Order Code RS20533
Updated February 21, 2002

CRS Report for Congress
Received through the CRS Web

VA-Home Loan Guaranty Program: An Overview

Bruce E. Foote
Analyst in Housing
Domestic Social Policy Division

Summary

The Department of Veterans Affairs (VA) has been providing home loan guarantees since 1944. Under this program, an eligible veteran may purchase a home through a private lender and the VA guarantees to pay the lender a portion of the losses if the veteran defaults on the loan. From the program's inception in 1944 through September 30, 2001, VA has guaranteed the purchase or refinancing of more than 16.6 million homes for veterans. This report discusses the features of the VA home loan guaranty program. The report will be updated as suggested by changes in law or regulation.

The VA Home Loan Guaranty Program

The Servicemen's Readjustment Act of 1944 established the VA home loan guaranty program. The program authorized 20-year loans at a 4% interest rate under which the VA guaranteed to pay the lender the lesser of 50% of the loan amount or $2,000 if the borrower defaulted. The loan term, interest rate, and the percentage and dollar guaranty limitations have been increased over the years.

The VA loan guaranty program was an alternative to cash bonuses for the millions of men and women who served in the Armed Forces during World War II. There was the feeling that veterans, during their service to the country, had missed the opportunity to accumulate savings or to establish a credit rating which could be the basis of borrowing to acquire a home or establish a business. In defense of the Nation, many had risked their lives and deferred their dreams. The loan guaranty program was an attempt to put them on par with their nonveteran counterparts. The program also provided an investment outlet for the large savings which had been accumulated. Under this program, an eligible veteran may purchase a home through a private lender and the VA guarantees to pay the lender a portion of the losses if the veteran defaults on the loan.

While initially established to benefit veterans who had served during war times, the program has been amended to extend eligibility to all parties who are on active duty or honorably discharged from the services. The main objective of the current VA home loan guaranty program is to help veterans finance the purchase of homes on favorable loan terms.

Features of the Program

Eligibility. Eligibility for VA-guaranteed housing loans is generally based upon the period and length of active duty service of honorably discharged veterans. Veterans who served more than 90 days of active duty during World War II, the Korean conflict, the Vietnam Era, or the Persian Gulf War are eligible for VA-guaranteed housing loans. Veterans whose service fell entirely within (1) 7/26/47 to 6/26/50, (2) 2/1/55 to 8/4/64, or (3) 5/8/75 to 9/7/80 (enlisted) or to 10/16/81 (officers) must have served at least 181 days of active duty. Veterans whose service began after 9/7/80 (enlisted) or 10/16/81 (officer) must have completed 24 months of active duty or the full period (at least 181 days) for which they were called or ordered to active duty. The unmarried surviving spouses of veterans whose deaths were service connected and the spouses of veterans listed for 90 days or more as missing-in-action or prisoners-of-war are also eligible for VA-guaranteed home loans. Veterans who receive a discharge other than honorable may apply to the Secretary of the Department of Veterans Affairs for a certificate of eligibility.

Under current law, a veteran's entitlement to a VA-guaranteed housing loan is good until used.

Through September 30, 2007, veterans who have had at least 6 years of service in the reserves are eligible for VA-guaranteed housing loans.

Through December 31, 2005, Native American veterans may qualify for direct loans from VA to purchase, construct, or improve homes on trust land.

Maximum Mortgage. VA places no limits on the maximum mortgage that the veteran may obtain, except that the mortgage may not exceed the home's value plus any loan funding fee which is financed, and the payments must be within the means of the borrower. As a rule, however, lenders will not make VA-guaranteed loans in excess of 4 times the maximum loan guaranty. Since the maximum guaranty is now $60,000, lenders usually will not make a VA-guaranteed loan in excess of $240,000.

Loan Term. VA-guaranteed loans may be obtained for mortgages with terms of up to 30 years and 32 days.

Owner Occupancy. In general, veterans obtaining VA-guaranteed loans to purchase or refinance a home must certify that they intend to occupy the property as a primary residence. Property that has been acquired by VA as a result of default or foreclosure by a veteran may be sold to owner-occupants or investors.

Eligible Loan Purposes. VA-guaranteed loans may be used to purchase single-family detached homes, townhomes, rowhouses, two-to-four family buildings where the owner will occupy one or more of the units, manufactured homes and lots, and condominiums in developments approved by VA.

The loans may also be used to build a home; to repair, alter, or improve a home; to refinance an existing home loan; to refinance an existing VA-guaranteed loan to reduce the interest rate; to simultaneously purchase and improve a home; or to install a solar heating and cooling system or other weatherization improvements.

Federal Guaranty. An eligible veteran may finance a home through a private lender, and the VA guarantees to pay the lender a portion of losses that may be suffered as a result of default by the borrower. The guaranty amount depends on the date on which the loan was closed. For loans closed on or after December 18, 1989, the maximum VA guaranty is as follows: (1) 50% of the loan amount for loans of $45,000 or less, (2) $22,500 for loans between $45,001 and $56,250, (3) the lesser of $36,000 or 40% of the loan for loans between $56,251 and $144,000, and (4) the lesser of $60,000 or 25% of the loan for loans in excess of $144,000.

Program Funding. From 1962 until 1990, the VA home loan guaranty program was funded by the VA Loan Guaranty Revolving Fund (LGRF). The LGRF was authorized to fund all operations of the loan guaranty program except administrative costs.

The LGRF was never designed to be self supporting. It was developed as a convenient means of paying the costs of the loan guaranty program and receiving program collections. The LGRF had been operating at a deficit since 1981 and had operated at a surplus in only 6 years since its inception. Prior to 1984, deficits in the LGRF were funded by transfers of unobligated balances from the VA Direct Loan Revolving Fund, so the loan guaranty program was able to operate without appropriations from Congress (except for administrative expenses). For a variety of reasons, in the 1980s, those balances were no longer available at the level needed to fund the deficits in the LGRF. Since 1984, deficits in the LGRF have been funded primarily by appropriations from Congress. Since 1982, the user fees paid by borrowers have also been used to help fund the program.

P.L. 101-237 made major changes in the home loan guaranty program. A new revolving fund, the Guaranty and Indemnity Fund (GIF), was established in the Treasury to fund the program for all new loans. For each VA loan guaranteed after October 1, 1990, the government will pay into the GIF a fee of 0.25% of the loan amount for the first 3 years of the loan. User fees paid by veterans will be credited to the GIF and the government will pay the fees on behalf of veterans who are exempt from paying fees.

Interest Rates. In the past, VA has determined the maximum interest rate that lenders could charge for VA-guaranteed housing loans. The rate varied from time to time based on changes in the mortgage market. Once a loan was made, however, the rate stayed the same for the life of the loan.

Through December 31, 1995, VA was authorized to let the borrower, home seller, and lender negotiate the interest rate that is charged for a VA-guaranteed loan. That authority was made permanent by P.L. 104-110.

User Fees. To defray part of the cost of the program, certain veterans are required to pay loan funding fees to VA when obtaining VA-guaranteed home loans. For most veterans, the loan fee is currently 2% of the loan amount when the downpayment is less than 5% of the property value, 1.5% of the loan amount when the downpayment is 5% to 9%, and a 1.25% of the loan amount when the downpayment is 10% or more. Persons who assume a VA guaranteed loan are required to pay a loan fee of 1.25% of the loan balance. Veterans who obtain a VA-guaranteed loan to refinance an existing VA loan are required to pay a loan fee of 1% of the new loan amount.

Veterans who are eligible for loans as a result of service in the reserves pay higher loan fees. For such veterans the loan fee is 2.75% of the loan amount when the downpayment is less than 5%, 2.25% of the loan amount when the downpayment is 5% to 9%, and 2% of the loan amount when the downpayment is 10% or more.

A veteran may sell an existing VA-financed home and purchase another home with a VA-guaranteed loan. The loan fee for the new loan would be 3% of the loan amount if the veteran makes a down payment of less than 5% of the home value.

All loan fees are paid into the VA Guaranty and Indemnity Fund (GIF). Certain veterans with service-connected disabilities (or their surviving spouses) are exempt from paying the loan fees, but the GIF is credited with the fees that would have been paid in the absence of the exemption.

Credit Limits. The VA-guaranteed home loan program now has permanent indefinite budget authority and VA may guarantee any volume of loans requested by veterans during a given fiscal year.

Downpayment. The downpayment is a matter of negotiation between the borrower and the lender. Standard lender practice is to permit eligible veterans to borrow up to $240,000 with no downpayment.

Assumption of Loans. VA loans may be assumed by nonveterans. The conditions governing the assumption of VA-guaranteed mortgages depend on the date on which the mortgage was closed. In general, loans closed prior to March 1, 1988 may be assumed without restrictions. For loans closed after March 1, 1988, the party who seeks to assume the loan must be proven creditworthy by the lender holding the loan, and the assumption must be approved by the VA or its authorized agent. This credit review is required for the life of the loan. If the assumption is approved, the new borrower pays a fee of 1.25% of the outstanding loan balance. If an unapproved assumption occurs, the lender may, within 30 days, demand immediate and full payment of the loan.

Other restrictions apply to assumptions of VA-guaranteed mortgages which were generated from proceeds of a state or local mortgage revenue bond issue. Generally, these mortgages may only be assumed by first-time homebuyers who meet the income guidelines established by the respective bond programs.

Multiple Purchases. By paying off an existing loan, either directly or by selling the property, a veteran becomes eligible for another VA-guaranteed loan. So the VA program permits a veteran to purchase a "starter home" and a number of "move-up" homes as long as the previous loans are repaid.

If a veteran sells the home and the loan is assumed by a nonveteran, the veteran's entitlement for a new VA-guaranteed loan will not be fully-restored until the loan is repaid. If, however, the loan is assumed by a veteran, the purchaser and seller may apply to VA for substitution of entitlement and the selling veteran's entitlement could be used to obtain another VA-guaranteed loan.

Under limited conditions, a veteran may obtain a second VA loan while the existing loan is outstanding. The maximum VA loan guaranty is set by law and has been periodically changed by the Congress. That guaranty amount is considered an entitlement to eligible veterans. If a veteran purchased a home when the guaranty was lower than it is under existing law, then the veteran is eligible to purchase another home with the unused guaranty. The maximum loan in such a case would be 75% of the appraised value of the home plus the unused guaranty. Of course, the new home would have to become the principal residence of the veteran and in most cases the mortgage could not exceed $240,000.

Underwriting Guidelines. Statutory credit criteria provide that VA may not guarantee a loan unless (1) the veteran is a satisfactory credit risk and (2) the contemplated loan terms are within the means of the veteran, as indicated by the veteran's present and anticipated income and expenses. In underwriting loans for approval, the VA's loan analysis form is used to evaluate the veteran's personal and financial status, the estimated monthly shelter expenses, the debts and obligations, and the monthly income and deductions. The veteran's residual income and debt-to-income ratio are calculated and used as guides in making a decision on the loan. The VA stresses, however, that no single factor should be used as a determinant in any applicant's qualification for a VA-guaranteed loan.

Residual income is determined by subtracting taxes, the proposed shelter cost, and other obligations from the veteran's monthly income. The VA has prepared a table which shows the minimum residual income, by region, for families of various sizes. The applicant's residual income should equal or exceed the stated minimum for the applicant's family size.

The veteran's debt-to-income ratio is another factor used in evaluating the application. If the ratio of monthly debt payments (including the proposed mortgage) to the monthly income is greater than 41%, there must be compensating factors that justify approval of the loan. If the ratio is greater than 45%, approval by the Chief of VA's Loan Processing section is needed. If the ratio is greater than 50%, approval by VA's Loan Guaranty Officer is needed in addition to that of the Section Chief.

Program Activity. During FY2001, VA guaranteed more than $31.3 billion in loans to finance the purchase or refinancing of 250,009 homes for veterans. From 1944 through September 30, 2001, VA has guaranteed about $708 billion in loans for the purchase or refinancing of more than 16.6 million homes for veterans.