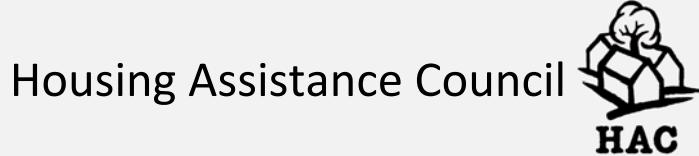




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Soldier's Home: A Closer Look at the Department of Veteran Affairs' (VA) Home Loan Program



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HAC, founded in 1971, is a nonprofit organization that supports affordable housing efforts in rural areas of the United States. HAC provides technical housing services, financial products, policy assistance, trainings, and research and information services. HAC is an equal opportunity lender.

Introduction

Most research about veterans focuses on their needs for and access to services upon their leaving military service, specifically needs related to healthcare and homelessness. While these are issues worthy of being policy priorities, it is also important to highlight an often-overlooked aspect of veteran life, mortgage activity. Because having access to safe, affordable, high-quality housing and the financing needed to obtain it is so vital, more scrutiny is needed to better understand the current housing market and how it affects veterans, especially efforts that go beyond anecdotal stories to review quantitative data. Having a better understanding of veteran home borrowing activity will help policymakers be better at ensuring veterans housing finance needs are being met.

The Department of Veterans Affairs' (VA) is specifically dedicated to serving veterans and its home finance program is a focus of recent policy efforts to increase veteran access to mortgage financing.¹ VA loans played a historically significant role in housing finance at the end of World War II by making it possible for returning service members to more easily own a home. These loans afford researchers an opportunity to use publicly available, longitudinal data to better understand veteran home finance activity.

This report provides a descriptive analysis of the VA home loan program^a between 2005 and 2014. The analysis provides an overview of the VA loan program, its trends, borrowers, and lenders. The findings highlight the growing role of VA loans in home finance markets since the beginning of the Great Recession. VA loans represented approximately 9 percent of all mortgage lending activity in 2014, up from less than 2 percent in 2005. The lenders originated at least one VA loan in 95 percent of all counties during the 2012 to 2014 period. During this time, refinance loans came to represent a majority of VA lending for three straight years (2012-2014) because of historically low interest rates. VA origination rates are consistently high for minority home purchase loans,^b when compared to conventional home purchase loans, even as default rates are said to be low,² which may, at least in part, reflect the programs' approach. Private mortgage companies and large volume lenders play a big role in the market, with program lender requirements possibly limiting small lender involvement. As long as the program can adapt to future changes, such as a smaller and more diverse veteran population and an increased importance of internet access, the VA loan products will continue to be a source of high quality, affordable housing finance for many veterans and their families.

^a This refers to VA home purchase and refinance products. Throughout this report also called VA loan or VA program.

^b Home purchase loans refer to loans classified in the HMDA data as being for the purpose of a home purchase. The analysis restricted home purchase loans to loans classified as first lien. The approach removed secondary lien loans to ensure second or so-called piggy back loans were not being counted.

Background

The VA home loan guarantee program was created to help veterans finance the purchase of homes.^c It was first enacted by President Roosevelt as part of the Servicemen's Readjustment Act of 1944 or, as it is more commonly known, the G.I. Bill. The underlying rationale for the loan guarantee program is that, during military service, veterans had given up their opportunity to build savings and establish a credit rating, both requirements for obtaining a home loan. The VA loan program attempted to make up for this financial sacrifice by helping veterans reintegrate into the civilian economy.³ Millions of returning GIs took advantage of this and other GI bill-related benefits. The establishment of the VA loan program served to accelerate home ownership in post-World War II America, which in effect, widened the middle-class.⁴

Eventually, the VA loan program was made a permanent benefit. It has expanded its eligibility to a wider range of people, resulting in over 22 million home loans being made since its inception.⁵ The program's impact on housing finance was at its peak immediately after World War II with the VA guaranteeing over 40 percent of all mortgages issued in 1946 and 1947.⁶ The VA has recently renewed its efforts to increase the proportion of veterans that take advantage of the home loan program through improved marketing, education, and further automated loan processing.⁷ In fiscal year 2013, the program reported an all-time high in total loans guaranteed, which suggest these efforts might be working.⁸

What We Know

There is a dearth of academic studies exploring veteran mortgage lending activity as a whole. The studies that exist focus mostly on how veterans are affected by homelessness and a lack of healthcare.^d This is not surprising since these are higher-profile topics, which often generate newspaper headlines, particularly with regards to policy efforts attempting to address them.^e Even when studies exploring housing markets do consider veteran-related mortgage lending, these efforts often refer to the historically-important role played by the GI Bill and the VA loan program, specifically in government housing policies.⁹

A lack of data is an underlying problem to better understanding veteran lending. A major reason for the limited academic analysis is the shortage of comprehensive, publicly-available data on housing related to veterans. For example, the American Community Survey (ACS), which is the primary source of housing data for all parts of the US, provides only a few veteran housing characteristic estimates. The more detailed ACS, Public Use Microdata sample (PUMs) can be

^c Before the GI bill owning a home was not really available to most people, it was only for the wealthy. Loan terms and conditions had high interest rates, required large down payments and short terms with balloon payments. The GI bill changed all of that and made home ownership possible for many more people. Cyd, McKenna. 2008. *The homeownership gap: How the post-world war II GI bill shaped modern day homeownership patterns for black and white Americans*. MIT Master's Thesis: url <http://hdl.handle.net/1721.1/44333> <http://hdl.handle.net/1721.1/4433>

^d For example, a recent search of scholarly articles on Academic Search using the term "veteran housing" and restricting to articles written since 2005 finds 18 of the first 20 studies exploring homelessness and transitional and supportive housing.

^e As an example, a recent April 19, 2016 *Washington Post* story by Eric Yoder was titled "Veterans still can face long waits for care – if they get it at all". A headline in the June 20, 2015 edition of the *New York Times* by Richard A. Oppel, Jr. entitled "Wait List Grow as Many More Veterans Seek Care and Funding Falls Far Short." Both articles discuss VA services.

used to describe veteran household characteristic¹⁰, but even this dataset does not include many mortgage lending measures.

Because there are no data resources providing comprehensive veteran housing finance information, this analysis is restricted to exploring an individual segment of the veteran mortgage market, VA loans. The VA loan program, which serves veterans and active duty service members, provides an interesting window into the world of veteran mortgage borrowing. Currently, the only source of veteran-specific mortgage lending information identifying VA loan records is Home Mortgage Disclosure Act (HMDA) data. But even with this data availability, there are few, if any large-scale analyses which look at VA loan data over multiple years.

Despite the lack of academic studies, newspapers, groups, think tanks, and government agencies have explored the VA program, particularly issues like veteran usage of services. The information provided often gives differing pictures of the program. For example, a 2004 study found that almost 60 percent of survey respondents used the VA loan program,¹¹ while a 2015 article noted decreased program usage with reasons given for the decline including a lack of awareness, brokers steering borrowers away, higher loan origination fees, and bureaucratic hassles like VA home inspections and a longer appraisal process.¹² This of course stands in contrast to the numbers put out by the and other resources noting the dramatic increase in VA lending after the Great Recession.¹³

Another common focus has been on the performance of VA loans. Goodman et al. explored why VA loans outperform FHA loans, despite both being government-backed loans. Even when income, credit, and mortgage burden are comparable, VA loans default less than FHA loans. The authors point to differences in program parameters to help explain the VA loans' better performance. Goodman et al. highlight the VA's use of a residual income test as potentially an important factor, noting that it might be a more realistic assessment of ability to pay than other approaches.¹⁴

Additional reason given for the program's high loan performance rate is that the VA stresses the importance of trying to set the borrower up for success. This means, for example, loan technicians are available to "help veterans navigate the servicing process, including giving advice and counsel to mitigate circumstances out of their control, and talking to servicers on the veteran's behalf."¹⁵ This counseling maximizes service members' ability to stay in their home as long as they want and it contributes to VA home loans having lower default and foreclosure inventory rates than FHA¹⁶ and conventional loans.

In the case of delinquent loans, the VA encourages servicers to work out agreements with borrowers. If that does not happen, the VA steps in to take over servicing. Taking it one step further, the Servicemembers Civil Relief Act helps veterans who have trouble making their mortgage payments after being called to active duty.¹⁷ These efforts, in total, represent a focus on avoiding long-term repayment problems before they reach a critical point. Better understanding such approaches and how they work with VA loans could be helpful regarding improving loan performance for other mortgage products.

However, one potential area of concern is the overall management of risk within the VA loan program. In 2009, the Office of Inspector General conducted an audit to evaluate the effectiveness of risk management within the VA's loan program. It found that the VA did not appropriately manage risk because it did not have policies and procedures requiring the service to perform such risk assessments.¹⁸ This is especially relevant given the recent Great Recession, which showed that even when people think risk is non-existent or greatly mitigated, it still exists and has to be well understood and managed. Otherwise, the repercussions can be dramatic.

Loan Products

The VA provides several different mortgage finance products. The most widely known is the home purchase product which applies to veterans^f, active duty service members, and eligible surviving spouses. It can be used for purchasing, building, repairing, retaining, or adapting a home. Approved lenders provide the loans that the VA then guarantees. The VA loan guarantee is essentially used in lieu of mortgage insurance and, in most cases, covers up to 25 percent of the loan.^g These loans come with favorable terms such as low closing costs, competitive interest rates, and no down payment or additional private mortgage insurance requirement. Veterans do not need to be first-time home buyers and the benefit can be used more than once, as long as the recipient inhabits the newly purchased home.

VA home purchase loans have several important requirements designed to help ensure the success of the loan and reduce the risk of default. In particular, applicants must meet service requirements and certain financial criteria, including a good credit score and sufficient income.¹⁹ A key requirement is meeting a debt-to-income ratio standard. This is determined by comparing anticipated housing expenses and monthly obligations with reliable monthly income. This ratio should not exceed 41 percent. In addition to the debt-to-income ratio, the residual income standard attempts to account for additional expenses like food, clothing, or healthcare that are not captured as part of debt. It is used to determine whether a veteran's income after housing payments and other debts is enough to meet living expenses.²⁰

Although less well-known, the VA offers two ways to refinance an existing loan, a cash-out refinance loan, or an Interest Rate-Reduction Refinancing Loan (IRRRL).^h The VA program being offering refinance products in 1970.²¹ The cash-out refinance loan allows homeowners to take out cash from their home equity. It can also be used to refinance a non-VA mortgage loan into a VA mortgage loan. The VA guarantees 100 percent of the value of the home through this process. The IRRRL helps veterans obtain lower interest rates by refinancing existing VA loans. Lastly, the VA offers the Native American Direct Loan which helps eligible families finance the purchase, construction, or improvement of homes on Federal Trust Land via reduced-interest-rate loans.²²

^f To be eligible for the VA loan, veterans must fulfill specific duration of service requirements. See the following link for more details www.benefits.va.gov/homeloans/purchaseco_eligibility.asp

^g For most loans, the VA guarantees up to 25 percent of the loan value. This means the VA will pay up to that amount if the loan is not paid off. There are exceptions related to very large and small amount loans and cases where a down payment is provided. For more information about these exceptions, see the following story: <http://www.military.com/money/pcs-duty-move/how-much-is-the-va-guarantee.html>

^h There are other VA related housing services like the Veterans Mortgage Life Insurance (VMLI) and Adaptive Housing Grant program, but this research looks at home purchase and refinance loans.

While all of these program-specific characteristics have been discussed and debated, a general overview of VA loan activities would be helpful. A review of lending trends, borrower characteristics, and lender involvement would put these other things, and the program as a whole, into context. This paper sets out to provide this review.

Guiding Questions

This study will look more closely at the VA loan program since it is focused on veterans and contains veteran-specific lending data. The research provides a descriptive analysis of the volume and type of loans the VA program supports and how it compares to other mortgage loans; a review of the borrowers involved and how they compare to other mortgage lending borrowers; and a discussion of the lenders involved with the program. There needs to be a better understanding of the VA loan program, including more information on the involved loan, applicant, and lender characteristics. A review of the VA loan program basics, as opposed to focusing on a single element, will help the lending industry, advocates, and policymakers more effectively serve the veteran population. This report fills this void and provides such a review guided by the following questions:

- What were the characteristics of the VA loan portfolio?
- Who were the VA loan applicants and borrowers?
- What types of lenders were involved in the VA program?

Data Sources

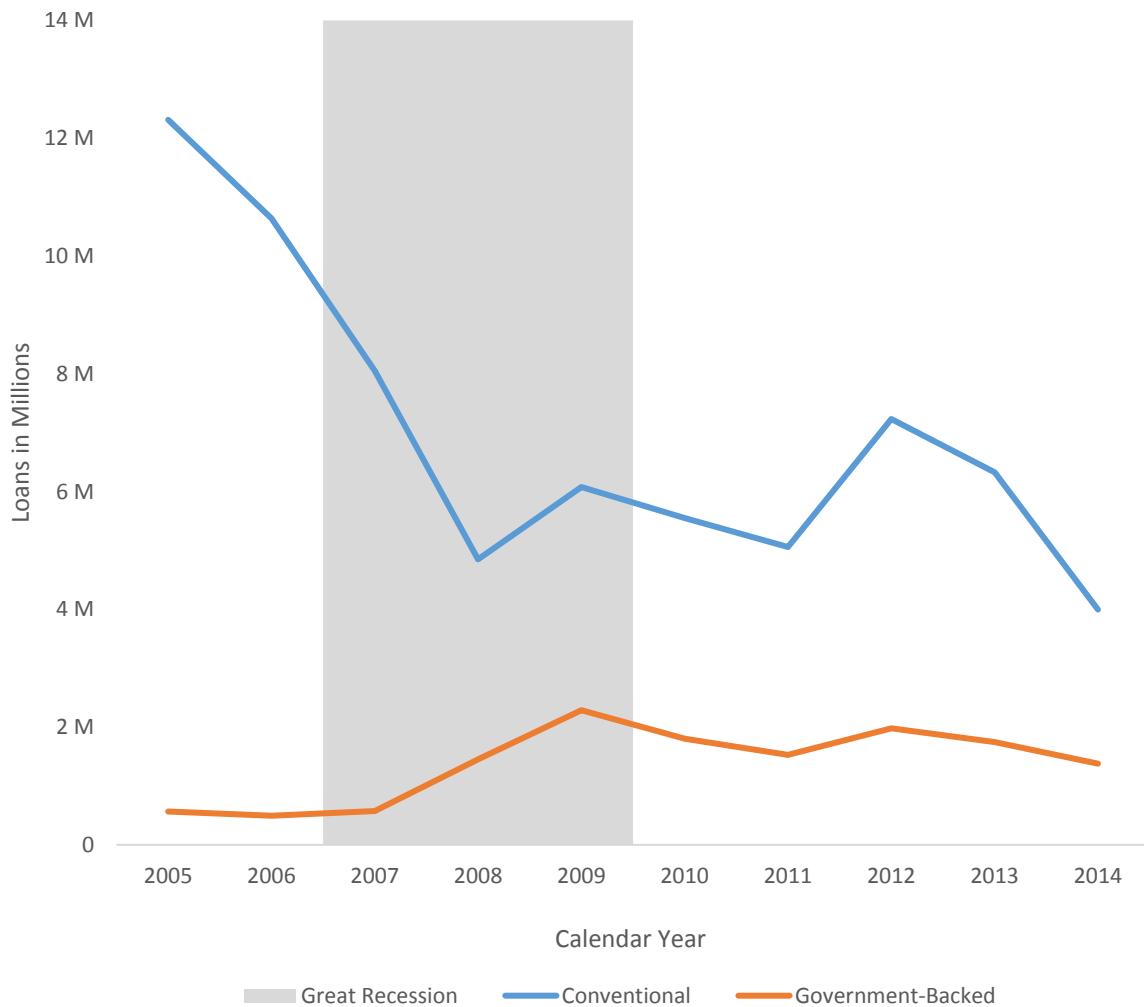
The report uses HMDA mortgage lending data because this data identifies VA loans. The VA loan program, which is specifically reserved for veterans and their families, allows for a clean look at their mortgage borrowing activities. The study explored HMDA data representing lending activity from calendar 2005 to 2014. The report includes American Community Survey (ACS) and Public Use Microdata sample (PUMs) data to describe veteran household and housing characteristics.

Analysis

Trends, 2005 to 2014

Generally speaking, economic conditions and mortgage lending activity are closely related, primarily at the local level but also, at times, the national level. For example, as economic conditions deteriorate, access to affordable credit often becomes more limited, particularly for higher-risk mortgage loan applicants. The relationship can also work in the other direction with a decline or expansion in mortgage lending facilitating economic decline or growth respectively. When widespread, significant economic deterioration occurs, government activity often comes to play a larger role in the economy as a whole, including mortgage lending markets. The data over the last ten years bears this out.

Home Purchase and Refinance Originations by Loan Type, 2005 to 2014*



Source: HAC tabulation of HMDA data released 2006 to 2015.

*Exclude loans involving manufactured homes and multi-unit buildings. Includes first, lien home purchase and all refinance loans.

The initial housing boom in the early 2000's, a period of expansion in homeownership and access to credit opportunities, followed by the Great Recession all greatly influenced mortgage lending activity over the last ten years.ⁱ The mortgage foreclosure crisis and subsequent economic contraction lead to a sharp decline in conventional mortgage lending from housing boom levels. By the depths of the recession in 2008, mortgage lending activity had declined by more than half from its pre-recession levels.^j The decline in absolute terms was from 12.9

ⁱ The National Bureau of Economic Research (NBER) officially defined the Great Recession as starting in December 2007 and ending in 2009. The official dates, as of 7/11/16, can be found at the following [url:www.nber.org/cycles.html](http://www.nber.org/cycles.html)

^j Over the last three years, home purchase loans have started to increase, but they still are less than half of what they were in 2005 and 2006 and this is why originations overall are still greatly reduced.

million originations to 6.3 million.^k While refinance^l activity increased dramatically post-recession, spurred by historically low interest rates,²³ the overall dramatic decline in lending was entirely driven by a drop-off in conventional loans.

As such, government-backed lending activity (FHA-insured, VA-guaranteed, and USDA Farm Service/Rural Housing Service loans) increased to pick up some of the slack. Government-backed loans increased from 566,000 in 2005 to a high of 2.3 million loans in 2009. After peaking in 2009, the number of government-backed loans has decreased; however, it continues to be more than twice as large as pre-recession levels. These government-backed loans in 2014 accounted for approximately 26 percent of all originations; whereas, they used to represent approximately 4 percent of all housing loans in 2005 and 2006.

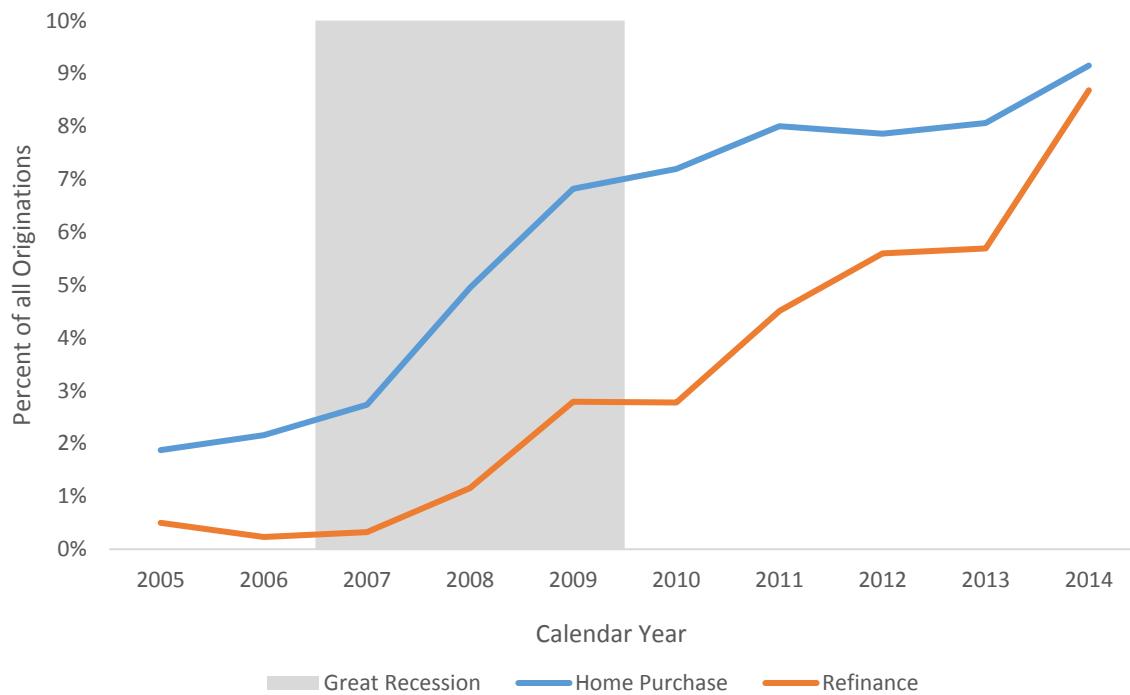
A big part of this increase in government-backed lending involved growth in VA-guaranteed loans. VA home purchase and refinance loans increased from an average of approximately 135,000 loans before the recession in 2005 and 2006 to slightly more than 505,000 loans in recent years (2013 – 2014). In 2014, VA loans represented 9 percent of all home purchase originations, compared to less than 2 percent before the Great Recession. The VA proportion of refinance loans followed a similar pattern. It is important to note that in addition to the increased demand for VA products, likely related to tight credit markets and access to alternative products, there were also several policy changes which likely impacted loan activity, such as expanding the size of loans that the VA could guarantee.²⁴

VA loans, even with recent growth, currently rank as the third largest loan type: Conventional (74 percent), FHA-Insured (14 percent), VA guaranteed (9 percent), and Farm Service Agency/Rural Housing Services (3 percent). Despite being a relatively small piece of the pie – particularly when compared to their post-World War II standing, where they represented 40 percent of all mortgages,²⁵ VA loans represent an important part of home loan options available to that 9 percent of the US population they target, veterans. The data shows that lenders reported 481,020 VA home purchase, first lien and refinance loans in 2014 with a total dollar amount of approximately \$112 billion (unadjusted dollars), which was relatively similar to the FHA total money lent.

^k Home improvement loans were removed from the analysis because they made up an extremely small percentage of all government-backed activity. In addition, manufactured home loans and multi-unit building loans were removed. They represent an extremely small part of total loans originated, approximately 1 percent of VA loans involved a manufactured home

^l Throughout this report refinance loans refers to loans with an HMDA stated purpose of refinancing.

**VA Origintaions as a Percent of All Home Purchase
and Refinance Originations,
2005 to 2014***

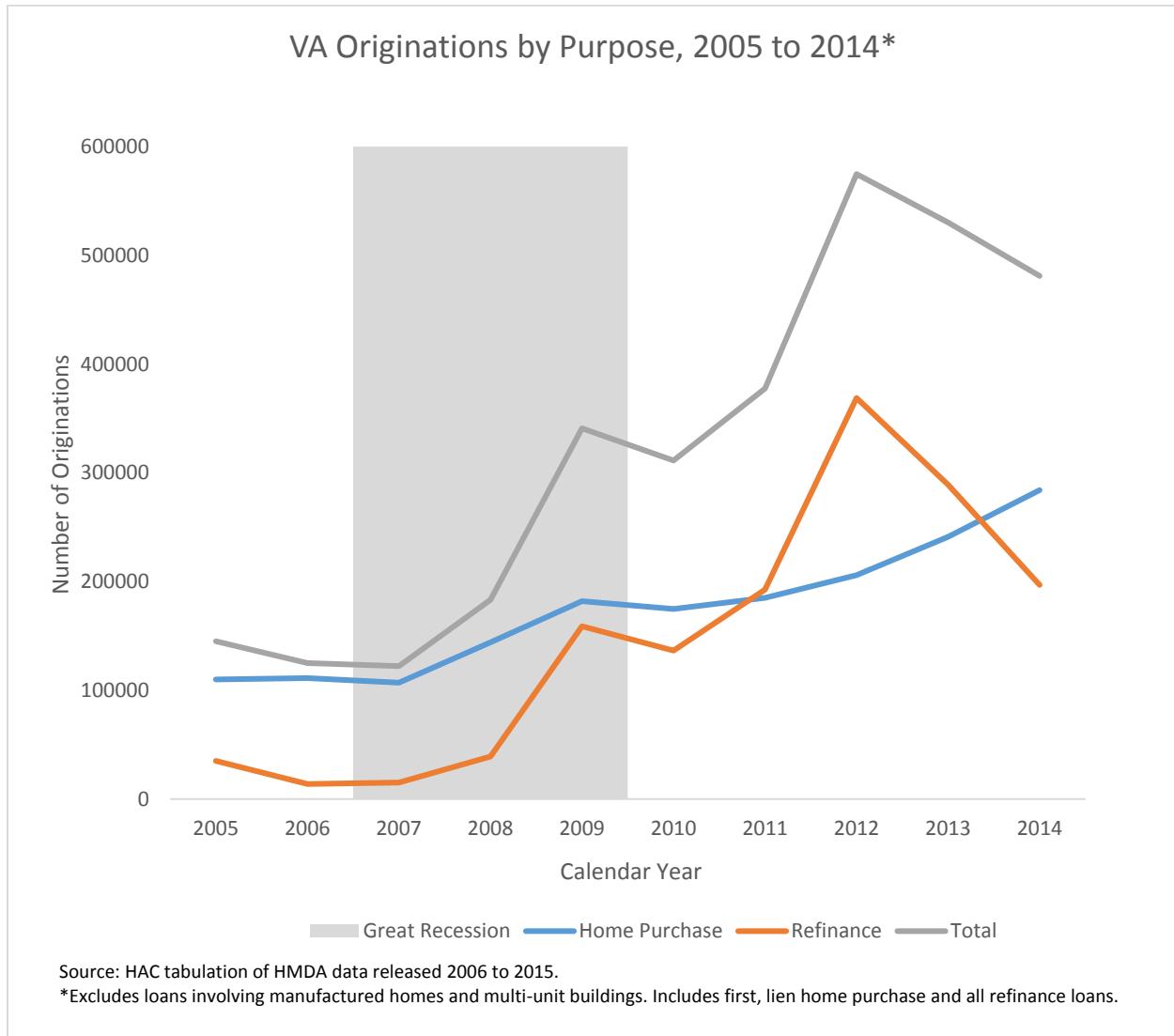


Source: HAC tabulation of HMDA data released 2006 to 2015

*Exclude loans involving manufactured homes and multi-unit buildings. Includes first, lien home purchase and all refinance loans.

During and immediately after the Great Recession, interest rates declined, reaching historically low levels which spurred refinance activity.²⁶ Refinance originations, as a result, came to represent a larger and larger share of all originations. VA loans were no exception to this trend. Home purchase loans made up 89 percent of all VA originations in 2006, but declined to just 36 percent in 2012. The decline reflected an increase in refinance originations from less than 15,000 in 2006 to approximately 369,000 in 2012. These numbers reflect the fact that today's VA loan portfolio is different from the one that existed World War II when the overwhelming majority of veterans used the loans to purchase a home, but then again, reflects the expansion in types of VA products made available (refinance started in 1970), flexibility of veteran limits (benefit time limit ended in 1970), and VA service population shift (now much older than post WWII).²⁷

VA refinance activity, like other loan types, has since declined, while home purchase activity has increased. In fact, in 2014 home purchase loans once again represented a majority of VA loans. It appears that the spike in refinance activity might have been a temporary circumstance, driven by historically-low interest rates. Regardless, the fluctuation in activity speaks to the dynamic nature of the market; that even when looking at a targeted loan program like the VA loan guarantee, change is the norm.



Geography of VA Loans

Rurality

As has often been cited, a higher rate of veterans live in rural areas when compared to the general public.²⁸ An estimated 23 percent of veterans live in rural communities compared to just 19 percent of the overall population.²⁹ While a disproportionate share of the veteran population lives in rural areas, rural applicants do not make up a disproportionate percentage of VA borrowers. In 2014, 14 percent of VA loans went to rural borrowers, which is comparable to the 15 percent of all originations that occurred in rural areas.

The relatively low proportion of VA loans occurring in rural areas is likely related, at least in part, to demographic characteristics. Rural veterans are more likely to be older, with about 70 percent of rural veterans being age 55 or older, compared to 65 percent for suburban/urban

veteran population. They also have higher rates of owning their homes with a paid-off mortgage, over 50 percent compared to just 43 percent for suburban/urban veterans.³⁰ This would mean fewer potential customers in rural areas.

Local Markets

Housing markets vary considerably by region, county and city. As a result, differences in lending behavior that might not be visible when looking at national level data can be better seen from closer geographic scrutiny. Using this approach, the HMDA data shows that lenders originated at least one VA-guaranteed loan in every state and almost all counties. In 2014 period, 95 percent of all counties (approximately 3,000 jurisdictions) had at least one VA loan origination reported. There was similar coverage for VA lending in 2013 and 2012

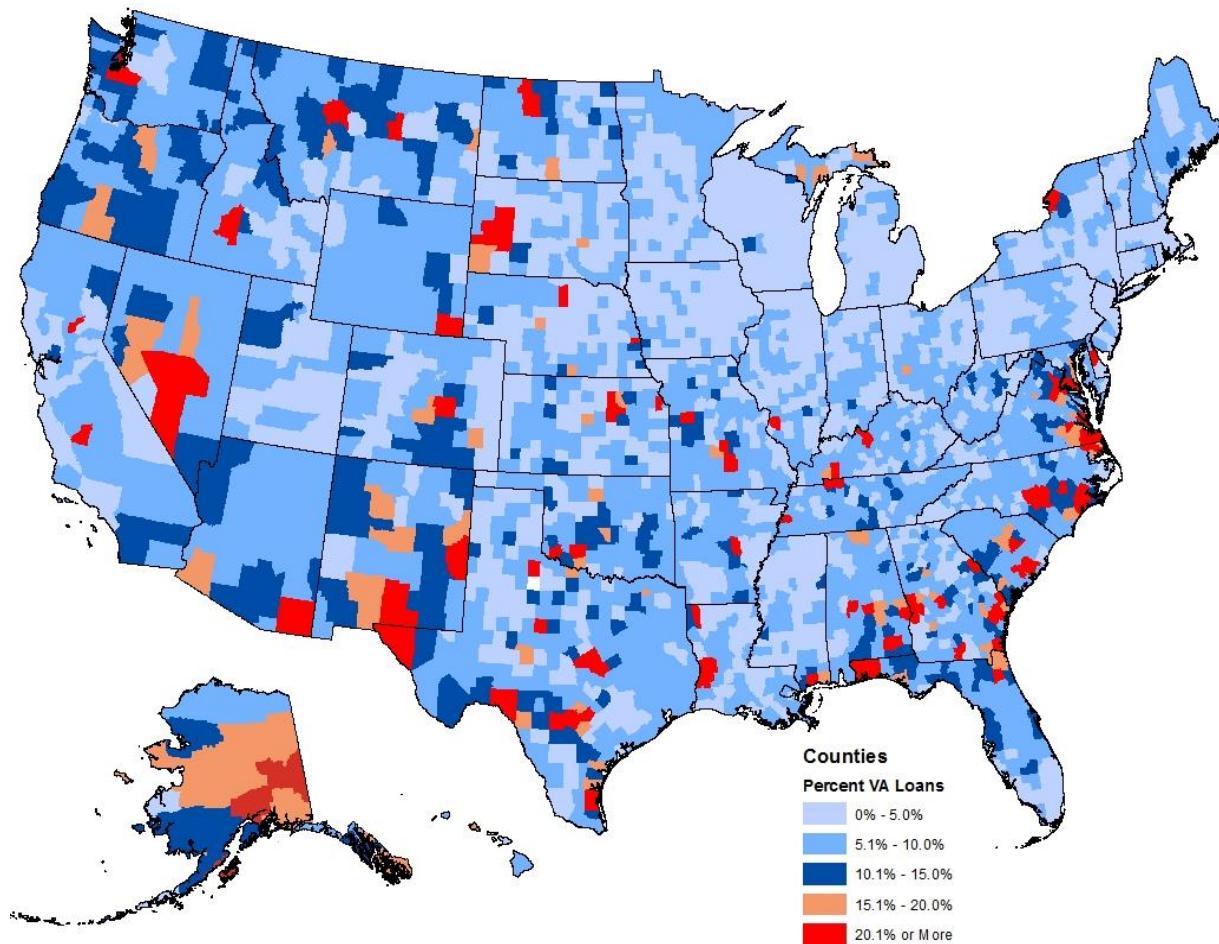
While VA loans represented a small percentage of all loans originated in most counties, there are some jurisdictions where this is not the case. Pooling loan data for the last three years (2012 to 2014), shows that in 125 counties, VA loans made up at least 20 percent of all loans originated. In a few cases, the higher VA percentage was related to low overall loan totals, but this was actually rare, with fewer than ten of these 125 counties having less than 50 loans over the three-year period. Counties with the highest percentage of VA loans have a military base. For example, Hoke County, North Carolina and Long County, Georgia had the highest percentage of VA loans and these counties are home, at least in part, to Fort Bragg and Fort Stewart, respectively. In these locations, veteran culture is strong so it is more likely that eligible applicants would be aware of the benefits of the program and how to use it.

Veteran Population Characteristics

The demographics of the veteran population have and will continue to shape lending patterns. A recent Housing Assistance Council (HAC) report on aging veterans found that veterans are older than non-veterans, an artifact largely shaped by a policy of conscription which ended in 1974. Because the veteran population is made up primarily of Baby Boom and Vietnam War-era members, approximately 66 percent of all veterans are age 55 or older, as compared to 27 percent for non-veterans.³¹ The larger proportion of veteran population age 55 or older, in turn helps drive the elevated veteran homeownership rate, which at 76 percent is considerably higher than the US rate of 63 percent. Furthermore, half of these veteran owner-occupied homes are owned free and clear, with no mortgage to pay.³² Therefore, this population is unlikely to demand many home purchase mortgage loans.

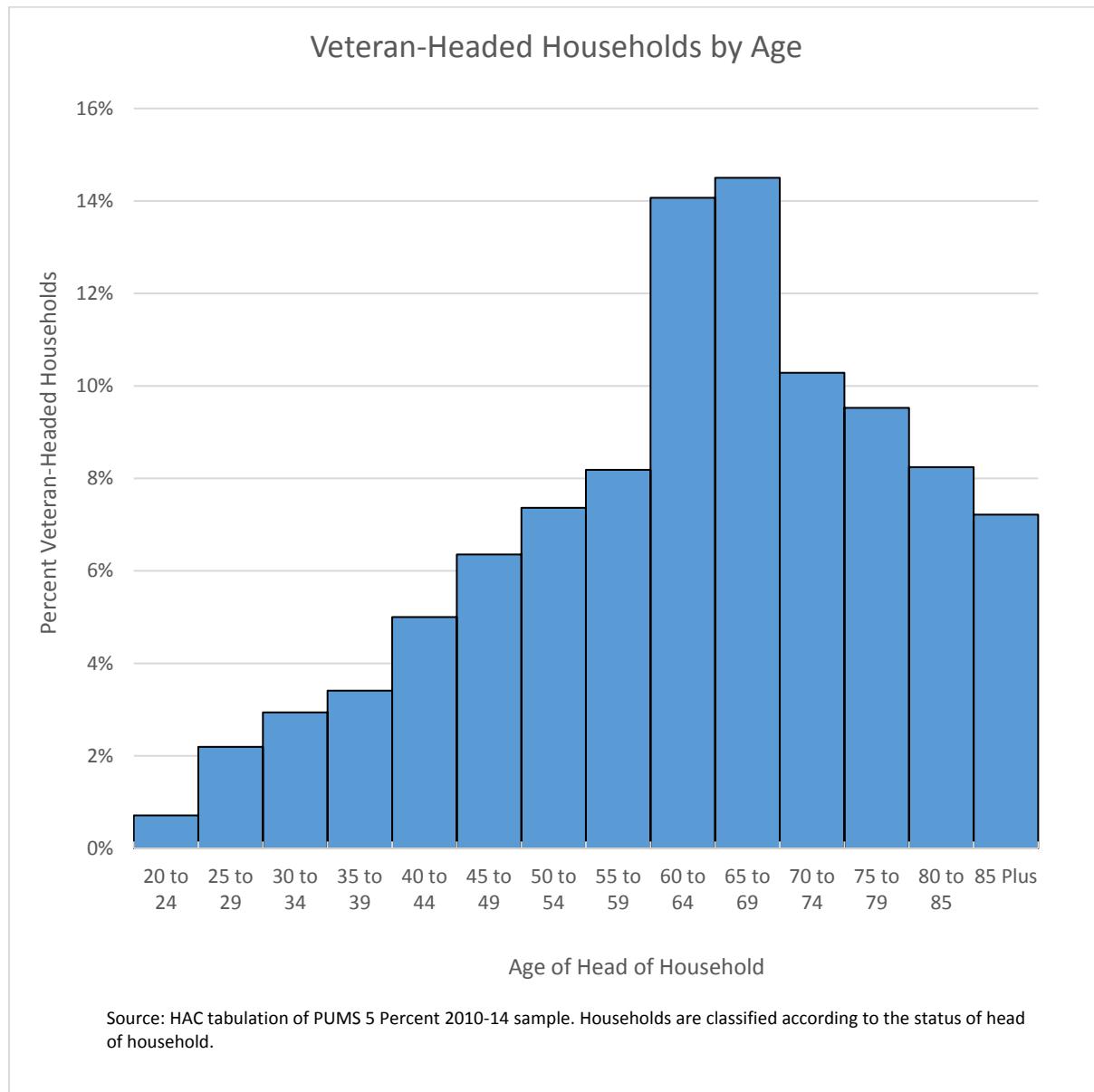
While a large proportion of veteran-headed households do not have a mortgage, there are still an estimated 4.9 million veterans or 53 percent of veterans who make mortgage payments. It is this group that likely helped drive the increase in refinance activity. Many of these veterans were able to take advantage of the historically low interest rates. The recent decline in refinance activity is likely to continue in the near future though, given that future interest rates are unlikely to exceed those historically low interest rates recently experienced. There could be some increase in refinance cash-out loans as older veterans might need the additional funds to help age in place. The VA projects the rate of veterans age 85 or older will increase from 7 to 12 percent by 2033.³³

VA Loans as a Percent of All Mortgage Originations, 2012-2014



Even with these larger demographic trends of an aging veteran population, more than 200,000 service members return to civilian life each year.³⁴ These returning service members make up a large number of the estimated 1.7 million veterans currently between the ages of 18 and 34.³⁵ This group includes the cohort, age 25 to 34, which is responsible for an estimated third of VA loans.³⁶ If all 200,000 returning members used the VA loan program, that total alone would exceed the average number of loans originated in the period before the Great Recession period.

These younger veterans are also much more diverse than older veterans. While older veterans are overwhelmingly White non-Hispanic males, the veteran population, age 18 to 34, contains many more females and minorities, reflecting the increased diversity of the overall population. This population might have different needs or require different approaches to reach. For example, a single female veteran with two children may have different housing needs or requirements than a male veteran household. There will also be new opportunities to reach and interact with these populations through the Internet and smart phones.



Borrowers

The VA loan program helped an annual average of more than 454,000 veterans and their families purchase or refinance homes between 2010 and 2014. It is the applicants for these VA loans and the outcomes they received which represents the program's ability to reach and serve all parts of the veteran community. HMDA data, while somewhat limited in the individual loan applicant characteristics, provides important information on the following: applicant race/ethnicity and income, application status (origination, denials, etc.), and reasons for denials. This analysis, in reviewing these characteristics, provides a description of the VA loan program in operation, not the rules and regulations that govern it, but the population it serves.

Origination and Denial Reasons

Home Purchase

A good place to start the analysis is loan application outcomes overall. Origination rates for VA home purchase loans remained stable and relatively high between 2005 and 2014 period.

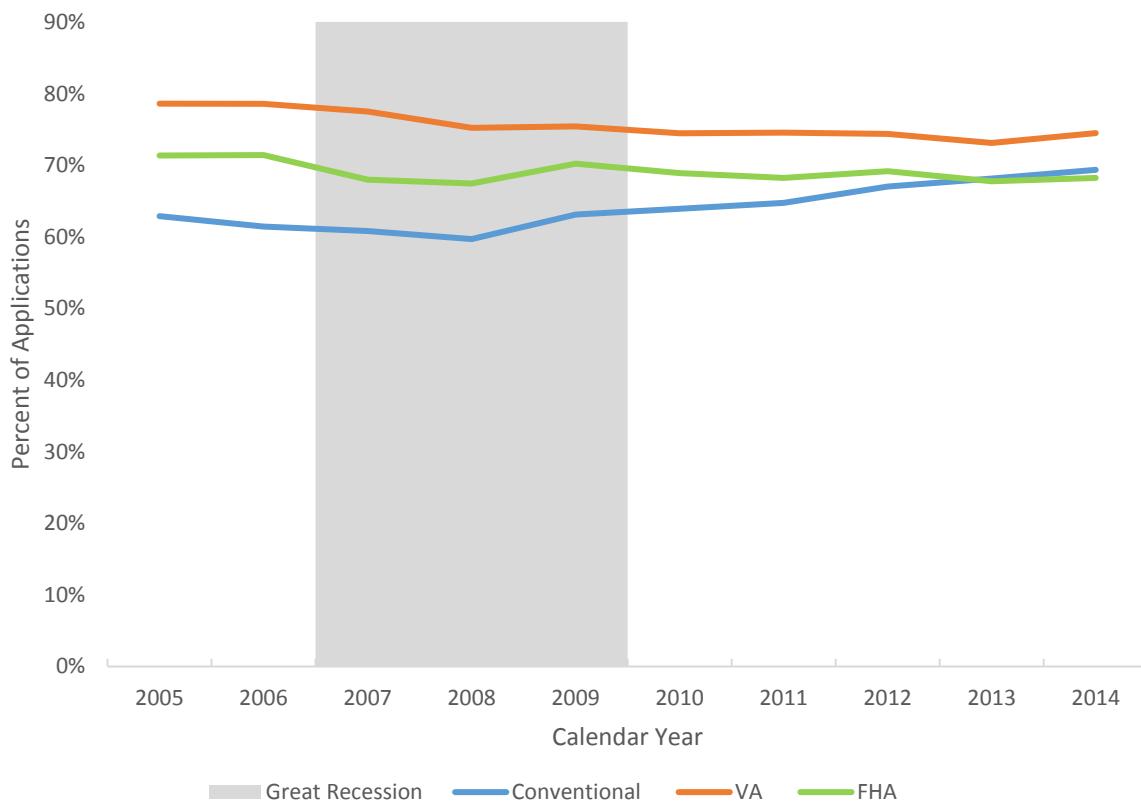
Although the number of VA home purchase loans more than doubled between 2007 and 2013, lenders consistently originated between 73 and 79 percent annually. In comparison, conventional home purchase origination rates were more variable and lower, under 70 percent for six out of the last 10 years. These differences reflect, at least in part, the VA loan's more favorable loan terms/requirements, such as a government-backed loan guarantee and no required down payment. This stability is why government-backed loans are particularly important during times of tight credit markets, since they ensure continued access to financing, at least for the veteran population.

VA home purchase loan denial rates ranged from 8 to 14 percent over the last ten years with an increase in rates from single digits pre-recession to double digits post-recession.^m However, conventional home purchase loan denial rates were somewhat different. During the pre-recession years (2005 to 2008), conventional loan denial rates were almost twice the VA rate; however, the conventional denial rates have trended lower. These lower conventional loan denial rates correspond with the decline in subprime or higher-risk applicants who are more likely to be denied or receive a high cost loan. The increase in VA home purchase application denials has been relatively small overall and this is why the origination rate remains largely the same pre-and post-recession. Again, this reflects the greater stability in the program.

High debt-to-income ratios and credit history were the two most commonly cited reasons for VA home purchase loans denials throughout the 2005 to 2014 period. In the most recent year (2014), VA home purchase applications with a reported reason for denial cited high-debt to income ratio at 32 percent and credit history at 30 percent. Lenders most often used these same two reasons for conventional and FHA loans, so, in this regard, VA applicants do not stand out. The one thing that did change over the last ten years is the decrease in lenders citing credit history as a denial reason, from a high in 2005 of 46 percent to a low of 29 percent in 2013. Debt-to-income, on the other hand, remained relatively constant with approximately a third of denials citing this as a reason for the denial. Possibly the recession and tightening access to credit meant fewer people with poor credit histories applied for loans than in the previous housing boom period.

^m It is important to remember that applications can be originated, approved not accepted, denied, withdrawn by applicant and closed due to incomplete files. As such, the denial rate is not simply the opposite of the origination rate.

Percent of Home Purchase Applications Originated by Loan Type, 2005 to 2014



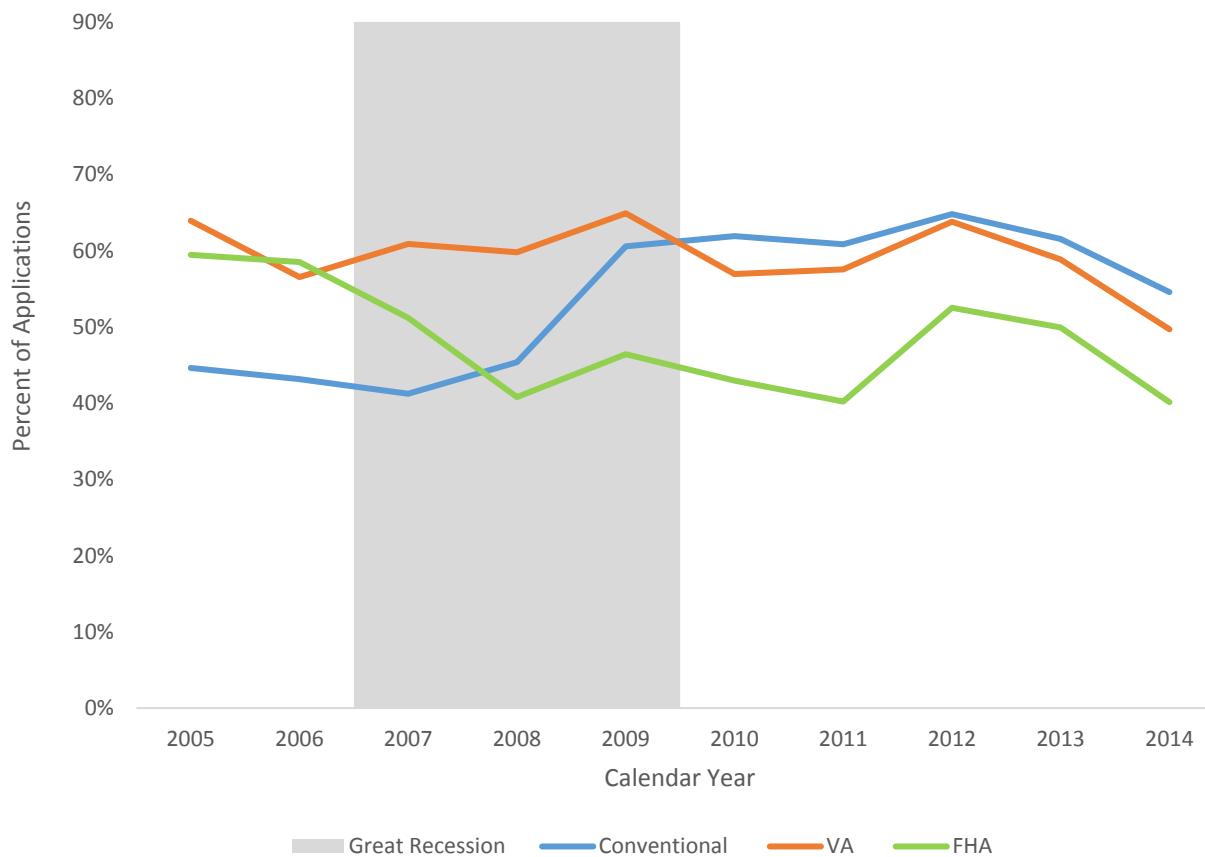
Source: HAC tabulation of HMDA data released 2006 to 2015.

*Excludes loans involving manufactured homes and multi-unit buildings. Includes first, lien home purchases.

Refinance

VA refinance loan origination rates exhibited more variability, ranging from 50 to 65 percent over the 2005 to 2014 period. To illustrate this variability, during the pre-recession (2005 to 2008), VA origination rates exceeded conventional loan rates by between 13 and 19 percent, but in the post-recession period (2009 to 2014), origination rates were similar for both. Interest rate fluctuations played a large role in the change and this continues to be the case. For example, VA refinance origination rates steeply declined in the recent 2013 to 2014 period, a time when interest rates began to increase above historic lows and immediately after a large wave of people had already refinanced, leaving less favorable applicants to apply with less favorable terms. These changes show the dynamic nature of home finance markets.

Percent of Refinance Applications Originated by Loan Type, 2005 to 2014



Over the last ten years, lenders denied between 13 and 23 percent of VA refinance applicants annually. There was no clear discernable pattern for denial rates – they fluctuated, even though there was a dramatic increase in VA refinance activity during the 2005 to 2014 period. In general, conventional refinance loan application denial rates were always higher than VA rates, but the differences became smaller in the 2011 to 2014 period when refinance activity peaked, going from 10 to 15 percentage point differences to 1 to 3 percentage point differences. The difference in denial rates between conventional and VA loans got smaller because conventional loan rates declined over the last three years.

The most common reason given for denied VA refinance applications was insufficient collateral, 29 percent in 2014. The data suggest that the ramifications from the housing foreclosure crisis are still impacting lending and this often shows up when the insufficient collateral denial reason is given. Insufficient collateral occurs because the property used to secure the proposed mortgage does not have a value equal to or greater than the amount borrowed, a phenomenon which occurred due to greatly reduced home prices. The UNC Center for Community Capital found that collateral concerns were “responsible for roughly 60 percent of the increase in the likelihood

of denial during the peak of the crisis between 2007 and 2009³⁷ and these were still concerns in 2014.

Racial/Ethnic Makeup of Applicants

The VA loan distribution generally reflects the overall veteran population distribution.ⁿ White non-Hispanic borrowers received approximately 73 percent of all VA loans annually during the 2010 to 2014 period with African American non-Hispanic borrowers comprising the second largest group at 11 percent. The estimated percentage of veteran population in these two groups is 80 and 11 percent, respectively. The slight under-representation of white non-Hispanic veterans in the loan distribution is due to the increasing diversity of the younger veteran population, which is more likely to take out a home loan than the less diverse older veterans. Over the 2005 to 2014 period, there was little change in the distribution of borrowers from year to year or by loan type. The increasing diversity among younger veterans however, will likely change this in the future.

While minority activity makes up a relatively small percentage of all VA lending, for several groups, these loans represent a large portion of the mortgage lending they receive. For example, while VA loans made up just 8 percent of all home loans in 2014, they represented 18 percent and 13 percent of all African American and American Indian/Alaska Native originations. The data shows that while the proportion of VA loans going to minority applicants is relatively small, this lending represents a much larger share of minority mortgage lending, thus reflecting the program's importance to many different communities.

Originations and Denials

Even though the distribution of VA loans is similar to the make-up of the VA population by race/ethnicity, a lower percentage of minority VA applicants had their loans originated and a higher percent were denied when compared to white non-Hispanic applicants. For example, during the 2012 to 2015 period, 78 percent of white non-Hispanic VA applications were originated annually, compared to 68 percent for American Indian/Alaska Native applicants. The difference in rates for VA applications, however, was smaller than what exists for conventional applicants. For example, there is an 8-percentage point difference in VA home purchase origination rates for white non-Hispanic and African American applicants, while there is a 17-percentage point difference between these groups when looking at conventional loan applicants.

ⁿ The differences which exist when comparing the overall veteran population and the average distribution of HMDA loan originations (2010 to 2014) are most likely related to two factors. First, the classification system for the HMDA data counts applicants with coapplicants of a different race/ethnicity than the primary applicant as joint or mixed. This likely reduces race totals for all groups. Second, the population taking out loans are likely younger than the overall veteran population. Younger veterans are a bit more diverse.

Annual Average Number of Home Purchase and Refinance Loans Made by Race and Ethnicity, 2010-2014

Applicant(s) Race/Ethnicity	All Loans		VA Loans	
	Numbers	Percent	Numbers	Percent
Total Loans	7,317,975		454,978	
Race/Ethnicity Provided*	6,512,038	89.0%	401,343	88.2%
Race/Ethnicity Provided*	6,512,038		401,343	
White, Non-Hispanic Only	5,151,740	79.1%	292,660	72.9%
Black, Non-Hispanic Only	287,158	4.4%	45,916	11.4%
Asian, Non-Hispanic Only	386,988	5.9%	5,754	1.4%
American Indian/Alaska Native, Non-Hispanic Only	16,878	0.3%	1,723	0.4%
Hawaiian Native/Other Pacific Islander, Non-Hispanic Only	16,922	0.3%	1,944	0.5%
Multiple Minority Races Non-Hispanic	3,414	0.1%	549	0.1%
Joint Race (White and Minority) Non-Hispanic	102,426	1.6%	11,858	3.0%
Hispanic (Includes all races)	430,666	6.6%	27,971	7.0%
Joint Hispanic (Hispanic and Non-Hispanic)	115,846	1.8%	12,968	3.2%

*Cases that did not include a classification for both race and ethnicity were not included

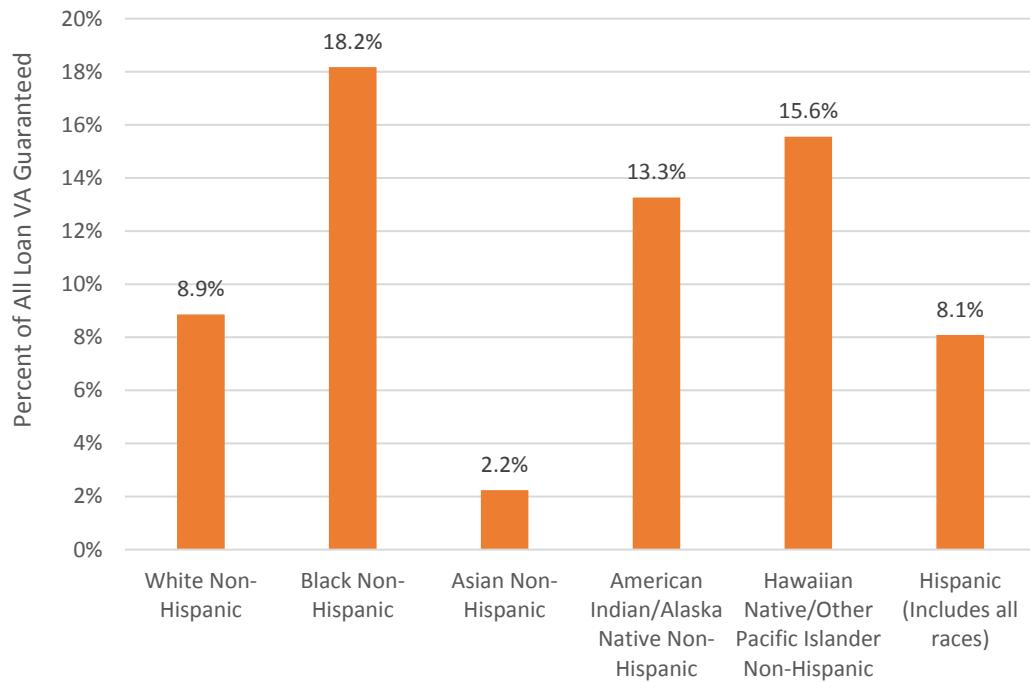
Comparison with Conventional Loans

Another way to look at origination rates is within group differences across loan type. Origination and denial rate comparisons of VA and conventional applicants by race/ethnicity show interesting differences.⁹ VA home purchase loan origination rates for African Americans and American Indian/Alaska Native, non-Hispanic applicants were higher than rates for conventional loan applicants. For example, an average of 68 percent of African American, non-Hispanic VA applications during the 2010 to 2014 period resulted in an origination, compared to 57 percent for conventional loans. Home purchase denials rates show these differences by race/ethnicity as well. An average of 17 percent of African American, non-Hispanic VA home purchase applicants were denied annually during the 2010-14 period, compared to 24 percent for conventional loan African American, non-Hispanic applicants. White non-Hispanic borrowers had similar denial rates for each loan type.

These differences in origination rates may well reflect underlying differences in the applicants. Research has found that veteran-headed households for minority groups had higher median household incomes and educational attainment than non-veteran households.³⁸ Military service, at least in part, helped people earn advanced skills and achieve better economic outcomes. It may be that these differences result in a higher origination for applicants. The results were consistent when considering refinance applications for African American, non-Hispanic applicants. It is unclear as to why there is a difference by loan type on origination rates.

⁹ For this analysis, we included only loans with both a race and Hispanic ethnicity classification provided. About 11 percent of the loans did not have both sets of information.

Percent of All Home Purchase Originations VA Guaranteed by Select Race/Ethnicities, HMDA 2014*



Source: HAC tabulation of HMDA data.

*Excludes loans involving manufactured homes and multi-unit buildings. Includes first, lien home purchase.

Borrower Income and Loan Amounts

Lower Incomes and Higher Loan Amounts

VA loan applicants had lower median incomes and were offered larger loan amounts in comparison to conventional loan applicants. In 2014, the median household income for VA home purchase loan borrowers was \$74,000, compared to \$95,000 for conventional loan. This has been consistent regardless of loan purpose or year. At the same time, the median loan amount for VA home purchase loans was \$213,000, slightly more than the \$201,000 for conventional loans. FHA, which targets low-income applicants, had much lower applicant incomes (\$58,000) and median loan amounts (\$157,000).

While the difference in incomes and loan amounts between the VA and conventional loans might at first seem odd, there are a few factors likely involved. VA loans with their explicit government guarantee represent a lower risk to lenders, when compared to a similar non-guaranteed loan, which means a larger loan can be made available. In addition, demographics probably shape the

lower incomes and higher amounts borrowed for VA loans. Veterans as a group are older which means, relative to younger adults, they have less debt and more wealth. This would qualify them for larger loans. The lower median incomes also might be related to more veterans living on fixed incomes.

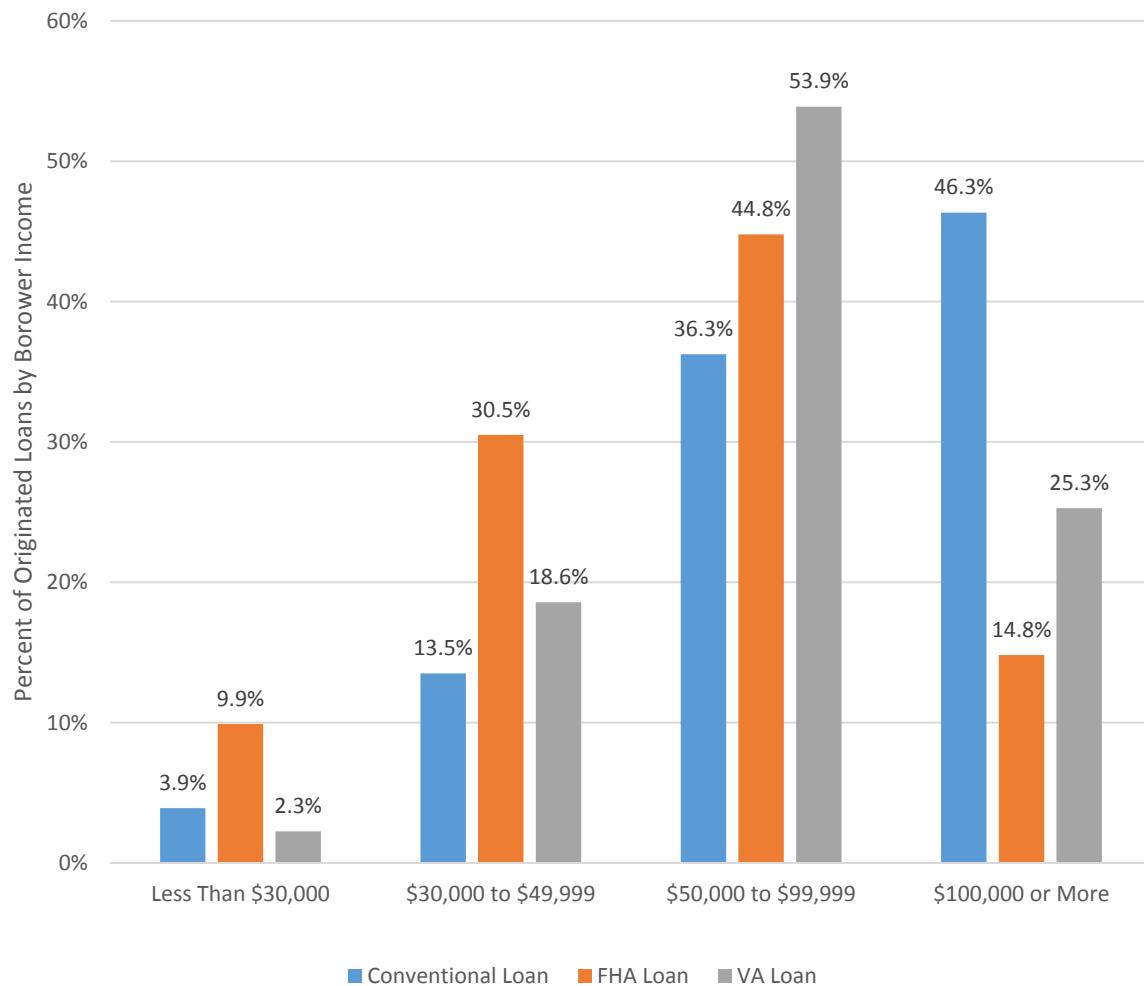
Middle Class Loan Program

A final facet to consider is the distribution of VA loans by borrower income. The data shows a program that primarily serves the middle class. Over half of all VA home purchase loan borrowers annually during the 2010-2014 period reported incomes between \$50,000 and \$99,999, essentially middle-class. This is in contrast to conventional loans, which steer more towards higher-income households. In fact, an average of 46 percent of conventional loan originations, compared to 25 percent for VA loans, went to borrowers with incomes of \$100,000 or more. The VA loan program's focus on middle-class borrowers reflects the fact that a large portion of its service population falls into that \$50,000 to \$99,999 income category. That is, 34 percent of veteran-headed households compared to 30 percent for the nation as a whole. Also, the dollar amount of VA loans is limited to \$417,000 which means wealthier borrowers who are more likely to purchase more expensive homes would not use this product.³⁹

Approximately 19 percent of VA home purchase loans went to borrowers with incomes less than \$50,000, and an extremely small percentage, less than 3 percent, went to very-low income borrowers, with incomes less than \$30,000. This is not surprising, given that the VA program is not means tested and does not specifically target low-income borrowers. However, the percentage of loans going to low-income borrowers does not actually look that low when one understands that only 10 percent of FHA home purchase loans, a program that targets low-income borrowers, went to borrowers with incomes of less than \$30,000.

It is important to note this discussion does not address VA refinance loans. The reason for this is that the overwhelming majority of VA refinance originations do not provide income information – approximately two-thirds. This was not the case for other loans and the exact reason for this omission is unclear. One certain thing is that it is an impediment to understanding the refinance loan distribution.

Home Purchase Borrowers by Income Amount and Loan Type, Annual Average 2010-14*



Source: HAC tabulation of HMDA data

*Excludes loans involving manufactured homes and multi-unit building. Includes first lien, home purchase and all refinance loans

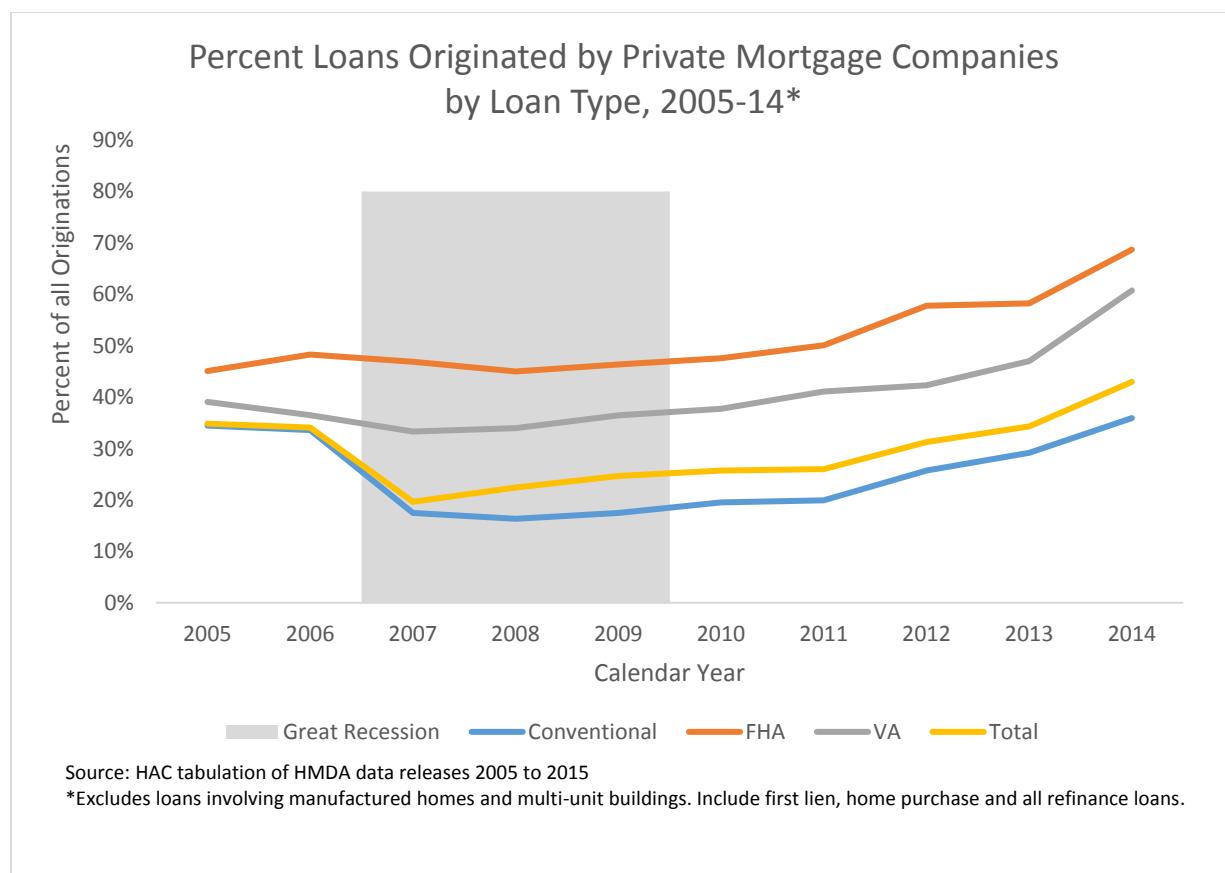
Lenders

Lenders that originate the VA-guaranteed loan are a critical part of the process. The lenders work with both the borrower and the VA to provide access to VA products. The degree to which they can do this at an efficient and high level goes a long way towards determining the success of the VA loan program. The following discussion describes who these lenders are and how they compare to the lenders originating other types of loans.

Limited Small Bank Involvement

Approximately one out of every five institutions reporting mortgage loans, an annual average of over 1,450 lenders, originated at least one VA loan during the 2012 to 2014 period. The fact that VA loan products are reserved for a small subset of the population, potential VA loan borrowers represent about 9 percent of US population,^p explains, at least in part, why lender involvement is somewhat limited. The ability to specialize and comply with additional requirements likely plays a role in limiting lender involvement as well, particularly for small-asset institutions. Over the last three years, less than 10 percent of HMDA-reporting, small-asset lenders originated at least one VA loan.^q The proportion and makeup of lenders originating FHA loans is similar.

The percent of lenders originating VA loans has consistently increased over the last eight years, even as the overall number of HMDA reporters has consistently declined. This increase occurred even during the last two years when the total number of VA loans originated declined. In total, the data shows more lenders of all types-- banks, credit unions and private mortgage companies-- are increasingly using VA loan products.

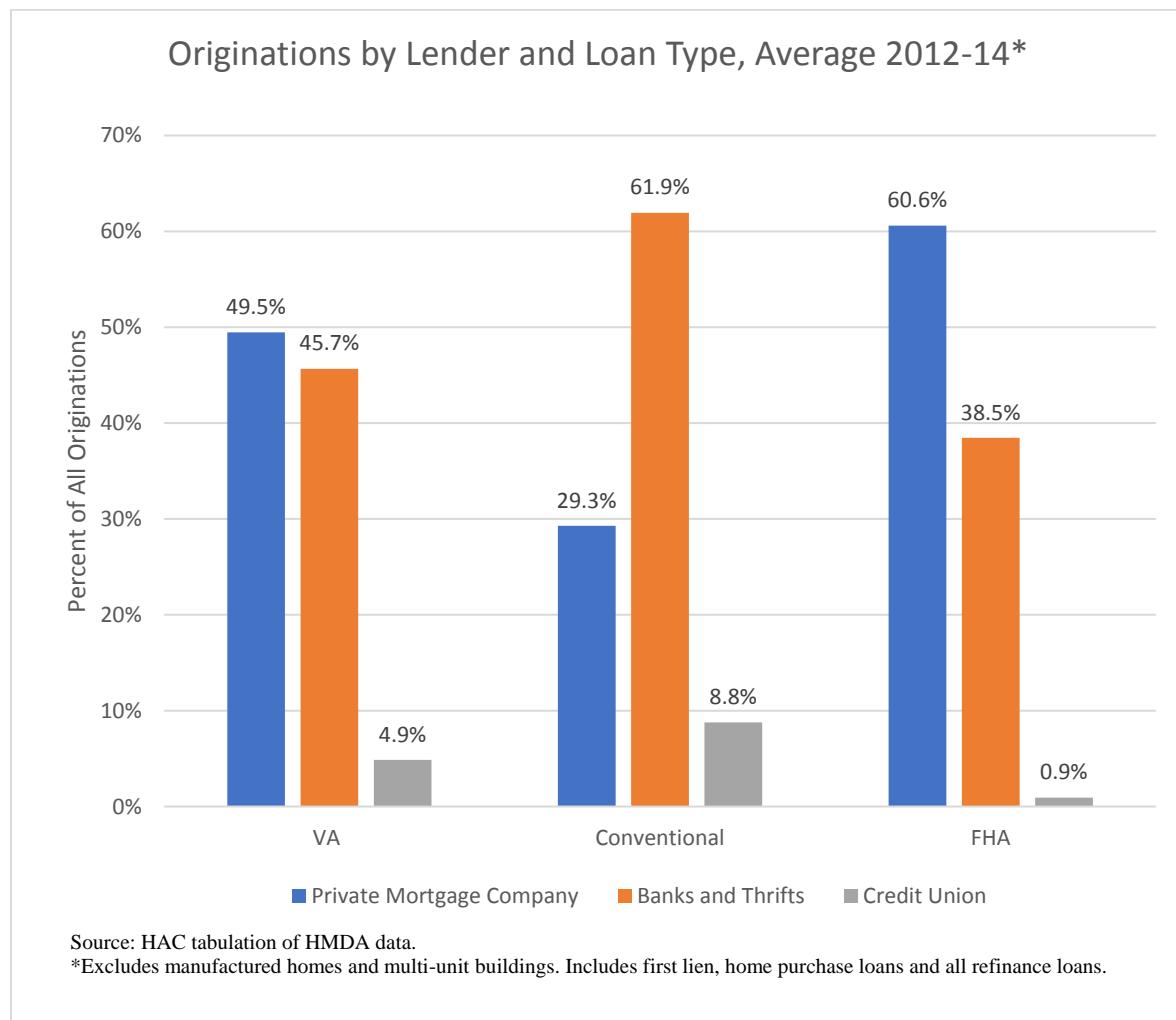


^p ACS 2010-14 estimated number of people in the armed forces (1,025,497) and veterans (20,700,911) totaled 21,726,408. This represents 9.1 percent of the total US population age 18 or older estimated to be 239,305,217.

^q This analysis uses the CRA examination thresholds defining banks on asset size. Small banks are those with fewer than \$304 million in assets as of January 1, 2016. The total is adjusted by the Federal Reserve annual to account for inflation. For a list of CRA examination thresholds see the following url: www.ffiec.gov/cra/pdf/AssetThreshold2016.pdf

Private Mortgage Companies Large Role

Over the last three years, private mortgage companies and their affiliates have increasingly come to play a larger role in the VA program. Most FHA loans were originated by private mortgage companies, making up 69 percent of FHA loans in 2014. However, private mortgage companies increased their share of originated VA loans by 18 percent during the 2012 to 2014 period, representing the biggest change among lender types. By 2014, private mortgage companies represented 42 percent of the lenders involved in the VA loan program and they originated 61 percent of all VA loans, compared to 11 and 36 percent, respectively for the conventional lending market.



Banks and Thrifts Declining Activity

Banks and thrifts originated a majority of both conventional and government-backed (FHA and VA) loans before the recession but their share of lending activity has steadily declined in all markets. In 2009, two-thirds of all loans were made by banks and thrifts, but by 2014, 43 percent were made by private mortgage companies. While private mortgage companies originated a

majority of FHA and VA in 2014, banks and thrifts still account for a majority of conventional loans.

Small-asset banks have little involvement in VA lending. Only seven percent of all small-asset banks made a VA loan. Large-asset banks, which represented only 33 percent of all banks and thrifts that made VA loans in 2014, originated 72 percent of the loans.^r

Credit Unions Limited Involvement

Credit unions originated 9 percent of conventional loans but only 5 percent of VA loans, on average over the 2012 to 2014 period. Fewer than 10 percent of all credit unions originated a VA loan in 2014. This likely reflects the fact that these institutions usually have limited assets and engage in few loans. For example, the median number of VA loans originated by a credit union is 6, compared to 77 for private mortgage companies and 19 for bank and thrifts in 2014.

Majority of VA Loans Securitized

Over 90 percent of VA loans were sold the same year they were originated, a common practice for all types of mortgage loans. Through a process known as securitization, these loans, or more accurately the payments to be made on them, are bundled together with investors purchasing bonds based on the return from these loan bundles. When an institution sells a loan it originates, this frees up the institution's funds so that it can loan them out again, thereby expanded the amount of money available to be borrowed. Playing a critical role in the securitization process for VA loans is the Government National Mortgage Association ("Ginnie Mae"), listed as being involved with of two-thirds of sold VA loans in 2014. Ginnie Mae, for a small fee, insures the bonds. These bonds, which are considered less risky due to the government guarantees, are mainly sold to mutual funds.

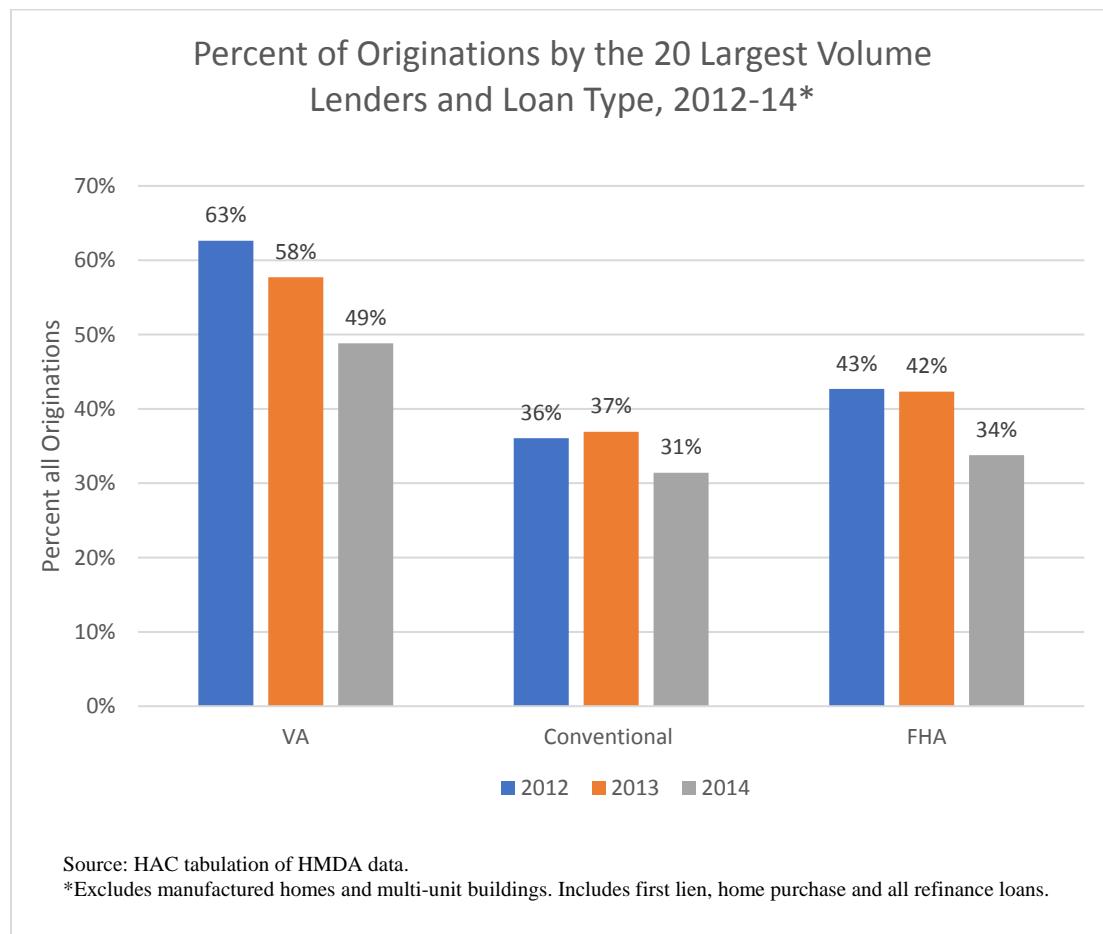
Large-asset institutions greatly shape credit union VA lending. For example, Navy Federal Credit Union, originated 79 percent of all VA loans made by credit unions in 2012 to 2014 period. The Navy Federal Credit Union case highlights the fact that a small number of large-asset lenders can make up a large part of the market.

Concentration of Activity Among Large Volume Lenders

Compared to the conventional loan market, VA lending is more highly concentrated among the largest volume lenders. That is, a smaller number of lenders are responsible for a larger number of VA loans than exists with conventional loans. During the 2012 to 2014 period, the 20 largest volume VA originators were responsible for an average of 57 percent of all VA loans a year, compared to 35 and 40 percent for the comparable group of lenders making FHA and conventional loans, respectively. In fact, the proportion of VA loans originated by the 20 largest

^r This analysis uses the Community Reinvestment Act large bank examination threshold to identify large banks. The threshold was 1.202 billion in 2014. The federal reserve adjusts the limit annual for inflation. For information see the following url: http://www.ffiec.gov/cra/pdf/Explanation_of_the_Community_Reinvestment_Act_Asset_Threshold_Change_2014.pdf

volume lenders exceeded 50 percent for nine of the last ten years, but it has trended downward since 2012.

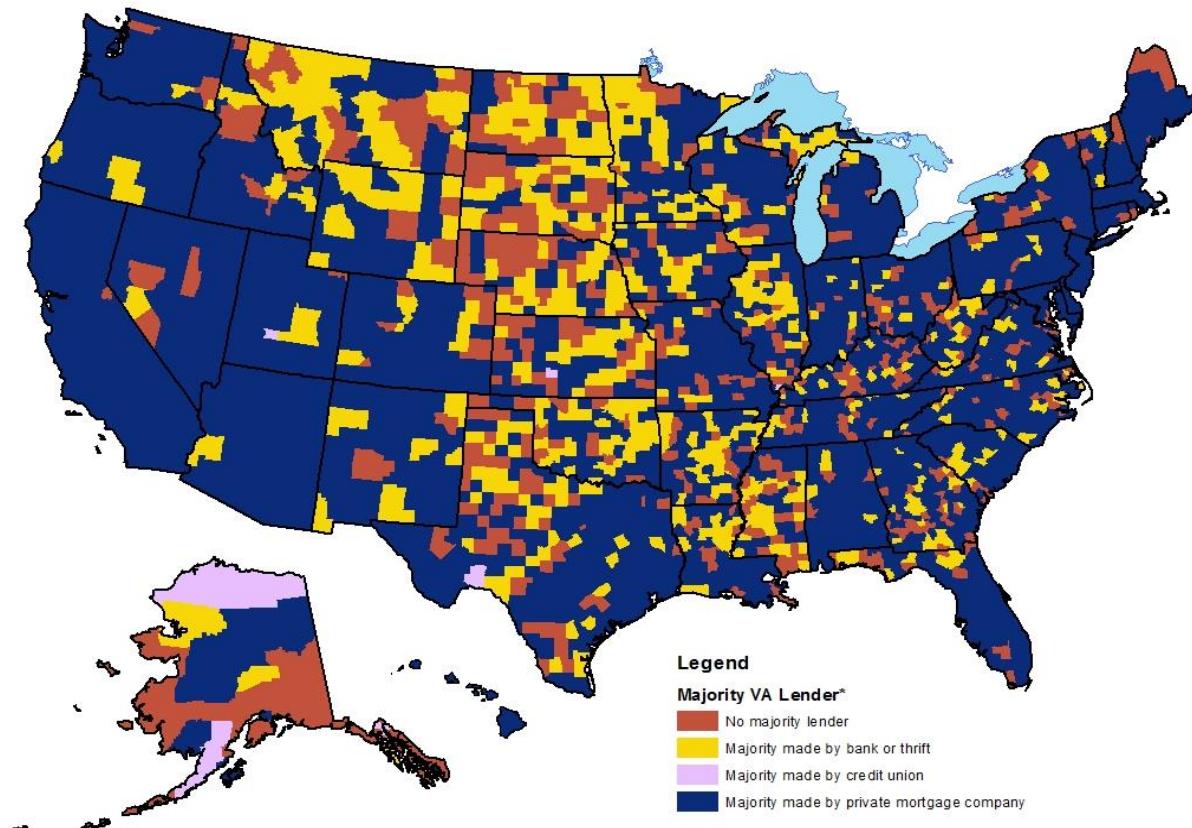


The 20 lenders originating the most VA loans are made up of ten banks and thrifts, nine private mortgage companies, and one credit union. The nine private mortgage companies alone accounted for 28 percent of all VA originations. In comparison, of the 20 lenders originating the most conventional loans, 14 were banks and thrifts. In fact, eight of the ten largest conventional lenders were banks and savings institutions. The differences may reflect the fact that it is easier for mortgage companies to specialize in one area, for example VA lending, than it is for commercial banks and thrifts. That is, private mortgage companies might be able to concentrate on a given product, helping them garner more business in that area than they could for more standard loan products.

There was some crossover among the largest volume lenders. Nine of the 20 largest VA lenders were also on the largest conventional lender list. This shows that even though VA loan activity is more concentrated and involves private mortgage companies to a greater degree, many of the same large lenders are heavily involved in both markets. For example, Quicken Loans, JP Morgan, Wells Fargo, and Bank of America are among the 20 largest lenders of both VA and conventional loans. It may be that these large-asset institution lenders can more easily afford to be involved in many different products than small-asset institutions can.

The top 20 lenders making VA loans have been relatively steady over time. In fact, 11 lenders were consistently top 20 VA loan originators for each of the last three years, 2012 to 2014. But the top 20 lenders making conventional loans has been even more steady, with 14 institutions listed as one of the 20 largest lenders during all three years. In comparison to the conventional loan business, the VA loan business exhibits more change among the involved institutions, even if a large amount of activity is often concentrated among a limited group of institutions. In addition, the total number of lenders originating VA loans has increased for each of the last eight years. Clearly, this is not a static market with the same players always involved at the top.

Lenders Making the Majority of VA Loans, by County, 2014



Source: HAC tabulation of 2014 HMDA loan data by lender type for county.

*Majority refers to lender category made 50 percent or more of loans. No majority lenders means there was no type of lender that made 50 percent or more of VA loans.

Changing Banking Industry and VA Loans

Products such as Quicken Loan's Rocket Mortgage seek to put banking and the mortgage lending process at the fingertips of the consumer. The increased access to banking services online has meant more people are now using the Internet to do their banking.⁴⁰ These changes in the banking industry have, at least in part, resulted in a decline in the number of physical bank branches over recent years. Data shows the number of bank branches dropped by 4 percent over the last five years⁴¹ and many of these closed bank branches were located in rural areas.⁴²

This move away from primarily brick and mortar interactions to more Internet-based transactions poses a significant challenge to effectively reaching and providing services to veterans and their families, as a higher percentage of veterans are older-- 45 percent are senior citizens compared to just 18 percent for the US population as a whole-- and senior citizens are less likely to use the Internet. In addition, a disproportionate share of veterans lives in rural areas-- 23 compared to 19 percent for the US population⁴³-- which tend to be the communities most often losing their bank branches.

While these overall challenges exist, particularly for older veterans, online products could increase access to VA loan products, especially for recently-returned veterans. Online tools may lower the costs associated with gaining information about VA loan products. The degree to which these tools help or hurt, in large part, depends on how well people are informed about them and how easy they are to use.

Conclusion

Veteran loan activity is largely not scrutinized. This paper sought to begin changing this fact by analyzing available loan data in hopes of shedding more light on this underexamined market and topic. While studying veteran mortgage lending activity in all its forms would have been preferable, data limitations restricted the source of information to VA loans, the only available data product that specifically targets the veteran population. The VA loan program has a long and storied history of helping veterans achieve home ownership. With publicly available data and its singular focus on veterans and current service members, the VA loan program provides a good window from which to view veteran mortgage finance.

VA mortgage activity has been increasing since 2005. While this increase may, in part, be related to the VA's marketing efforts, the largest factor was likely the Great Recession of 2007 to 2009. This economic downturn hastened the collapse of the subprime lending market and significantly tightened access to all private credit markets. Government-backed mortgage lending programs, like the VA, FHA and USDA stepped in to fill the vacuum. At that time, dramatically-reduced interest rates further spurred refinance activity, both VA – where it increased from less than 20,000 pre-recession to over 250,000 in 2013, and non-VA, for several years. Because of these two factors, the number of originated VA loans increased by more than 250 percent pre- to post-recession. While the volume of VA loan is relatively small when compared to all mortgage lending activity, less than 10 percent today, the program's reach is widespread, with lenders originating VA loans in almost every county in the U.S. In some cases, specifically counties with a military base, VA loans make up one in every five loans originated.

VA home purchase applications have a consistently high origination rate throughout the study period, 2005 to 2014. The home purchase origination rates ranged from 73 to 79 and were consistently higher than the conventional home purchase loan rates. The stability of the program, which largely reflects the government guarantee and loan terms, even in the face of serious problems with credit markets, is why these products play a large role in finance when other private markets dry up. Since the recession has ended, origination rates have become more similar for VA and conventional loans. This is particularly true when looking at refinance applications.

Differences exist for certain racial and ethnicity groups. When looking specifically at African American, non-Hispanic applicants, the data shows higher origination rates and lower denial rates for VA products, when compared to conventional loan applicants. The same differences exist for American Indian/Alaska Native, non-Hispanic and Hispanic borrowers when looking at home purchase applications. At least, in part, because of these origination differences, VA home purchase loans accounted for 18 and 13 percent of all such loans for African American, non-Hispanic and American Indian/Alaska Native non-Hispanic. Related research shows that minority veterans have higher incomes and educational attainment than their non-veteran counterparts which may, in part, explain the differences in origination rates.⁴⁴

The lenders originating VA loans play a critical role in the process. Approximately 20 percent of all HMDA mortgage data filers reported making a VA loan. Small-asset banks play a limited role in the VA loan program, originating relatively few loans. One plausible reason for this dearth of activity is that VA bureaucracy makes involvement in the program either too difficult or simply not worth it financially for small-asset lenders. Since the economic crisis, private mortgage companies have come to originate a majority of VA loans. It is the large-volume lenders that make a larger percentage of VA loans. VA lending is highly concentrated among the largest volume lenders and this has been the case for the past 10 years. For example, one credit union, Navy Federal Credit Union, was responsible for almost 80 percent of all credit union VA originations.

As the number of new veterans continues to grow and the overall population becomes more diverse, the VA will have a challenge ahead in reaching all of their target population. Whether it is the older Baby Boom veteran seeking to improve his or her home's accessibility so they can age in place or the newly discharged veteran who wants to refinance an older home loan so they save some extra money for child care each month, the VA needs to strive to reach and provide high quality financial products to them. The data shows that over the 2012 to 2014 period, the program has guaranteed more than 500,000 loans each year and has been a beacon of hope during tough economic times.

The VA's ability to maintain high usage rates and increase lender involvement will go a long way towards ensuring that veterans' mortgage finance needs are met. Can the program find a way to help meet the housing needs of their largest cohort, aging baby Boomers? Can the VA increase lender involvement, particularly from smaller-asset institutions? Is there a role to play for new technologies and products in expanding access to the VA loan program? Regardless of the circumstances, the VA loan program will continue to play a vital role in our nation's home finance market.

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