



# VA-Home Loan Guaranty Program: An Overview

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## **Summary**

Under the Department of Veterans Affairs' (VA) home loan guaranty program, an eligible veteran may purchase a home through a private lender and the VA guarantees to pay the lender a portion of the losses if the veteran defaults on the loan. From the program's inception in 1944 through the end of 2008, VA had guaranteed the purchase or refinancing of nearly 18.4 million homes for veterans. This report discusses the features of the VA home loan guaranty program; it will be updated as suggested by changes in law or regulation.

## Contents

The VA Home Loan Guaranty Program .....	1
Features of the Program .....	1
Eligibility .....	1
Federal Guaranty.....	2
Maximum Mortgage .....	2
Downpayment.....	2
Loan Term .....	3
Owner Occupancy.....	3
Eligible Loan Purposes .....	3
Interest Rates .....	3
User Fees .....	3
Credit Limits.....	4
Assumption of Loans .....	4
Multiple Purchases.....	4
Underwriting Guidelines .....	4
Program Funding .....	5
Program Activity.....	5

## Contacts

Author Contact Information .....	5
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# The VA Home Loan Guaranty Program<sup>1</sup>

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

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

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

## Features of the Program

### Eligibility

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

Generally, persons who have had at least six years of service in the Selected Reserves or National Guard are eligible for VA-guaranteed housing loans. Reservists and National Guard members, however, who were activated on or after August 2, 1990, served at least 90 days and were discharged honorably, are eligible.

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<sup>1</sup> The program is codified at 38 U.S.C. 3701 et seq.; the regulations can be found at 38 C.F.R. Part 36.

Under current law, eligible veterans are entitled to participate in the program.

## Federal Guaranty

An eligible veteran may finance a home through a private lender, and the VA guarantees to pay the lender a portion of losses that may be suffered as a result of default by the borrower. The guaranty amount depends on the price of the home and the location of the property. For loans closed on or after December 18, 1989, the maximum VA guaranty is as follows: (1) 50% of the loan amount for loans of \$45,000 or less, (2) \$22,500 for loans between \$45,001 and \$56,250, (3) the lesser of \$36,000 or 40% of the loan for loans between \$56,251 and \$144,000. For loans in excess of \$144,000, the maximum guaranty amount is equal to the lesser of 25% of the loan or 25% of the Freddie Mac conforming loan limit. Sec. 501 of the Veterans' Benefits Improvement Act of 2008, P.L. 110-389, provides that, through December 31, 2011, the maximum VA guaranty amount is the greater of 25% of (1) the Freddie Mac general limit or (2) the lesser of 125% of the median home price for the area, or 175% of the Freddie Mac general limit.<sup>2</sup> This implies a potential loan amount of \$1,094,625 and a maximum guaranty amount of \$273,656. Alaska, Guam, Hawaii, and the U.S. Virgin Islands are special high cost areas, and their limits are up to 50% higher.<sup>3</sup> This implies a potential loan of \$1,641,937 and a maximum guaranty of \$410,484 for these areas.

## Maximum Mortgage

VA places no limits on the maximum mortgage that the veteran may obtain, except that the mortgage may not exceed the home's value plus any loan funding fee which is financed, and the payments must be within the means of the borrower.

## Downpayment

There are no statutory downpayment requirements on VA-guaranteed home loans. Standard lender practice is to permit eligible veterans to borrow up to four times the maximum VA guaranty with no down payment. For all VA-guaranteed home loans, the amount of cash down payment, plus the amount of the VA guaranty, must equal at least 25% of the value of the home. As noted above, the amount of the guaranty depends on the location of the property. VA establishes county limits which must be used to calculate the maximum guaranty for particular counties. For example, in 2009, the limit in Cannon County, TN, is \$427,500, so the maximum VA guaranty for a loan in that county is \$106,875 (25% of \$427,500). In that county a veteran can get a VA-guaranteed loan of up to \$427,500 with no downpayment. But a downpayment of \$43,125 would be required if the veteran purchased a home in that county which was valued at \$600,000. The maximum guaranty of \$106,875 plus \$43,125 equals 25% of the value of the property.

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<sup>2</sup> The Housing and Economic Recovery Act, P.L. 110-289, provides that, effective January 1, 2009, Freddie Mac will have a general limit and a high cost limit. The general limit is \$417,000. The general limit may be changed on January 1 of each year on the basis of changes in a home price index maintained by the newly created Federal Housing Finance Agency.

<sup>3</sup> 12 U.S.C. § 1715d.

## Loan Term

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

## Owner Occupancy

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

## Eligible Loan Purposes

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

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

## Interest Rates

Since 1992, VA is authorized to let the borrower and lender negotiate the interest rate that is charged for a VA-guaranteed loan.<sup>4</sup>

## User Fees

To defray part of the cost of the program, certain veterans are required to pay loan funding fees to VA when obtaining VA-guaranteed home loans. For most veterans, the loan fee is currently 2.15% of the loan amount when the downpayment is less than 5% of the property value, 1.5% of the loan amount when the downpayment is 5% to 9%, and 1.25% of the loan amount when the downpayment is 10% or more. Persons who assume a VA guaranteed loan are required to pay a loan fee of .5% of the loan balance. Veterans who obtain a VA-guaranteed loan to refinance an existing VA loan are required to pay a loan fee of .5% of the new loan amount.

Veterans who are eligible for loans as a result of service in the reserves pay higher loan fees. For such veterans, the loan fee is 2.4% of the loan amount when the downpayment is less than 5%, 1.75% of the loan amount when the downpayment is 5% to 9%, and 1.5% of the loan amount when the downpayment is 10% or more.

A veteran may sell an existing VA-financed home and purchase another home with a VA-guaranteed loan. The loan fee for the new loan would be 3.3% of the loan amount if the veteran makes a down payment of less than 5% of the home value.

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<sup>4</sup> 38 U.S.C. 3703(c)(4)

Certain veterans with service-connected disabilities (or their surviving spouses) are exempt from paying the loan fees.

## **Credit Limits**

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

## **Assumption of Loans**

VA loans may be assumed by nonveterans. The conditions governing the assumption of VA-guaranteed mortgages depend on the date on which the mortgage was closed. In general, loans closed prior to March 1, 1988 may be assumed without restrictions. For loans closed after March 1, 1988, the party who seeks to assume the loan must be proven creditworthy by the lender holding the loan, and the assumption must be approved by the VA or its authorized agent. This credit review is required for the life of the loan. If the assumption is approved, the new borrower pays a fee of .5% of the outstanding loan balance. If an unapproved assumption occurs, the lender may, within 30 days, demand immediate and full payment of the loan.

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

## **Multiple Purchases**

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

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

Under limited conditions, a veteran may obtain a second VA loan while the existing loan is outstanding. The maximum VA loan guaranty is set by law and has been periodically changed by the Congress. That guaranty amount is considered an entitlement to eligible veterans. If a veteran purchased a home when the guaranty was lower than it is under existing law, then the veteran is eligible to purchase another home with the unused guaranty. The maximum loan in such a case would be 75% of the appraised value of the home plus the unused guaranty. Of course, the new home would have to become the principal residence of the veteran.

## **Underwriting Guidelines**

Statutory credit criteria provide that VA may not guarantee a loan unless (1) the veteran is a satisfactory credit risk and (2) the contemplated loan terms are within the means of the veteran, as indicated by the veteran’s present and anticipated income and expenses. In underwriting loans for

approval, the VA's loan analysis form is used to evaluate the veteran's personal and financial status, the estimated monthly shelter expenses, the debts and obligations, and the monthly income and deductions. The veteran's residual income and debt-to-income ratio are calculated and used as guides in making a decision on the loan. The VA stresses, however, that no single factor should be used as a determinant in any applicant's qualification for a VA-guaranteed loan.

Residual income is determined by subtracting taxes, the proposed shelter cost, and other obligations from the veteran's monthly income. The VA has prepared a table which shows the minimum residual income, by region, for families of various sizes.<sup>5</sup> The applicant's residual income should equal or exceed the stated minimum for the applicant's family size.

The veteran's debt-to-income ratio is another factor used in evaluating the application. If the ratio of monthly debt payments (including the proposed mortgage) to the monthly income is greater than 41%, there must be compensating factors that justify approval of the loan.

## Program Funding

The Veterans Programs Enhancement Act of 1998, P.L. 105-368, created the Veterans Housing Benefits Program Fund—a new fund established in the Treasury. Other than administrative expenses, all operations of VA housing programs are financed out of this fund.

## Program Activity

During FY2008, VA guaranteed \$36 billion in loans to finance 179,600 homes, of which 142,356 loans were for home purchases and 37,304 loans were for refinancing existing loans for veterans. From 1944 through the end of FY2008, VA has guaranteed nearly \$997 billion in loans for the purchase or refinancing of nearly 18.4 million homes for veterans.

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<sup>5</sup> U.S. Department of Veterans Affairs, *VA Pamphlet 26-7, Guaranty of Insurance of Loans to Veterans—GI Loan Programs* (Washington: July 20, 2007), pp. 4-57, at [http://www.warms.vba.va.gov/admin26/pamphlet/pam26\\_7/ch04.doc](http://www.warms.vba.va.gov/admin26/pamphlet/pam26_7/ch04.doc).