AMERICAN ENTERPRISE INSTITUTE

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Subcommittee on Economic Opportunity
Legislative Hearing

VA Loan Servicing at a Crossroads

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Chairman Van Orden and Ranking Member Pappas, and distinguished Members of the Subcommittee, thank you for the opportunity to testify today.

The VA Loan Program: Managing Mortgage Risk and Policy Considerations

The VA loan program has consistently outperformed other government-backed mortgage programs—including FHA, Fannie Mae, and Freddie Mac—in managing mortgage risk.

- During the aftermath of the Great Financial Crisis, VA loans recorded default rates:
    - Nearly 50% lower than FHA loans, despite serving borrowers with comparable risk profiles.
    - Nearly 45% lower than Fannie Mae and Freddie Mac's loans when adjusted for differences in risk profiles.
- Even in recent years, under less stressful market conditions, the VA's serious delinquency rates have remained about half the level of those of FHA, despite serving borrowers with comparable risk profiles. (See Appendix 1 for more details.)

While the precise reasons for this disparity are complex, several factors likely contribute:

- More prudent underwriting standards, particularly the VA's residual income requirement, which ensure borrowers have sufficient income after expenses.
- The VA's appraisal process, including its Tidewater Initiative, is veteran-focused and promotes more accurate appraisals, while reducing the risk of inflated valuations.
- The military background of VA borrowers, which may correlate with greater financial discipline and stability.
- Unlike the FHA, which insures 100% of the loan amount, the VA guaranty has a stop loss of 25% of the loan amount. This aligns the private servicer's loss mitigation interests with those of the VA and the veteran.

VA Loan Servicing at a Crossroads

Despite these strengths, VA loan servicing faces significant challenges. While no one wants to see foreclosures, especially among veterans, it is essential to recognize that a housing finance system without the possibility of foreclosure is inherently unsustainable—much like "religion without hell." Without accountability, the system risks morphing into an entitlement program, distorting market incentives and ultimately undermining long-term stability for both veterans and taxpayers.

Moreover, history has shown that government programs often begin with a limited scope, only to expand beyond recognition and sustainability due to constant program expansion—the federal student loan program being a prime example.

Expanded loss mitigation programs carry significant risks:

- Short-term reductions in delinquency and default rates may be illusory, as borrowers may continue struggling even after intervention.
- Encourages riskier lending practices, with some already advocating for more generous loan terms despite high default risks.

    - This is particularly concerning, given that 54% of VA first-time borrowers have less than one months' of reserves (assets remaining after deducting closing costs, gifts, and down payments), leaving them financially vulnerable in the event of unexpected hardships.
- Increases housing demand without addressing supply constraints, further inflating home prices.
- Places taxpayers at greater risk, as federal backing means losses are ultimately borne by the public.

Recent Biden administration initiatives reflect a trend toward socializing mortgage finance. I commend this committee's leadership for seeking to reverse some of these concerning developments.

Concerns with the VA Servicing Purchase (VASP) Program

The VASP program could set a negative precedent for direct lending by the VA, potentially reshaping the entire veteran housing finance system—at the expense of veterans, taxpayers, and private servicers.

The VA is apparently using its statutory authority to adopt a more interventionist approach to foreclosure prevention. As my AEI colleague Philip Wallach recently testified, this approach amounts to an "extraordinarily generous form of relief," potentially tempting borrowers holding mortgages with 7–8% interest rates to undertake strategic default. The program's protections against such default, however, appear insufficient, creating moral hazard.

This represents a philosophical shift from the VA's traditional role of guaranteeing private loans in Ginnie Mae securities to directly managing veteran mortgages—a step toward socialized lending with potentially unintended consequences, including:

- Potentially disrupting the current alignment among private servicers, the VA, and veterans in managing loss mitigation efforts. If this were to happen, default rates within the VA program—particularly under financial stress—could begin to mirror those of FHA, Fannie Mae, and Freddie Mac, undermining the program's historically stronger performance.
- Increased taxpayer exposure in the event of widespread defaults, as the VASP program merely defers financial risk rather than addressing its root causes. By kicking the can down the road, VASP could amplify long-term losses, creating a greater financial burden on taxpayers in the future.
- Higher taxpayer costs, as lowering the interest rate to 2.5% on a VASP loan can be extremely expensive. To my knowledge, the VA has not disclosed the per-loan cost of this rate reduction, making the total financial impact unclear.
- Looser lending standards, increasing overall mortgage risk and the likelihood of defaults.
- Increased risk of political interference, leading to expanding benefits and growing financial liabilities over time.
- Servicers potentially exiting the market due to diminished roles and crowding out of traditional lenders, which could reduce competition and limit financing options for veterans, ultimately leaving them with fewer choices and less flexibility in the mortgage market.
- Potentially disadvantaging veterans over time as the VA assumes the role of direct lender and servicer, despite lacking the expertise required for large-scale loan management.

The parallels between VASP and the federal student loan program are clear:

- The 2010 Student Aid and Fiscal Responsibility Act made the government the sole student loan lender through the Direct Loan Program, thereby eliminating private underwriting.
- Unrestricted borrowing fueled tuition inflation and rising defaults.
- Income-driven repayment shifted costs to taxpayers, with forgiveness after 10–25 years.
- Moral hazard increased as borrowers expected partial or full loan forgiveness.

Just as the student loan program evolved into an unsustainable entitlement, VASP marks the first step down a similar path, eroding private-sector discipline in favor of costly, taxpayer-funded federal intervention.

Given that the VA intends this program to serve "more than 40,000 Veterans" and that it likely is already well underway, I commend the committee's leadership for its efforts to limit its scope by:

- Capping VA loan purchases at 250 per fiscal year, and
- Mandating the VA to study within 180 days the sale of acquired VASP loans to the private sector, where they can be managed more efficiently.

Furthermore, it is likely a vast overstatement to claim that all borrowers currently seriously delinquent on their VA loans will inevitably lose their homes to foreclosure if the VASP program is curtailed.

Today, loan workouts are still available but much harder to achieve given today's higher mortgage rates. Yet there's a simpler, common-sense option for many struggling borrowers: selling the home. My analysis of servicer data shows that out of approximately 80,000 seriously delinquent VA loans, about 84% of borrowers would hold positive equity after selling their homes — even after accounting for arrearages and transaction costs (see table).[1] This reflects the fact that most veterans purchased their homes years ago and have benefited significantly from rapid home price appreciation during the pandemic, along with steady principal paydown through amortization. Among those with positive equity, the average amount is $128,000, with a median of $97,000. But instead of encouraging sales that would preserve veterans' dignity — as was traditionally the case — the VASP program fosters government dependency while shifting the risk and losses onto taxpayers.

To be clear, 16% of seriously delinquent borrowers — roughly 13,000 veterans — would still face negative equity if forced to sell, with an average shortfall of $19,000 and a median of $14,000. But this is primarily due to transaction costs — costs that are part of the risk and responsibility that come with homeownership, willingly accepted at the time of purchase. They are also far less behind on their payments and they also have the most to gain from the VASP's 2.5% mortgage rate as their rates are on average over 6%.

[1] The current equity position is calculated as the difference between the estimated current home value and the unpaid principal balance. We estimate the current home value by adjusting the original loan amount and loan-to-value (LTV) ratio using ZIP-level changes from the FHFA Home Price Index. From this, we subtract all missed interest payments — inferred from the loan term, note rate, loan age, and original loan amount — as well as assumed transaction costs equal to 7% of the current home value. The data exclude any equity that a borrower may have extracted previously through a home equity loan or a HELOC.

Table: Estimated equity distribution of VA seriously delinquent borrowers if they sold their homes

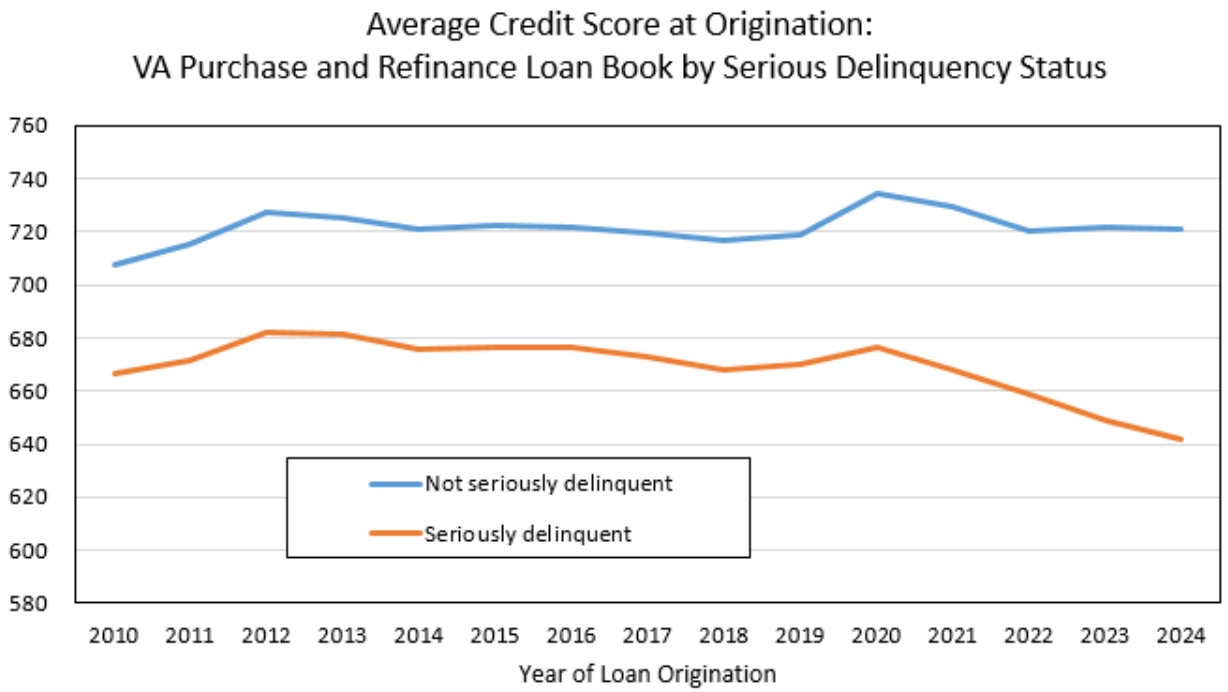
Percentile	Total Equity	Minus Arrears	Minus Transaction Cost
5%	10,691	1,440	(21,427)
10%	19,768	10,361	(10,569)
25%	49,055	40,451	18,437
50%	108,684	99,943	76,949
75%	188,216	177,970	148,474
90%	290,406	279,545	241,389
95%	374,002	360,982	316,996
Mean	141,408	131,493	103,865
# Obs.	58,062	58,062	58,062
% Positive Equity	99%	96%	84%

Note: Data are for purchase and refinance loans and are as of Dec. 2024. The current equity position is calculated as the difference between the estimated current home value and the unpaid principal balance. We estimate the current home value by adjusting the original loan amount and loan-to-value (LTV) ratio using ZIP-level changes from the FHFA Home Price Index. From this, we subtract all missed interest payments — inferred from the loan term, note rate, loan age, and original loan amount — as well as assumed transaction costs equal to 7% of the current home value.
Source: ICE McDash and AEI Housing Center.

My analysis also compares the loan characteristics of the roughly 80,000 currently seriously delinquent VA borrowers to the broader VA loan portfolio. The data show a clear pattern: Seriously delinquent borrowers had significantly lower credit scores at origination — about 51 points lower on average, with an average score of 673 —than those of borrowers who remain current, who have an average score of 723.[2] The problem of borrowers with lower credit scores becoming seriously delinquent seems to have become significantly worse since 2020 (see chart).[3]

This points to a deeper problem — not simply borrower hardship, but a failure of too loose government underwriting standards that should be addressed at the front end, rather than through costly government programs after the fact. (See Appendix 1 for more details, which provides periodic tables of actual defaults under severe stress for various combinations of credit score, LTV, and DTI buckets at loan origination. For reference, the loans that are serious delinquent and were originated in 2022-2024 have an expected default rate of 22.5% under severe stress, while the ones that are not seriously delinquent have an expected default rate of 9.3% -- or about 2.5 times lower.)

[2] The analysis controls for loan purpose and year of origination. The seriously delinquent borrowers also have about 2.4 ppts higher debt-to-income (DTI) ratios at origination than those that are not seriously delinquent, but DTIs are only reported in about 20% of loans.
[3] Some of this effect may also be due to selection bias as seriously delinquent borrowers may have exited the VA loan book through foreclosure or home sale over the years. But the point remains that lower credit scores are a significant contributor to serious delinquency.



Evaluating the VA Home Loan Program Reform Act

The proposed loss mitigation options offer a more structured and balanced approach compared to the VASP program, but they come with significant drawbacks:

- Establishes a waterfall for servicers, with partial claims as last resort.
    - However, it could create incentives for servicers to bypass traditional loss mitigation tools (e.g., servicer forbearance, repayment plans, loan modifications) and move directly to partial claims since they bear no financial risk leaving taxpayers on the hook.
    - It also front-loads partial claims against the 25% stop loss, potentially disadvantaging veterans in the long run. If a veteran exhausts their entitlement early, they could have fewer loss mitigation options available 5, 10, or 15 years down the road, leaving them more vulnerable in future financial hardships.
    - It is crucial to remember that the VA's 25% stop-loss provision has historically protected the program under financial stress, ensuring long-term sustainability.
- The inclusion of a sunset provision for the Partial Claim option in September 2027 is a notable strength, as it effectively limits taxpayer exposure when compared to the VASP program. The one-claim-per-loan limit further curbs long-term liability.
    - However, there is no overall cap on the Partial Claim program, which could lead to moral hazard, encouraging some borrowers to take advantage of 0% loans and live payment-free for extended periods (especially if they restart payments within three years).
- Requiring reporting to Congress is a positive step toward oversight and evaluation.

    - However, reporting should be ongoing, publicly accessible, and include all costs, in order to allow policymakers, researchers, and taxpayers to assess the program's effectiveness in time.

While VA Home Loan Program Reform Act is a clear improvement over the VASP program, it should not be considered as a long-term solution. Ultimately, a well-designed loss mitigation strategy should balance borrower relief with fiscal responsibility, preventing unnecessary taxpayer exposure. Proponents argue that forbearance and partial claim programs were successful during the pandemic, but the pandemic was not a true stress test because:

- Double-digit home price appreciation (HPA) artificially protected borrowers from foreclosure risk, which allowed borrowers to easily sell their homes.
- Historically low unemployment rates minimized delinquency rates.
- Pre-pandemic trends (2017-2019) saw an average of 15,000 completed VA loan foreclosures per year. Despite all loss mitigation efforts, 2023 still saw 10,000 completed foreclosures, proving that some defaults are inevitable and that expanded loss mitigation cannot eliminate risk.

A Better Path Forward: Sustainable Homeownership

The ultimate goal should be to provide every veteran a fair opportunity to succeed at homeownership without relying on government bailouts.

My research, analyzing 200,000 VA loans and 1,600,000 GSE loans originated in 2006–07 (just before the Global Financial Crisis, a true stress event), identifies several key factors that significantly reduce default risk:

- Shorter Loan Terms:
    - Loans with terms of 15–20 years reduced serious default rates by over 50%, particularly among borrowers with credit scores below 660.
- Multiple Borrowers:
    - Loans with two borrowers instead of one saw a 20–30% reduction in serious defaults, likely due to greater income stability and diversification within the household.
- Stable Housing Markets:
    - In areas where lending practices were more prudent, home prices remained stable and did not experience significant declines, default rates were about 50% lower for the typical VA borrower.
- Adequate Liquid Reserves:
    - Borrowers with sufficient liquid reserves demonstrated greater staying power, reducing defaults by several percentage points. Importantly, these findings are consistent with more recent loan data from 2013–2015, suggesting that these factors remain relevant predictors of loan performance across different market cycles.

The details of this analysis can be found in Appendix 1.

Conclusion: Balancing Sustainability with Accessibility

As this committee considers next steps, the choice is clear:

- Market-based solutions that promote sustainable homeownership, or

- A socialized housing finance system, with the long-term risks that entails.

While homeownership brings many societal and personal benefits, it must be sustainable—not forced. By focusing on responsible underwriting, prudent loan characteristics at origination, and borrower resilience, we can protect both veterans and taxpayers while ensuring a stable housing finance system for years to come.

In Appendix 2, I also offer brief comments on the **Fair Access to Coops for Veterans Act of 2025**, which may not represent a significant expansion of housing supply accessible to most veterans.

APPENDIX 1:

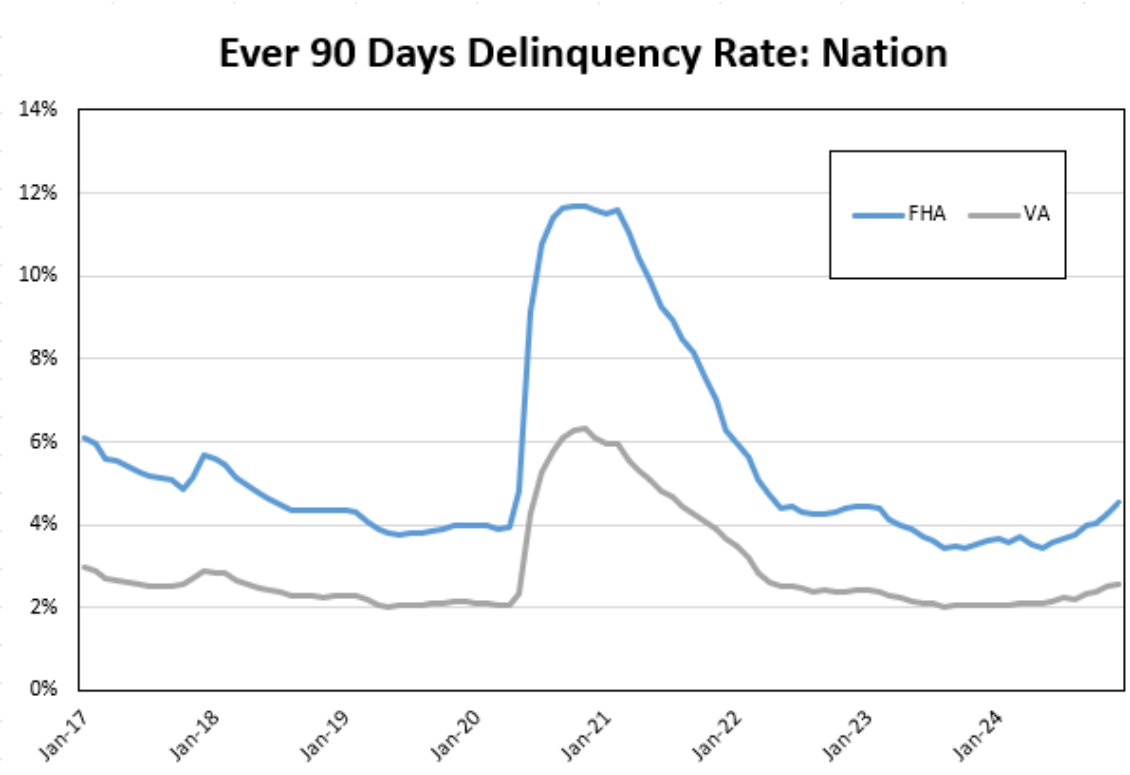
Periodic Tables of Mortgage Risk

The VA loan program has consistently outperformed other government-backed mortgage programs—including FHA, Fannie Mae, and Freddie Mac—in managing mortgage risk. The periodic tables show the actual default rates of fixed-rate, fully amortizing, fully documented first-lien home purchase mortgage loans secured by 1-4 unit properties that were originated in 2006-2007.

Note: Periodic tables are based on AEI Working Paper "A Quarter Century of Mortgage Risk" (2023). This paper was also published by the Federal Housing Finance Agency (FHFA) in collaboration with the American Enterprise Institute (AEI) Housing Center's Senior Adviser Steve Oliner (and AEI Adjunct Scholar Morris Davis).

See tables on following pages.

Serious Delinquency Rate



Note: Data are for purchase and refinance loans combined.
Source: McDash and AEI Housing Center, www.AEI.org/housing.

New Insights into Borrower Resiliency
See PowerPoint deck below.

Periodic Table of Housing Risk: VA Home Purchase Loans

primary owner-occupied, 30-year fixed rate, fully amortizing, fully documented

v. 4.19.23: Default rates based on AEI Working Paper "A Quarter Century of Mortgage Risk" (2023).*

GREEN (low risk): <7%
ORANGE (medium risk): 7 - <14%
RED (high risk): >=14%

FICO Buckets	DTI Buckets	Cumulative Default Rates for Loans Originated in 2006 - 2007							
		1 - 60 CLTV	61 - 70 CLTV	71 - 75 CLTV	76 - 80 CLTV	81 - 85 CLTV	86 - 90 CLTV	91 - 95 CLTV	>= 96 CLTV
>= 770	1 - 33	0.5%	0.9%	0.9%	1.0%	2.1%	0.9%	1.8%	3.6%
	34 - 38	1.1%	1.5%	1.6%	2.0%	2.1%	1.8%	1.2%	6.8%
	39 - 43	1.3%	1.9%	2.4%	2.4%	2.5%	2.9%	5.7%	4.0%
	44 - 50	2.2%	2.6%	2.6%	2.9%	3.4%	3.8%	1.8%	4.5%
	> 50	3.3%	3.9%	4.8%	5.6%	5.1%	6.0%	1.7%	7.4%
720 - 769	1 - 33	1.0%	1.9%	2.1%	2.3%	2.4%	3.1%	5.7%	6.4%
	34 - 38	1.9%	3.1%	3.7%	3.6%	3.9%	4.2%	4.2%	6.8%
	39 - 43	2.6%	3.9%	4.1%	4.3%	5.4%	4.4%	3.6%	7.5%
	44 - 50	4.2%	5.0%	6.0%	5.9%	6.0%	3.9%	2.9%	8.7%
	> 50	5.9%	7.2%	7.3%	10.1%	9.2%	12.2%	5.2%	10.0%
690 - 719	1 - 33	2.5%	3.6%	4.1%	4.3%	4.3%	9.4%	6.4%	9.6%
	34 - 38	4.6%	5.5%	5.9%	6.4%	7.1%	7.5%	5.9%	9.4%
	39 - 43	4.8%	7.2%	7.3%	8.5%	8.8%	9.6%	10.6%	11.1%
	44 - 50	6.4%	9.7%	10.6%	9.9%	11.0%	12.4%	12.0%	11.9%
	> 50	8.3%	12.2%	14.2%	16.9%	17.6%	18.4%	6.3%	12.5%
660 - 689	1 - 33	3.9%	4.4%	5.4%	6.1%	6.3%	13.1%	10.8%	13.7%
	34 - 38	3.5%	7.7%	9.7%	10.1%	10.5%	10.8%	37.7%	17.1%
	39 - 43	6.4%	10.8%	11.9%	11.9%	13.1%	14.2%	8.3%	15.0%
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	> 50	11.4%	20.0%	22.5%	28.3%	23.4%	25.6%	12.4%	19.5%
640 - 659	1 - 33	5.7%	7.0%	8.1%	8.2%	9.1%	10.1%	14.5%	19.8%
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300 - 579	1 - 33	22.9%	25.1%	35.8%	28.8%	29.4%	34.8%	32.3%	44.3%
	34 - 38	50.5%	34.2%	29.9%	37.6%	39.0%	47.4%	36.8%	43.8%
	39 - 43	44.5%	41.5%	46.7%	65.4%	51.7%	51.3%	39.6%	45.0%
	44 - 50	44.4%	48.2%	47.3%	55.6%	56.3%	55.1%	38.1%	45.6%
	> 50	47.2%	53.8%	76.0%	63.5%	69.1%	63.4%	39.2%	48.8%

* Published by the Federal Housing Finance Agency (FHFA) in collaboration with the American Enterprise Institute (AEI) Housing Center's Senior Adviser Steve Oliner (and AEI Adjunct Scholar Morris Davis).

Periodic Table of Housing Risk: FHA Home Purchase Loans

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300 - 579	1 - 33	30.6%	39.0%	46.2%	43.0%	45.3%	50.3%	55.1%	58.0%
	34 - 38	25.5%	40.5%	46.8%	50.2%	49.2%	55.7%	57.2%	62.1%
	39 - 43	32.0%	38.0%	50.1%	44.9%	48.5%	55.7%	56.7%	63.1%
	44 - 50	35.5%	44.9%	50.3%	55.3%	54.4%	62.6%	59.6%	65.1%
	> 50	42.0%	51.0%	53.6%	57.1%	49.8%	54.1%	59.9%	65.8%

* Published by the Federal Housing Finance Agency (FHFA) in collaboration with the American Enterprise Institute (AEI) Housing Center's Senior Adviser Steve Oliner (and AEI Adjunct Scholar Morris Davis).

Periodic Table of Housing Risk: GSE Home Purchase Loans

primary owner-occupied, 30-year fixed rate, fully amortizing, fully documented

v. 4.19.23: Default rates based on AEI Working Paper "A Quarter Century of Mortgage Risk" (2023).*

GREEN (low risk): <7%
ORANGE (medium risk): 7 - <14%
RED (high risk): >=14%

FICO Buckets	DTI Buckets	Cumulative Default Rates for Loans Originated in 2006 - 2007							
		1 - 60 CLTV	61 - 70 CLTV	71 - 75 CLTV	76 - 80 CLTV	81 - 85 CLTV	86 - 90 CLTV	91 - 95 CLTV	>= 96 CLTV
>= 770	1 - 33	0.5%	1.1%	1.6%	2.5%	2.6%	3.8%	5.1%	7.8%
	34 - 38	1.0%	1.9%	3.0%	3.7%	3.8%	5.4%	7.2%	10.0%
	39 - 43	1.1%	2.2%	3.3%	4.5%	4.6%	6.6%	8.4%	12.1%
	44 - 50	1.3%	2.6%	3.5%	4.8%	5.4%	7.5%	9.6%	13.7%
	> 50	0.8%	2.8%	4.3%	5.3%	6.8%	9.0%	11.3%	19.6%
720 - 769	1 - 33	1.1%	2.3%	3.4%	4.2%	3.9%	6.2%	7.5%	10.9%
	34 - 38	1.7%	3.6%	4.4%	6.3%	6.0%	8.4%	9.9%	13.1%
	39 - 43	1.9%	4.4%	5.6%	7.4%	7.2%	10.4%	12.0%	15.8%
	44 - 50	2.1%	4.5%	6.4%	8.5%	8.6%	11.6%	13.7%	18.2%
	> 50	2.2%	4.9%	6.8%	8.8%	9.8%	13.0%	16.4%	25.0%
690 - 719	1 - 33	1.8%	3.7%	5.7%	7.2%	7.2%	9.9%	11.2%	16.9%
	34 - 38	3.1%	6.5%	7.0%	9.6%	10.8%	13.6%	14.2%	19.4%
	39 - 43	3.5%	7.2%	9.1%	11.4%	10.7%	15.5%	16.9%	22.9%
	44 - 50	3.7%	6.8%	10.4%	11.8%	13.2%	17.3%	19.5%	25.6%
	> 50	3.6%	7.5%	11.8%	13.2%	15.0%	18.8%	22.7%	32.9%
660 - 689	1 - 33	3.4%	6.3%	9.0%	8.9%	8.3%	13.5%	15.1%	23.5%
	34 - 38	4.2%	7.9%	9.4%	13.2%	13.0%	16.4%	18.4%	27.5%
	39 - 43	5.1%	10.4%	12.2%	14.1%	15.3%	19.6%	21.5%	30.9%
	44 - 50	5.8%	10.4%	13.6%	16.0%	17.4%	21.9%	24.1%	33.4%
	> 50	4.9%	11.7%	15.0%	17.0%	22.8%	24.5%	29.9%	41.1%
640 - 659	1 - 33	4.9%	8.9%	9.4%	13.1%	12.5%	17.2%	21.3%	31.6%
	34 - 38	6.7%	12.9%	17.6%	16.1%	20.4%	20.0%	24.3%	36.1%
	39 - 43	8.8%	13.6%	17.6%	20.2%	20.5%	24.5%	27.9%	39.9%
	44 - 50	7.2%	14.3%	17.3%	19.9%	21.2%	27.2%	31.4%	42.9%
	> 50	9.3%	16.8%	20.4%	22.3%	27.5%	31.6%	36.9%	49.3%
620 - 639	1 - 33	6.6%	12.9%	15.3%	16.3%	18.2%	21.1%	25.9%	39.3%
	34 - 38	7.9%	17.2%	18.3%	21.0%	25.2%	25.5%	30.3%	43.6%
	39 - 43	10.8%	16.9%	20.0%	21.1%	27.0%	27.6%	34.3%	47.4%
	44 - 50	10.5%	15.9%	24.1%	26.0%	27.1%	31.8%	37.8%	50.5%
	> 50	12.6%	18.2%	29.0%	26.9%	33.5%	38.5%	43.4%	56.2%
580 - 619	1 - 33	10.2%	17.0%	21.1%	22.3%	27.7%	28.3%	32.6%	48.9%
	34 - 38	12.3%	21.5%	23.7%	25.4%	29.4%	31.4%	39.5%	53.3%
	39 - 43	10.9%	24.7%	28.3%	28.4%	38.0%	34.6%	41.6%	55.8%
	44 - 50	14.2%	21.1%	27.3%	30.2%	33.3%	38.4%	45.4%	58.6%
	> 50	15.0%	28.2%	34.0%	33.4%	42.5%	44.9%	51.4%	63.3%
300 - 579	1 - 33	21.3%	30.4%	36.3%	38.5%	46.6%	44.6%	52.7%	61.5%
	34 - 38	24.1%	32.1%	34.6%	40.1%	49.5%	49.7%	52.2%	64.9%
	39 - 43	20.5%	34.4%	35.8%	41.5%	46.1%	48.1%	56.5%	67.3%
	44 - 50	22.6%	36.5%	46.4%	46.7%	48.9%	54.8%	58.4%	68.9%
	> 50	24.9%	37.4%	43.3%	47.0%	56.9%	55.1%	65.6%	71.6%

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AEI Housing Center

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New Insights into Borrower Resiliency

Tobias Peter

Co-Director and Senior Fellow

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Key Takeaways

- **The AEI Housing Center's research has long shown that underwriting matters for loan performance, particularly under stress (cohort years 2006 and 2007).**
    - We created the *Periodic Tables* of Mortgage Risk, which were primarily based on credit score, CLTV, and DTI, but this research was long constrained by data availability.
    - In new research, we find that loan term and the number of borrowers have a prophylactic effect on serious default.
- **Access to administrative VA data has allowed us to test various other indicators' Predictive power of serious default (D180+) for loans with CLTVs >= 96%.**
    - FICO was the most predictive variable followed by a ZIP Code's home price decline.
    - Months' reserves or net residual income were also predictive and more predictive than debt-to-income ratio

Example Periodic Table

Periodic Table of Housing Risk: GSE Home Purchase Loans

primary owner-occupied, 30-year fixed rate, fully amortizing, fully documented

v. 4.19.23: Default rates based on AEI Working Paper "A Quarter Century of Mortgage Risk" (2023).*

GREEN (low risk): <7%
ORANGE (medium risk): 7 - <14%
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FICO Buckets	DTI Buckets	Cumulative Default Rates for Loans Originated in 2006 - 2007							
		1 - 60 CLTV	61 - 70 CLTV	71 - 75 CLTV	76 - 80 CLTV	81 - 85 CLTV	86 - 90 CLTV	91 - 95 CLTV	>= 96 CLTV
>= 770	1 - 33	0.5%	1.1%	1.6%	2.5%	2.6%	3.8%	5.1%	7.8%
	34 - 38	1.0%	1.9%	3.0%	3.7%	3.8%	5.4%	7.2%	10.0%
	39 - 43	1.1%	2.2%	3.3%	4.5%	4.6%	6.6%	8.4%	12.1%
	44 - 50	1.3%	2.6%	3.5%	4.8%	5.4%	7.5%	9.6%	13.7%
	> 50	0.8%	2.8%	4.3%	5.3%	6.8%	9.0%	11.3%	19.6%
720 - 769	1 - 33	1.1%	2.3%	3.4%	4.2%	3.9%	6.2%	7.5%	10.9%
	34 - 38	1.7%	3.6%	4.4%	6.3%	6.0%	8.4%	9.9%	13.1%
	39 - 43	1.9%	4.4%	5.6%	7.4%	7.2%	10.4%	12.0%	15.8%
	44 - 50	2.1%	4.5%	6.4%	8.5%	8.6%	11.6%	13.7%	18.2%
	> 50	2.2%	4.9%	6.8%	8.8%	9.8%	13.0%	16.4%	25.0%
690 - 719	1 - 33	1.8%	3.7%	5.7%	7.2%	7.2%	9.9%	11.2%	16.9%
	34 - 38	3.1%	6.5%	7.0%	9.6%	10.8%	13.6%	14.2%	19.4%
	39 - 43	3.5%	7.2%	9.1%	11.4%	10.7%	15.5%	16.9%	22.9%
	44 - 50	3.7%	6.8%	10.4%	11.8%	13.2%	17.3%	19.5%	25.6%
	> 50	3.6%	7.5%	11.8%	13.2%	15.0%	18.8%	22.7%	32.9%
660 - 689	1 - 33	3.4%	6.3%	9.0%	8.9%	8.3%	13.5%	15.1%	23.5%
	34 - 38	4.2%	7.9%	9.4%	13.2%	13.0%	16.4%	18.4%	27.5%
	39 - 43	5.1%	10.4%	12.2%	14.1%	15.3%	19.6%	21.5%	30.9%
	44 - 50	5.8%	10.4%	13.6%	16.0%	17.4%	21.9%	24.1%	33.4%
	> 50	4.9%	11.7%	15.0%	17.0%	22.8%	24.5%	29.9%	41.1%
640 - 659	1 - 33	4.9%	8.9%	9.4%	13.1%	12.5%	17.2%	21.3%	31.6%
	34 - 38	6.7%	12.9%	17.6%	16.1%	20.4%	20.0%	24.3%	36.1%
	39 - 43	8.8%	13.6%	17.6%	20.2%	20.5%	24.5%	27.9%	39.9%
	44 - 50	7.2%	14.3%	17.3%	19.9%	21.2%	27.2%	31.4%	42.9%
	> 50	9.3%	16.8%	20.4%	22.3%	27.5%	31.6%	36.9%	49.3%
620 - 639	1 - 33	6.6%	12.9%	15.3%	16.3%	18.2%	21.1%	25.9%	39.3%
	34 - 38	7.9%	17.2%	18.3%	21.0%	25.2%	25.5%	30.3%	43.6%
	39 - 43	10.8%	16.9%	20.0%	21.1%	27.0%	27.6%	34.3%	47.4%
	44 - 50	10.5%	15.9%	24.1%	26.0%	27.1%	31.8%	37.8%	50.5%
	> 50	12.6%	18.2%	29.0%	26.9%	33.5%	38.5%	43.4%	56.2%
580 - 619	1 - 33	10.2%	17.0%	21.1%	22.3%	27.7%	28.3%	32.6%	48.9%
	34 - 38	12.3%	21.5%	23.7%	25.4%	29.4%	31.4%	39.5%	53.3%
	39 - 43	10.9%	24.7%	28.3%	28.4%	38.0%	34.6%	41.6%	55.8%
	44 - 50	14.2%	21.1%	27.3%	30.2%	33.3%	38.4%	45.4%	58.6%
	> 50	15.0%	28.2%	34.0%	33.4%	42.5%	44.9%	51.4%	63.3%
300 - 579	1 - 33	21.3%	30.4%	36.3%	38.5%	46.6%	44.6%	52.7%	61.5%
	34 - 38	24.1%	32.1%	34.6%	40.1%	49.5%	49.7%	52.2%	64.9%
	39 - 43	20.5%	34.4%	35.8%	41.5%	46.1%	48.1%	56.5%	67.3%
	44 - 50	22.6%	36.5%	46.4%	46.7%	48.9%	54.8%	58.4%	68.9%
	> 50	24.9%	37.4%	43.3%	47.0%	56.9%	55.1%	65.6%	71.6%

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Data and Methodology

- We limit the analysis to “plain vanilla” purchase loans originated in 2006 and 2007.* We track their performance through Dec 2019.
- We focus on loans with CLTV >= 96%.
- A loan is considered to have defaulted if it was ever delinquent for 180 or more days (E180+).

Fannie and Freddie Loan Performance data

- Loan total of more than 1,600,000 records.

VA administrative data**

- Compared to servicer data, it is more complete and includes additional variables such as assets, income, net residual income, or ZIP-Code, which allows us to merge on FHFA Home Price Index data.**
- Loan total of about 200,000 records.

* Plain vanilla loans are defined as 30-year fixed rate, primary owner-occupied, fully amortizing, fully documented loans.
** Loan originated from October 2005 – September 2007.
*** We use the FHFA HPI ZIP-Code level change from 2007 to 2012. We group ZIPs into equally-sized quintiles based on their population totals.

The Prophylactic Effect of Shorter Loan Terms – GSE Data

Across all credit score buckets, 15- and 20-year loans cut the serious default rates in at least half.

Average Default Rate (E180+) for Loans with CLTV ≥ 96% by Term: GSE Purchase Loans									
Data: Fixed rate, primary owner-occupied, fully amortizing, fully documented, excl. manufactured housing.									
FICO Buckets	DTI Buckets	Default Rate (E180+)			Loan Count			Ratio: 15/20 vs. 30-yr	
		30-yr	20-yr	15-yr	30-yr	20-yr	15-yr	20-yr	15-yr
≥770	1-33	8.0%	3.6%	3.9%	26,423	139	513	0.5	0.5
	≥34	14.3%	3.1%	1.7%	64,551	196	656	0.2	0.1
690-719	1-33	18.3%	13.2%	6.7%	25,118	106	300	0.7	0.4
	≥34	28.9%	9.0%	8.4%	104,424	133	404	0.3	0.3
620-659	1-33	37.9%	18.7%	13.0%	28,075	91	208	0.5	0.3
	≥34	49.9%	20.0%	21.7%	137,563	100	254	0.4	0.4
580-619	1-33	50.8%		33.0%	14,909		109		0.7
	≥34	60.6%		34.3%	69,200		105		0.6
Note: Cells with less than 50 loans are not shown, 50 ≤ n-counts <100 are in red.									

Source: Fannie, Freddie, AEI Housing Center.

The Prophylactic Effect of Having An Additional Borrower on the Loan – GSE Data

- Across all credit score and DTI buckets, loans with two borrowers on the note experienced fewer serious defaults than loans with one borrower .
- The effects were greatest for higher credit scores.

Average Default Rate (E180+) for Loans with CLTV ≥ 96% by borrowers: GSE Purchase Loans						
Data: 30-year fixed rate, primary owner-occupied, fully amortizing, fully documented, excl. manufactured housing.						
FICO Buckets	DTI Buckets	Default Rate (E180+)		Loan Count		Ratio: two vs. one borrower
		one borrower	two borrowers	one borrower	two borrowers	
≥770	1-33	10.0%	5.5%	14,623	11,781	0.6
	≥34	16.6%	10.6%	39,490	24,988	0.6
690-719	1-33	23.2%	12.9%	13,054	12,039	0.6
	≥34	32.8%	23.4%	60,073	44,171	0.7
620-659	1-33	42.7%	30.3%	17,209	10,849	0.7
	≥34	53.4%	43.4%	88,786	48,508	0.8
580-619	1-33	54.9%	42.0%	10,125	4,765	0.8
	≥34	63.4%	53.9%	48,695	20,389	0.9

Source: Fannie, Freddie, AEI Housing Center.

Predictive Power of FICO Score Buckets and Home Price Quintiles – VA data

- A clear pattern on serious default emerges.
- After controlling for FICO bucket, loans that experienced significant price declines during the period from 2007 to 2012 exhibited higher default rates. The difference in default rates between the highest and lowest HPI quintile ranges from 7 to 18 ppts.
- A 720-769 credit score loan made in an area with the highest price declines had about the same default rate as a 580-639 credit score loan in an area with no price decline.

Average Default Rate (E180+) for CLTV ≥ 96%: 2006-2007 VA Purchase Loans						
Data: 30-year fixed rate, primary owner-occupied, fully amortizing, fully documented.						
FICO Buckets	**Median FHFA HPI Decline: 2007-2012**					**Diff. btw. highest and lowest bin**
	Q1-Largest	**Q2**	**Q3**	**Q4**	**Q5-Smallest**	
≥770	15.6%	8.1%	5.3%	3.9%	2.7%	12.9 ppts.
720-769	23.3%	12.1%	8.5%	6.4%	4.9%	18.4 ppts.
690-719	25.8%	15.5%	12.3%	10.2%	8.5%	17.2 ppts.
660-689	29.9%	20.4%	16.3%	14.7%	11.8%	18.1 ppts.
640-659	32.7%	25.3%	21.9%	18.8%	16.3%	16.4 ppts.
620-639	37.0%	28.8%	25.4%	24.7%	21.1%	15.9 ppts.
580-619	39.4%	33.0%	30.3%	28.7%	25.7%	13.7 ppts.
300-579	43.7%	38.9%	37.6%	40.2%	36.5%	7.2 ppts.
Diff. btw. highest and lowest bin	28.1 ppts.	30.7 ppts.	32.4 ppts.	36.3 ppts.	33.8 ppts.	

Note: Median FHFA HPI change from 2007-2012 for each quintile: Q1: -42.7%; Q2: -26.3%; Q3: -16.7%; Q4: -8.7%; Q5: 0.4%.
Source: VA, FHFA, and AEI Housing Center.

Predictive Power of FICO Score Buckets & Home Price Quintiles & Reserves – VA data

Combining FICO Score Buckets & Home Price Quintiles & Months' Reserves

- After controlling for FICO bucket & home price quintile, loans with more reserves exhibited lower default rates. The difference in default rates between the highest and lowest months' reserved buckets were 2 to 13 ppts.
  - For some credit score and home price buckets, the decline in the average default rate can be as large as 50% when months' reserves were greater than 12 months rather than less than 1 month.
- The benefits of higher levels of reserves were generally greater for lower credit score borrowers and in areas with more moderate price declines.
- We find similar benefits for net residual income.

Average Default Rate (E180+) for CLTV ≥ 96%: 2006-2007 VA Purchase Loans								
Data: 30-year fixed rate, primary owner-occupied, fully amortizing, fully documented.								
FICO Buckets	Median FHFA HPI Decline: 2007-2012	Months' Reserve (in month)*						Diff. btw. highest and lowest bin
		<1		3-6		≥ 12		
≥770	Q1-Largest	22.3%		13.1%		13.3%		9.0 ppts.
	Q3	9.5%		6.0%		4.1%		5.3 ppts.
	Q5-Smallest	4.1%		3.0%		2.3%		1.8 ppts.
660-689	Q1-Largest	32.2%		30.1%		25.2%		7.0 ppts.
	Q3	21.9%		16.5%		10.6%		11.3 ppts.
	Q5-Smallest	15.7%		11.4%		9.0%		6.6 ppts.
620-659	Q1-Largest	38.6%		34.7%		28.3%		10.3 ppts.
	Q3	28.5%		22.2%		19.0%		9.5 ppts.
	Q5-Smallest	24.6%		17.1%		11.7%		12.9 ppts.

*Months' reserve are calculated as Total assets / monthly PITI.
Note: Median FHFA HPI change from 2007-2012 for each quintile: Q1: -42.7%; Q2: -26.3%; Q3: -16.7%; Q4: -8.7%; Q5: 0.4%.
Source: VA, FHFA, and AEI Housing Center.

Reserves Provide Staying Power during Good Economic Times – VA Data

- When focusing on the 2013-2015 VA cohorts while home prices were rising uniformly, the benefits from additional reserves were greatest for lower credit score borrowers.

Average Default Rate (E180+) for CLTV ≥ 96%: 2013-2015 VA Purchase Loans						
Data: 30-year fixed rate, primary owner-occupied, fully amortizing, fully documented.						
FICO Buckets	**Months' Reserve (in month)***					**Diff. btw. highest and lowest bin**
	<1	**1-3**	**3-6**	**6-12**	**≥ 12**	
≥770	3.2%	2.2%	1.9%	1.6%	1.6%	1.6 ppts.
720-769	4.6%	3.6%	2.9%	2.4%	2.1%	2.6 ppts.
690-719	6.8%	5.1%	4.0%	3.6%	2.8%	4.0 ppts.
660-689	9.8%	7.7%	6.3%	5.4%	4.6%	5.2 ppts.
640-659	13.9%	11.1%	9.0%	7.9%	6.6%	7.2 ppts.
620-639	16.6%	13.6%	11.3%	9.6%	8.7%	7.8 ppts.
580-619	17.3%	15.4%	12.9%	10.0%	10.0%	7.4 ppts.
Diff. btw. highest and lowest bin	14.1 ppts.	13.2 ppts.	11.0 ppts.	8.4 ppts.	8.4 ppts.	

*Months' reserve are calculated as Total assets / monthly PITI.
Note: We track loan performance through Dec 2019.
Source: VA, FHFA, and AEI Housing Center.

Policy Recommendations

- **Ultimately, we need to build more naturally affordable housing using Light-touch Density and equip borrowers, especially those with high CLTVs and lower credit scores, with more staying power to withstand periods of economic stress.**
    - There appear to be clear benefits from borrowers having liquid reserves of at least 3 months.
        - Should reserves be substituted for higher CLTVs?
        - Should liquid reserves or net residual income replace DTI in underwriting?
        - Should we be pricing for one vs. two borrowers on the note?
    - Loan terms well below 30 years reduce the risk of default and build equity at a faster rate. They were the norm until the mid-1950s.
        - There are many tools in the box to make them attractive relative to a 30-year loan (e.g. interest rate buy-down, higher CLTV, ARM structure, LLMA/MIP changes, etc.)
    - Predicting home price swings ex-ante is very hard, but prudent underwriting (and more supply) can avoid the worst excesses.

Appendix

Explanatory Variable Ranking

- **Aligned with our previous research, FICO is predictive of VA default rates. However, changes in housing prices and months' reserves prove to be more effective compared to DTI.**

Avg. Default Rate by Variables: 2006-2007 VA purchase cohorts (CLTV>= 96%)
30-year fixed rate, primary owner-occupied, fully amortizing, fully documented

									Diff. btw. the highest and lowest default rate
FICO Buckets	**300-579**	**580-619**	**620-639**	**640-659**	**660-689**	**690-719**	**720-769**	**≥770**	33.3%
	38.8%	30.2%	26.0%	21.4%	16.8%	12.6%	8.9%	5.5%	
Median FHFA HPI Change: 2007-2012	**Q1-Largest**	**Q2**	**Q3**	**Q4**	**Q5-Smallest**				15.8%
	29.1%	20.1%	17.0%	15.3%	13.3%				
Months' Reserve (in month)*	**<1**	**1-3**	**3-6**	**6-12**	**≥ 12**				16.3%
	26.9%	20.9%	16.5%	13.6%	10.6%				
Net Residual Income Amount ($)	**<500**	**500-999**	**1,000-1,499**	**1,500-1,999**	**≥2,000**				11.1%
	22.3%	18.8%	16.1%	14.4%	11.2%				
DTI Buckets	**1-33**	**34-38**	**39-43**	**44-50**	**≥51**				3.8%
	14.4%	16.5%	18.0%	18.3%	18.3%				

*Median FHFA HPI change for each quintile group

Q1-Largest	Q2	Q3	Q4	Q5-Smallest
-42.7%	-26.3%	-16.7%	-8.7%	0.4%

Note: *Month reserve is calculated using Total asset / monthly PITI
Source: VA, FHFA, and AEI Housing Center

Model Comparison

Table of R^2

2006-2007 VA purchase cohorts (CLTV>= 96%)

30-year fixed rate, primary owner-occupied, fully amortizing, fully documented

Model	R^2
FICO Bucket	0.063
FHFA HPI Change*	0.017
Months Reserve**	0.020
Net Residual Income	0.012
FICO Bucket + FHFA HPI Change	0.084
FICO Bucket + FHFA HPI Change + DTI	0.085
FICO Bucket + FHFA HPI Change + Months Reserve	0.090
FICO Bucket + FHFA HPI Change + Net Residual Income	0.093
FICO Bucket + FHFA HPI Change + Months Reserve	
+ Net Residual Income	0.102
+ First-time Buyer	0.093
+ Number of Borrowers	0.092
+ Active Status	0.092
+ Gender	0.091
+ Race	0.091

Note: *Median FHFA HPI change for each quintile group: Quintile 1: -42.7%; Quintile 2: -26.3%; Quintile 3: -16.7%; Quintile 4: -8.7%; Quintile 5: 0.4%
**Month reserve is calculated using Total asset / monthly PITI

Source: VA, FHFA, and AEI Housing Center

Net Residual Income

Average Default Rate (E180+) for CLTV>= 96%: 2006-2007 VA purchase loans							
30-year fixed rate, primary owner-occupied, fully amortizing, fully documented							
FICO Buckets	**Median FHFA HPI Decline: 2007-2012**	**Net Residual Income Amount ($)**					**Diff. btw. highest and lowest bin**
		<500	**500-999**	**1000-1499**	**1500-1999**	**≥2000**	
≥770	**Quintile 1**	23.4%	16.7%	15.6%	10.8%	12.4%	10.9 ppts.
	Quintile 2	9.7%	10.1%	8.9%	6.7%	5.4%	4.2 ppts.
	Quintile 3	7.4%	7.3%	4.9%	4.2%	3.1%	4.3 ppts.
	Quintile 4	6.6%	3.9%	4.3%	3.9%	1.9%	4.6 ppts.
	Quintile 5	4.7%	3.4%	2.6%	2.3%	1.7%	3.0 ppts.
660-689	**Quintile 1**	33.2%	28.8%	28.3%	31.9%	26.6%	6.6 ppts.
	Quintile 2	23.8%	21.0%	20.9%	16.5%	14.5%	9.3 ppts.
	Quintile 3	21.3%	16.7%	15.3%	11.6%	11.0%	10.2 ppts.
	Quintile 4	19.5%	15.1%	12.9%	11.7%	8.7%	10.8 ppts.
	Quintile 5	15.1%	12.1%	11.5%	10.0%	7.2%	7.9 ppts.
580-619	**Quintile 1**	45.2%	40.7%	39.7%	31.6%	35.7%	9.5 ppts.
	Quintile 2	40.2%	36.6%	28.6%	26.5%	26.8%	13.4 ppts.
	Quintile 3	37.9%	31.9%	28.5%	24.7%	21.1%	16.8 ppts.
	Quintile 4	33.5%	31.6%	26.5%	24.1%	20.8%	12.7 ppts.
	Quintile 5	30.4%	27.2%	23.5%	23.3%	18.9%	11.5 ppts.

Note: Median FHFA HPI change for each quintile group: Quintile 1: -42.7%; Quintile 2: -26.3%; Quintile 3: -16.7%; Quintile 4: -8.7%; Quintile 5: 0.4%

Source: VA, FHFA, and AEI Housing Center

APPENDIX 2: Fair Access to Coops for Veterans Act of 2025

Co-ops may not represent a significant expansion of housing supply accessible to most veterans.

Market Share:

- Co-ops represent only about 1% of the U.S. residential housing stock.

Geographic Concentration:

- Primarily found in large urban markets, with significant concentrations in:
    - New York City (NYC) – the largest co-op market.
    - Washington, D.C., Chicago, and San Francisco also have notable co-op inventories.

Property Characteristics:

- Co-ops are often located in historic or luxury buildings, which can drive higher price points compared to other housing options in less desirable areas.

Pricing Dynamics:

- While co-ops can command higher absolute prices due to their locations and building characteristics, they are generally priced lower than comparable condos in the same area. Reasons for lower pricing relative to condos include:
    - Limited buyer familiarity with the co-op ownership structure.
    - Governance by co-op boards, which may impose:
        - Stricter purchase requirements, including higher down payments.
        - Background checks and board approval processes that deter some potential buyers.
        - Monthly maintenance fees for co-ops often include property taxes, potentially increasing upfront monthly costs.

Implications for veterans:

- The additional 3.25% loan fee may present a financial hurdle for some veterans, particularly those purchasing entry-level co-op units relative to condos.
- Given these factors, co-ops may not represent a significant expansion of housing supply accessible to most veterans.