Legislative Fiscal Bureau
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April 29, 2009 Joint Committee on Finance Paper #823

In-House Mortgage Loan Portfolio (DVA -- General Agency Provisions)

[LFB 2009-11 Budget Summary: Page 671, #19]

CURRENT LAW

Under the primary mortgage loan program (PMLP), the Department of Veterans Affairs (DVA) may provide mortgage loans to qualifying state veterans to purchase or construct a home. Funding for the program is derived from the proceeds of state bond issuances.

GOVERNOR

Provide $125,000 SEG in 2009-10 from the primary mortgage loan fund for an evaluation of the viability of servicing primary mortgage loans at the DVA. The Department would hire a consultant to advise the Department regarding the following: (a) staffing, and supplies and services that would be needed to perform loan servicing in-house; (b) changes in loan origination and administrative procedures; and (c) the costs and revenues of the proposal, including the costs of purchasing servicing rights for existing veterans mortgage loans.

DISCUSSION POINTS

1. Under current law, the Board of Veterans Affairs sets the interest rate for PMLP loans, but the rate is highly dependant on the interest rate of the associated bond issuance. As of March 16, 2009, the PMLP interest rate was 5.875% for a 30-year loan.

2. Borrowers currently pay loan servicing agencies a monthly servicing fee based on an annualized 37.5 basis points (0.375%) on the outstanding principal balance for each mortgage. In other words, a veteran with a PMLP and a remaining principal of $100,000 would pay one-twelfth of 37.5 basis points on $100,000, or $31.25 for that month. The loan servicer retains that amount and forwards the remaining payment to DVA.

3. Loan servicing includes the following: (a) collection of payments; (b) providing tax, special assessment, insurance, and maintenance payments when they are due; (c) ensuring that proper hazard insurance is carried by the owner; (d) inspection of properties when mortgages have become more than 60 days delinquent; and (e) protecting mortgaged property that has been defaulted upon.

4. As of December 31, 2008, there were 3,100 outstanding primary mortgage loans with an outstanding balance of $291,004,300. Currently, all primary mortgage loans are serviced outside of the agency.

5. The Department currently uses 53 authorizes lenders as servicing agents. In 2007-08, a total of $988,100 was paid to these loan servicers for primary mortgage loans.

6. The Department has requested and the Governor has recommended providing $125,000 SEG in 2009-10 to hire a consultant to determine the feasibility of the Department establishing in-house servicing of the PMLP.

7. The Department indicates that, based on financial viability, DVA would request position and budget authority under state agency supplement authority (s. 13.10 of the statutes) or as part of the 2011-13 biennial budget to service PMLP's in-house.

8. In order for the Department to assume the current PMLP servicing rights, DVA would have to purchase those rights from the current loan servicers. The Department maintains the right to purchase PMLP servicing rights. The cost to purchase these rights is 50 basis points of the remaining unpaid aggregate principal amount. For a loan that had an outstanding principal of $100,000, DVA would have to pay the current servicer $500 for the right to service the remainder of the loan. It would cost DVA $500,000 for each $100,000,000 of loan servicing rights it purchased.

9. The Department currently has oversight of the revenue collection and foreclosure process and is responsible for ensuring that loan servicers are acting within the guidelines established by DVA. Loan servicers must perform due diligence on delinquent accounts and see to it that foreclosure actions are done promptly and are prosecuted expeditiously and in general protect DVA's interests.

10. If DVA serviced these loans it would have to take over the collection of revenues (including escrow accounts) as well as the foreclosure process, when required. There would be a significant increase to administration, including direct telephone and written communication with borrowers.

11. If payments were delinquent for 60 days DVA would have to inspect the property every month, until the home is liquidated, to ensure that the home is not becoming dilapidated.

12. The Department would become responsible for contracting for, and directly overseeing, the activities of the attorneys prosecuting the foreclosure action, performing routine

property inspections and ordering the securing and maintenance of properties. The Department would have to arrange for basic maintenance such as lawn mowing and snow removal for foreclosure properties. The Department would also be responsible for obtaining a writ of assistance for owners who refuse to vacate the property following confirmation of sale.

13. As part of the 2001-03 biennial budget (2001 Wisconsin Act 16), the Legislature made the following modifications that would potentially allow DVA to service PMLP's in-house:

- Created a segregated appropriation funded from the mortgage loan repayment fund, for the receipt of and payments of escrow payments (payments for taxes and insurance premiums) required as part of mortgage borrowing.

- Created a segregated appropriation funded from the mortgage loan repayment fund, for the purchase of PMLP loan servicing rights.

- Created a segregated appropriation funded from the mortgage loan repayment fund for the administration of PMLP loan servicing.

- Specified that DVA, could collect additional funds from the borrower, if amounts set aside under escrow are insufficient and would be responsible for refunding excess escrow payments.

- Specified that the revenues of the segregated mortgage loan repayment fund could include PMLP serving revenues and that the purchase of loan servicing rights and escrow payments were available expenditures from that fund.

- Specified that DVA would not be classified as a mortgage banker under state statutes.

- Provided $30,000 SEG in 2001-02 for DVA and the Department of Administration (DOA) to jointly develop a plan for the most cost-effective method for the in-house servicing of the PMLP portfolio.

- Specified that DVA could not expend funds from the appropriations created to purchase PMLP servicing rights or escrow payments until a plan was approved by DOA.

14. The Department of Veterans Affairs, under current law provisions, would still have to have a plan for in-house PMLP servicing approved by DOA before moneys could be expended for purchasing the servicing rights or escrowed funds were collected or expended.

15. The Department did not conduct the feasibility study allowed in 2001 Wisconsin Act 16.

16. It could be argued that if there are potential revenue gains for DVA that the option of PMLP servicing should be explored. These revenues could help support DVA mortgage loan administration as well as funding veteran's assistance programs such as the county veterans service offices. There have also been transfers from the mortgage loan repayment fund to the veterans trust

fund, which funds a variety of veterans assistance programs.

17. Alternatively, the servicing of fees would require the Department to address payment delinquency issues. Since DVA is responsible for providing various other services for veterans ranging from education assistance to veteran's care facilities, it could be argued that it is important for veterans to have a good working relationship with the Department. In the case of home foreclosure, there could be considerable disagreement between the parties about issues ranging from re-establishing a payment schedule to eviction.

18. On the other hand, the foreclosure process is uncommon and in those cases, the Department may be in a good position to recommend veterans services that are available. Additionally, DVA is ultimately responsible for the foreclosures whether they occur through a loan service agent or directly.

19. An issue could be raised about the potential loss of referrals from lending agencies. It is unlikely that all of the loan servicing could be brought in-house, since lending agencies are important to DVA for primary mortgage loan referrals of potential borrowers. These lending agencies may still earn some fees from originating the loans, but it is likely that the incentive to refer clients to DVA would be reduced if there was no possibility of receiving serving rights.

20. However, the Department is aware of this issue and it is likely that the question of which loans would be serviced at DVA and which would be offered to servicing agents would be explored in the study as well as whether the initial cost of purchasing the loans plus the additional administrative staff would make in-house servicing feasible. In addition, the ability to set servicing fees could allow the Department to be more competitive with the primary mortgage loans, if the Department can efficiently administer this new operation and the servicing fees could be set less than 37.5 basis points.

21. Finally, it could be argued that the number of loans issued can fluctuate, which could cause an uneven workload within the Department. If other lenders were able to offer significantly lower interest rates than were offered by DVA, there could be significant refinancing that would reduce the Department's return on its investment. This could cause the Department to lose significant investments relating to buying servicing rights as well as personnel, office space, and computer hardware and software costs.

22. If the Committee believes that the one-time expenditure of $125,000 SEG from the mortgage loan repayment fund is unwise given the issues relating to the Governor's recommendation, it could delete the provision.

23. Alternatively, if the Committee believes that DVA should at least explore the option of in-house servicing of primary mortgage loans, then it could approve the recommendation.

24. If the Committee wishes to approve the Governor's recommendation, it may wish to require DVA to report to the Governor and the Legislature regarding the evaluations findings. Since the funding would be approved in the 2009-10, such a report could be required to by submitted by

October 1, 2010.

ALTERNATIVES

1. Approve the Governor's recommendation to provide $125,000 SEG in 2009-10 for an evaluation of the viability of servicing primary mortgage loans at the Department of Veterans Affairs.

2. In addition to Alternative 1, require the Department of Veterans Affairs to report to the Chairs of the veterans issues standing committees in the Legislature, the Co-chairs of the Joint Committee on Finance, and the Governor, by October 1, 2010, on the evaluation of the viability of servicing primary mortgage loans at the Department.

3. Delete the Governor's recommendation.

ALT 3	**Change to Bill** Funding
SEG	**-** $125,000

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