Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

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In-House Servicing of the Primary Mortgage Loan Program Portfolio (Veterans Affairs -- General Agency Provisions)

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CURRENT LAW

Chapter 208, Laws of 1973 authorized the issuance of bonds to provide low-interest home mortgages to qualified veterans. Lending activities under the program began in 1974. The program is designed to be self-supporting. This means that the veteran mortgage loan repayments (principal and interest) are intended to be sufficient to repay the funds borrowed, plus interest costs, as well as the administrative costs of the home loan program.

To obtain a loan, a veteran applies through a financial institution approved by DVA. The financial institution reviews a veteran's loan application for creditworthiness. DVA also reviews the loan application to ensure that a veteran is qualified for the loan program. If the application is approved, the local lending institution originates the loan using monies from the capital improvement fund and acts as the collection agent for DVA. The financial institution typically charges a fee of three-eighths of 1% to one-half of 1% of the amount of the loan to cover its loan servicing costs.

GOVERNOR

Authorize the Department to assume the servicing of the veterans primary mortgage loan portfolio and to purchase from authorized lenders the servicing rights for such portfolios. Provide $4,840,600 SEG in 2001-02 and $898,800 SEG in 2002-03 for the likely implementation of an in-house loan servicing function following the development of a plan for the most cost-effective method of servicing such loans, as follows:

Loan Servicing Administration. Create a SEG-funded sum certain appropriation, funded from the veterans mortgage loan repayment fund, to support the in-house servicing of the veterans primary mortgage loan portfolio and provide $1,297,000 SEG in 2001-02 and $898,800 SEG for this purpose. Of the amounts provided, all but $30,000 SEG in 2001-02 for supplies and services costs would be budgeted in unallotted reserve. Define the Department as a "mortgage banker" for the purpose of providing the in-house servicing of the veterans primary mortgage loan portfolio.

Escrow Payments. Create a SEG-funded continuing appropriation, funded from the veterans mortgage loan repayment fund, to which would be credited monthly escrow payments from borrowers for real estate taxes and casualty insurance premiums, in the event that the Department assumes the in-house servicing of the veterans primary mortgage loan portfolio. Require the Department to hold in escrow all such payments and to pay all of the required amounts due for real estate taxes and casualty insurance premiums for each borrower making escrow payments, even if the amounts held in escrow are insufficient. In the case of an insufficiency, the Department would be directed to recover the amount of the insufficiency from the veteran. If the amounts in the borrower's escrow account were in excess of the amounts required for the real estate taxes and casualty insurance premium payments, the Department would be required to pay all of the amounts due and refund the amount of the excess to the veteran. Extend the current law provision requiring that borrowers maintain adequate fire and extended coverage insurance to specify that the Department also be named as an insured in the event that it assumes the in-house servicing of the veterans primary mortgage loan portfolio. No expenditures are estimated under this new appropriation.

Loan Servicing Rights. Create a SEG-funded biennial appropriation, funded from the veterans mortgage loan repayment fund, to support the purchase of loan servicing rights from existing authorized lending institutions and provide $3,543,600 SEG in 2001-02 for this purpose. All of these amounts would be budgeted in unallotted reserve.

Development of a Plan for Servicing Primary Mortgage Loans. Require the Department and DOA to develop a plan for the most cost-effective method for the in-house servicing of the veterans primary mortgage loan portfolio. Specify that the Secretary of DOA could not authorize the encumbrance or the expenditure of funds under any of the new appropriations described above until after the plan developed by the two agencies had been completed. Finally, the Department would be prohibited from holding any escrow payments until the actual completion of the plan.

DISCUSSION POINTS

1. The Department states that the primary benefit of developing an in-house capability to service the veterans primary mortgage loan portfolio is that the program will no longer be required to provide qualified lending institutions with a servicing fee for processing the loans. [These institutions will continue to assess standard loan origination and closing fees.] While the Department would newly incur additional loan administration and escrow account management expenses, it is estimated that the elimination of servicing fee payments to lending institutions would

net the program an additional $2.1 million per year, based on the value of the current portfolio. The agency estimates that it would require approximately two years for the program to achieve sufficient savings to offset the agency's start-up costs associated with this initiative.

2. In concept, the proposal to have the Department provide in-house servicing of the veterans primary mortgage loan portfolio appears reasonable. Discussions with the Department and a review of the testimony presented to the Committee during its public hearings on the biennial budget have not identified any major areas of concern with the concept.

3. However, the agency has identified some implementation issues that still must be addressed before the program can be implemented:

- The agency does not want to bring the existing loan portfolio in house until after the beginning of the next calendar year. This arrangement would be least disruptive to financial institutions and borrowers that have existing escrow accounts in place. However, this delay could have a significant impact of the agency's administrative funding needs for the remainder of the 2001-02 fiscal year and may impact its administrative funding for 2002-03.

- The agency must explore the degree to which certain administrative activities, such as the management of escrow accounts, can be centralized. For example, the responsibility for making all year-end escrow payments could be contracted to an outside financial services vendor.

- Adjustments to the agency's current loan accounting system will likely be required as a result of the proposed change.

- No additional position authority has been provided to the Department to staff the proposed initiative. The agency initially identified a staffing need of 7.0 FTE positions; however, this position authority was denied by the Governor, pending the results of a feasibility study and associated implementation plan.

4. The Governor has recommended that DVA and DOA jointly develop a plan for the most cost-effective manner of providing in-house servicing of the veteran primary mortgage loan portfolio and has provided $30,000 SEG in 2001-02 for consultant services for this purpose. However, as the bill is drafted, the Secretary of DOA may not authorize the expenditure of any funds appropriated to DVA for in-house loan servicing, including the amounts appropriated to complete this plan, until after the plan has actually been completed. A technical correction to the bill is required to permit the release of the funds for preparing the plan.

5. Pending the development of that plan and proposed options for implementation of the in-house loan servicing initiative, the Committee may wish to shift $4,810,600 SEG in 2001-02 and $898,800 SEG in 2002-03 initially recommended for loan-servicing administration and the purchase of loan-servicing rights to the Committee's s. 20.865(4)(u) appropriation. These funds would be reserved for possible future release to the Department, once the Committee has reviewed and approved the plan developed by DVA and DOA and is satisfied that the implementation proposal is the most cost-effective. Under this alternative, $30,000 SEG in 2001-02 would be

retained under DVA's loan-servicing administration to fund the costs of preparing the plan.

6. Alternatively, if the Committee believes that the recommended plan to be developed jointly by DVA and DOA, coupled with DOA's ability to release the necessary in-house portfolio funding amounts from unallotted reserve, based on the results of the plan, are sufficient to ensure that the most cost-effective option is pursued, then it could approve the Governor's recommendation. If the Committee chooses this option, however, it should make a technical adjustment to the Governor's recommendation to specify that $30,000 SEG in 2001-02 is available for expenditure to fund the development of the plan.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation with the modification that $30,000 SEG in 2001-02 may initially be expended to develop a plan for the most cost-effective method for the in-house servicing of the veterans primary mortgage portfolio.

2. Modify the Governor's recommendation by: (a) providing $30,000 SEG to the Department of Veterans Affairs for hiring a consultant to assist DVA and DOA in developing a plan for the most cost-effective method for implementing the in-house servicing of the veterans primary mortgage portfolio; and (b) shifting $4,810,600 SEG in 2001-02 and $898,800 SEG in 2002-03 initially recommended for loan servicing administration and the purchase of loan-servicing rights to the Committee's s. 20.865(4)(u) appropriation for possible future release to the Department, once the Committee has reviewed and approved the plan developed by DVA and DOA.

3. Delete the Governor's recommendation.

Alternative 3	SEG
2001-03 FUNDING (Change to Bill)	**-** $5,769,400

Prepared by: Darin Renner