December 14, 2023

Secretary Denis R. McDonough
U.S. Department of Veterans Affairs
810 Vermont Avenue NW
Washington, DC 20420

RE: Concern with Key Element in the Veterans Assistance Servicing Purchase Program

Dear Secretary McDonough,

On behalf of the clients, communities, companies, and borrowers we serve, we are concerned with a key feature of the forthcoming Veterans Assistance Servicing Purchase (VASP) Program. We appreciate VA's work on the program, and we agree with the statement that your team filed with OMB, that "the rising rate environment combined with the residual impact of the pandemic has left traditional loss mitigation options insufficient to meet the need of affordable home retention options."[1]

Last year, our organizations requested that the VA – "reconfigure and expand the statutorily authorized refund program, which enables the VA to purchase delinquent loans from servicers and change the terms of the original loans to reduce Veterans' monthly payments."[2] We are encouraged that your team announced that this program will be rolled out in the next month. Unfortunately, however, the stakeholders that will be called upon to implement the program have not seen draft policy terms to provide the type of feedback needed to enable an efficient rollout of this new program.

We are concerned that the VASP Program will modify loans based on an interest rate target rather than borrower payment reduction. The VA team has verbally indicated that VASP will require mortgage servicers to modify Veterans' loans to a specific and uniform interest rate target of 2.5%. This policy decision to target a fixed interest rate, rather than targeting a payment reduction, is inconsistent with the approach deployed by the GSEs and government agencies over the last several years and could create substantial inequities and unintended outcomes. Briefly, resetting all affected VA borrowers to the same fixed interest rate, rather than targeting a standard payment reduction could produce unintended outcomes:

[1] Final Supporting Statement for the VA Servicing Purchase Program, published on 11/17/23.
[2] January 17th Joint Letter to the VA on the Advanced Notice of Proposed Rulemaking. In addition, this letter requested that the VA reinstate the partial claim option.

- Borrower payment reduction will vary widely and inequitably. Similarly situated Veterans facing similar hardships will receive different benefits. Veterans with comparable needs for payment reduction may get minimal or no payment relief because their mortgage already has a low rate, while others may get some of the most generous payment relief that any government lending program has ever offered because they start with a much higher current mortgage rate. For example, some borrowers will get a very small reduction in their principal and interest (P&I) payment (e.g. 5%), while others could receive between 35% and 50% P&I reductions. In other words, the amount of the benefit will not be based on the Veteran's need; instead, benefits will be apportioned based on the existing interest rate on their loan.

- Insufficient payment reductions could lead to redefaults while excessive reductions could produce surplus benefit relative to need for some borrowers. Research has shown that there is a causal relationship between payment reduction and redefault rates.[3] This research showed that a 25% reduction in P&I leads to a 36% reduction in 5-year redefault rates.[4] Moreover, recent analysis finds that 20% to 30% of P&I reduction is optimal, whereas smaller P&I reductions (< 10%) and larger P&I reductions (>30%) have a limited marginal effect on redefault rates.[5] The GSEs and FHA structure their loss mitigation programs based on these findings; they target a 20% and 25% payment reduction, respectively. VA staff indicated that a 2.5% target rate for VASP will generate a P&I reduction of less than 20% for the majority of VASP recipients). In other words, for most beneficiaries, the level of P&I reduction may be insufficient to prevent foreclosure, yet other borrowers may achieve a P&I reduction greater than 30%, expending VA resources with little to no marginal positive impact on redefault rates.

- Further, concerns have been raised that guaranteeing a substantial interest rate reduction to Veterans who become delinquent at a time when mortgage rates are 7 percent or above may create an incentive for some borrowers to default without any financial hardship to avail oneself of this significant payment reduction. That is neither prudent nor fair, yet the system could motivate that very behavior.

For these reasons, we recommend that VA design VASP to rely on *payment reduction targeting*, with a target 20% P&I reduction. That is, the VA should mirror the process used by other government housing programs and set the expectation that mortgage servicers calculate the

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[3] Peter Ganong and Pascal Noel, in the online appendix to *Liquidity Versus Wealth in Household Debt Obligations: Evidence from Housing Policy in the Great Recession*, American Economic Review, 110(10): 3100-3138 (2020), estimate the causal effect of a reduction in principal and interest payments on re-defaults (defined as a 90-day delinquency) over the next 5 years.

[4] We derive the causal impact of a 25% reduction in P&I on 5-year default rates from the Replication Kit for Ganong and Noel (2020), available at: GitHub - ganong-noel/mtg_mods_public: Repkit for Liquidity vs. Wealth in Household Debt Obligations: Evidence from Housing Policy in the Great Recession.

[5] As described in https://www.milliman.com/-/media/milliman/pdfs/2023-articles/9-25-23_assessing-the-effectiveness-of-payment-reduction_20230925.ashx. Appendix Figure 11 shows that borrowers who received a P&I reduction of less than 10% had higher redefault rates over the next 2 years than borrowers who received no payment reduction at all, and that increasing P&I reduction beyond 30% has little marginal impact on 2-year redefault rates.

appropriate interest rate that will create a 20% reduction in P&I for the Veteran. We acknowledge that payment reduction targeting comes with slightly more operational complexity for servicers, but we are confident that industry participants (which some of our organizations represent) can readily accommodate this, and there will be no delay in implementing VASP due to this potential policy change.

Thank you for your consideration. We would welcome the opportunity to meet with you to discuss our recommendations and concerns. Please have your staff contact Matt Douglas at matt.douglas@housingpolicycouncil.org, Steve Sharpe at ssharpe@nclc.org, Brendan Kelleher at Bkelleher@mba.org, or kanavbhagat@gmail.com with any questions or to arrange further discussion.

Yours truly,

Center for Responsible Lending
Housing Policy Council
Mortgage Bankers Association
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