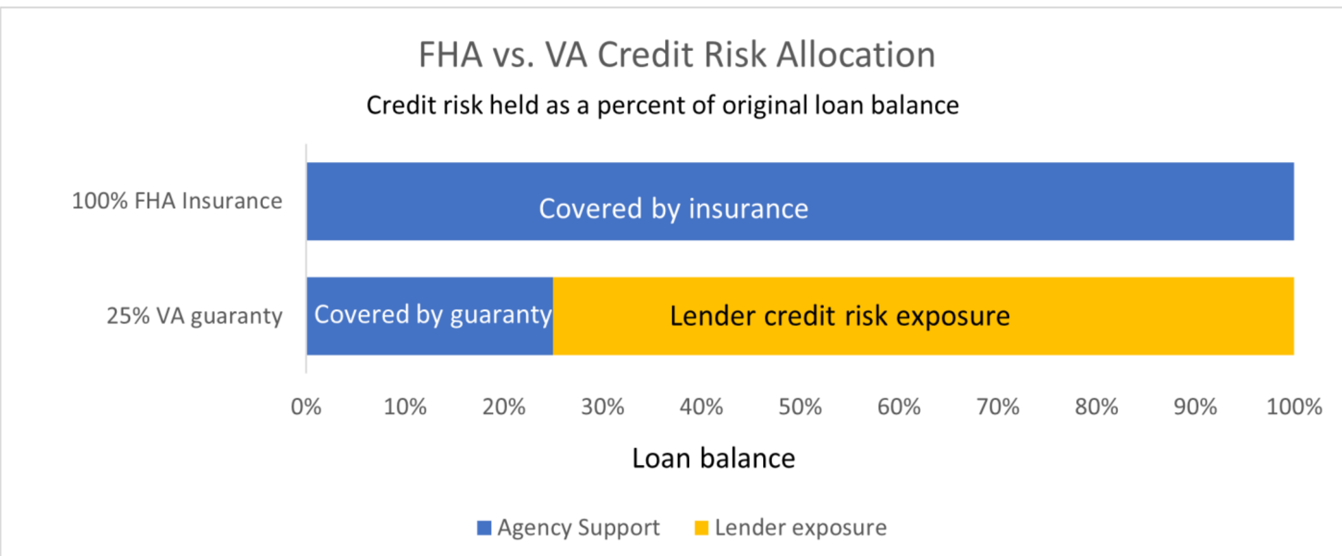
[1] FHA's partial claim arrangement can also be used in conjunction with a loan modification, to cover arrearages-only or to reduce the principal balance on the loan to make a loan modification (loan restructuring) more affordable.

Additionally, FHA has the revenue from the insurance premiums paid for the full, maximum 100 percent insurance coverage. That revenue pays for the cost of the partial claim program.

As discussed more below, in the case of VA, the issue of how a partial claim can work is far more complicated.

Fundamental Consideration: Limited VA Guaranty Constrains Policy Options

To appreciate why adding a partial claim option is harder in the VA program than in the FHA program, we must consider how the unique government insurance and guaranty authorities present a meaningful distinction between VA and FHA. Critically, the VA has a much smaller loan guaranty to protect lenders against credit losses - typically only 25 percent compared to a 100 percent guaranty for FHA. The limited guaranty and correspondingly lower revenue generated by the VA to pay for the single-family loan guaranty program, results in less "insurance" available to cover losses. This means that the risk of monetary loss to lenders is higher when a foreclosure occurs on a VA loan, and that the VA has less flexibility to use the guaranty coverage as the means to fund loss mitigation.



At its inception in 1944, the VA Home Loan Guaranty was set at a maximum of 50% of the approved loan balance.[2] With the success and growth of the VA Home Loan Program, subsequent legislation reduced the maximum guaranty to 25% for the typical home loan.[3] This system worked well until the

[2] Legislative History of the VA Home Loan Program (https://www.benefits.va.gov/homeloans/documents/docs/history.pdf).
[3] Id.

Great Financial Crisis period, which introduced a dramatic shift in government policy. At that time, two critical changes occurred. First, the Federal Government put in place new modification programs that required extensive documentation from homeowners in financial distress, with the goal to tailor payment reductions to be most affordable for these households. Second and simultaneously, a number of states imposed additional regulatory requirements to slow or halt the foreclosure process. The intent at the Federal and state level was to offer more generous loss mitigation programs, including added time for borrowers to recover financially, to reduce unnecessary foreclosures and keep borrowers in their homes. This approach resulted in a protracted period of delinquency for many households and, for some, this exacerbated their financial hardship and made delinquency resolution more difficult, if not impossible.

During the COVID pandemic, Federal programs were streamlined, enabling servicers to offer assistance to homeowners quickly without excessive documentation and evaluation. Pandemic assistance was dominated by forbearance, which allows the borrower to suspend payments for a period of time. Ideally, this suspension would be followed by a permanent resolution of the forborne payments.[4]

While well-intended and broadly supported by consumer advocates and industry alike, policies that allow consumer indebtedness to grow for an extended period fundamentally alter the risk of loss. The risks are borne by different parties depending on the program; the GSEs and private mortgage insurers hold the risk for conventional loans; FHA holds the risk for FHA loans with 100 percent insurance coverage; and VA holds the risk up to the 25 percent guaranty limit for VA loans, with the remaining risk held by private market participants.[5]

Forbearance in the VA program requires servicers to pay the principal and interest owed to investors each month, on behalf of delinquent borrowers. The VA ultimately reimburses servicers for the accumulated missed borrower payments (arrearages) if the borrower is unable to avoid foreclosure – up to 25 percent of the original loan balance. However, once a loan has arrearages that exceed 25 percent of the original loan balance, there is an increased risk that every dollar of additional arrearage

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[4] COVID loss mitigation programs that permanently resolved the missed payments accrued during forbearance, were also streamlined and simplified, to move borrowers quickly from forbearance to permanent forms of assistance.

[5] The government policy shift in avoiding foreclosures through protracted delinquency also has significantly increased the liquidity risks associated with government lending. The difficulty has been exacerbated by Ginnie Mae policies that limit the financing available to support servicing. The liquidity challenge has been generally the same for VA loans as it is for FHA but increased for VA as result of the most recent VA foreclosure moratorium.

could result in a loss to the servicer if the loan proceeds to foreclosure (depending on the value of the property when the property is sold at foreclosure). In other words, the seemingly beneficial forbearance policy and current VA foreclosure moratorium[6] may provide more time for VA borrowers to recover, but it may also produce losses greater than the maximum VA guaranty amount. In that case, every additional missed payment may become an unrecoverable loss to the company that services the mortgage.

The Veterans Housing Stability Act of 2024 authorizes the VA to set up a permanent “partial claim” program. <u>We support the legislative effort to provide the VA a “partial claim” tool</u>, to be added to a full suite of VA loss mitigation programs. FHA’s historical experience demonstrates that the partial claim program is effective for borrowers who sustain a temporary loss of income but subsequently recover their economic stability. However, this elegant solution is a challenge for VA, with its 25 percent guaranty structure. As already noted, any missed payments associated with delinquency or forbearance must be advanced to mortgage-backed security holders. The servicer covers this risk and cost initially, with the expectation of future reimbursement from VA. For FHA, the 100 percent loan insurance coverage easily covers the servicer reimbursement. For VA, however, with only a 25 percent guaranty, this is more difficult. VA loans are pooled in Ginnie Mae mortgage-backed securities and Ginnie Mae requires a sufficient level of government guaranty coverage to protect the Ginnie Mae financial interest.[7] The limited guaranty and the coverage requirements make the math difficult for a partial claim program. If the partial claim of up to 30 percent – the amount that VA allowed under the previous COVID Partial Claim Program and what is proposed under the Veterans Housing Stability Act of 2024 – accessed the VA 25 percent loan guaranty there would be less (or no) insurance available to cover future losses.

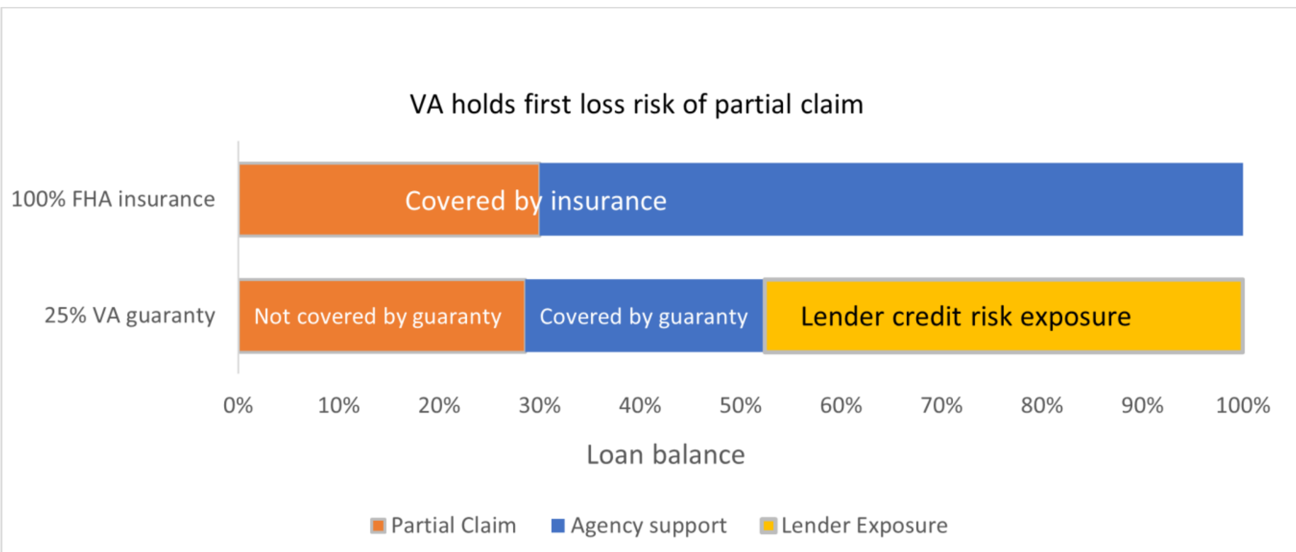
This is in direct contrast to FHA, with its 100 percent insurance coverage, where there is still typically a 70 percent loan insurance cushion that remains in place (the 100 percent loan guaranty/insurance is reduced by the partial claim of 30 percent of the loan balance). One of the great benefits of the FHA

[6] On November 30, 2023, the VA announced a “voluntary” foreclosure moratorium, which asks servicers to pause all foreclosure actions. However, during a moratorium period, the Veterans arrearage continues to grow, which hurts rather than helps borrowers in need, and makes finding permanent solutions more challenging.

[7] Ginnie Mae 5500.3, Rev. 1, Chapter 24: For a VA-guaranteed loan to be eligible for pooling, the following additional requirements apply: The amount of cash down payment and/or equity, plus the amount of available VA guaranty must equal at least 25% of (i) the purchase price of the property or (ii) the Certificate of Reasonable Value (CRV), whichever is less. The guaranty fee charged by VA must not be included in this calculation.

partial claim is that it is roughly budget neutral because the partial claim has proven over time to save the government money on unnecessary foreclosures.

Because budget neutrality is not easily replicable with the VA 25 percent loan guaranty, the VA decided to take a first-risk loss on the COVID Partial Claim Program. In other words, the VA allowed the missed payments to be folded into a subordinate lien held by the VA and did not tap its guaranty at all to pay for this expense. VA expects to collect on those second liens in the future, but they could not use the guaranty to cover their initial expense, which is to reimburse the servicers. VA was forced into this program design because they chose not to offset the 25 percent loan guaranty with a 30 percent partial claim. Had VA instead chosen to reduce the 25 percent loan guaranty by the amount of a partial claim, the partial claim could consume the entirety of the VA guaranty and make these loans ineligible for placement back into Ginnie Mae securities. That also is an untenable outcome for the program and its borrowers.



If VA had not accepted the first risk loss, ahead of the guaranty, in the COVID Partial Claim Program, the risk would have been borne by servicers. The VA recognized that such a model was entirely uneconomical; servicers could not be expected to hold all the credit risk and forgo re-pooling the loans into Ginnie Mae securities. Such a program would lead to massive disruptions to the VA lending market.

Similar to the short-lived VA COVID Partial Claim Program, the Veterans Housing Stability Act of 2024 establishes partial claim authority that does not impinge on the 25 percent loan guaranty. However, without tapping the 25 percent guaranty, the risk and cost of the partial claim shifts to the VA, similar to the COVID Partial Claim Program. This means that, under the Veterans Housing Stability Act of 2024, the VA's actual risk position changes from a maximum loss of 25 percent to a maximum loss of 55 percent (the 30 percent partial claim is in the first-loss risk position, as a subordinate lien that is to be repaid at the time of the first lien payoff). The additional VA risk exposure is not budget neutral as it is in the FHA program and will likely produce immediate budgetary costs for the VA Home Loan Program.

The options for absorbing the costs of a partial claim are limited, and include:

1. Offset the costs of future claims against the guaranty (the Veterans Housing Stability Act of 2024 prohibits this);
2. Generate additional revenue through charges or fees to the borrower to cover some or all the losses (the Veterans Housing Stability Act of 2024 prohibits this);
3. Appropriate funds to VA to offset the losses;
4. Increase the guaranty fees for future Veteran homeowners;[8] or
5. Shift the cost of the losses to servicers.

HPC is not aware of any other solutions for funding the costs of a partial claim program that defers missed payments until the full payoff of the mortgage. In short, mandating a VA partial claim creates costs that must be funded.

We acknowledge that all these options are challenging. We also note that the FHA program does not have to confront these unfortunate policy/budgetary options, as the FHA is a 100 percent insurance program and has the flexibility to pay for unexpected losses by adjusting future mortgage insurance premiums. Expecting the VA to offer equivalent loss mitigation assistance to veterans without similar loan guaranty authority or without separate funding for a partial claim effectively gives VA an *obligation* to provide assistance without giving it the budgetary *resources* to do so.

Analysis and Potential Technical Amendments for the Veterans Housing Stability Act of 2024

Turning now to the specifics of today's legislative hearing, HPC supports the legislative goals and purpose of the Veterans Housing Stability Act of 2024. A partial claim program like the one authorized by this legislation would be a very useful complementary loss mitigation tool for the VA. This type of

[8] This same policy goal could be achieved by reducing the number of borrowers who are entirely exempt from paying the VA guaranty fee.

program is beneficial for borrowers whose temporary hardship has ended and who can resume their contractual mortgage payment but need assistance resolving their missed payments. With that said, the legislation can be strengthened in several ways. Specifically, the legislation provides the VA with four new authorities that would benefit from additional refinement. These authorities are powers to:

1) Declare foreclosure moratoria and mandatory forbearance;
2) Develop a partial claim program;
3) Levy additional civil penalties against lenders; and
4) Require servicers to offer all available loss mitigation options.

Below is a review of these authorities, with HPC feedback as to how each section of the legislation could be improved.

Authority #1: The power to declare foreclosure and forbearance

> **Suggested Technical Amendments:** We recommend striking the phrase "or a widespread and significant crisis as determined by the Secretary" from Section (2)(a) of the legislation (language in proposed 38 U.S.C. § 3720(i)(1). Alternatively, this provision could be removed altogether.

The bill would grant the VA Secretary authority to impose a foreclosure moratorium on VA loans in response to a declared national emergency or major disaster or, at the discretion of the Secretary, in response to a "widespread and significant crisis." No other government agency has explicit authority to execute a foreclosure moratorium; to-date, the government credit agencies have instituted foreclosure moratoria generally simultaneously and collectively, as part of their credit risk management role, or in response to Federal Executive Orders. Therefore, this provision is not necessary and HPC members are wary of the unintended consequences associated with providing such authority to a single agency. That said, HPC recognizes that, in certain well-defined and time-bound circumstances such as a national emergency, it could be appropriate for the VA to require servicers to implement a foreclosure moratorium or a period of forbearance. However, we believe that this power to change the economic terms of the affected loans must be accompanied by an obligation for the VA to reimburse servicers for the cost of advancing payments on the borrowers' behalf. That is, the VA must pay for the added costs of a policy that imposes an extended period of delinquency, where servicers are expected to continue to advance the monthly payments to Ginnie Mae security holders. For this type of foreclosure/forbearance policy to meaningfully address the costs it imposes on servicers, the reimbursement must be periodic, to reduce the liquidity strain and financing expense to servicers, who must cover these costs in real time.

Additionally, and in light of the current limitations of the VA loan guaranty, and the costs that this imposes on servicers, we support this authorization only when these powers are exercised in response to a federally declared emergency or major disaster. Limiting the use of foreclosure moratoria in this way prevents any arbitrary activation to address a political or administrative problem. This is not a speculative fear, as the November 2023 request from the VA Secretary for servicers to self-impose an unreimbursed foreclosure moratorium resulted from VA's failure to establish timely post-forbearance protocols rather than a federally declared emergency.

An alternative approach would be for the VA Secretary to retain the discretion to declare a foreclosure moratorium or a period of forbearance for "a widespread and significant crisis" but only in alignment with and approval from the HUD Secretary. The rationale for this coordinated decision-making requirement is that the HUD Secretary has responsibility for overseeing the Ginnie Mae program, which is put at financial risk when borrower payments are legally suspended due to forbearance and foreclosure holds.[9]

Authority #2: The power to develop a partial claim program

> **Suggested Technical Amendments:** We recommend eliminating the following paragraphs from Section 2(b) of the legislation (proposed 38 U.S.C. §§ 3723(c)(3) & (4)):
>
> **"(3) No Advance on Loan Guaranty.** — The Secretary may not structure a partial claim under this section as an advance on a loan guaranty provided under this chapter;" and
>
> **"(4) Expenses. —** Expenses related to a partial claim under this section, including administrative expenses associated with such partial claim, may not be charged to the borrower of the guaranteed loan with respect to which the partial claim is paid."

[9] Ginnie Mae's risk is similar to that of servicers. The reason for this is that if a servicer is unable to make pass-through payments to investors, Ginnie Mae must step into the servicers shoes and make the payment.

We support authorizing the VA to develop a partial claim program, as a complement to other loss mitigation programs in the full suite of tools available. However, as discussed above, while a partial claim program offers benefits that we would like VA borrowers to have access to, the program poses a cost that must be accounted for. As written, the Veterans Housing Stability Act of 2024 does not account for these costs and explicitly prohibits the VA from using the guaranty or borrower fees as a funding source. Although we strongly prefer consideration of other options, the legislation should not prohibit any funding options.

For example, a partial claim program with a zero-interest subordinate lien similar to FHA is preferrable, but charging the borrower a minimal interest rate could be a means to cover at least a portion of the program cost and therefore, worthy of consideration. Similarly, we strongly support a partial claim program that reimburses servicers for up to 30 percent of the unpaid loan balance, like the FHA program. However, if the VA wants to set up a 5-10 percent partial claim for borrowers who are less than one year delinquent and wants to structure this as an offset against the 25 percent maximum loan guaranty, that policy option is also worthy of consideration.

To be clear, HPC members are not advocating for any specific solution, but omitting revenue-generating ideas from consideration simply gives the VA an unfunded mandate. As described earlier, the two simplest options to absorb the costs of a partial claim program are (i) a new and permanent appropriation; or (ii) increased VA loan guaranty fees for future borrowers.

To reiterate, absent another funding source, the Veterans Housing Stability Act of 2024 would be strengthened, but not resolved, by eliminating both Section (c)(3) and (c)(4) from the partial claim authorization. These funding prohibitions constrain the VA's policy options for paying for the program.

Authority #3: The power to levy additional civil penalties against lenders

> **Suggested Technical Amendments:** We recommend eliminating the following paragraph from section 2(b) of the legislation (proposed 38 U.S.C. § 3723(f)(2)):
>
> **"(2) Final and Conclusive.** — Any decision by the Secretary under this paragraph is final and conclusive and is not subject to judicial review."

The VA Home Loan Program currently has full authority to levy civil penalties against lenders who knowingly and materially make false statements to the VA. In fact, and as required by law, every year the VA publishes a regulation that adjusts these penalties for inflation.[10] This year's inflation update increased the penalty to $13,946 which is almost half the amount identified in the Veterans Housing Stability Act of 2024. Therefore, we recommend removal of the penalty provisions from the bill; the existing penalties serve as an effective and sufficient deterrent to protect the integrity of the VA Home Loan Program.

Further, under the legislation, any decision by the VA Secretary regarding these new civil money penalties is final and conclusive and not subject to judicial review. This contrasts with the assessment of civil money penalties under the FHA program and the current VA program, where both agencies' decisions are subject to judicial review.[11] In fact, before judicial review can occur, FHA has an entire administrative division, the Mortgagee Review Board, that is charged with providing lenders due process before assessing penalties.[12]

Making lenders subject to a civil money penalty without adequate regulatory due process or the ability to challenge a decision in court is unjust. HPC strongly believes the committee should strike Section 2(c) of this bill.

Authority #4: The power to require servicers to offer all available loss mitigation options.

> **Suggested Technical Amendments:** We recommend eliminating the following subsection from section 2(c) of the legislation (proposed 38 U.S.C. § 3724(d)): "The Secretary may prescribe loss mitigation procedures, including a mandatory sequence in which the holder of a loan guaranteed under this chapter shall offer loss mitigation options to veterans, to help prevent the foreclosure of any such loan.''

The last provision in the Veterans Housing Stability Act of 2024 for which we have recommendations is the authorization for VA to establish a "mandatory sequence" or hierarchy for the application of loss mitigation programs. While the legislative intent of Section 2(d) seems to be alignment between the VA

[10] 89 FR 1458 on January 10, 2024.
[11] See, 12 U.S.C. § 1735f-14(d) and 31 U.S.C. § 3805.
[12] The VA currently has a hearing and notice process too, but it is used much less frequently and has less transparency than the FHA Mortgagee Review Board.

and FHA loss mitigation “waterfalls”, the mandate is inconsistent with FHA’s statutory authority under 12 U.S.C. § 1715u. FHA and other federal entities execute hierarchies at their discretion rather than by statutory mandate. They do so to reduce the severity of their own credit losses; the hierarchies require that lower-cost loss mitigation be used prior to higher-cost loss mitigation - to use government resources judiciously.

Given the differences in distinct guaranty coverage between FHA and VA, a mandatory VA loss mitigation hierarchy could result in a shifting of loan losses to servicers. Shifting credit losses to servicers could result in servicer withdrawal from the VA program and would certainly result in higher prices for new VA loans.

Servicers cannot and will not engage in uneconomical programs; today, VA’s uneconomical Deferment program is almost completely unused by lenders. The VA Deferment program permits servicers to add missed payments (that a servicer has paid to investors) to the end of the loan. The deferred balance does not accrue additional interest and is due only upon payoff of the loan balance. As such, unlike the terminated COVID Partial Claim Program where the VA covered the cost of the missed payment, the VA Deferment calls on servicers to cover the cost of the deferred balance, which is not a sustainable or sound business practice. Under the Veterans Housing Stability Act of 2024, an uneconomic program like VA Deferment could become mandatory. This would either cause an exodus of lenders from the program, increase the costs of VA loans for future borrowers, or both.

Given that the FHA and other federal entities do not rely on any statutory authority to establish their loss mitigation hierarchies, the VA does not need this type of statutory authority. However, if the Congress wants to leave such a provision in the bill, we recommend removing the word “mandatory” from the legislative text.

Concluding Remarks

I encourage this Committee to strengthen and pass the Veterans Housing Stability Act of 2024. Additionally, in the coming months, we believe this committee should take a hard look at whether the VA has all the other resources and authority the agency needs to operate this critical housing program effectively.

On behalf of HPC and its members, thank you for inviting me to participate today.