February 10, 1995

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Veterans Benefits Administration
Reinventing Government, Phase II
Program Options

Proposal: Contracting out Portfolio Loan Servicing/Accounting

Discussion: Current Portfolio

VA services 29,000 loans at 46 VAROs. All financial accounting for the portfolio is done by the Finance Divisions at almost every regional office. All accounting transactions and servicing actions depend on a 25-year-old Austin DPC mainframe system known as the Portfolio Loan System or PLS. It is cost prohibitive or impossible to make it comply with today's legal and regulatory requirements.

We are unable to administer tax and insurance escrow accounts as required by recent law (RESPA). A penalty of $100 per incident can be imposed.

PLS is unable to process payments as required in Ch. 13 bankruptcies.

PLS is unable to properly calculate the total due on seriously delinquent loans, often requiring labor-intensive manual calculations.

VA sells over 20,000 loans each year. The sale scheduled for September 1995, and all subsequent sales, will have to be postponed until VA can provide borrowers with information required by RESPA. This could take years with the PLS system.

Contracting for these services will enable VA to avoid violating laws in the servicing of our portfolio and reduce internal operating staff. The private sector has much newer equipment for accounting and servicing than VA and greater flexibility in operations; it can perform these functions at a far lower cost.

Option: Contract Out Portfolio Loan Servicing

Contractor processes payments, maintains accounting records on an ADP system, does all delinquent loan servicing, provides VA with required reports on the portfolio (including updates to the General Ledgers), handles escrow accounts in compliance with RESPA, pays taxes and insurance (using third party vendors at its discretion) timely, obtains necessary flood hazard certifications as required by FEMA, sets up new accounts at VA's direction, refers seriously delinquent accounts to VA for foreclosure, sends final accounting on terminated loans to VA and provides account information and performs reviews at VA's direction for loan sales.

Advantages:

- Immediate ability to comply with RESPA
- No need to devote staff time to correction of accounting errors
- No need to replace PLS (estimated cost is $1 million)
- Loan sales can resume in 6-12 months
- Reduced tax penalties (current cost is $350,000 per year)
- Compliance with flood hazard legislation
- VA won't need to review flood maps
- Reduced staffing requirement
- VA retains control of accounts which require special handling, such as refunded and native-american loans

Disadvantages:

- Loss of servicing control over portfolio loans
- Loss of hands-on training opportunity for new technicians

Areas of Consideration:

- VA will control foreclosures and monitor the servicer
- OMB approval will be needed to use loan income instead of GOE
- Also, VA will have to pay a price above market if servicing subcontracts must be periodically rebid; legislation is needed to overcome this FAR restriction

CONTRACT OUT
PORTFOLIO LOAN SERVICING

VBA currently manages a portfolio of approximately 29,000 loans with a value of about $1.1 billion. The portfolio consists of vendee loans (loans made by VA to finance the sale of foreclosed properties), direct loans made to veterans living in rural areas or made to disabled veterans in connection with a specially adapted housing grant, and guaranteed loans purchased from lenders to prevent foreclosure. Approximately 77 percent of the portfolio is made up of vendee loans. New vendee loans are added to the portfolio each month as the field stations sell properties. Vendee loans are then sold about every four months in a complex arrangement involving the sale of mortgage backed securities.

VBA has been able to sell regularly most of the newly created vendee loans. However, over time, a residue of loans not sold has accumulated. These loans have not been sold because they are in default, have a bad payment history, or have been categorized as unsalable for a variety of reasons (low balance, documentation problem, lack of hazard insurance, etc.)

The management of this portfolio is very labor intensive. We estimate that 200 FTE, about 10 percent of Loan Guaranty employment is dedicated to this function. This does not include resources in Finance and Administration to support this activity. It involves maintaining tax and insurance escrow accounts with an antiquated mortgage loan accounting system. Stations receive tax bills, special assessments and insurance bills which must be associated with the appropriate loan and paid timely. Regional offices are often dealing with numerous taxing authorities (counties, school districts, etc.) and many different insurance companies. These problems are compounded by the fact that a number of these loans are delinquent and carry insufficient balances in their escrow accounts to fund these expenses. An additional burden on the stations is that the tax and insurance workflow is uneven. Tax bills tend to be concentrated in certain months. This means that resources for GI loan supplemental servicing are diverted to meet this workload bulge. The T&I responsibilities are in addition to servicing and/or terminating delinquent accounts. Some of these problems can be abated by replacing the current portfolio Loan System (PLS) with a state of the art system like those used in the private sector. This has always been our plan, but it has lower priority than LPS development which directly impacts service to veterans. Realistically, a new system could not be acquired for several years.

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CONTRACT OUT PORTFOLIO LOAN SERVICING AND ACCOUNTING COST BENEFIT ANALYSIS

The proposal to contract out portfolio servicing and accounting will improve efficiency as well as generate substantial annual savings to the government. The five year net savings is estimated to be $20.4 million. The following describes the costs and savings of this proposal:

Cost

We made informal contacts with several mortgage loan servicers. There are numerous companies well suited to perform this service for VA. Loan servicing is a very competitive business and we would expect the contract costs to be very reasonable. One reliable source estimated the cost to be between $75 and $88 dollars per loan per year. This portfolio is unique in that it contains many older loans with low balances and a high degree of delinquency. We believe that once servicers examine this portfolio the bids could substantially exceed these estimates. Therefore, we used $152 per loan times average number loans in the portfolio to obtain estimated costs. Because of the importance of doing this soon, the FY 1996 Budget will have to be amended so that a contract can be in place by October 1, 1995.

FY	Loans in Portfolio	Per Loan Cost	($000) Total
1996	25,000	$ 152	$ 3,800
1997	24,000	152	3,648
1998	23,000	152	3,496
1999	22,000	152	3,344
2000	21,000	152	3,192
			$ 17,480

NOTE: The five year cost of $17.5 million would not be paid from GOE. The contract servicer will collect the compensation as a deduction from monthly payments and forward the balance to VA. Therefore, the cost of this proposal is in the form of reduced cash flows to the revolving funds which support the program.

Savings

All the savings of this proposal are realized in GOE from reduced FTE and overhead costs. The personnel savings are in the Loan Guaranty, Finance and Administrative Divisions.

Loan Guaranty

Savings of 112 FTE are estimated assuming VA will retain some functions such as loan foreclosure, delinquent loan servicing of certain sensitive accounts (e.g., disabled veterans) and general contractor oversight.

Finance

Savings of 45 FTE are estimated because of accounting functions performed by the contractor instead of Finance staff.

Administration

Savings of 14 FTE are estimated for the administrative support of this proposal.

Summary

Reduction of 171 FTE including salaries, benefits, and overhead coupled with the estimated costs generates the following net savings:

FY	GOE Savings	Costs	($000) Net Savings
1996	~~$7,159~~	$ 3,800	~~$ 3,359~~
1997	7,393	3,648	3,745
1998	7,597	3,496	4,101
1999	7,787	3,344	4,443
2000	7,983	3,192	4,791
	~~$37,919~~	$17,480	~~$20,439~~

PROPOSAL: ELIMINATION OF THE MANUFACTURED HOME LOAN PROGRAM

DISCUSSION: Since 1970, VA has had the authority to guarantee manufactured home loans. The number of veterans making use of the manufactured home loan program has declined significantly over the years. There is virtually no lender interest in using the program.

Fiscal Year	Number of Manufactured Home Loans
1984	13,110
1985	8,916
1986	6,022
1987	5,100
1988	2,071
1989	834
1990	434
1991	313
1992	126
1993	67
1994	24

OPTION: Eliminate VA's authority to guarantee manufactured home loans under the provisions of 38 USC 3712.

ADVANTAGES:

1. The manufactured home loan program has experienced extremely high foreclosure rates for a long period of time with no signs of improvement. Cumulatively through FY 1994, VA has paid guaranty claims on 38.7 percent of all manufactured home loans guaranteed, compared to a 5.58 percent foreclosure rate on site-built VA guaranteed home loans.

2. While the number of manufactured home loans is small, VA's obligation to guarantee these loans requires expertise in consumer installment finance, which differs in many respects from traditional real estate finance. Elimination of the manufactured home loan program would free VA from having to develop and retain this expertise.

3. Veterans would still be able to obtain VA financing to purchase manufactured homes that are permanently affixed to a foundation and treated as real estate under State law. These homes are considered the same as traditional site-built homes, and can be financed with no downpayment, 30 year VA guaranteed loans.

DISADVANTAGES:

o The manufactured home loan program is a source of financing for affordable housing. However, equivalent financing is available under the FHA Title 1 program. These FHA loans are available with 5 percent down and loan terms of 20 years for single-wide manufactured homes and 25 years for double-wides, the same terms as are available from VA, and with no use of the veteran's home loan entitlement. Conventional loans are also available with 5 percent down.

AREAS OF CONSIDERATION: Legislation would be required.

COST BENEFIT ANALYSIS: In FY 1994 VA guaranteed 24 mobile home loans (for credit reform only 13 loans actually closed in FY 1994). For budget purposes we have estimated 30 loans a year for FY 1997-2001. GOE resources to support new loan activity is minimal and spread around the country. Therefore, eliminating new loan originations produces no GOE savings. The only savings from this proposal is the subsidy appropriated to fund future loan foreclosures. Subsidy savings for the five year period FY 1997-2001 is estimated to be $728,000.

FY	Subsidy
1997	$136,000
1998	143,000
1999	145,000
2000	151,000
2001	153,000
	$728,000

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Proposal: Privatization of VA Loan Guaranty Program (Public-Private Partnership)

Discussion:

The model for this proposal is likely the partnership model designed for disposition of RTC assets. The Government retains an 80% interest in net disposition proceeds and remains a SP (Silent Partner, or non-managing partner), although retaining some level of "oversight" over the partnership. The business partner or Managing Partner (MP) purchases a 20% interest and is only permitted to make money from disposition proceeds (not from collateral enterprises, such as property insurance, sales brokerage, property repairs.).

Option: Contract Out Sale of VA-Owned Homes.

Advantages: Savings in overhead expenses, such as FTE, rental space, travel costs.

Disadvantages:

1. "Frontier territory" with few guideposts and established roads. Since this program involves disposition of capital assets, the reduction in overhead expenses has to be viewed in the total context of the return on those assets disposed of. There has been no known definitive evaluation of the RTC model by an independent source, although such an evaluation is planned or underway.

2. Disruption of existing local partnerships. VA runs a sales program which is already a fundamentally "privatized" disposition program, involving thousands of sales brokers, management brokers, repair contractors, etc. The proposed partnership would insert a large general contractor between VA and these thousands of small entrepreneurs --- with the strong possibility that the general contractor would find it more economical to utilize only a small fraction of these contractors in its operations.

3. Savings would not be immediate. It would probably take more than twelve months to complete the competitive contracting for the selection of the MP, and the VA would continue its overhead expenses in the meantime.

4. Loss of flexible vendee financing. Partnership disposition would probably have to be done without seller-financing, which is an invaluable tool in the depressed real estate markets where most REO is located. The loss of the ability to provide up to 100% financing on sales would be detrimental to affordable housing objectives and would also result in greater losses to the Government than under current property disposal methods.

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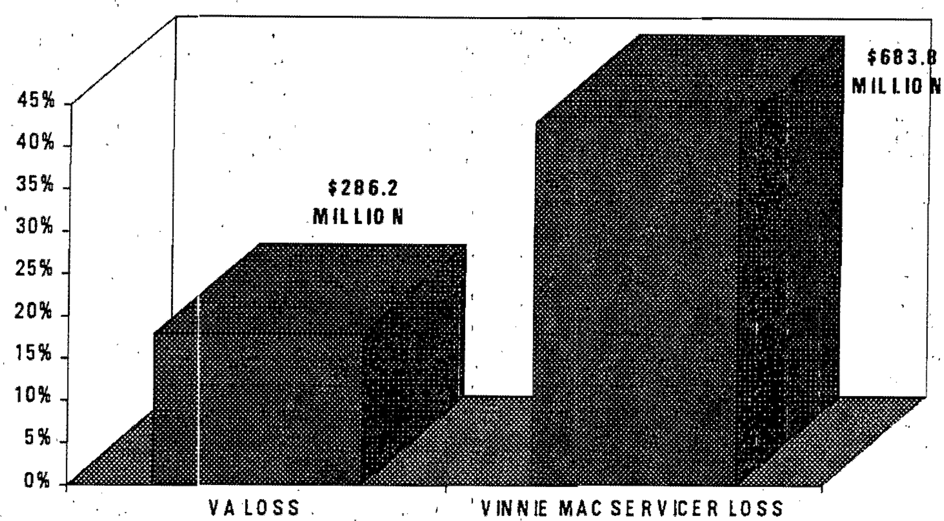
5. Greater disposition losses expected. VA's property disposition losses during FY 94 were 18.4% in relation to total cost to acquire. Comparable loss percentages for VA's securitized vendee loan trusts have amounted to a composite 43%. During the years that VA had mandatory percentages of cash sales to make (1986-92), the percentage loss on cash sales only ranged between 30-35%. The following graph compares actual FY 1994 VA losses with those that would have occurred if Vinnie Mac servicers had disposed of VA properties.



VA's INVESTMENT IN THE PROPERTIES SOLD IN FY 1994 = $1.6 BILLION. VA's LOSS ON THESE PROPERTIES = $286.2 MILLION (18%)

IF VA HAD UTILIZED THE VINNIE MAC SERVICERS TO DISPOSE OF THESE PROPERTIES, VA's LOSSES WOULD HAVE BEEN MORE THAN DOUBLE ,OR $683.8 MILLION (43%)

Areas of Considerations:

1. Legal/Legislative. If the MP is to be paid from the proceeds of asset disposition, this would probably require legislation because administrative costs are prohibited from being paid from the LG funds, and the properties are assets of the Funds.. To the extent the MP will be performing functions presently performed by VA staff, it is doubtful that the cost of those functions could be paid from disposition proceeds. VA would still require some funding from Departmental GOE.

2. Extensive ADP Programming changes needed so that properties will be correctly assigned to MP and so that VA will have some basis for carrying out its oversight functions as SP.

3. Contracting Time. Best estimates are that contracting requirements would take about 12 months before (MP(s) could be selected.

4. Local opposition from small businesses. Substantial opposition is likely from local real estate brokers and small repair contractors. This would represent a major economic disruption for them. For example, in FY 94, VA expended $94 million - sales brokers
$51 million - property repairs
$15 million - management brokers

RECOMMENDATION: Proposal should not be implemented.

Savings Realized From VA's Acquisition of Foreclosed Properties

EXECUTIVE SUMMARY

- VA decides whether it is in the financial best interest of the Government to accept conveyance of the property or pay maximum claim in each case.

- VA's decision takes into account the estimated acquisition, management and sales expenses, including any expected losses on resale based on the previous year.

- By establishing an upset price and acquiring the properties, VA saved an average of $9,762 per claim in FY 1994.

- VA's average profit on the resale of a property was $2,339 in FY 1994

- **By acquiring and remarketing properties, VA saved the Government a total of $271,558,541 in FY 1994 and $294,742,234 in FY 1993.**

When a loan holder notifies VA that a foreclosure sale will take place on a VA guaranteed home loan, the regional office must decide whether it is in the best interest of the Government to establish an upset price and acquire the property, or to decline to establish an upset price, refuse conveyance of the property, and pay the maximum claim for which VA is liable.

To establish a reasonable market value, VA staff reviews an appraisal conducted by an independent fee appraiser. Prior to the Deficit Reduction Act of 1984, VA's determination of a property's value was based solely on this reasonable market value, with no deduction except prorated property taxes. During the early 1980's, the Grace Commission concluded that it would be in the best interest of the Government for VA to pay its maximum guaranty in every case and not acquire any properties. Congress did not agree that this procedure would benefit the Government or the veteran borrowers, but legislated that certain acquisition and disposition costs be deducted from the value of the property at the time of foreclosure. This was intended to ensure VA would only acquire properties when it was in the best interest of the Government. Based on this legislation, VA implemented a new procedure.

After a reasonable market value has been established, a percentage of that value based on VA's estimated acquisition, management and sales expenses (including VA administrative costs) is deducted to arrive at the property's "net value" to VA. Beginning in 1993, the previous years losses on resales, if any, were also included in this percentage, based on another change in the law.

Following a loan termination, VA must pay a claim to the loan holder for the difference between the total indebtedness on the loan and the proceeds from the sale of the property, or the amount of the maximum guaranty, whichever is less. If the unguaranteed portion of the loan (the total indebtedness less the maximum guaranty) is less than the net value for the property, VA establishes an upset price equal to the net value or the total indebtedness, whichever is less. VA then agrees to acquire the property from the holder for that amount after the foreclosure sale, provided the holder is the successful bidder. By acquiring the property under these circumstances, VA pays less than the maximum guaranty on the claim, and guarantees that the veteran's indebtedness is credited with at least the net value of the property. In those instances where the net value exceeds the total indebtedness, the proceeds from the sale satisfy the mortgage obligation, and no claim is payable by VA

If the net value is less than the unguaranteed portion of the debt, the claim paid by VA would not be reduced below the maximum guaranty by requiring that the veteran's indebtedness be credited with the net value. Therefore, VA does not establish an upset price and does not acquire the property from the holder. This type of case is commonly referred to a "no amount specified" or a "no-bid."

During FY 1994, VA sold 22,441 properties. The average claim paid by VA after the foreclosure of these properties was $15,359, while the average maximum claim payable was $25,121, a savings of $9,762 per claim paid. The savings to VA were increased by $2,339 per property, the average profit realized by VA on the resale. **By acquiring and remarketing these properties, VA saved the Government a total of $271,558,541 in FY 1994.** The saving in FY 1993, were equally impressive at $294,742,234.

The question is sometimes asked: if VA doesn't specify an amount for the loan holder to bid at the sale, won't third parties bid it in for a greater amount, perhaps even enough to satisfy the mortgage so no claim will be payable? VA tested this hypothesis at foreclosure sales of portfolio loans 10 years ago. The results confirmed our intuition that, because third party bidders are generally speculators who are only interested in acquiring property for substantially less than its value, they would not bid amounts that would benefit VA. (After all, anyone who is willing to pay what a property is worth can take the time to look at homes which are listed for sale in the real estate market.) If VA stopped setting upset prices, and left it to the market to set foreclosure sale prices, bids would be so low that we would wind up paying the maximum guaranty claim in almost every case.