

Recommendations for Implementing a Cost-Effective VA Loss Mitigation Program

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About the Author

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Executive Summary

The Department of Veterans Affairs (VA) holds 25% of the risk of loss associated with borrower default on VA-guaranteed mortgages. Therefore, VA has an economic interest in directing mortgage servicers to engage in risk management techniques that will reduce the number of defaults on VA-guaranteed loans that transition to disposition (i.e., foreclosure, short sale, or deed-in-lieu of foreclosure) and cause losses to the agency.

These risk management techniques, referred to as home retention programs, serve a specific purpose: to enable delinquent borrowers to reperform.¹ Through reperformance, the mortgage guarantor avoids the high cost of dispositions and thus mitigates losses it would otherwise incur. For VA, the potential benefit of cost-effective home retention programs is significant, as we estimate that the average disposition today would cost VA \$73,750.² For context, my research finds that home retention programs generate substantial savings relative to disposition. For example, for each home retention action completed, Fannie Mae and Freddie Mac (the GSEs) save \$19,000 relative to disposition, and the Federal Housing Administration (FHA) saves \$25,000 relative to disposition.³

The VA Home Loan Program Reform Act (HLPRA), which was signed into law on July 30, 2025, requires VA to implement a Partial Claim (PC) program.⁴ In addition, the statute requires VA to implement a mandatory loss mitigation waterfall that prescribes the sequence of assistance measures that mortgage servicers must follow to resolve delinquent loans.⁵

With the purpose of home retention programs in mind, we suggest VA consider three recommendations for the VA loss mitigation program, which, when taken together, will allow VA to structure home retention solutions that generate loan reperformance and thereby avoid the high cost of dispositions.

We recommend VA:

- 1) Adjust the VA loss mitigation program to bring it into alignment with the best practices found in programs for other government-backed mortgages:
 - Delegate to mortgage servicers the authority and responsibility to use VA's loss mitigation waterfall to assist VA borrowers in default with retaining their homes and to reduce claims on the VA guaranty fund.
 - Permit forbearance for up to 12 months of total delinquency, to be resolved using the new home retention waterfall.

¹ See [Home Retention Programs Save the GSEs and FHA Billions by Avoiding the High Cost of Dispositions \(HPC, July 2025\)](#) for a discussion of home retention best practices.

² The details of the calculation are provided in the Appendix.

³ Sources: [Quantifying the Savings from the GSEs' Home Retention Programs \(HPC, July 2025\)](#) and [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#).

⁴ See <https://www.congress.gov/bill/119th-congress/house-bill/1815/text>.

⁵ Ibid.

- Require borrowers to complete a 3-month Trial Payment Plan to demonstrate affordability before any home retention solution becomes permanent and VA absorbs the cost.
 - Permit no more than one loan modification every 24 months, with an exception for borrowers impacted by natural disasters.
 - Implement a single set of home retention solutions for all borrowers, including those affected by a natural disaster.
- 2) Structure the PC as a servicer advance secured by the first lien, rather than a subordinate lien, which will reduce the cost and risk of administering the PC program compared to the COVID-era VA Partial Claim Program (PCP).
- 3) To sustain the economic viability of the VA home loan program while also helping VA borrowers retain their homes, develop a waterfall with a sequence of steps ordered to reduce dispositions in a cost-effective manner:
- Lump-sum repayment.
 - Repayment Plan, with a term of up to 24 months.
 - Borrowers who have overcome a temporary hardship and can resume their original monthly payment should be offered a 30-Year Modification if it can provide a payment reduction, otherwise a Standalone PC.
 - Borrowers who are facing an ongoing hardship and need a payment reduction to make their mortgage affordable should be offered an Up-to 40-Year Modification that targets a 25% reduction in monthly principal and interest (P&I) payments. If the target P&I payment cannot be reached, the home retention alternative that creates the lowest monthly payment should be offered.

Collectively, our recommendations will allow VA to create a cost-effective loss mitigation program that provides VA borrowers who fall behind on their mortgage with similar assistance measures available to borrowers with other federally backed mortgages. In doing so, the VA program will generate loan reperformance in a cost-effective manner and allow VA to avoid absorbing the high cost of dispositions.

Recommendations to Structure a Cost-Effective VA Loss Mitigation Program

Recommendation 1: Adjust the VA loss mitigation program to bring it into alignment with the best practices found in programs for other government-backed mortgages.

As detailed in my recent paper, [Home Retention Programs Save the GSEs and FHA Billions by Avoiding the High Cost of Dispositions \(HPC, July 2025\)](#), government home retention programs have proven to be cost-effective and are expected to generate considerable savings relative to disposition for the government going forward. Therefore, VA should incorporate the best practices embedded in other government programs by making five adjustments to their loss mitigation program.

First, as FHA does, VA should delegate to mortgage servicers both the authority and responsibility to use VA's loss mitigation waterfall to assist VA borrowers in default with retaining their homes and to reduce claims on the VA guaranty fund. This step, when combined with clear guidance laying out the mandatory home retention waterfall described below, will reduce the strain on limited VA resources that would be created if VA needed to approve home retention applications on a loan-by-loan basis.

To develop the guidance for the new VA PC program and the waterfall, and for other consequential changes made to the guaranteed loan program, we urge VA to use the drafting table to allow the public to provide even quick feedback on proposed policies. By taking this step, VA will be able to consider and incorporate, when appropriate, feedback from the mortgage industry, consumer advocates, and Veterans Service Organizations before releasing final policy guidance.

Second, VA should adjust their forbearance early intervention to permit borrowers to request forbearance in increments of 1 to 3 months, up to a maximum of 12 months of delinquency, including the forbearance period, per default episode.⁶ As described in the aforementioned research, mortgage forbearance, when used judiciously, can be an effective early intervention tool, but **must be followed by suitable, permanent home retention alternatives**. Accordingly, VA should eliminate the requirement that, after forbearance, borrowers either repay the total delinquency through a lump-sum payment or enter a short-term repayment plan, or otherwise face disposition. Instead, at the end of the forbearance period, borrowers should be evaluated using the new VA home retention waterfall described below.

Third, VA should require that borrowers complete a 3-month Trial Payment Plan (TPP) for each home retention alternative before it becomes effective.⁷ By doing so, VA would not rely solely on the borrower's statements to determine the appropriate home retention alternative, but rather use TPPs to discern borrower capacity. Importantly, VA should only approve the home

⁶ VA may wish to provide a longer forbearance period for VA borrowers who have been affected by a natural disaster and require additional time to make substantial repairs to their property. In this instance, FHA provides up to 24 months of forbearance (See [Tightening and Expediting Implementation of the New Permanent Loss Mitigation Options](#), page 126).

⁷ FHA's home retention programs and the GSEs' modification have a similar TPP requirement.

retention solution after successful completion of the TPP and therefore would only absorb the cost of the home retention solution once the TPP has been successfully completed.

Fourth, VA should allow seriously delinquent (SDQ) VA borrowers who successfully resolve a default episode with a modification but suffer a subsequent financial hardship to be eligible for another modification after 24 months, rather than maintaining the current requirement that 36 months elapse between modifications.⁸ The period between permissible uses of modifications should be long enough to discourage program abuse while short enough to generate loan reperformance in a cost-effective manner after legitimate redefaults due to a subsequent hardship. If the period between permissible uses of modifications is too long, it will increase the number of borrowers who resolve a delinquency using a modification but then experience a second default episode and have no other choice but to move to disposition, which is the costliest outcome for VA.

The GSEs have found the appropriate balance by allowing one use of their home retention solutions (the Flex Mod and Payment Deferral) every 12 months and permitting up to three modifications over the life of the loan.⁹ Similarly, FHA borrowers who resolve a delinquency with a home retention solution but suffer a subsequent hardship and redefault are not eligible for an additional home retention option until 24 months have elapsed since the effective date of the initial intervention, except in the case of a natural disaster.¹⁰

Importantly, unlike the GSEs and FHA, VA need not impose the limit of one use per 24 months on the Standalone PC as a fraud-prevention measure. While research finds little to no evidence of fraud in the use of loss mitigation programs, because VA PC use is already limited by the HLPRA to one per loan, the risk of fraudulent use has already been greatly reduced.¹¹ As described below, by not counting the Standalone PC against the one modification in 24 months limitation, VA can build additional flexibility into their loss mitigation waterfall that will generate loan reperformance and avoid dispositions that impose high costs on VA.

Therefore, in conjunction with implementation of the waterfall described below, VA should reduce the period required between modifications to 24 months, with an exception for borrowers impacted by natural disasters. While more conservative than the GSEs' policy for modifications, permitting one modification every 24 months will bring the VA program into alignment with FHA's modification policy and allow VA to avoid costly dispositions after post-modification redefaults in a similar fashion to FHA.

⁸ Serious delinquency is defined as missing 3 or more monthly payments.

⁹ As described in [Fannie Mae Flex Modification | Fannie Mae](#), the GSEs stipulate that the borrower must not have failed a Flex Mod TPP within 12 months of being evaluated for eligibility for another Flex Mod and must not have received a Flex Mod and become 60 days or more delinquent within the first 12 months without being reinstated.

¹⁰ As described in [Tightening and Expediting Implementation of the New Permanent Loss Mitigation Options](#).

¹¹ For a summary of research examining evidence of fraud in home retention programs, see [Home Retention Programs Save the GSEs and FHA Billions by Avoiding the High Cost of Dispositions \(HPC, July 2025\)](#), pages 17 – 18.

Fifth, VA should implement a single set of home retention solutions for all borrowers, including those affected by a natural disaster.¹² By doing so, VA can simplify their home retention waterfall for borrowers, servicers and VA by permitting servicers to follow a single set of prescribed steps to resolve delinquent loans. Implementation of a single waterfall for all delinquencies would allow VA to eliminate disaster-specific solutions such as the Disaster Modification and Disaster Extend Modification. Importantly, as noted above, the 1 modification per 24-month period restriction would not apply to borrowers affected by a natural disaster.

VA Recommendation 2: Structure the PC as a servicer advance secured by the first lien, rather than a subordinate lien, which will reduce the cost and risk of administering the PC program compared to the COVID-era VA PCP.

VA should structure the PC as a first lien, servicer advance, similar to the structure used by the Department of Agriculture (USDA) Mortgage Recovery Advance (MRA) program and the Fannie Mae and Freddie Mac Payment Deferral programs.¹³

In the VA PCP, which was available during the COVID-19 pandemic but expired in October 2022, PCs were secured by the property, with repayment due under a subordinate mortgage owed by the borrower to VA. Setting up a subordinate lien creates additional costs and risks for VA. VA must pay for recording subordinate liens and then either service the subordinate mortgages itself or pay a separate servicer to do so. VA must also expend staff resources tracking and collecting PCs that were not properly recorded or repaid upon house sale. In addition, VA may suffer losses due to intervening, senior liens that are still junior to the VA-guaranteed first mortgage or when these PC subordinate liens aren't identified when the house is sold. This is not simply a theoretical issue—VA has discovered enough instances where the original guaranteed loan has been paid off but the PC remains outstanding to issue [Circular 26-25-9](#) to aid in PC collection.

In contrast, using the first lien model for the new VA PC program would allow the PC to be managed by the first mortgage servicer, to be paid in full as part of the primary VA mortgage payoff. In this structure, the mortgage servicer managing the first lien advances funds on behalf of the borrower as part of a home retention action. VA reimburses the servicer for these funds, and the servicer establishes a receivable to be collected from the borrower upon loan payoff, which the servicer then remits to VA. From an accounting perspective, the PC is treated similarly to servicer advances for taxes and insurance; it is not part of the principal balance of the first mortgage and is not accruing interest. However, it is an outstanding obligation secured by the property, in accordance with the mortgage and note.

¹² Eligibility requirements for certain loss mitigation solutions may differ for borrowers affected by Presidentially-declared disasters, for example as described in the HLPRA.

¹³ The USDA MRA servicer advance model is described in <https://www.federalregister.gov/documents/2024/08/15/2024-18291/single-family-housing-guaranteed-loan-program-changes-related-to-special-servicing-options>.

In the servicer advance structure, there is no second lien to record or service, and this arrangement would reduce the cost to VA of administering the program and increase recoveries on deferred amounts. With this deferred balance managed in conjunction with the primary mortgage, the borrower will see the amount owed on their monthly statement and payoff statement, making clear that this obligation is indeed due upon payoff or maturity of the loan, thereby reducing confusion and misunderstanding that may contribute to non-payment. While there are multiple reasons for the failure to collect PCs upon payoff as noted above, virtually all of them would be mitigated under the servicer advance approach.

VA Recommendation 3: To sustain the economic viability of the VA home loan program while also helping VA borrowers retain their homes, develop a waterfall with a sequence of steps ordered to **reduce dispositions in a cost-effective manner.**

Given the top-line economics of the VA guaranteed loan program, it is critical that the VA home retention program reduce dispositions in a cost-effective manner. A full accounting of the economics of the VA-guaranteed home loan program is well beyond the scope of this paper, but even a cursory examination of the program economics indicates the need for greater efficiency. The credit subsidy, which is a measure of the benefit (negative subsidy) or cost (positive subsidy) to the government, of VA-guaranteed loans increased from -0.19% in FY2025 to 0.15% in FY2026.¹⁴ These figures indicate that each new VA guaranteed loan made in FY2025 is expected to adequately cover losses from defaults, whereas each new loan in FY2026 is expected to generate a cost for VA, after accounting for expected defaults. Among the components of the credit subsidy, the largest driver of the year-over-year change is the increase in defaults net of recoveries (0.19%) for FY2026 loans. The rising cost of defaults highlights the importance of and need for a cost-effective VA home retention program to reduce the number of defaults that terminate in disposition.¹⁵

Therefore, for VA borrowers who are behind on their mortgage but want to stay in their home, VA's mandatory home retention waterfall should follow the sequence of steps outlined below. **Our recommended waterfall is designed to balance keeping VA borrowers in their homes and reducing dispositions with the need to manage program costs.** Note that we have assumed that PC funds cannot be applied to defer principal. Should VA interpret the HLPRA as allowing PC funds to be used to defer principal, VA should follow the waterfall provided in Appendix Section A3.

Recommended VA Waterfall

- 1) **Lump-Sum Repayment:** Does the borrower state that they can repay their arrearages in a lump-sum payment?

¹⁴ Source: Tables 4 and 6 of [BUDGET-2026-CREDIT.pdf](#).

¹⁵ Ibid.

- a) If yes, accept lump-sum payment to bring loan current.
 - b) If no, proceed to Step 2.
- 2) **Repayment Plan:** Has the borrower missed 12 or fewer payments and does the borrower state that they can afford a higher monthly payment for a period of time?
- a) If yes to both, offer a repayment plan no shorter than 3 months and no longer than 24 months.
 - b) If no, proceed to Step 3.
- 3) **Payment Resumption:** Does the borrower state that they can resume making their original monthly payment after the arrearages are resolved?
- a) If yes, evaluate for a **30-Year Modification**. After adding arrearages to the unpaid principal balance (UPB) at Default to reach the Capitalized UPB, does a 30-year loan at the Market Rate produce a monthly P&I payment at least \$1 lower than the Existing P&I Payment?¹⁶
 - i) If yes, offer the 30-Year Modification. If the TPP fails, proceed to Step 6.
 - ii) If no, does the borrower have PC eligibility?
 - (1) If yes, proceed to Step 3(a)(iii).
 - (2) If no, proceed to Step 4(a).
 - iii) Evaluate for a **Standalone PC:** Are Available PC Funds greater than or equal to Arrearages?
 - (1) If yes, offer a Standalone PC. If the TPP fails, proceed to Step 6.
 - (2) If no, proceed to Step 4(a).
 - b) If no, proceed to Step 4.
- 4) **Payment Reduction when the P&I Target is attained.** Does the borrower state that they need a payment reduction to afford their mortgage?
- a) If yes, evaluate for an **Up-to 40-Year Modification**. Using the Capitalized UPB, solve for the minimum Modified Term (rounded up to the nearest whole month) at the Market Rate that results in a monthly P&I payment at or below the P&I Target. Is the Modified Term less than or equal to 480 months?
 - i) If yes, offer the modification with the Modified Term. If the TPP fails, proceed to Step 7.
 - ii) If no, proceed to Step 5.

¹⁶ The Market rate is defined as a rate not greater than the Freddie Mac Primary Mortgage Market Survey (PMMS) rate rounded to the nearest 0.125%, plus 0.25% for 30-year modifications and plus 0.50% for modifications with a term longer than 30 years. As in the FHA home retention waterfall, an outstanding VA PC should not be capitalized into the UPB of the modified loan.

- 5) **Payment Reduction when the P&I Target cannot be attained.** Determine the home retention solution that creates the **Lowest Monthly Payment**. Does the borrower have PC eligibility?
 - a) If yes, are Available PC Funds greater than or equal to Arrearages?
 - (1) If yes, offer the Standalone PC or 40-Year Modification, whichever creates the lower monthly P&I payment. If the TPP fails, proceed to Step 7.
 - (2) If no, offer the 40-Year Modification. If the TPP fails, proceed to Step 7.
 - b) If no, offer the 40-Year Modification. If the TPP fails, proceed to Step 7.

- 6) **Payment Resumption TPP Failures and Standalone PC Redefaults.** Evaluate for an **Up-to 40-Year Modification**. Add arrearages to the UPB at Default to reach the Capitalized UPB and set the P&I Target to 75% of the Existing P&I Payment. Solve for the minimum Modified Term (rounded up to the nearest whole month) at the Market Rate that results in a monthly P&I payment at or below the P&I Target. Is the Modified Term less than or equal to 480 months?
 - a) If yes, offer the modification with the Modified Term. If the TPP fails, proceed to Step 7.
 - b) If no, does a 40-Year Modification result in a monthly P&I payment that is at least \$1 lower than the Existing P&I Payment?
 - i) If yes, offer the 40-Year Modification. If the TPP fails, proceed to Step 7.
 - ii) If no, proceed to Step 7.

- 7) Initiate a request with VA for a **Traditional VA Purchase** evaluation, if applicable. If inapplicable, evaluate the loan for **Disposition**.

The home retention waterfall above has been structured to match the FHA home retention waterfall wherever possible. Therefore, based on the evidence presented in [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#), we conclude that VA's home retention solutions will generate loan reperformance for a significant percentage of treated loans and therefore will, on average, be less costly to VA than moving directly to disposition. Moreover, as described below, the recommended waterfall will automatically adjust across economic cycles and interest rate environments to dynamically manage the cost of the program by reducing dispositions.

A home retention solution can generate costs for VA from three sources: first, if the solution uses a PC, VA must finance the deferred amount, paying interest at roughly the rate on U.S. Treasuries on the PC balance until the loan pays off and the PC is repaid. Second, should the loan redefault and move to disposition, VA will pay a claim when disposition proceeds from selling the house are less than the total debt, including any PC. Third, VA may make an

incentive payment to mortgage servicers for completed home retention actions.¹⁷ Therefore, the cost of each home retention solution utilized in the waterfall above will depend on whether the PC is used, the expected redefault and disposition rate, and any incentive payment made.

Lump-sum repayments and repayment plans do not use the PC and therefore are positioned first in the waterfall. As long as the expected redefault rates for these two solutions are consistent with redefault rates for the Standalone PC, these two alternatives will be the least costly for VA. As such, VA should take care to limit eligibility for these two solutions to loans with a reasonable number of missed payments to mitigate the risk that the lump-sum outlay or temporary increase in monthly payments leads to high redefault rates.¹⁸

Next, the remaining borrowers are categorized according to what they state they can afford to pay on their mortgage: those who have overcome a temporary hardship and state that they can afford to resume their original monthly payment are categorized as **payment resumption loans** and are resolved in Step 3. Those borrowers who are experiencing an ongoing hardship and state they need a payment reduction to afford their mortgage are categorized as **payment reduction loans** and are resolved in Step 4.

In Step 3, payment resumption loans are offered a 30-Year Modification if it can reduce their monthly payment by at least \$1, because under these circumstances this modification is less costly to VA than a Standalone PC. The modification uses no PC funds and, because it produces a lower monthly payment than a Standalone PC, has lower expected redefault and disposition rates than a Standalone PC. In contrast, if the 30-Year Modification increases the monthly payment, which is the case for the average SDQ VA loan today, it will have higher expected redefault and disposition rates and therefore be more costly than the Standalone PC. Therefore, when the 30-Year Modification cannot generate at least \$1 of payment reduction, the more cost-effective Standalone PC will be offered.¹⁹

We include the 30-Year Modification in Step 3 so that, should mortgage rates fall and make modifications less costly than Standalone PCs, the waterfall will automatically adjust to offer modifications in lieu of the Standalone PC, reducing the cost of the VA home retention program. Even today, some payment resumption loans with high note rates (e.g., above 7.40%) will be offered 30-Year Modifications that produce a reduction in P&I payment and therefore are less

¹⁷ VA makes incentive payments of up to \$700 to mortgage servicers for completed home retention actions. The payment amounts vary by servicer tier and home retention solution. See [eCFR :: 38 CFR 36.4319 -- Servicer loss-mitigation options and incentives](#).

¹⁸ Repayment plans result in a temporary increase in total monthly payment, equal to number of missed payments / repayment plan length. In terms of the monthly P&I payment, the increase equals the number of missed payments / repayment plan length / (P&I / PITI). For the maximum missed payments (12) and maximum length (24 months), our proposal would result in a 50% increase in PITI and a 70% increase relative to P&I (assuming T&I = 40% of P&I).

¹⁹ Our recommended resolutions for payment resumption loans match the FHA home retention waterfall. For a discussion of how the FHA waterfall automatically adjusts as interest rates change to provide cost-effective home retention solutions, see [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#), Appendix Section A2. While the Standalone PC will increase VA's exposure beyond the original 25% guarantee, for the average SDQ VA payment resumption loan, the Standalone PC has a lower expected cost to VA than a modification because the Standalone PC would result in a significantly lower redefault rate.

costly to VA than Standalone PCs. Moreover, using the modification when it is less costly for VA than the Standalone PC preserves the PC, which is limited to one per loan, for a future default episode.

Payment reduction loans are addressed in Step 4. For SDQ borrowers who are facing an ongoing hardship, research has shown that reperformance will depend crucially on the amount of payment reduction delivered by the home retention solution.²⁰ Therefore, the target payment is set to produce a 25% reduction in monthly P&I payment. Including taxes and insurance, this equates to an estimated 18% reduction in total monthly payment. Borrowers are offered an Up-to 40-Year Modification if it reaches the target payment.

The Up-to 40-Year Modification is modelled after the GSEs' Flex Mod, which provides term extension in the amount necessary to meet the target payment.²¹ We recommend limiting term extension in Step 4 to the amount necessary to reach the target payment because VA does not have as many tools to generate payment reduction as compared to FHA (e.g., FHA's Combination Modification and PC and Payment Supplement).²² Moreover, payment reduction beyond 30% of P&I has not been shown to provide a material reduction in redefault rates.²³ By holding some term extension in reserve when the target payment can be reached without it, VA can ensure that the remaining term extension will be available should the borrower face a future hardship and redefault. This reserve can then be used in the future to generate loan reperformance, keep the VA borrower in their home, and avoid the high cost of disposition.²⁴

If the target payment cannot be attained, in Step 5 borrowers are offered whichever home retention solution produces the lowest monthly payment, a 40-Year Modification or Standalone PC, which would only become effective after the borrower successfully completes a 3-month TPP. We recommend offering the home retention solution that produces the lowest monthly payment because it will provide the VA borrower with the best opportunity to retain their home and reduce dispositions. With the mortgage rate at 6.19%, the average SDQ VA loan today would receive a 20% P&I increase from a 40-Year Modification, and therefore in this step would be offered a Standalone PC, if eligible.²⁵ Should mortgage rates fall such that a 40-Year Modification produces a lower monthly payment than a Standalone PC, the waterfall will automatically adjust to offer the more cost-effective 40-Year Modification. In addition, some loans with high note rates (e.g., above 6.90%) will be offered 40-Year Modifications that provide payment reduction and are therefore less costly to VA than a Standalone PC.

²⁰ As discussed in [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#), Appendix Section A5.

²¹ Source: [Processing a Fannie Mae Flex Modification | Fannie Mae](#).

²² Source: [Tightening and Expediting Implementation of the New Permanent Loss Mitigation Options](#).

²³ As discussed in [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#), Appendix Section A5.

²⁴ See [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#), pages 36 – 38 for a discussion of the importance of preserving term extension and PC capacity.

²⁵ Source: [Mortgage Rates - Freddie Mac](#) as of December 4, 2025.

Step 6 is used for payment resumption loans that fail a TPP and for loans that are resolved with a Standalone PC, complete the TPP, but then redefault within 24 months of the effective date of the Standalone PC. Both cases are described in more detail below.

The final home retention step in the waterfall is the Traditional VA Purchase, or tVAP, which is provided only at VA's discretion.²⁶ Since the details of each tVAP modification are bespoke, we cannot model the cost of tVAP to VA. Therefore, we place tVAP at the end of the waterfall and leave it to VA to determine when to consider loans for tVAP. The waterfall terminates at disposition.

TPP Failures

A home retention solution does not become permanent until the borrower has demonstrated that the intervention resulted in an affordable payment by successfully completing a 3-month TPP and returned the signed final agreement.

Accordingly, the recommended VA waterfall permits payment resumption loans that are resolved with a 30-year Modification or a Standalone PC but fail the ensuing TPP, thus demonstrating the need for payment reduction, to be reclassified as payment reduction loans. Loans that fail a TPP in Step 3 are re-evaluated in Step 6 and offered a modification **only if it can provide a lower monthly payment**. If so, the modification is likely to generate loan reperformance for many of these loans and thereby avoid dispositions and the associated claim on the VA guaranty fund.

For payment reduction loans that fail a TPP in Step 4 or Step 5, there are no further solutions that can generate loan reperformance, and, unless the borrower can bring the loan current through other means, these loans are moved on to disposition.

A modification offer followed by a failed TPP does not count against the one modification in a 24-month period limit because it never became permanent. Similarly, a Standalone PC followed by a failed TPP would not constitute a use of the PC.

Redefaults within 24 Months

As recommended above, VA should permit no more than one modification every 24 months. However, because the PC is limited to one per loan by statute, the Standalone PC should not count against the 1-in-24-month limit for modifications. Exempting the Standalone PC from the 1-in-24 restriction provides VA with additional flexibility for resolving loans that successfully complete a TPP but then redefault within 24 months.

²⁶ As described in [VA Manual M26-4 Chapter 9 VA Purchase](#). We assume mortgage servicers will not be delegated authority to approve borrowers for tVAP.

Some payment resumption borrowers who complete the TPP successfully may subsequently find that they have overestimated their ability to resume making their original monthly P&I payment and redefault before 24 months have elapsed. Despite completing the TPP, these loans were likely misclassified as payment resumption loans and are instead payment reduction loans. Similarly, some payment reduction borrowers will successfully complete a TPP but redefault before 24 months have elapsed. For these loans, in the specific instances described below, providing a second home retention solution will be less costly to VA than moving directly to disposition, without raising the risk of moral hazard.

There are two cases in which VA can apply a second home retention solution to resolve redefaults that occur within the 24-month window. In the first case, payment resumption and payment reduction loans that were resolved with a Standalone PC but redefault within 24 months can receive a modification by re-entering the waterfall at Step 6, but **only if the modification can result in a lower monthly P&I payment and the loan has not been modified in the past 24 months.**²⁷ For many of these loans, the lower monthly payment provided by the modification will be sufficient to generate loan reperformance, and therefore the expected cost of providing the modification will be less than the expected cost of disposition, just as is the case for FHA.²⁸

In the second case, loans that were resolved with a modification but redefault within 24 months can receive a Standalone PC, if eligible, by re-entering the waterfall at Step 3(a)(iii).²⁹ In this instance, providing the Standalone PC as a second home retention solution would restore the modified and reduced payment, give the borrower another chance to re-perform on their mortgage, and, when successful, reduce dispositions and the associated claims on the VA guaranty fund.

Because the PC is limited by statute to one per loan, using the PC after a post-modification redefault and using a modification after a post-PC redefault would only have a marginal impact, if any, on the risk of serial use of home retention solutions. In both cases, the borrower would have no opportunity to receive a second PC and would not be eligible to receive an additional modification if they encounter a subsequent hardship until 24 months have elapsed.

Additional Policy Consideration

VA should adjust their policy to ensure that an outstanding PC does not preclude a VA borrower from completing an Interest Rate Reduction Refinance Loan (IRRRL). Completion of an IRRRL reduces VA's risk because the resulting lower payment reduces the probability of future defaults

²⁷ For payment reduction loans, the monthly P&I payment would only be reduced if mortgage rates have fallen in the months between the Standalone PC effective date and the redefault date.

²⁸ See the discussion on the expected cost of resolving SDQ loans in [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#) Appendix Section A2.

²⁹ In the second case, loans that have already used a Standalone PC or where arrearages exceed available PC funds will move through the remaining steps in the waterfall and, because 24 months have not elapsed since the last modification effective date, will be ineligible for a modification and move to disposition.

that may result in a claim on the VA guaranty fund. Therefore, VA should make clear that a borrower need not repay an outstanding PC in order to complete an IRRRL.

If the VA PC is implemented as a subordinate lien, then, upon completion of the IRRRL, any outstanding PC should be resubordinated to the new mortgage.³⁰

If the VA PC is implemented as a first lien, servicer advance structure, VA should specify that a servicer advance can remain outstanding as long as the IRRRL is completed with the incumbent mortgage servicer. If the IRRRL is to be completed with a lender that is different from the incumbent servicer, the borrower should be required to repay the PC first, since it would be too difficult in practice to transfer the deferred balance between two servicers.

Conclusion

VA has an economic incentive to create an effective home retention program that generates loan reperformance and avoids the need to absorb the high costs of dispositions. To do so, we urge VA to consider our recommendations—establish a VA loss mitigation program that is aligned with the proven programs for other government-backed mortgages; structure the PC as a servicer advance secured by the first mortgage; and develop a VA home retention waterfall that prescribes the steps servicers must take to reduce dispositions in a cost-effective manner for VA.

To be sure, foreclosure is still necessary when a home is abandoned, or a delinquent borrower fails to engage with his or her servicer or faces a deterioration in financial circumstances beyond what can be addressed by home retention. But the central lesson is clear: just as the GSEs and FHA do, by reducing the risk of disposition through a well-designed home retention program, VA can save a considerable sum of money.

³⁰ This approach would match FHA's Streamline Refinance program, which permits PCs to be resubordinated to the new loan. Source: [FHA Single Family Housing Policy Handbook](#).

Appendix

In this Appendix, in Section A1 we provide our calculation for the estimate of the cost to VA of the average loan disposition. In Section A2 we illustrate how permitting deferred principal as part of a modification would improve post-modification loan performance and reduce dispositions and the associated claims on the VA guaranty fund relative to a 40-Year Modification. In Section A3, we provide our recommended waterfall if it is permissible for PC funds to be applied to defer principal.

Section A1. Estimating the Cost to VA of a Loan Disposition

To estimate the cost to VA of the average loan disposition, we begin with the terms of the average SDQ VA loan: originated three years ago, the loan has a note rate of 4.80%, an original loan balance of \$295,000, a monthly P&I payment of \$1,548 and a monthly T&I payment of \$604.³¹ Then, beginning 24 months after origination, we assume the borrower missed 12 consecutive payments, which create arrearages of \$25,824. The UPB at default is \$286,159.

We assume total loss severity on VA dispositions of 30%, which is slightly higher than the historical loss severity on GSE dispositions, which has averaged 28% over the last six years, but below the historical loss severity on FHA dispositions, which has average 38% over the same period.³² Note that this is not VA's loss severity, which will be capped at the VA guaranteed amount, but rather the total loss severity for the average VA loan that goes to disposition. Our 30% total loss severity figure is likely to be a conservative assumption given that VA loans are originated with LTVs similar to the LTVs on FHA loans and considerably lower than the LTVs on GSE loans.

VA's guaranteed amount is calculated as:

$$(1) \text{ VA Guaranteed Amount} = 25\% \times \text{Lesser of (Original Loan Balance, Total Debt Outstanding at Default)}$$

where

$$(2) \text{ Total Debt Outstanding at Default} = \text{UPB at Default} + \text{Arrearages}$$

For the average SDQ VA loan, the original loan balance (\$295,000) is less than the total debt outstanding at default (\$311,983), so VA's guaranteed amount is 25% of \$295,000 or \$73,750. VA's loss at disposition is then calculated as:

³¹ Loan data is sourced from Recursion, as of September 2025. T&I as a percentage of P&I is sourced from page six of [ICE Mortgage Monitor - October 2024](#).

³² Source: [Quantifying the Savings from the GSEs' Home Retention Programs \(HPC, July 2025\)](#) and [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#).

(3) VA Loss at Disposition = Lesser of (VA Guaranteed Amount, UPB at Default x Loss Severity)

The guaranteed amount (\$73,750) is smaller than the product of UPB at default and loss severity (\$85,848), so for the average SDQ VA loan, VA's loss at disposition is equivalent to the guaranteed amount, \$73,750. In this example, the mortgage servicer must absorb the remaining \$12,098 at disposition.

Section A2. Quantifying the Impact of Principal Deferral on Modification Performance

The HLPRA specifies "a holder of a loan guaranteed under such chapter for which the Secretary makes a partial claim under this section shall apply the amount paid by the Secretary for the partial claim first to arrearages, if any, on the guaranteed loan." The word "first" implies that there can be a second use of PC funds after arrearages have been covered, and it is possible that VA may interpret this language to permit a second use of PC funds to defer principal. If this is the case, VA should use the PC to defer principal when necessary to generate loan reperformance, thereby reducing dispositions and the associated claims.

For SDQ borrowers who are facing an ongoing hardship and require a reduction in their monthly payment to make their loan affordable, research has shown that reperformance will depend crucially on the amount of payment reduction delivered by the home retention solution.³³ In the current environment, with the prevailing mortgage rate (6.19%) well above the note rate on the average SDQ VA loan (4.80%), VA modifications will result in **higher** rather than lower monthly payments for most SDQ VA loans, with high rates of redefault and disposition.

Today, even for a loan with the note rate equal to the prevailing mortgage rate, VA modifications are an ineffective assistance measure for borrowers facing an ongoing hardship. For example, consider a loan with the following terms: originated three years ago, the loan has a note rate of 6.30%, an original loan balance of \$295,000, a monthly P&I payment of \$1,826 and a monthly T&I payment of \$712.³⁴ Then, 24 months after origination, the borrower misses 6 consecutive payments, which create arrearages of \$15,228. The UPB at default is \$288,242.

To complete a 40-year Modification, first arrearages would be capitalized, creating a UPB of \$303,470. The term would be extended to 40 years, and the modified interest rate would be set to PMMS rounded to the nearest 0.125% plus 0.50%, which works out to 6.75%. The modified P&I payment would be \$1,820 per month, about the same as the existing P&I payment. My analysis suggests that an unchanged payment for a payment reduction loan would lead to a 65% redefault rate and a 39% disposition rate.³⁵

³³ As described in [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#), Appendix Section A5.

³⁴ T&I as a percentage of P&I is sourced from page six of [ICE Mortgage Monitor - October 2024](#).

³⁵ See Appendix Section A5 of [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#).

To complete a Combination 40-Year Modification and PC with deferred principal, the initial steps are the same as above: arrearages are capitalized, creating the same UPB of \$303,470, the term is extended to 40 years, and the modified interest rate is set to 6.75%. In this case, however, the servicer would solve for the interest-bearing UPB that reaches the 25% P&I reduction target, which is a UPB of \$226,976. Assuming the PC for this loan is limited to 25% of UPB at default, the available PC capacity would be \$72,060, which means the interest-bearing UPB could be no less than the capitalized UPB minus the remaining PC amount, or \$229,534. All of the remaining PC capacity, \$72,060, would be used to defer principal, resulting in a P&I payment of \$1,385, a 24% reduction. In this example, while there is not quite enough PC capacity to reach the 25% P&I reduction target, the P&I reduction is still substantial and substantially better than the 40-Year Modification.

In fact, my analysis suggests that the 24% P&I reduction from the Combination 40-Year Modification and PC applied to payment reduction loans would lead to a 43% redefault rate and a 26% disposition rate.³⁶ Therefore, permitting PC funds to be used to defer principal for this loan would lead to a significant 33% drop in the expected disposition rate, from 39% for the 40-year modification to 26% for the Combination 40-Year Modification and PC. We conclude, then, that permitting PC funds to be used to defer principal will lead to better post-modification reperformance and fewer disposition-related claims that must be paid by VA compared to a 40-Year Modification alone.

It is important to note that, while deferring principal comes at a cost to VA, the expected cost of a 40-Year Combination Modification and PC would be substantially lower than the expected cost of disposition unless mortgage rates move significantly higher. Moreover, the waterfall we recommend will automatically adjust based on the relationship between the prevailing mortgage rate and loan note rates to offer the home retention solution that generates loan reperformance while preserving the cost advantage of the program over dispositions. For example, just as is the case with the FHA waterfall, should mortgage rates fall, the VA waterfall will automatically adjust to offer more modifications because they can reach the target payment and, in this scenario, are more cost-effective than a Standalone PC or a 40-Year Combination Modification and PC.³⁷

Section A3. Recommended Waterfall with Deferred Principal

Our recommended waterfall assumes that the PC funds cannot be applied to defer principal. If PC funds can be applied to defer principal, VA should follow the waterfall below.

- 1) **Lump-Sum Repayment:** Does the borrower state that they can repay their arrearages in a lump-sum payment?

³⁶ Ibid.

³⁷ This dynamic is described in detail in [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#), Finding 3 and Appendix Sections A2 and A3.

- a) If yes, accept lump-sum payment to bring loan current.
 - b) If no, proceed to Step 2.
- 2) **Repayment Plan:** Has the borrower missed 12 or fewer payments and does the borrower state that they can afford a higher monthly payment for a period of time?
- a) If yes to both, offer a repayment plan no shorter than 3 months and no longer than 24 months.
 - b) If no, proceed to Step 3.
- 3) **Payment Resumption:** Does the borrower state that they can resume making their original monthly payment after the arrearages are resolved?
- a) If yes, evaluate for a **30-Year Modification**. After adding arrearages to the UPB at Default to reach the Capitalized UPB, does a 30-Year loan at the Market Rate produce a monthly P&I payment at least \$1 lower than the Existing P&I Payment?³⁸
 - i) If yes, offer the 30-Year Modification. If the TPP fails, proceed to Step 6.
 - ii) If no, does the borrower have PC eligibility?
 - (1) If yes, proceed to Step 3(a)(iii).
 - (2) If no, proceed to Step 4(a).
 - iii) Evaluate for a **Standalone PC:** Are Available PC Funds greater than or equal to Arrearages?
 - (1) If yes, offer a Standalone PC. If the TPP fails, proceed to Step 6.
 - (2) If no, proceed to Step 4(a).
 - b) If no, proceed to Step 4.
- 4) **Payment Reduction when the P&I Target is attained.** Does the borrower state that they need a payment reduction to afford their mortgage?
- a) If yes, evaluate for an **Up-to 40-Year Modification**. Using the Capitalized UPB, solve for the minimum Modified Term (rounded up to the nearest whole month) at the Market Rate that results in a monthly P&I payment at or below the P&I Target. Is the Modified Term less than or equal to 480 months?
 - i) If yes, offer the modification with the Modified Term. If the TPP fails, proceed to Step 7.
 - ii) If no, does the borrower have PC eligibility?
 - (1) If yes, proceed to Step 4(b).
 - (2) If no, proceed to Step 5(b).

³⁸ The Market rate is defined as a rate not greater than the Freddie Mac Primary Mortgage Market Survey (PMMS) rate rounded to the nearest 0.125%, plus 0.25% for 30-year modifications and plus 0.50% for modifications with a term longer than 30 years.

- b) Evaluate for a **Combination 40-Year Modification and PC**: Solve for the Target Loan Balance that, with a 40-year term at the Market Rate, results in a monthly P&I payment that matches the P&I Target. Is the loan's Available PC Capacity greater than or equal to the Capitalized UPB minus the Target Loan Balance?
 - i) If yes, offer the 40-year modification at the Market Rate with the Target Loan Balance and a PC in the amount of Capitalized UPB minus the Target Loan Balance. If the TPP fails, proceed to Step 7.
 - ii) If no, proceed to Step 5.
- 5) **Payment Reduction when the P&I Target cannot be attained.** Determine the home retention solution that creates the **Lowest Monthly Payment**. Does the borrower have PC eligibility?
- a) If yes, does a Combination 40-Year Modification and PC, where Deferred Principal is equal to Available PC Capacity, produce a monthly P&I payment that is less than or equal to 90% of the Existing P&I Payment?
 - i) If yes, offer the Combination 40-Year Modification and PC. If the TPP fails, proceed to Step 7.
 - ii) If no, are Available PC Funds greater than or equal to Arrearages?
 - (1) If yes, offer the Standalone PC or 40-Year Modification, whichever creates the lower monthly P&I payment. If the TPP fails, proceed to Step 7.
 - (2) If no, offer the Combination 40-Year Modification and PC, where Deferred Principal is equal to Available PC Capacity. If the TPP fails, proceed to Step 7.
 - b) If no, offer the 40-Year Modification. If the TPP fails, proceed to Step 7.
- 6) **Payment Resumption TPP Failures and Standalone PC Redefaults.** Add arrearages to the UPB at Default to reach the Capitalized UPB and set the P&I Target to 75% of the Existing P&I Payment.
- a) Evaluate for an **Up-to 40-Year Modification**. Solve for the minimum Modified Term (rounded up to the nearest whole month) at the Market Rate that results in a monthly P&I payment at or below the P&I Target. Is the Modified Term less than or equal to 480 months?
 - i) If yes, offer the modification with the Modified Term. If the TPP fails, proceed to Step 7.
 - ii) If no, does the borrower have PC eligibility?
 - (1) If no, proceed to Step 6(b)
 - (2) If yes, proceed to Step 6(c).
 - b) Does a 40-Year Modification result in a monthly P&I payment that is at least \$1 lower than the Existing P&I Payment?
 - i) If yes, offer the 40-Year Modification. If the TPP fails, proceed to Step 7.
 - ii) If no, proceed to Step 7.

- c) Evaluate for a **Combination 40-Year Modification and PC**: Solve for the Target Loan Balance that, with a 40-year term at the Market Rate, results in a monthly P&I payment that matches the P&I Target. Is the loan's Available PC Capacity greater than or equal to the Capitalized UPB minus the Target Loan Balance?
 - i) If yes, offer the 40-year modification at the Market Rate with the Target Loan Balance and a PC in the amount of Capitalized UPB minus the Target Loan Balance. If the TPP fails, proceed to Step 7.
 - ii) If no, proceed to Step 6(d).
 - d) Does a Combination 40-Year Modification and PC, where Deferred Principal is equal to Available PC Capacity, result in a monthly P&I payment that is at least \$1 lower than the Existing P&I Payment?
 - i) If yes, offer the Combination 40-Year Modification and PC. If the TPP fails, proceed to Step 7.
 - ii) If no, proceed to Step 7.
- 7) Initiate a request with VA for a **Traditional VA Purchase** evaluation, if applicable. If inapplicable, evaluate the loan for **Disposition**.

In the revised waterfall, if the Up-to 40-Year Modification cannot reach the target payment, the borrower is offered a Combination 40-year Modification and PC if it can reach the target payment. This modification appears after the 40-Year Modification because it is the costliest home retention solution due to its use of PC funds to defer principal.³⁹

It is important to note that, in Step 5, a Combination Modification and PC will exhaust any remaining PC funds. Therefore, this solution is only offered in two instances. First, the combination modification should be offered if it can reduce the monthly P&I payment by at least 10%. Research suggests that, for payment reduction loans, reducing the monthly payment by less than 10% does little to improve loan reperformance relative to an unchanged payment.⁴⁰ Therefore, the Combination Modification and PC solution should only be used if it provides a meaningful reduction in monthly P&I payment and therefore is likely to lead to better loan reperformance compared to other available solutions.

Second, the combination modification should be offered if there are insufficient PC funds available for a Standalone PC. Otherwise, if available PC funds exceed arrearages, a Standalone PC will generate about the same monthly payment while leaving some PC funds available in the event of a future default episode, and therefore will be the more cost-effective solution for VA.

³⁹ Our recommended resolutions for payment reduction loans is aligned with the FHA home retention waterfall and the costs of the FHA alternatives are quantified in [Quantifying the Savings from FHA's Home Retention Programs \(HPC, September 2025\)](#).

⁴⁰ See Figure 8 in [Assessing the effectiveness of payment reduction on preventing borrower re-default for mortgages](#).