August 1, 2011

The Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
250 E Street, SW
Washington DC 20219

RE: Credit Risk Retention—RIN 3064-AD74

Dear Acting Chairman Gruenberg:

On behalf of Community Associations Institute (CAI),[1] I am pleased to submit the following comments on the jointly proposed regulation implementing Section 941 of the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd Frank).

Introduction

CAI's members believe the proposed joint regulation—in particular, the definition of qualified residential mortgage (QRM)—will profoundly impact how Americans approach homeownership as well as the vitality of the communities they call home. As the nationwide advocate for community associations, CAI believes the QRM definition must take into account the millions of families who have chosen to make a community association their home. [2]

[1] CAI is the only national organization dedicated to fostering competent, well-governed community associations that are home to approximately one in every five American households. For nearly 40 years, CAI has been the leader in providing education and resources to the volunteer homeowners who govern community associations and the professionals who support them. CAI's 30,000 members include community association volunteer leaders, professional managers, community management firms, and other professionals and companies that provide products and services to community associations.

[2] All community associations have three defining characteristics: (1) membership is mandatory and automatic for all owners; (2) certain documents bind all owners to be governed by the community association; and (3) mandatory lien-based assessments are levied on each owner in order to operate and maintain the community association. There are three basic types of community associations: condominiums, cooperatives and planned communities.

6402 Arlington Blvd.
Suite 500
Falls Church, VA 22042

888.224.4321
www.caionline.org

A QRM definition that implements congressional intent will protect consumers from predatory mortgage products and offer long-term stability to the housing finance system by ensuring that mortgage loans are prudently underwritten. Alternatively, a QRM definition that is unnecessarily restrictive will prevent well-qualified consumers from achieving homeownership, limiting the very economic freedom Congress intended to promote by creating the QRM exemption from the credit risk retention requirements of Dodd Frank Section 941.

In prior correspondence, CAI urged all Agencies crafting the QRM standard to recognize the presence of community associations in the nation's housing stock.[3] CAI believes the Agencies have a duty to respect the decision of homeowners to choose the community association housing model and to ensure equal access to mortgage credit for these consumers. With this understanding, and on behalf of CAI's members, I respectfully offer the following comments and recommendations to the joint Agency proposal implementing Dodd Frank Section 941.

Risk Retention Exemption for the GSEs

The Agencies propose to exempt the Government Sponsored Enterprises (GSEs)—Fannie Mae and Freddie Mac—from the credit risk retention requirements of Section 941 while the enterprises operate under a Federal Housing Finance Agency (FHFA) ordered conservatorship or receivership and rely on capital infusions from the United States. The Agencies further propose an exemption from the credit risk retention requirements for any limited-life entity succeeding to the charter of a GSE. The Agencies request comment on the appropriateness of the proposed exemption and if prohibitions on hedging activities by the GSEs should be should be considered.

CAI Supports Proposed GSE Exemption

In general, CAI supports the Agencies' decision to exempt mortgages purchased by the GSEs and mortgage backed securities (MBS) issued by the enterprises from the credit risk retention requirements of Section 941 while operating under FHFA-ordered conservatorship or receivership with capital support from the United States. CAI also supports the Agencies' proposal to extend this exemption to any limited-life entity succeeding to a GSE charter that operates under similar circumstances.

The GSEs currently provide critical support to our nation's distressed housing finance system, purchasing and guaranteeing a substantial majority of mortgages nationwide.[4] Absent this

[3] Appendix A—CAI letter to Agencies concerning QRM definition dated December 16, 2010.

[4] Federal Housing Finance Agency: Conservator's Report on the Enterprises' Financial Performance, First Quarter 2011, Figure 1.2 shows the GSEs and Ginnie Mae account for a combined 97 percent of MBS issued in the United States in Q1 of 2011.

support, mortgage credit would not be widely available and further damage would be visited on the housing market. The Agencies' proposed exemption of the GSEs from credit risk retention requirements will ensure a liquid secondary market as private capital is not currently available to perform this vital function.

CAI Supports Hedging Exemption for GSEs

The Agencies request comment on the appropriateness of the proposed exemption for GSE purchases of pool insurance as a hedge against losses. In general, CAI supports prudential actions by the Agencies to preserve the ability of the GSEs to provide support to the housing finance system. Pool insurance will protect the GSEs from incurring further losses or dilution of available resources.

The Senior Preferred Stock Purchase Agreement executed in September 2008 between the United States and the GSEs requires that the GSEs pay a quarterly 10 percent dividend to the U.S. Treasury. Cumulatively, Fannie Mae and Freddie Mac have remitted dividend payments of approximately $24 billion to the Treasury since this time.[5] The GSEs are now also subject to a commitment fee paid to the United States under the terms of the Agreement. While these encumbrances ensure the American people receive some return on the capital invested in the GSEs, these restrictions have increased the reliance of the enterprises on public capital.

Further encumbering the GSEs through a prohibition on the purchase of pool insurance that protects the GSEs (and by extension U.S. taxpayers) from losses is unnecessary and runs counter to the government's interest. Preventing the GSEs from employing an appropriate risk management strategy will force the enterprises to use additional government capital to account for those risks rather than to support the housing finance system. Accordingly, CAI supports the Agencies' broad exemption from credit risk retention requirements for Fannie Mae and Freddie Mac.

Impact of Risk Retention on Availability of Credit as GSE Operations are Curtailed

CAI views the Agencies' proposed exemption for GSE mortgage purchase and securitization activities primarily as a means to offer continued government support for the housing finance system. CAI believes this support is necessary and appropriate. This view notwithstanding, CAI shares the broad consensus that the GSEs must be reformed and that the status quo is unsustainable. Already the Administration and FHFA have announced a series of independent measures designed to reduce the enterprises' market share. Various legislative proposals on GSE

[5] Federal Housing Finance Agency: Conservator's Report on the Enterprises' Financial Performance, First Quarter 2011, Figure 3.1.

reform have received consideration in the U.S. House of Representatives, while the U.S. Senate Committee on Banking, Housing, and Urban Affairs has held hearings on the future of housing finance.

As the housing finance system adjusts to structural reforms, careful consideration must be given to the ability of the system to sustain change emanating from such multiple actors. A hasty withdrawal of federal support for the housing finance system, coupled with increased capital requirements and higher costs of funding for mortgage originators, could impede the flow of capital to the housing finance system. To avoid this outcome, CAI urges the Agencies to consider the impact of the proposed QRM definition on the housing finance system post GSE reform.

The effect of extending the government agency exemption to the GSEs is, in essence, to exempt a very large percentage of mortgage loans (at the moment, 97 percent) from credit risk retention requirements. Given the dearth of private capital currently deployed in the housing finance system, a narrow QRM standard will ensure government agencies continue to dominate the secondary market. A broad QRM standard and a methodical, predictable withdrawal of the GSEs from the market are both required if the housing finance system is to transition to from reliance on public capital to private capital. Failure by the Agencies to contemplate the combined effect of a narrow QRM exemption and a precipitous winding down of the GSEs will harm the economy and lead to a credit crunch in housing markets.

Overall Approach to Defining QRM

The Agencies have requested comment on the overall approach taken to define the QRM standard. Specifically, the Agencies have inquired about (1) the appropriateness of the approach taken by the Agencies; (2) the impact of the proposed QRM standard on securitization of QRM and non-QRM loans; (3) the impact the proposed QRM standard will have on low-to-moderate income borrowers; and (4) ways the Agencies could clarify the QRM standards to reduce uncertainty as to whether a residential mortgage loan qualifies as a QRM at origination.

General Approach to QRM Definition

Dodd Frank Section 941 directs the agencies to take "… into consideration underwriting and product features that historical loan performance data indicate result in a ***lower*** risk of default…"[6] The statute further provides that the QRM definition may not be "broader than the

[6] 15 USC § 78o-11(e)(4)(B)—*Emphasis added.*

definition 'qualified mortgage' as the term is defined under section 129C(c)(2) of the Truth in Lending Act. …"[7]

In crafting the proposed QRM definition, the Agencies view the QRM exemption as a complement to the general credit risk retention requirements of Dodd Frank Section 941. The Agencies describe this approach in the proposed rule, writing that "The sponsor of an ABS that is collateralized solely by QRMs is completely exempt from the risk retention requirement…This requirement suggests that the underwriting standards and product features for QRMs should help ensure that such residential mortgages are of very high credit quality."[8]

The Agencies further note that by statute the QRM definition may not be broader than the definition of "qualified mortgage" (QM) and propose to incorporate statutory QM requirements in the QRM standard. The Agencies write that "The proposed approach also helps reinforce the goal of ensuring that QRMs are of very high credit quality."[9]

In taking this approach, the Agencies are seeking to use the QRM exemption as a tool to ensure the broadest application of the credit risk retention requirement. The Agencies note that viewing the QRM exemption in this context will have a material impact on many borrowers, writing that "… many prudently underwritten residential mortgage loans will not meet the proposed definition of a QRM."[10]

CAI's members believe the Agencies have taken too narrow a view of the QRM exemption from credit risk retention requirements, proposing a QRM definition that is beyond the intent of Congress. CAI does not believe Congress intended the QRM exemption to force well-qualified borrowers to pay higher mortgage costs. If this were the case, Congress would not have created the QRM exemption.

Understanding that credit risk retention requirements would increase the cost of credit, Congress created the exemption for residential mortgage loans to avoid this consequence of risk retention. During debate on Senate Amendment 3956 to S. 3173, Senator Johnny Isakson stated:

> *The committee did a great job to ensure subprime loans would never be made again by requiring risk retention of 5 percent. The only problem is they have called it on all loans, which meant there would be no mortgage loans. You would*

[7] 15 USC § 78o-11(e)(4)(C).
[8] *Federal Register,* Vol. 76, No. 85: p. 24117.
[9] *Federal Register,* Vol. 76, No. 85: p. 24118.
[10] *Ibid.*

> *not have subprime, you would not have good loans because you cannot make it work with a 5-percent risk retention. As I have cautioned all my colleagues, in the 1980s when the savings and loan industry failed, they had 100 percent risk retention. Risk retention is not the cure-all to good lending; underwriting is.*[11]

Additionally, Congress included a general exemption for agencies of the federal government that support mortgage lending and securitization. This exemption includes mortgages insured by the Federal Housing Administration (FHA) and securities issued by the Government National Mortgage Association (Ginnie Mae). FHA insured loans allow downpayments as low as 3 percent; allow closing costs to be financed; and are offered to borrowers that, in general, can represent a higher credit risk profile. If not for the explicit QRM exemption provided by Congress, FHA insured loans and Ginnie Mae securities would be subject to credit risk retention, significantly increasing costs for these borrowers. By statutorily designating FHA and Ginnie Mae activities as exempt from risk retention, Congress preserved access to credit for borrowers supported by these agencies.

The Agencies expanded Congress' policy by qualifying the activities of the GSEs for the general agency of the federal government exemption in Dodd Frank Section 941. According to data supplied by the Agencies, only 30 percent of mortgages purchased by the GSEs in 2009 (when credit standards were very high) would meet the proposed QRM definition. The percentage of QRM loans that would have qualified in prior non-financial crisis years approaches a mere 20 percent. [12] The statutory exemption for government-supported mortgage lending, as well as the Agencies' expansion of this exemption to the GSEs, is an explicit acknowledgement of the costs of risk retention and the benefits that will accrue to consumers able to obtain federally-supported mortgages.

It is doubtful Congress would have considered and adopted broad exemptions to the credit risk retention requirements, such as the QRM exemption and exemptions for FHA and Ginnie Mae activities, if the intent was to offer only limited relief from credit risk retention requirements. Further, it seems incongruous for the Agencies to ensure the GSEs qualify (even if only during a transitional period) for a blanket exemption from credit risk retention requirements while at the same time proposing to limit the QRM exemption for such a significant portion of well-qualified borrowers.

[11] *Congressional Record, Volume 156, No. 71: p. S3576.*
[12] *Federal Register,* Vol. 76, No. 83: p. 24141.

CAI urges the Agencies to reconsider the overall approach taken to defining the QRM exemption and redraft the exemption to expand the number of American consumers that will qualify for mortgages that meet the QRM definition. CAI believes this general approach is authorized in the statute, that the legislative history clearly shows this approach to be the intent of Congress, and that this approach will attract private capital to the mortgage markets.

Impact of Proposed QRM Definition on Securitization of QRM and non-QRM Loans
Data provided by the Federal Reserve show that mortgage securitizations by commercial banks or other private firms were valued at $724 billion in 2005; $723 billion in 2006; and $641 billion in 2007. The impact of the financial crisis on this market was substantial with non-GSE securitizations reduced from $641 billion in 2007 to $28.6 billion in 2008. While non-GSE securitizations have improved from 2008 levels, the market has yet to match pre-crisis securitization levels of 2005. [13]

Over the period of July 2010 to July 2011, the total approximate value of non-Agency MBS issued in the United States was $44.7 billion.[14] By contrast, Federal Reserve data show that securitization activity for similar loans in 2002 was valued at $213 billion and in 2003 at $296 billion.[15] This means the current rate of non-Agency mortgage securitizations is approximately 15 percent of 2002 levels.

The current rate of non-Agency mortgage securitization shows a very weak secondary market for private label mortgage backed securities, which would be the market for non-QRM securitizations. When the cost of risk retention is taken into consideration, non-QRM securitizations will be at a further cost disadvantage than current non-Agency securitizations. One estimate shows originators will require a surcharge of up to 100 basis points (bps) simply to account for the cost of risk retention. Additional charges are likely to be required to provide sufficient profit motive for lenders and securitizers to operate in this space.[16] Given these factors, CAI is not confident that non-QRM loans will be viewed by markets as good candidates for securitization.

The more likely scenario is that lenders will originate FHA loans or loans to be purchased by the GSEs to avoid the costs of risk retention. Not only will this likely scenario have an impact on non-QRM securitizations, non-Agency QRM securitizations are likely to languish as lenders

[13] *Report to Congress on Risk Retention*: Federal Reserve System, October 2010.
[14] Data obtained via Asset Backed Alert at http://www.abalert.com/market_statistics.php.
[15] *Report to Congress on Risk Retention*: Federal Reserve System, October 2010.
[16] Ken Fears: National Association of Realtors at http://link.brightcove.com/services/player/bcpid1465406675?bctid=973945347001.

seek to avoid risk retention through a greater reliance on federally-supported mortgages. This outcome is all the more probable if the Agencies fail to broaden the QRM definition.

This is not to say that CAI believes borrowers will be unable to obtain a non-QRM loan. The more probable scenario is that if a non-QRM loan market develops, the loans will be held in portfolio by the originator, subjecting mortgage activity to capacity and risk limitations of individual lenders and federal regulators. A reliance on portfolio lending will have significant impacts on consumers and the business decisions of lenders.

The cost—both monetary and regulatory—of managing a significant mortgage portfolio means that smaller lenders are not likely to have robust operations in the non-QRM market. According to the FDIC's Quarterly Banking Profile for 2011 Q1, the average cost of funding earning assets for FDIC-insured banks was 75 bps. When broken out by institution size, the spread in cost of funds for the first quarter of 2011 was as much as 109 bps for banks with $100 million to $1 billion in assets to as little as 68 bps for banks with more than $10 billion in assets.[17] This and other factors will make non-QRMs originated by smaller financial institutions more expensive and, therefore, less attractive to consumers, driving these borrowers to larger lenders as smaller financial institutions will be unable to overcome the cost of funds advantage enjoyed by larger financial institutions.

Larger nationwide lenders could perhaps manage a significant non-QRM portfolio given that certain economies of scale could work in their favor. However, CAI does not believe it would be prudent for the housing finance system to rely to such a great extent on a limited number of large, national lenders with substantial retained mortgage portfolios to support the non-QRM market. Concentrating mortgage lending activity in this manner would continue to expose the entire financial system to risks similar to those prompting the public rescue of Fannie Mae and Freddie Mac. A broader QRM standard would certainly prevent this occurrence and provide consumers with greater lender choice and more accurate pricing of credit.

Impact on Minority, Low-to-Moderate Income, and First Time Borrowers

CAI believes aspects of the proposed QRM definition will likely prevent minority and low-to-moderate income borrowers from becoming homeowners and significantly delay homeownership for most first-time homebuyers. The Agencies' proposed 20 percent downpayment requirement, coupled with a borrower's inability to finance closing costs, will dramatically increase the financial resources required to close a mortgage loan.

[17] FDIC Quarterly Banking Profile: First Quarter 2011—Commercial Bank Performance, Table III.A.

According to the Census Bureau's 2009 *American Housing Survey*, an overwhelming number of minority borrowers used a downpayment of less than 20 percent to purchase a home. In the case of African American borrowers, the percentage of lower downpayment purchases approaches 70 percent. Additionally, the survey reported that almost 78 percent of Hispanic borrowers obtained mortgages with downpayments less than 20 percent.[18] Based on this criterion alone, the Agencies' proposed QRM definition will push minority borrowers into higher cost mortgage loans or simply place homeownership out of reach for a substantial portion of this population.

The Agencies acknowledge that the proposed QRM standard will have a material impact on some borrowers. To illustrate this impact in more concise terms, CAI examined the impact of the proposed downpayment criterion on minority borrowers in the condominium market sector. The 2009 *American Housing Survey* showed that approximately 14 percent of existing owner-occupied condominiums are owned by African Americans or Hispanics. An additional 8 percent of condominiums in the survey were reported as owned by individuals living below the poverty line.[19] When combined, the maximum percentage of these populations owning a condominium reaches a potential 22 percent. Given the above downpayment and purchase data, a substantial number of these owners would have been denied homeownership if the proposed QRM definition were in effect.

To further explore the material effect of the Agencies' proposed QRM definition on low- to moderate-income borrowers, recent research shows that a family with a household income of $50,000 would need as much as 14 years to raise funds sufficient to cover a 20 percent downpayment and closing costs on a $172,000 home.[20] As the Agencies exclude private mortgage insurance as a factor from the proposed QRM definition, the only low downpayment option in the QRM basket will likely be FHA-insured loans. The 20 percent downpayment criterion alone will unnecessarily force well-qualified low-to-moderate income and first-time borrowers to either postpone a home purchase or to seek FHA-supported financing.

CAI is concerned this policy will lead to an over-reliance on FHA programs, exposing the agency to unanticipated financial and operational risk. As a case in point, FHA operates under certain annual fiscal restraints, and borrowers seeking FHA-insured mortgages will be subject to congressionally-approved FHA commitment limitations. In fiscal year 2010, FHA approached its $15 billion commitment limitation, prompting the Agency to notify Congress and the market that

[18] *2009 American Housing Survey*, U.S. Census Bureau: Table 3.14.
[19] *2009 American Housing Survey*, U.S. Census Bureau: Table 3.1.
[20] *Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery*, prepared by the Coalition for Sensible Housing Policy, May 2011: p. 3.

its operations would be disrupted unless the limitation was expanded. CAI does not believe that markets or consumers are well-served by FHA operations being exposed to even greater political risk.

A broader QRM definition will offer greater opportunity for all American households to achieve and maintain homeownership. This will be a result of the cumulative statutory improvements to protect consumers from predatory mortgage products and to require prudent underwriting. However, as proposed, the QRM definition will deny these households access to responsible credit, frustrating their economic aspirations. A broader QRM definition that does not disqualify such a significant portion of the population from access to mortgage credit on responsible and reasonable terms is more in line with congressional intent. Such a standard will allow private capital greater opportunity to support minority, low- to moderate-income, and first time buyers. Otherwise, a material impact of the proposed QRM standard on these borrowers will be recurring FHA-related credit crunches as FHA programs become oversubscribed.

Validating QRM Status at Origination

For a lender to validate QRM status for a mortgage loan at origination, the lender will necessarily rely on information supplied by numerous sources that are not a party to the real estate transaction. Importantly, the proposed QRM exemption requires MBS sponsors to repurchase any mortgage loan in an asset pool if the mortgage loan was improperly designated as meeting the QRM standard.[21] Thus, the potential liability of third parties providing information to mortgage originators and securitization sponsors is likely to increase. CAI does not see evidence that the Agencies considered how this increased legal liability may affect the behavior of these third parties or the pricing that may be associated with the information provided.

CAI is concerned that some third parties may be hesitant to supply information to originators or securitization sponsors if doing so increases their legal liability. Specifically, CAI is concerned that community association boards, managers, and management companies will be hesitant or will refuse to supply information to lenders regarding the periodic common expense assessment for a unit of housing if doing so increases their legal liability. An important example of this in the current market is the reluctance of some condominium associations, community association managers and community association management companies to supply lenders with information regarding FHA-related condominium unit mortgages or to fully respond to lender questionnaires regarding common expense assessments and special assessments.

[21] Joint Agency Proposed Regulation—Credit Risk Retention: Subpart D § ___.15(e).

Recent changes to FHA's condominium unit mortgage insurance programs require lenders and condominium associations to attest under threat of criminal penalty to certain information regarding the condominium prior to approval for participation in FHA mortgage insurance programs and prior to FHA endorsement. Condominium association boards and managers are hesitant to provide information for FHA program approval or lender loan level certifications as the information is either not readily available or doing so significantly increases legal liabilities. The impact on individual borrowers is that FHA-supported financing is not available. In fact, FHA recently disclosed that of a potential 12,000 condominiums eligible for recertification under the Agency's new condominium unit mortgage insurance program, only 1,000 have been recertified.[22]

Legal Liability for Third Parties under Proposed "Qualified Mortgage" Regulation

The Agencies are under statutory direction that the definition of QRM be no broader than the definition of "qualified mortgage" (QM); accordingly, the regulatory definition of QM must be imbedded in any final QRM definition the Agencies adopt.[23] In its proposed rule defining QM, the Federal Reserve Board (Board)[24] attempts to facilitate lender collection of information material to a determination of a borrower's ability-to-repay their loan by allowing lenders to use "reasonably reliable" information supplied by third parties, including information regarding mortgage-related obligations.[25] The Board will also permit the use of estimates for certain mortgage-related obligations if the estimate is based on "information that is known to the lender at the time the lender underwrites the mortgage obligation"[26] and complies with certain standards for disclosure on the basis of an estimate.[27]

Notwithstanding this flexibility, the Board additionally holds a lender liable for information affecting a borrower's ability-to-repay if records show that a material change in this calculation may occur after closing. Relevant Official Staff Interpretations indicate that if a lender knows a borrower's verified current income is likely to be reduced given the borrower's intention to retire within 12 months of closing that the creditor must determine ability-to-repay on the basis of the borrower's future rather than current income.[28] This policy means, by extension, a lender may be liable for any material change to any variable in the ability-to-repay calculation that the lender

[22] *FHA's new rules: more pain for condo market—calculated phase down under way?* July 19, 2011, by Ken Harney: www.inman.com/buyers-sellers/columnists/kenharney/fhas-new-rules-more-pain-condo-market
[23] 15 USC § 78o-11(e)(4)(C).
[24] As of July 21, 2011, the Consumer Financial Protection Bureau assumed the Board's rulemaking and enforcement authority under TILA. As the QM proposed rule was originated by the Board prior to this transfer, this letter refers to the Board's proposed regulatory amendments and proposed Official Staff Interpretations rather than the Bureau.
[25] Federal Reserve Board Docket No. R-1417—Proposed § 226.43(c)(3).
[26] Federal Reserve Board Docket No. R-1417—Proposed Official Staff Interpretation Paragraph 43(c)(2)(v)-3
[27] 12 C.F.R. § 226.17(c)(2)(i).
[28] Federal Reserve Board Docket No. R-1417—Proposed Official Staff Interpretation Paragraph 43(c)(1)-1.

could have discovered in the underwriting process. CAI's members are disturbed by this aspect of the Board's proposal, especially as it may apply to information supplied by a community association to a lender regarding a unit's common expense assessment or a special assessment.

Lenders commonly seek information from community associations when financing the sale of property in an association. Such requests are most commonly associated with the sale of a condominium unit and seek information pertaining to the unit's common expense assessment, any outstanding special assessment, and any pending special assessment. Condominium boards, community association managers and community association management companies routinely refuse to provide such information to lenders absent an agreement by the lender that the association, in providing the information, does not attest to its accuracy.

Lender and Securitization Sponsor Reliance on Third Party Information

The Agencies' proposed QRM definition adds to the legal liability that third parties will assume when providing information used to validate QRM status at origination. If a lender is subject to penalties under the Truth in Lending Act, as well as the sanctions under the Agencies' proposed rule, third party suppliers of information will be exposed to significant threat of litigation if a loan is subsequently determined to be in violation of the QM definition or the QRM definition. For the ordinary citizens who volunteer to serve on their community association board, the personal legal liability they assume by supplying lenders and securitization sponsors such information may simply cause them to cease doing so. This is also the case for community managers and community management companies. At the minimum, should community managers and management companies opt to provide lenders and securitization sponsors information on mortgage-related obligations, the fees for doing so will increase

Acceptance of Estimated Mortgage-Related Obligations

CAI's members believe the Agencies should ensure that lenders and securitization sponsors clearly have authority to estimate and to rely on estimates of mortgage-related obligations when validating QRM status at origination and when complying with relevant securitization standards. In this regard, the previously discussed QM proposed rule discusses the difficulty lenders may have in determining certain mortgage-related obligations, such as property tax payments, and the challenges this may pose to lenders when making an ability-to-repay determination.

CAI's members believe this is an appropriate approach for the Agencies to consider as it recognizes the difficulty that lenders and securitization sponsors may face when complying with the proposed QRM definition. The use of reasonable estimates of association assessments or special assessments will improve market function and ensure that mortgage closings can proceed

in a timely manner. Should a lender encounter resistance from a community association where the association board has a policy of not responding to lender questionnaires due to the risk to the association this may pose, permitting the lender to estimate a borrower's common expense association assessment will allow the transaction to proceed. Further, if a lender is permitted to request an estimate of the borrower's common expense assessment, community associations are more likely to provide the requested information.

Reliance on Borrower as Source of Association Assessment Information

Many states have adopted the Uniform Common Interest Ownership Act (UCIOA), drafted and supported by the National Conference of Commissioners on Uniform State Laws.[29] Under UCIOA, property owners are required to provide certain information to a buyer if the unit or property is located in a community association. Included in the information the owner must provide the purchaser is the current periodic common expense assessment for the unit or property as well as any unpaid common expense or special assessment. CAI notes that UCIOA requires that the owner provide information to a purchaser, not the association; however, associations are directed to supply resale certificates to sellers within a specified amount of time.[30] To cover the association's costs in producing resale certificates and to account for legal risks associated with doing so, associations charge a fee for the preparation of resale certificates.

In the proposed QM rule, the Board permits lenders to rely on certain information supplied by the borrower, such as a self-prepared tax return, which is material to a lender's determination that the borrower has the ability-to-repay a loan. CAI believes it may be useful for the Agencies to consider a similar approach, permitting a borrower, acting through the seller, to provide information regarding (actual or estimated) common expense association assessments or special assessments. This approach places the burden of disclosure and associated liability on the actual parties to the transaction, which is likely among the most efficient means of obtaining required information and limiting the chain of liability.

Mortgage-Related Obligations and Ability-to-Repay

Membership in a community association creates a common bond among homeowners. Under the community association structure, associations are often responsible for waste removal expenses, maintenance of community infrastructure, utility services, and insurance premiums. Additionally, the association is responsible for preparing an appropriate operating budget that

[29] The most recent version of the Uniform Common Interest Ownership Act may be viewed at: http://www.law.upenn.edu/bll/archives/ulc/ucioa/2008final.pdf.
[30] Uniform Common Interest Ownership Act (2008) § 4-109(a).

funds current association obligations and adequate reserve funds for anticipated future major repairs and maintenance. All association members pay assessments that fund these critical association services. To ensure each member of the association pays their fair share, association assessments are mandatory and lien-based.

Most States Require Disclosure of Association Assessments Prior to Sale
In general, CAI supports the Agencies' view that association assessments should be a required element in mortgage-related obligations under the proposed rule. A homeowner's community association assessments are critical to the proper functioning of the association. When a homeowner is unable to pay assessments, all other homeowners are forced to bear the expense of the delinquency. Ensuring that borrowers are qualified on the basis of their ability to pay all mortgage-related obligations will reduce assessment delinquencies in community associations, protecting homeowners from unanticipated housing costs.

While the Agencies' proposal does not address acceptable sources of information concerning mortgage-related obligations, relevant information pertaining to a borrower purchasing or refinancing property in a community association will likely be supplied by the association. To satisfy the requirements of the proposed QRM definition, community associations will therefore be subject to ongoing requests by lenders for information concerning (at the very least) individual unit or property common expense assessments. Further, as lenders and securitization sponsors are now subject to new and significant penalties for failure to comply with QM and QRM standards, the liability of associations and managers will also significantly change. Given that community associations vary greatly in both size and operational capacity, CAI reiterates the above recommendation that the Agencies clarify that lenders may estimate or obtain any required information regarding current common expense assessments or special assessments from unit owners if this information is supplied consistent with state law.

Inclusion of Association Assessments in Monthly Housing Debt and Total Monthly Debt
CAI supports borrowers being qualified on the basis of their ability to pay all mortgage-related obligations, including common expense assessments. Qualifying borrowers on this basis will reduce incidence of assessment delinquencies, promoting the overall fiscal health and stability of other owners in the association.

CAI's 2010 Association Impact Survey[31] illustrates the impact on a community association when owners cease paying association assessments. According to the survey, 35 percent of community associations reported delinquency rates of less than 5 percent; 32 percent of associations reported

[31] Community Associations Institute: September 2010 Association Impact Survey.

a delinquency rate of 6 to 10 percent; and 32 percent reported a delinquency rate of more than 20 percent. Community associations indicated that vacant homes due to foreclosure, abandoned properties, and other factors, such as lender refusal to take title to a foreclosed property, were causal factors in increased rates of association assessment delinquencies. Contrasted with pre-financial crisis levels, the differences are stark. In 2005, community associations across the country reported low rates of assessment delinquencies—95 percent of associations reported delinquency rates of less than 10 percent with 81 percent reporting delinquency rates of less than 5 percent. Unsafe and unsound underwriting by mortgage lenders has had a significantly negative impact on the community association model of housing.

CAI strongly supports underwriting requirements that verify a borrower's ability to repay a mortgage at the fully-indexed rate and to prohibit loans with predatory characteristics. Qualifying borrowers on the basis of all regularly recurring mortgage-related obligations, including common expense assessments, is an important component of the ability to repay standard and will ensure that both homeowners and their community associations remain in good fiscal health.

Inclusion of Special Assessments in Monthly Housing Debt and Total Monthly Debt
Community associations raise revenue through limited means: periodic common expense assessments; user and other fees; and special assessments. The last category of revenue, special assessments, occurs when an association faces a large non-budgeted expense and the owners vote to assess an additional amount to cover these costs.

The Agencies propose to include special assessments in the calculation of a borrower's total monthly housing debt and total monthly debt when determining if the borrower meets the proposed debt-to-income ratios for QRM loans. However, CAI notes the Agencies provide no definition of the term "special assessment" or any guidance on what is or is not considered a special assessment.

While the Agencies fail to define or qualify the term "special assessment," CAI notes again the relationship of the Federal Reserve Board's proposed QM regulation to the Agencies' QRM rulemaking. In its rulemaking, the Board seeks to amend its Official Staff Interpretations to define special assessment as, "… assessments that are imposed on the consumer at or before consummation, such as a one-time homeowners' association fee that will not be paid by the consumer in full at or before consummation."[32]

[32] Federal Reserve System: Docket No. R-1417—Proposed Official Staff Interpretation Paragraph 43(b)(8).

CAI's members have strong reservations regarding the potential inclusion of special assessments as an underwriting requirement to determine if a borrower will have access to mortgage credit or to govern mortgage rates and terms. This concern is further heightened as the term special assessment is not defined in the QRM proposal. If the Agencies intend the Federal Reserve Board's proposed Official Staff Interpretation to serve as the definition of "special assessment," CAI offers the following observations and recommendations.

1. Special Assessment Criterion Unfairly Penalizes Borrowers in Community Associations.
CAI's members are concerned that criteria regarding special assessments may reach beyond the intent of Congress, applying extraordinary underwriting criteria to borrowers seeking to purchase a home in a community association or to refinance an existing mortgage. Special assessments occur when associations face unexpected expenses; every homeowner faces unanticipated costs from time to time, yet the Board does not propose individual underwriting criteria to address this fact for all borrowers.

A key difference between homeowners in a community association and non-association homeowners is that community associations are required to set aside reserves for the anticipated replacement costs of common infrastructure. The ability to share in these expenses through reserving and through special assessments, rather than covering such expenses individually, provides a substantial advantage to owners in a community association.

CAI believes that by including special assessments as a factor solely for borrowers in community associations, the Agencies are subjecting this sector of the market to a different set of underwriting requirements, effectively penalizing these consumers for purchasing housing of their choice. CAI's members believe this is fundamentally unfair, as this policy will restrict access to credit for these otherwise well-qualified borrowers not due to any credit impairment but simply due to regulatory fiat.

2. Statute Addresses Regularly Occurring Mortgage-Related Obligations.
Dodd Frank Section 941 contains no specific reference to mortgage-related obligations or to community association assessments, special or otherwise. Section 941 does refer to "monthly obligations," "housing payments," and "monthly installment payments".[33] Notwithstanding this, the Agencies have proposed an extensive list of undefined terms that constitute mortgage-related obligations and direct lenders to include these items in a borrower's total monthly mortgage payment. Rather than define these terms in the proposed QRM definition, the Agencies have

[33] 15 USC § 78o-11(e)(4)(B).

simply used similar terminology (absent descriptive language or relevant guidance) as is found in the Federal Reserve Board's QM proposed rule.

CAI is strongly urging the Board to reconsider aspects of its proposed QM rule that pertain to the treatment of community association special assessments when determining a borrower's ability to repay. The general ability to repay standard and the QM rule are required by Sections 1141and 1412 of the Dodd Frank Act, which read in relevant part as follows:

> *Section 1141*
> *§ 129C. Minimum standards for residential mortgage loans*
> *(a) Ability to Repay.—*
> *(1) In General.—In accordance with regulations prescribed by the Board, no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verifiable and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.*
>
> *Section 1412*
> *(b)(2)(A)—*
> *(iv) in the case of a fixed rate loan, for which the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments;*
> *(v) in the case of an adjustable rate loan, for which the underwriting is based on the maximum rate permitted under the loan during the first 5 years, and a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments;*

The statute, which discusses "taxes, insurance, and assessments," is concerned with payments that are regularly occurring and predictable as well as other terms that are regularly occurring, quantifiable and clearly defined in loan documentation. CAI supports the inclusion of common expense assessments as a variable in the ability-to-repay calculation, as these are expected periodic payments in the same manner that property taxes and hazard insurance payments are both widely expected by borrowers and predictably periodic in nature.

Further, the statute does not require common expense association assessments to be indexed at the maximum rate of increase under applicable state law in the ability-to-repay calculation. Congress was explicit in its concerns over payment escalation and payment shock due to changes in interest rates and other loan characteristics that contributed to borrower default. It is instructive that Congress did not treat increases in property taxes, insurance or assessments in a similar manner, as these are costs that all homeowners bear and have exposure to irrespective of their being located in a community association or not. Congress did not intend to insulate homeowners from the actual costs of homeownership in adopting the ability-to-repay requirement; rather, Congress was protecting borrowers from predatory mortgage terms.

The Agencies' inclusion of the Board's proposed treatment of special assessments in the ability-to-repay standard moves away from this standard and will cause economic harm to homeowners in community associations with an active special assessment and all future homeowners in community associations that adopt a special assessment.

Unlike the specific loan terms Congress sought to eliminate from the market, special assessments directly benefit properties subject to the assessment, protecting values. This promotes borrower stability; it does not harm it. Further, special assessments are enforced for a set period of time and then expire. This reduces future mortgage-related obligations, further contributing to borrower financial stability and stability of values. Punishing community associations that have taken the prudent step of addressing unanticipated community costs through a special assessment by disqualifying these owners from receiving mortgage credit will have negative consequences. Such an approach by the Agencies will cause associations to dramatically increase common expense assessments, forego necessary major repairs, risk default on payments to contractors, or to seek loans to cover these expenses.[34]

Accordingly, CAI urges the Agencies to remove "special assessments" from the proposed QRM definition or to substantively revise the proposed approach.

2. If Special Assessments are Included in Ability-to-Repay, only Current Special Assessments Should be Included in Mortgage-Related Obligations.

If the Agencies opt to retain special assessments in the calculation of a borrower's ability-to-repay, CAI members strongly urge that the standard be clearly limited to only those special assessments actually in force at time of disclosure. Community association boards, community

[34] As of August 1, 2011, FHA will not certify any condominium project for participation in FHA mortgage insurance programs if the condominium association has an active or pending special assessment or an outstanding loan.

association managers, community association management companies, and lenders should not be required to speculate if a future special assessment will be adopted. Neither should these parties be asked to speculate on the amount of any future special assessments that may be applied to individual units or properties. Absent such clear and unambiguous guidance, community association boards, managers and management companies will likely refuse to provide information on special assessments to lenders.

3. If Special Assessments are Included in the Ability-to-Repay Standard, Lenders Should Follow *Pro Rata* Monthly Payment and Offer Flexible DTI Ratios.

The structure of special assessments can vary from association to association. For example, it is common for some associations to require a one-time payment of special assessments, while other associations will accept quarterly payments or payments on a schedule negotiated between the association and the owner. Further, some associations will adopt a fixed special assessment for a certain period of time. If the Agencies pursue a special assessment criterion for the ability-to-repay standard, CAI strongly urges the Agencies to provide lenders flexibility when qualifying borrowers on the basis of a special assessment. Specifically, CAI members urge (1) where practical, a creditor use the *pro rata* monthly payment of a special assessment rather than qualifying a borrower on the basis of a one-time or quarterly payment, and (2) lenders be authorized to use a flexible DTI standard that takes into account the reduction in the borrowers' mortgage-related obligations once the special assessment expires.

CAI notes the Agencies appear to offer lenders the flexibility to use *pro rata* monthly payments in the ability-to-repay calculation with regard to special assessments. If special assessments are to be included in mortgage-related obligations, qualifying a borrower on a *pro rata* basis is likely the only means of ensuring the ability-to-repay standard can be fairly applied. Otherwise, the benefits of the ability-to-repay standard would be lost for such borrowers, having the effect of punishing rather than protecting these consumers.

The Agencies have, in proposing at least two debt-to-income tests, demonstrated a willingness to consider that in certain circumstances a borrower can be well-qualified, having the ability to repay a mortgage loan where total monthly mortgage payment and total monthly debt payment ratios are higher than other borrowers. If the Agencies retain special assessments as a factor in mortgage-related obligations, CAI strongly urges the Agencies to offer borrowers subject to special assessments flexibility when limiting debt-to-income ratios. CAI believes this is consistent with the flexibility provided to the Agencies in statute that permits certain exemptions, exceptions, and adjustments that "… improve the access of consumers and businesses to credit

on reasonable terms …"[35] Given that a borrower's mortgage-related obligations will be reduced upon a special assessment's expiration, CAI believes the Agencies should acknowledge this fact in the underwriting process, protecting access to reasonably priced credit for these consumers.

Adoption of Government Agency Underwriting Guidelines

CAI urges caution as the Agencies consider a requirement that lenders generally adopt underwriting standards of housing-related government agencies. Such agencies have statutory-based missions to serve specific populations and demographic groups, and are not intended to serve as the primary means by which the general population accesses mortgage credit. CAI's members believe that while seemingly prudent, such a policy could apply criteria appropriate for the target populations served by these agencies to the general population, whom are not well-served by certain restrictions required for the agency to serve its mission-related consumers.

Definition of Points and Fees

The Agencies propose to limit total points and fees in the QRM definition to no more than 3 percent of the total loan balance as required by Section 129C(b)(2)(C) of the Truth in Lending Act.[36] In general, the Agencies propose to include real estate-related fees in the definition of points and fees unless the fees (1) are bona fide and reasonable; (2) are not paid, directly or indirectly, to a creditor or mortgage originator; and (3) the charge is not paid to an affiliate of the creditor or originator. As with other aspects of the Agencies' proposed QRM definition, the definition of points and fees and the limitations of total points and fees are subject to the Federal Reserve Board's proposed QM rulemaking.

CAI's members are concerned the Agencies' proposal lacks sufficient guidance on the process of determining whether certain transactional fees, real estate-related or otherwise, are exempt from the 3 percent limitation. In particular, CAI's members are concerned that this lack of guidance may harm the economic interests of homeowners who have purchased a unit or property in a community association if the Agencies determine that certain community association-related transactional costs must be included in the calculation of points and fees.

CAI's members strongly urge the Agencies to more clearly define the process of determining total points and fees so all market participants have certainty regarding the applicable standards. CAI's members are concerned that lenders will interpret limitations on points and fees either too strictly or unevenly absent clear guidance. It is vital that consumers understand the regulatory-

[35] 15 USC § 78o-11(e)(2)(B).
[36] 15 U.S.C. 1639c(b)(2)(C).

based factors that may increase their cost of credit and ensure that these factors are established and considered in a fair manner well in advance of closing. To that end, CAI offers the following commentary on practices that are long-standing and commonly associated with the purchase of real property in a community association.

Charges for Association Expenses Relating to Change of Ownership
It is a long-standing practice that many community associations assess a fee to purchasers to fund costs associated with a change in ownership of a unit or property. Associations opt for this approach rather than requiring all residents to subsidize expenses related to a change in ownership each time a unit or property is sold in the form of higher common expense assessments. This arrangement is fair to all owners in that each purchaser is required to cover costs to the association for the change in ownership.

Charges for Association Expenses Relating to Preparation of Required Resale Certificates
Many states require (and CAI strongly supports) prior disclosure of material information to a purchaser regarding their personal rights and responsibilities with regard to ownership of property in a community association. CAI believes such prior disclosure is fundamental to a purchaser making a fully informed decision based on essential information relating to their new home as well as the governing community association. Prior disclosure ensures the purchaser is fully aware of all obligations with respect to the property before transfer occurs.

According to CAI's public policy, Disclosure Before Sales in Community Associations,[37] CAI supports state law requiring disclosure of:

- Pertinent financial information describing the financial condition of the association
- The projected amount of common expense assessments
- The projected amount of approved special assessments
- Association governing documents, including bylaws, declarations and deeds, as may be required by statute
- Pending legal action or outstanding judgments
- Pees pertaining to transfer of ownership
- A statement of remedies at the association's disposal to collect delinquent assessments and association collection policies
- List of association amenities

[37] CAI Public Policies (2010), p. 25. CAI Public Policies may be viewed at http://www.caionline.org/govt/policies/Documents/Public%20Policies%20November%202010.pdf.

While it is the duty of a seller to provide a purchaser with the information contained in a resale disclosure package, in practice, associations prepare the required disclosures on behalf of the seller. Given the expenses associations incur as a result of preparing resale disclosures, associations routinely charge a fee to sellers requesting a resale disclosure package. As associations will be exposed to legal liabilities where lenders and securitization sponsors obtain this information from an association and rely on it to validate QRM status, it is reasonable to expect an increase in fees to offset these additional costs.

Community Transfer Fees

In the preamble discussion of the Federal Reserve Board's proposed QM rulemaking, there is a single reference to homeowners association transfer fees. The Board "… solicits comment on how to address any issues that may arise in connection with homeowner's association transfer fees and costs associated with loans for energy-efficient improvement."[38] Given the impact of this rulemaking on the Agencies' QRM definition, CAI offers the following discussion on community transfer fees, their use, and the emergence of harmful third party transfer fees in the market.

Some federal financial regulators, most notably the Federal Housing Finance Agency (FHFA), have recently examined the evolution of deed-based, private transfer fees in the housing market and the impact such fees have on consumers. Additionally, some national trade associations have expressed concerns over the market impact of deed-based, private transfer fees where fee proceeds flow to third parties with no interest in the encumbered land (third party transfer fees), and attempts to sell securities on the basis of these third party transfer fees.

Third party transfer fees are substantially different from deed-based transfer fees remitted to a governing community association. These fees, known as community transfer fees, directly support association activities and, therefore, provide a direct benefit to the encumbered properties. Community transfer fees have long been regarded by the Courts as falling within the traditional interpretation of the Law of Servitude and meeting the burden-benefit test.

Community transfer fees are a long-standing and important component of community associations and constitute a critical source of financial support for association activities. Ill-conceived regulations restricting the use of community transfer fees or restricting access to credit for homeowners living in a community association subject to a community transfer fee would be devastating. CAI strongly encourages the Agencies not rewrite established legal precedent

[38] Federal Register, Vol. 76, No. 91: p. 27415.

governing land use to restrict the use of community transfer fees or to red-line via regulation communities with such fees.

1. CAI's Members Oppose Third Party Transfer Fees

CAI's members unequivocally oppose deed-based transfer fees where fee proceeds are transmitted to third parties with no interest in the encumbered land. CAI strongly believes such deed-based fees do not meet the traditional interpretation of the Law of Servitude, which, in general, requires that any fee that burdens the land and purports to run with the land also benefit the land. Clearly, a deed-based transfer fee paid to a third party with no interest in the land does not benefit the land. Accordingly, CAI supports efforts by several state legislatures to void or render unenforceable third party, deed-based transfer fees. CAI also supports aspects of a pending FHFA rulemaking that will not permit Fannie Mae, Freddie Mac or the Federal Home Loan Bank System to support mortgage lending on properties subject to a third party transfer fee.

2. Community Transfer Fees Provide Direct Benefit and Positively Affect Valuation.

CAI's members strongly support the long-standing practice of transfer fees that are payable to a governing community association. These community transfer fees support governance, maintenance of common elements, and operations of community associations, providing a direct benefit to the encumbered land. Indeed, in its proposed rule concerning deed-based transfer fees, FHFA found that "transfer fees paid to associations contribute to the value of the burdened property through the amenities and maintenance that they fund."[39]

CAI's members will strongly oppose any attempt by federal agencies to limit the extension of mortgage credit or to condition the terms of any mortgage credit extended to a consumer on the basis of a community transfer fee. In this context, CAI believes the intent of Congress in establishing the ability-to-repay requirement and QRM exemption was to improve mortgage underwriting, not to create a new federal regulatory structure for community associations.

Conditioning access to mortgage credit for residents of community associations on the basis of a community transfer fee does not improve mortgage underwriting; rather, it will in many cases irreparably harm the economic interests of these property owners. This is because federal financial regulators lack the legal authority to vitiate or render unenforceable private contracts that are lawful under both federal and state law. Federal financial regulators may only refuse to allow federally-related mortgage credit to flow to such properties or create other regulatory

[39] 12 CFR Part 1228, RIN 2590-AA41, *Fannie Mae, Freddie Mac and the Federal Home Loan Banks Restrictions on the Acquisition of, or Taking Security Interests In, Mortgages on Properties Encumbered by Certain Private Transfer Fee Covenants and Related Securities,* page 18.

machinations intended to prevent the flow of credit to properties encumbered by a community transfer fee. In either case, the transfer fee will persist, but the owners of these properties will have no ability to market these assets, which will substantially lower values.

3. CAI Members Support Prior Disclosure of Homeowner Obligations.

CAI strongly supports prior disclosure of all existing obligations purchasers undertake when living in a community association. CAI's public policy, *Disclosure Before Sales in a Community Association,*[40] clearly states our members' belief that state law should require prior disclosure of all fees, including any community transfer fees, to prospective purchasers well in advance of closing. Such existing prior disclosure requirements in most states allow purchasers meaningful opportunity to negotiate with sellers the payment of any transfer fee along with other *bona fide* costs associated with the transfer of real property in a community association. Further, the Uniform Common Interest Ownership Act provides consumers the right to rescind a purchase contract without penalty on the basis of their review of resale certificate disclosures required under Section 4-109 of the Act.

CAI's members have urged the Federal Reserve Board to clarify that community transfer fees paid at closing should be excluded in the calculation of points and fees and urge the Agencies to make a similar clarification in the QRM definition. Community transfer fees directly benefit encumbered properties and directly support association activities, association reserve funds, and maintenance of common elements. As community transfer fee proceeds provide a direct benefit to the purchaser, the fees are bona fide and should fall within the exemption provided by statute.

Loss Mitigation Requirements

The Agencies propose that mortgage loan originators have a written servicing policy requiring loss mitigation. Further, the Agencies propose that loss mitigation policies be included in loan documentation; that the policies be transferable to any party assuming servicing rights for the loan; and that loss mitigation policies be explained to consumers at or before closing.

CAI's Members Generally Support Effective Mandatory Loss Mitigation Requirements

The experience of community associations during the housing crisis has been that financially troubled borrowers cease paying required association assessments prior to defaulting on their mortgage. Associations have a history of working with delinquent borrowers to restore their good standing with the association, but, increasingly, circumstances have led associations to

[40] See note 36 for information on how to view CAI's Public Policies.

undertake more substantial efforts to collect delinquent assessments to protect the financial interests of all other owners in the community.

CAI's members have two general areas of concern regarding the proposed servicing standards in the Agencies' proposed rule. The first concern stems from the fact that while showing modest improvements, to-date loan modification and certain loss mitigation strategies have a demonstrated record of failure. The second area of general concern is for financially-healthy owners in community associations with a large concentration of homeowners in loan modification or loss mitigation programs.

1. Mortgage modifications and loss mitigation could, if properly constructed and administered, offer substantial benefits to troubled borrowers.

CAI's members support policies that encourage servicers to offer meaningful relief to troubled borrowers to help them remain in their homes where possible. Modifying mortgages with new payment terms based on reasonable ability-to-repay standards could provide troubled borrowers meaningful assistance.

Regrettably, loan modification and loss mitigation programs offered by the federal government have been widely reported as unsuccessful. For example, Neil Barofsky, Special Inspector General for the Troubled Asset Relief Program (SIGTARP), testified before the House Financial Services Committee that there is "near universal" agreement that one of the most significant federal government loan modification programs, the Home Affordable Modification Program (HAMP), has failed to offer meaningful relief for troubled borrowers.[41] The Government Accountability Office has confirmed this view by reporting earlier this year that HAMP had produced approximately 522,000 modifications with more than 735,000 loan modifications being cancelled. [42]

While CAI's members greatly desire that troubled borrowers receive reasonable offers of assistance from lenders and servicers, the verifiable track record of these efforts is disheartening. Accordingly, CAI recommends the Agencies to use caution when requiring blanket modification or loss mitigation strategies that are demonstrated policy failures. Not only could this harm mortgage lending, but it may also sustain a policy that is known to harm borrowers. According to Mr. Barofsky,

[41] Statement of Neil Barofsky before the House Committee on Financial Services Subcommittee on Insurance, Housing, and Community Opportunity: March 2, 2011.
[42] Statement of Mathew J. Scirè before the House Committee on Financial Services Subcommittee on Insurance, Housing, and Community Opportunity: March 2, 2011.

Failed trial modifications often leave borrowers with more principal outstanding on their loans, less home equity, depleted savings, and worse credit scores. And even in situations where they never missed a payment, such borrowers may face back payments, penalties, and even late fees that become due once their trial modification is cancelled. The impact of these added burdens becomes even greater when trial modifications are allowed to continue long past the three-month period called for by the program. While it may be true that some homeowners benefit from the "temporary relief" of a trial modification even though the modification ultimately fails, Treasury's repeated references to the benefits of failed modifications ignores the real and often debilitating harm that such modifications have influenced on many families, and appears to be little more than an attempt to define specific failures as successes.[43]

CAI urges the Agencies to consider both the benefits and potential risks of embedding such policy in what is likely to become the nationwide standard for mortgage servicing. Absent such careful analysis, policies intended to protect homeowners could end up causing them harm.

2. Housing costs for financially healthy borrowers are rising as a result of ineffective loan modification and loss mitigation policies.

Offering troubled borrowers a false sense of hope through what have to-date been poorly coordinated and ineffective loan modification and loss mitigation policies can be harmful to financially-healthy borrowers in community associations. Borrowers entering loan modification and loss mitigation programs have a greater tendency to be delinquent on other housing-related payments such as association assessments. While in these programs, association delinquencies continue to increase and, given the percentage of loan modification failures, the economic interests of all other property owners in the community are harmed.

CAI's members are concerned over the financial hardship visited upon otherwise healthy borrowers whose housing costs increase due to the non-payment of association assessments by other owners. These hardships are compounded when unavoidable foreclosures are delayed or when troubled borrowers are offered mortgage modifications only to default again within a short period of time. Increasingly, community associations are unwilling or unable to offer such delinquent owners the flexibility once extended when an owner experienced financial difficulty.

[43] Statement of Neil Barofsky before the House Committee on Financial Services Subcommittee on Insurance, Housing, and Community Opportunity: March 2, 2011.

If the Agencies' proposed loss mitigation standards are to be successful in community associations, the Agencies have a duty to ensure these standards do not harm the economic interests of other homeowners in the community. This harm comes in the form of higher assessments, special assessments or reductions in the very services that prompted the property owner to purchase their home. It is unfair to force these homeowners to accept increases in housing costs and reductions in services, which, in some cases, can threaten their own financial stability. Accordingly, the Agencies must be mindful of the full range of impacts that all aspects of the proposed QRM definition will have on the various sectors of the housing market, including community associations.

Impact of Underwriting Criteria Specific to Community Associations on Loss Mitigation
In responding to the housing and financial crisis, federal agencies and regulators have expanded the reach of underwriting standards to include community associations. New FHA condominium unit mortgage insurance program guidelines and the Agencies' proposed QRM definition offer clear examples of new underwriting standards that target community associations. Unfortunately, these policies are likely to frustrate the success of loss mitigation strategies.

Under current FHA program rules, the agency will not provide mortgage insurance in condominium projects that do not meet stringent FHA-mandated criteria. Under this policy, all qualified borrowers in affected condominium projects are denied access to FHA-supported mortgage credit, if, for example, a certain percentage of unit owners are delinquent in their condominium association assessments. Accordingly, condominium associations are strictly enforcing all rules and guidelines (including taking action to collect on assessment delinquencies) so that all owners in the condominium are eligible to seek FHA-insured mortgages.

Additionally, the Agencies' propose to condition the extension of mortgage credit on the basis of a special assessment through the proposed QRM definition. If adopted in current form by the Agencies, any community association voting to approve a special assessment will be denying homeowners and prospective buyers access to credit on the best possible terms. These policies may reduce the incidence of special assessments (which may be the Agencies' intent), but would also result in many negative and unintended consequences for residents of community associations.

This intersection of federal government policy with the lives of community association residents is increasingly rendering it impossible for associations to work with delinquent property owners, forcing outcomes that do not benefit the delinquent owner. Indeed, these and other federal

government underwriting standards actively impede efforts of community associations to work with financially-troubled homeowners because to do so harms all other owners in the community by limiting their access to credit at the best price and on the best terms.

Association boards have a duty to owners to ensure assessment delinquency rates do not violate federal underwriting standards if the delinquency rate will limit the flow of mortgage credit to the community. Further, association boards have a duty to all owners to not allow delinquencies to lead to special assessments, which, under the proposed QRM definition, limits access to mortgage credit for residents of community associations. If federal agencies continue to promulgate and rigidly enforce such lending standards without regard to market impact, association-initiated foreclosures and other legal remedies pursued by associations to collect delinquencies will increase as a direct consequence, frustrating the success of loan modification and loss mitigation programs. This is not an outcome CAI desires in the least.

Coordination Key to Successful Loss Mitigation for Troubled Borrowers

CAI is not aware of any ongoing program of outreach by mortgage servicers or any federal agencies involved in loss mitigation to include community associations as part of the overall solution to mortgage delinquencies. Rather, CAI's members report that federal underwriting requirements are forcing associations to aggressively pursue delinquencies and other legal remedies that are beneficial to the overall community but may not be in the best interests of troubled borrowers.

Further, CAI is not aware of any ongoing effort by federal regulators to facilitate dialogue between mortgage lenders, servicers and community associations regarding foreclosures. This lack of communication has led some associations to file liens or initiate foreclosures to avoid substantial harm to other homeowners in the community.

CAI members have grown increasingly frustrated over instances where lenders refuse to foreclose on properties where a modification is not possible and the most responsible outcome for all parties is foreclosure. To make matters worse, lenders delay foreclosure as long as possible to avoid taking title and being required, like any owner, to pay assessments to support the community association. While it may be profitable to lenders with substantial REO to avoid paying association assessments, this greatly exacerbates assessment delinquencies and vacancy rates for community associations, especially in severely depressed housing markets. Further, private lenders are not the only parties that fail to pay association assessments. CAI members have reported significant delinquencies on HUD-owned properties as well.

Irrespective of the delinquent party, refusal to pay association assessments forces all other homeowners in the affected community to cover these costs. This is as unfair as it is harmful. Laws adopted in California and Florida have provided only limited relief in such circumstances, which has come too late for many communities and homeowners and is simply not widespread enough to have a meaningful impact.[44]

In still other instances, the lack of coordination has led certain groups, ostensibly acting on behalf of homeowners, to pursue policies at the state level that would prevent associations from collecting delinquent assessments. Purporting to help homeowners, these efforts cause significant harm to the financial health of all owners in community associations and have the potential to deny these homeowners access to mortgage credit. Specifically, North Carolina recently enacted a statutory restriction governing the means by which a community association can seek collection of delinquent assessments.[45] In this instance, state statute will actively prevent condominium associations from maintaining FHA eligibility and will likely increase the rate of special assessments in all of North Carolina's community associations as these associations attempt to cope with reductions in revenue.

CAI strongly urges the Agencies to encourage lenders and servicers to communicate and work with community associations as appropriate to ensure that any loss mitigation requirements in the QRM definition are successful and effective. Further, CAI strongly encourages the Agencies to examine the impact of existing loan modification and loss mitigation programs on community associations and the financial stability of healthy borrowers. CAI's members greatly desire that troubled borrowers be restored to financial stability and wish to work cooperatively to that end. Regrettably, some lenders, as well as new federal and state government policies, are frustrating efforts of community associations to do so.

General Borrower and QRM Limitations

In June 2011, CAI surveyed its members regarding the Agencies' proposed QRM definition. The results of the survey show that CAI's members strongly support reforms to the housing finance system to prevent lenders and borrowers from returning to the unsafe credit standards that precipitated the housing and financial crisis. In general, 67 percent of survey respondents indicated their support for changes to mortgage lending standards that balanced access to mortgage credit against commonsense underwriting and regulatory standards. At the conclusion

[44] See California Senate Bill 1511 (2008) enrolled as CA Civil Code Section 2924b.
[45] General Assembly of North Carolina Session 2011, Session Law 2011-362.

of the survey, CAI members were asked if the Agencies' proposal achieved this commonsense balance: 61 percent of respondents said the proposed QRM standard was too extreme.[46]

A closer examination of CAI's QRM survey shows the nuanced view of CAI's members on reforms to mortgage lending standards. Members support certain approaches the Agencies have used in developing the proposed QRM definition, but also oppose, by substantial margins, other aspects of the proposal.

CAI Members Oppose Owner Occupancy Requirement

When asked if only owner occupied properties should qualify for a QRM loan, 56 percent of survey respondents responded negatively. CAI's members believe that the cost of credit should reflect a borrower's credit risk. The fact that an owner may not occupy a property as a primary residence should not automatically result in that borrower paying a higher interest rate and face substantial hurdles in obtaining mortgage credit.

CAI Members Support ARMs with Proposed Protections

An overwhelming 78 percent of survey respondents support the continued availability of ARMs in a future housing finance system. CAI's members strongly support the limitations on ARMs the Agencies have proposed that will protect borrowers from volatile increases in annual interest rates as well as the overall limitation on the maximum potential increase in interest rate over the life of the loan.

CAI Members See Value of Walk-Through Appraisals for New Purchases

CAI's members support the use of a full walk-through appraisal to determine the value of a property at purchase with 55 percent of survey respondents supporting a full walk-through appraisal for purchase mortgages. However, CAI's members do not support this approach for all mortgage transactions. Only 25 percent of respondents indicated that full walk-through appraisals should be a requirement for all mortgages. Combined, 75 percent of survey respondents opposed the proposed appraisal criteria as written, with a strong majority supporting the proposed appraisal criteria for purchase mortgages only.

CAI Members Strongly Support Elimination of Certain Predatory Mortgage Terms

Survey respondents offered strong support for the Agencies' proposed elimination or restriction of loans with certain terms from the QRM definition. When provided a menu of loan characteristics that would be banned from the QRM definition, 60 percent of respondents supported the elimination of pre-payment penalties and negative amortization from the QRM

[46] Appendix B—CAI Member Survey: Qualified Residential Mortgage Proposal (June 2011).

standard. Other mortgage terms that were scored negatively by respondents included interest-only payments, and high points and fees.

CAI Members Oppose 20 Percent Downpayment Requirements

CAI's members are overwhelmingly opposed to the Agencies' proposed 20 percent downpayment requirement. Believing a 20 percent downpayment is too great of a hurdle for most borrowers, 62 percent of survey respondents indicated the downpayment criterion should be lowered. CAI's members believe a 20 percent downpayment requirement will needlessly delay homeownership opportunity for first-time borrowers and price many low-to-moderate income buyers out homeownership.

CAI Members Support Financing of Closing Costs

Respondents, at a rate of 70 percent, supported allowing borrowers to finance closing costs when obtaining a QRM loan. CAI's members did not believe the Agencies offered a significant enough rationale for prohibiting the financing of closing costs, especially given the barrier that such a policy would mean for certain borrowers.

CAI Members Urge Agencies to Amend LTV Limitations

CAI's members oppose the high loan-to-value (LTV) ratios required for rate and terms refinance mortgages as well as cash-out refinances. By incorporating such rigid LTV requirements, the Agencies will limit access to household wealth and prevent homeowners from accessing mortgage credit with more favorable rates and terms.

CAI members acknowledge that LTV ratios can be a significant predictor of borrower default or delinquency, but CAI does not view LTV as the sole predictor of either of these outcomes. Accordingly, CAI urges the Agencies to view LTV ratios in the overall context of borrower qualification and the protections offered to originators and investors through private mortgage insurance.

CAI Members Urge Changes to Borrower Credit Criteria

Survey respondents offered strong support for certain aspects of the borrower credit criteria developed by the Agencies, but were strongly opposed to others. Respondents overwhelmingly oppose the proposed 30 day delinquency on any debt standard with 94 percent stating the criterion is too stringent. Additionally, 65 percent of respondents opposed the criterion on 60-day delinquencies on any debt. CAI members believe these criteria, as currently constructed, are simply too restrictive, offering no flexibility for lenders to determine if a borrower is a low risk borrower notwithstanding negative credit factors in these areas.

Survey respondents did, however, offer strong support for other borrower credit criteria as proposed by the Agencies. In general, support for QRM restrictions on borrowers who filed for bankruptcy protection, were subject to a court order to repay a debt, or were a party to a lender foreclosure, short sale or deed-in-lieu-of foreclosure was high. Support for these credit restrictions ranged from 60 percent to 76 percent.

As the response to the Agencies' proposed borrower credit criteria suggest, CAI's members support reasonable restrictions for borrowers with a demonstrated inability to manage credit. However, respondents also encouraged a more careful approach to the 30-day and 60-day delinquency criteria. CAI's members believe the Agencies have sufficient flexibility in the statute to address the 30- and 60-day delinquency criteria as the Agencies jointly designed these criteria. CAI's members urge the Agencies to consider the total dollar amount of delinquencies when refining these criteria and to allow borrowers to provide supplemental information that accounts for delinquencies violating these standards. More broadly, 63 percent of survey respondents indicated that a borrower violating any of the disqualifying criteria should have the right to appeal to a lender's business judgment.

Conclusion

CAI members appreciate the difficult charge given the Agencies by Congress to craft an exemption to the credit risk retention requirements of Dodd Frank Section 941. The Agencies acknowledge this difficulty by writing in the joint proposed rule that

> *… sound underwriting practices require judgment about the relative weight of various risk factors … These decisions are usually based on complex statistical default models or lender judgment, which will differ across originators and over time. However, incorporating all of the tradeoffs that may prudently be made as part of a secured underwriting process into a regulation would be very difficult without introducing a level of complexity and cost that could undermine any incentive for sponsors to securitize, and originators to originate, QRMs.*[47]

As the above excerpt shows, the Agencies address the difficulty of writing lender judgment into regulation by refusing to attempt the task of prudently balancing the exercise of lender judgment in the QRM basket of loans with policies to minimize a repeat of the current crisis. Thus, the Agencies have proposed a narrow QRM basket with the intent of maximizing lender business

[47] *Federal Register*, Vol. 76, No. 91: p. 24118.

judgment in a broader non-QRM mortgage market. CAI does not believe this policy option is practical.

The Agencies' proposed narrow QRM loan basket will have a significant effect on mortgage originators and consequently the cost of credit. CAI's members, by a rate of 2 to 1, believe these costs far outweigh any benefit the proposed QRM definition may provide to the housing finance system. This is particularly the case over the short-to-medium term.

CAI's members believe the Agencies have proposed to define the QRM exemption based on numerous criteria where a borrower's violation of just one of those factors, however minor, will obligate a lender to disqualify the borrower from receiving a QRM loan. Unfortunately, some such criteria are required by statute and the Agencies have limited flexibility to address any legitimate issues that may subsequently arise. However, this is not the case for many other criteria, and CAI's members do not believe, for example, that a $50, 60-day delinquency on a department store credit card should necessarily disqualify a borrower from obtaining a QRM loan. Yet, this is the practical effect of the Agencies' QRM definition as proposed.

CAI's members are further concerned about aspects of the Agencies' proposed rule that appear to have negative consequences for borrowers choosing to purchase a home in a community association. Ownership in a community association and the benefits accorded to a property due to the activities of the association far outweigh any potential encumbrances. Working cooperatively together as neighbors allows these homeowners to address community issues in a coordinated and effective fashion. Homeowners in non-association neighborhoods have no comparable structure in place to manage abandoned properties, ensure properties are maintained, or to offer assistance to troubled borrowers. The advantages of community associations are unparalleled, and the Agencies seemingly ignore this fact by proposing criteria that may disadvantage borrowers choosing the community association model of housing.

When CAI's members were asked their opinion of the Agencies' proposed QRM standard, more than 60 percent of respondents said the Agencies have failed to achieve the proper regulatory balance that will allow America to remain a nation of responsible homeowners. CAI's members do not wish a return to the market malfeasance that precipitated the housing crisis, but CAI's members do not want to see the government limit housing choice and prevent legitimate transactions from taking place in the housing market either.

On behalf of CAI, I appreciate your consideration of these comments. If you have any questions, or if CAI may provide any additional information please do not hesitate to contact me or Mr. Andrew S. Fortin, Esq., CAI's vice president of government and public affairs, at (703) 970-9224.

Sincerely,

Thomas M. Skiba, CAE
Chief Executive Officer

Appendix A

CAI Letter to Agencies Concerning Development of QRM Definition

December 15, 2010

The Honorable Timothy F. Geithner
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Ave, NW
Washington DC 20220

The Honorable Shaun Donovan
Secretary
U.S. Department of Housing and Urban Development
451 Seventh Street, SW
Washington DC 20410

The Honorable Mary Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington DC 20549

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave
Washington DC 20551

Mr. John G. Walsh
Acting Comptroller of the Currency
250 E Street, SW
Washington DC 20219

Mr. Edward DeMarco
Acting Director
Federal Housing Finance Agency
1700 G Street, NW
Washington DC 20552

The Honorable Sheila Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington DC 20429

Ladies and Gentlemen:

On behalf of Community Associations Institute (CAI)[48], I am pleased to submit the following discussion and recommendations as you continue to study and develop proposed regulations as required by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2009 (DFA). CAI's members are keenly interested in the development of the regulatory definition of "qualified residential mortgage" and the process by which this definition and other exemptions to the risk retention requirements of Section 941 will be derived.

Community Associations' Access to the Housing Finance System and the Financial Crisis

[48] CAI is the only national organization dedicated to fostering competent, well-governed community associations that are home to approximately one in every five American households. For nearly 40 years, CAI has been the leader in providing education and resources to the volunteer homeowners who govern community associations and the professionals who support them. CAI's 30,000 members include community association volunteer leaders, professional managers, community management firms, and other professionals and companies that provide products and services to community associations.

Community associations[49] have long been the housing option of choice for millions of American families with more than 60 million American households currently located in a community association[50]. These homeowners choose to live in a community association for any number of reasons, but chief among them are a desire for a strong community identity, to protect the value of their home, to enjoy amenities that may not otherwise be available, to mutually share some of the expense of property maintenance, and to provide a decent home and suitable living environment. While community associations have been in existence for more than 150 years, the community association model of homeownership has become more popular and widespread in the past several decades.

Role of Federal Agencies in Supporting Standardization of Community Association Governance

As the community association model of housing developed, the housing finance system, led in large part by the U.S. Department of Housing and Urban Development (HUD), began to offer mortgage insurance for condominium project mortgages and for condominium unit mortgages in the early 1960s. These program offerings began the process of standardizing financial management and operational requirements for community associations as HUD published model governing documents for community associations. Later, toward the end of the 1960s and during the early 1970s, HUD, via the Federal Housing Administration (FHA), worked with the Urban Land Institute, the Department of Veterans Affairs (VA) and the National Association of Homebuilders to create Community Associations Institute (CAI)—recognizing that none of the existing housing organizations were able to provide continuous and credible information about best practices in the development, management and governance of community associations.

The government sponsored enterprises or GSEs (Fannie Mae, Freddie Mac and the Federal Home Loan Bank System) followed HUD's leadership, developing programs to serve the community association market. State legislatures provided a strong legal foundation, as well, by devising and implementing statutory frameworks for community associations. Taken together, actions by FHA, the GSEs and state governments have encouraged the standardization of association development, management and governance, all of which are significant benefits to the residents of community associations.

While the residents of community associations clearly benefited from healthy associations and increased access to mortgage credit, over time, the program standards of the individual agencies became less harmonious. This situation created confusion in the community association housing market as associations were required to meet different program criteria to ensure that mortgage financing would be available to residents. In 1994, CAI requested the GSEs, FHA and VA form a working group to facilitate a harmonization of program criteria.

The interagency working group met periodically over the course of two years seeking to eliminate individual program requirements that were no longer necessary given market developments and to achieve standardization through program reciprocity where possible. In

[49] All community associations have three defining characteristics: (1) membership is mandatory and automatic for all owners; (2) certain documents bind all owners to be governed by the community association; and (3) mandatory lien-based assessments are levied on each owner in order to operate and maintain the community association. There are three basic types of community associations: condominiums, cooperatives and planned communities.

[50] 2009 CAI National Survey

some circumstances, a statutory directive focused the agencies on different sectors of the housing market, and these differences prevented the publication of a unified set of recommendations among the agencies. The process did, however, produce tangible and positive results for the residents of community associations by allowing these homeowners to more easily connect with the housing finance system and live in well-governed and prudently managed communities.

The basis for the movement to standardize criteria for community association programs is the fact that residents of community associations have a mutual interest in the performance of the association. The fiscal condition of a community association has always had a direct bearing on the value of property in the association and the ability of the association to deliver the benefits that residents expect. While community associations may vary in scale, the basic requirements to maintain adequate reserves, prepare a realistic annual budget, obtain important insurance coverage, govern in a responsible manner, and levy and collect appropriate assessments are all similar, regardless of whether the community is a condominium, cooperative or planned community.

CAI's goal was, and is, to build a "partnership in community" among the many parties involved in making the community association model of homeownership successful, which includes the GSEs, FHA and VA. In many cases, CAI's effort to coordinate community association programs at the GSEs, FHA and VA led to stronger community associations. This has protected the value of the real property, securing mortgages purchased, insured or guaranteed by these agencies.

How the Financial Crisis Impacted Residents of Community Associations

As the financial crisis developed in 2008, it became apparent that lax mortgage underwriting and securitization standards, so pervasive from 2005 through 2007, exposed the entire financial system to substantial losses. Similar to other homeowners across the country, some residents of community associations purchased homes during this period with exotic mortgage products, which they could not have reasonably been expected to repay. As household budgets became severely constrained, many troubled borrowers in community associations ceased paying association assessments and, shortly thereafter, ceased making mortgage payments. In some cases, homeowners simply walked away from their homes, mortgages and associations.

The common bond between homeowners living in community associations caused the housing crisis to have a unique impact if the association was faced with a significant foreclosure rate. It is well documented that a foreclosure lowers property values for most neighboring homes, compounding any financial distress these homeowners may be experiencing. For residents of community associations, the impact of widespread foreclosures was magnified as a high number of homeowners ceased paying the assessments required to fund association operations. In many community associations, the association is responsible for waste removal expenses, maintenance of community infrastructure, utility services and insurance premiums. When an association has a sudden reduction in income and is forced to use emergency reserve funds to cover ongoing expenses, the only available means to recapitalize these funds are through assessment increases, special assessments or a combination of the two. As these costs are borne by residents of the association, homeowners who are otherwise in a healthy financial condition can be subjected to significantly higher housing costs, thereby increasing the number of financially distressed owners in the association. To further aggravate this situation, many associations have taken on

the expense of maintaining vacated homes and adjacent common areas for security and fire safety reasons, while mortgage lenders have intentionally delayed unpreventable foreclosures and failed to take title of properties to avoid paying association assessments.

As reported in CAI's September 2010 Association Impact Survey[51], the impact of the crisis was broad and profound for community associations. Approximately 54 percent of responding community associations described the impact of the housing and financial crisis as serious or severe. Vacant homes due to foreclosure, abandoned properties and other factors increased with more than 25 percent of communities reporting vacancy rates of greater than 6 percent. Most telling are data regarding association assessment delinquencies. In 2005, community associations across the country reported low rates of assessment delinquencies—95 percent of associations reported delinquency rates of less than 10 percent with 81 percent reporting delinquency rates of less than 5 percent. In 2010, approximately 35 percent of associations reported a delinquency rate of less than 5 percent; 32 percent of associations reported a delinquency rate of 6 to 10 percent; and 32 percent reported a delinquency rate of more than 20 percent.

Association boards, comprised of homeowners elected from the community, have responded to the crisis through a variety of means. The most commonly reported means of managing the crisis have been postponing planned capital improvement projects; laying-off staff and/or reducing work hours; reducing contributions to or borrowing from emergency reserve accounts; and, levying special assessments or increasing regular assessments. The economic impact of these actions is significant. In 2009, residents of community associations assessed themselves more than $41 billion for the purpose of funding association operations. Additionally, association boards maintain investment accounts of more than $35 billion for the long-term maintenance and replacement of commonly held property.[52] The contraction of operations forced on community associations by the housing and financial crisis has not only impacted the residents of those associations, but also the economies of the cities and towns in which they are located.

Community Associations Support Return to Prudential Underwriting Standards

CAI strongly supports new public policies demanding that mortgage originators and securitizers adhere to more strict credit underwriting standards for borrowers. CAI has supported the efforts of both the federal financial regulators and the Congress to require that mortgage originators verify a borrower's ability to repay a mortgage at the fully-indexed rate and to prohibit loans with predatory characteristics. Further, CAI strongly supported regulatory and congressional efforts to require that originators qualify borrowers on the basis of all monthly payments required to keep a mortgage current. The DFA contains specific language requiring that association assessments, which are lien-based and mandatory for all homeowners in the association, be included in the calculation of a borrower's mandatory monthly mortgage obligations.

The return to prudential management and operation standards in the nation's federally-insured financial institutions and non-bank lenders, as well as the imposition of new regulatory discipline on secondary mortgage market actors, is welcomed by CAI. A renewed focus on the fundamental business of banking—taking deposits, underwriting and making loans, and earning a reasonable

[51] Community Associations Institute: September 2010 Association Impact Survey
[52] 2009 CAI National Survey

return on the interest rate spread of these activities—will ensure that mortgage financing is available to creditworthy individuals and families, and that they are prepared for the financial burden necessary to maintain homeownership. Congress clearly intended to require that mortgage originators and securitizers employ fundamentally sound and historically valid loan underwriting standards as a means to avert a future housing crisis of this magnitude.

Regrettably, there have been recent instances in which federal agencies have not acted in a manner consistent with the new congressional mandate to enforce sound and historically verifiable underwriting standards for mortgages, and these actions have harmed the housing market. The FHA has implemented economically harmful and significant changes to its condominium insurance program without providing notice and opportunity for public comment. Additionally, the Federal Housing Finance Agency (FHFA) has sought to restrict the use of certain private transfer fee covenants in community associations and has proposed guidance directing the GSEs not to purchase or otherwise support any mortgage where the underlying property may be encumbered by a private transfer fee. CAI believes these actions go beyond the pale of prudential regulation, and CAI believes that rather than protecting the interests of homeowners these agencies are causing homeowners economic harm.

FHA Condominium Program Guidelines

On June 12, 2009, FHA released Mortgagee Letter (ML) 2009-19[53] announcing economically significant changes to the process by which condominium associations are certified to participate in FHA insurance programs. The announcement was not preceded by a notice in the *Federal Register* and, therefore, was not subject to prior notice or public comment. ML 2009-19 does not explain or justify how the new program guidelines protect borrowers or the associations they live in, nor did FHA offer any examination of compliance costs or the economic impact of the guidelines on condominium residents or associations. FHA followed ML 2009-19 with the release of ML 2009-46A and 46B[54] on November 2, 2009, which made further changes to the agency's condominium program, again, without providing notice to the public in the *Federal Register*.

The changes executed to FHA's condominium program guidelines have a material effect on the economic interests of many groups such as homeowners and their volunteer board members, attorneys, managers, insurers, planners, and developers. Yet, there is no evidence of outreach by FHA to communicate the need for such sweeping policy changes or to provide justification for the specific policy changes being implemented. Given the inclusive and deliberative process that FHA has used in the past to improve its condominium program guidelines, the agency's failure to seek public input is uncharacteristic of its public reputation. Put simply, FHA failed to follow the statutory requirement of Section 941 of the DFA that will guide your collective efforts to define the term "qualified residential mortgage."

The DFA provides guidance and direction to the agencies involved in the joint rule-making to define "qualified residential mortgage," stating that the agencies shall take "*…into consideration underwriting and product features that historical loan performance data indicate result in a*

[53] ML 2009-19

[54] ML 2009-46A; ML2009-46B

lower risk of default …"[55] FHA offers no empirical data demonstrating its unilaterally imposed condominium program guidelines are based on an evaluation of historical loan performance data and, therefore, fails to meet the rule-making standard set in Section 941. CAI urges your agencies to use a more inclusive and comprehensive approach to this rulemaking and reject a closed process that hinders rather than facilitates public input.

In addition to failing to meet the data-driven, empirically verifiable standard applied to the agencies in the formulation of a joint definition of "qualified residential mortgage," FHA has implemented its new condominium guidelines without adopting a new regulatory framework that could then be available in HUD Handbooks as are the other FHA programs. The Housing and Economic Recovery Act of 2008 moved the statutory authority for FHA's condominium program from Section 234(c) of the National Housing Act to Section 203(b) of the Act.[56] FHA has yet to engage in rulemaking to transfer regulatory authority from Section 234(c) to Section 203(b). While these legislative and regulatory changes were implemented as long as two years ago, FHA has made no effort to update its regulations or relevant HUD Handbooks, which provide specific guidance to homeowners and industry partners on the administration of FHA's condominium program. This has exposed many homeowners and community associations to legal uncertainty and constantly changing program requirements that are implemented differently across the country.

FHFA's Proposed Guidance on Private Transfer Fees

On August 16, 2010, FHFA published proposed guidance in *the Federal Register* directing that the GSEs not purchase, invest in securities or accept as collateral for advances any mortgage or security where the real property securing the mortgage or security is encumbered by a private transfer fee covenant.[57] The proposed guidance, as published, would have a devastating impact on millions of homeowners living in community associations across the nation by denying up to an estimated 11 million households access to the secondary mortgage market through the GSEs.[58] Given the breadth of impact, it is not surprising that more than 2,600 individual comments (an overwhelming majority in opposition) were submitted to FHFA in response to its proposal.

CAI's members commend FHFA for publishing the proposed guidance to the GSEs in the *Federal Register* even though no statutory requirement to do so existed. Yet, given the number of and the content of comments the agency received from the public, it appears the agency may not have clearly understood the impact its proposed guidance would have on the housing market. Further, in its proposed guidance, FHFA arrived at certain conclusions, yet failed to provide or make available the data used to support its conclusions. By failing to employ a data-driven, empirically verifiable process in developing its proposed guidance, FHFA failed to meet the statutory standard to be used in the joint rule-making process to define "qualified residential mortgage."

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[55] P.L. 111-203: Section 941(b)(e)(4)(B)—*Qualified Residential Mortgage*
[56] P.L. 110-289: Section 2117—*Insurance of Condominiums*
[57] FHFA No. 2010-N-11: *Guidance on Private Transfer Fee Covenants*
[58] *For the Common Good: Use of Community Transfer Fees by Community Associations*; September 27, 2010.

The Response to the Housing and Financial Crisis Should Address Causal Factors

CAI's members have been greatly disturbed by the actions of FHA with regard to the agency's condominium program and FHFA's proposal to restrict access to credit for any property encumbered by a transfer fee (regardless of whether or not the fee provides a direct benefit to the property). These policies seem to target community associations as a contributing factor to the housing and financial crisis. CAI's membership strongly rejects this notion.

Community associations are organized under state law and are comprised of individual homeowners bound together by private contract. Association boards are populated by volunteers from among these homeowners through fair and open elections governed by state law. These volunteers serve their neighbors by managing association operations, enforcing association rules, and ensuring compliance with federal and state law. This can be a tough assignment, but it is one that 2 million homeowners take on each year.[59]

CAI is not aware of any published or credible study identifying a causal link between community associations, and the lax mortgage underwriting standards and secondary market operations or the excessive leverage in the financial system that precipitated the housing and financial crisis. Association boards do not set loan underwriting requirements for homeowners nor do associations select the lenders that owners must use. Homeowners living in community associations did not cause the crisis; rather, many of these homeowners experienced significant economic loss due to poor business decisions of originators and secondary mortgage market actors. This is why CAI strongly believes the federal financial regulators should focus efforts on restoring sound underwriting practices in the mortgage finance industry and the secondary mortgage market rather than attempting to regulate the private contractual obligations between homeowners living in community associations.

Recommendations on Definition of "Qualified Residential Mortgage"

Residents of community associations understand the need for, and strongly support, improved underwriting standards for the mortgage lending industry and the secondary mortgage market. CAI strongly supports the return to sound mortgage lending and securitization practices. As mentioned earlier, CAI also has a long history of supporting and working with housing-related federal agencies and federal financial regulators to ensure that community associations are financially stable and well-managed. With this background and recent experience in mind, CAI respectfully offers the following recommendations for your consideration.

The qualified residential mortgage definition must recognize the presence of community associations in the nation's housing stock, respecting the decision of homeowners that choose the community association housing model and the local governments that support it as the most effective means of land planning and ensuring sustainable housing that does not require public financial support.

[59] 2009 CAI National Survey

- Section 941 is concerned with aligning the interests of originators and the secondary markets with those of the borrower by focusing on borrower qualification and the borrower satisfying the ability to repay standard.
- Regulators should avoid conditioning the extension of credit to qualified borrowers meeting all requirements of the ability to repay standard solely on the basis of a common ownership element of the real property securing the mortgage.
- Housing-related government agencies and individual lenders should retain the responsibility to determine whether or not to extend credit to qualified borrowers for the purchase of a home in a community association on the basis of their own statutory and risk requirements.
- A qualified residential mortgage standard that promotes sustainable mortgage lending to creditworthy borrowers will allow qualified consumers to purchase housing of their choice and promote healthy, vibrant, and sustainable neighborhoods and community associations.

The qualified residential mortgage definition should not restrict access to mortgage credit and/or the secondary mortgage markets for residents of community associations.

- CAI urges you to carefully consider the legal basis for the structure and governance of community associations in recorded covenants, as well as state and common property law when constructing the definition of qualified residential mortgage.
- Given that more than 300,000 individual community associations exist across the nation, CAI encourages a careful and deliberate analysis of common legally valid concepts in recorded covenants and state and common property law for any element of the qualified residential mortgage definition that may affect the management and operation of community associations.
- As residents of community associations are governed by private contractual obligations duly authorized by state law and/or conventional real estate transaction, the federal government has limited authority to interfere with the terms of these contracts.
- Any criteria included in the definition of qualified residential mortgage that compels community associations to amend existing and enforceable contractual obligations will have a significantly negative effect on millions of American homeowners by restricting their access to mortgage credit.
- CAI notes that in correspondence to your respective agencies on the development of the qualified residential mortgage definition, the Mortgage Bankers Association states:

> *The potential impact on the availability of credit stemming from the QRM risk retention exemption cannot be overestimated. The design of the QRM and the "Qualified Mortgage" (QM) under the "ability to repay" provisions of Title XIV of the DFA will largely govern who can and cannot achieve homeownership for years to come. Few loans to ordinary customers are likely to be made*

outside the QRM construct; the loans that are made will be costlier and likely to be made only to more affluent customers.[60]

- As loans not satisfying the qualified residential mortgage definition will be severely limited, CAI is concerned that unanticipated consequences of any underwriting criteria specifically applied to community associations will devastate millions of American households by rendering their largest asset unmarketable.

Strict adherence to the statutory directive that the definition of qualified residential mortgage be based on empirical data that is verifiable, subject to public review and scrutiny, and is historically-demonstrated to have a significant correlation to reduced borrower default.

- CAI urges that the qualified residential mortgage definition be developed through strict adherence to the statutory directive that underwriting criteria be clearly demonstrated by verifiable and testable data to reduce the likelihood of borrower default.
- Data driven standards that are testable and, therefore, verifiable will ensure only those underwriting criteria shown to reduce the likelihood of borrower default will define the qualified residential mortgage basket of loans.
- CAI urges that data sets and tests demonstrating the efficacy of individual underwriting requirements for the qualified residential mortgage basket of loans be published in the *Federal Register* and available for public review.
- To ensure the efficacy and relevancy of the underwriting criteria and to provide opportunity to address unintended market impacts, CAI urges the rule defining qualified residential mortgage establish a regular periodic review of the definition.

To ensure transparency in the development and application of the qualified residential mortgage definition, the Department of Housing and Urban Development should publish the historical and actual performance data used to support its underwriting criteria for all single family FHA insurance programs.

- The statutory exemption granted FHA insured loans from the risk retention requirements of Section 941 of DFA confer upon FHA programs qualified residential mortgage status.
- Given the substantial concern that this statutory exemption will lead to increased usage of FHA programs and the likely adoption of FHA underwriting criteria by a substantial portion of the mortgage finance industry, markets and consumers will benefit from additional transparency and disclosure of the justification for FHA program underwriting criteria.
- CAI believes FHA's newly developed condominium program guidelines offer a case study on the need for additional transparency and disclosure in FHA operations.
- To date, FHA has imposed the following restrictions on its condominium program that have eliminated access to FHA programs for many condominium owners:
    - Rental restrictions:

[60] Letter from the Mortgage Bankers Association to Financial Regulators Developing Qualified Residential Mortgage Definition: November 9, 2010.

        - Condominiums may not have less than 50 percent of units owner-occupied.
        - FHA has prevented condominiums from adopting policies to restrict the percentage of leased-units to less than 50 percent of total units in order to comply with FHA guidelines.
    - Delinquency rates:
        - FHA will not insure loans in a condominium where 15 percent of association assessments are more than 30 days in arrears.
        - FHA includes REO properties that are delinquent on assessments in its calculation, despite the fact that the delinquency rate criteria disqualifies many of its own REO from borrowers seeking FHA financing.
    - Commercial space limitations:
        - FHA restricts to 25 percent the amount of space used for commercial purposes in mixed-use developments.
        - This policy is in direct conflict with other federal programs, many sponsored by HUD, to encourage more environmentally-friendly housing in locations convenient to employment, healthcare facilities, transportation hubs and other services.
- CAI urges additional transparency and disclosure for FHA program guidelines to ensure that further revisions in its single family programs comply with the standards applied to all other underwriting criteria required for the qualified residential mortgage exemption.
- Additional transparency in FHA's single family programs will ensure that residents of community associations will be protected from any unintended consequences of changes to FHA programs that may affect their eligibility for FHA-insured mortgages and/or refinancing based not on their creditworthiness, but on a regulatory determination regarding their association's governance and operations.

To ensure consumer choice and attract private capital to the mortgage market, the qualified residential mortgage definition should be as broad as the statute permits.

- To guard against overutilization of FHA due to its statutory exemption from DFA Section 941 risk retention requirements, CAI urges that the definition of qualified residential mortgage be broader than FHA's traditional market.
- Given the limitations of Section 941 on the scope of the qualified residential mortgage definition placed on regulators, CAI believes it appropriate for the standard to be as broad as the statute allows.
- CAI believes an overly restrictive qualified residential mortgage definition will limit consumer choice and ensure that public resources rather than private capital will support the housing finance system as the mortgage finance industry will have a substantial incentive to mainly originate mortgages eligible for FHA insurance to ensure legal safe harbor.
- CAI urges that FHA program standards serve as a floor for the definition of qualified residential mortgage and that the "Qualified Mortgage" standard in Section 1412 of the DFA serve as the definition's ceiling.
- By taking as broad a definition as the statute will allow, the qualified residential mortgage exemption can be crafted to allow the GSEs (or their successors) and private

firms to compete in the secondary market, providing efficiently priced and appropriately constructed mortgages to qualified borrowers.

CAI appreciates the difficult and sensitive work involved in crafting a definition of qualified residential mortgage that fulfills the intent of Congress and that promotes the return of private capital to our nation's housing finance system. The recent experiences of community associations discussed in this letter demonstrate the impact that seemingly narrow regulation can have on homeowners living in community associations if not carefully constructed. CAI's members are committed to the principle that qualified borrowers should have access to credit on fair terms so they are free to live in housing of their choice—an American aspiration that the housing and financial crisis has jeopardized. We look forward to working with you to attain this shared goal.

Sincerely,

Thomas M. Skiba, CAE
Chief Executive Officer

Appendix B

CAI MEMBER RESPONSES TO PROPOSED QUALIFIED RESIDENTIAL MORTGAGE REGULATIONS

Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 granted seven federal agencies the power to set mortgage lending standards. This past March, the bank regulators released draft guidelines for mortgages that will meet the new Qualified Residential Mortgage (QRM) standard. Major mortgage lenders and large investors that purchase mortgage loans in the secondary mortgage market have said that mortgage loans meeting the QRM standard will be in high demand. Because banks would have to retain a share of any loan that does not meet the standards of QRM, it is anticipated that buyers who do not meet the new requirements will have limited options for homeownership. As a result, the proposed QRM standard has the potential to radically change the way Americans approach homeownership.

Because more than one in five homes in the United States is in a community association, CAI members have a stake in the outcome of any rulemaking process. The common ownership element that is the foundation of community associations also means that homeowners in community associations are actively engaged in the governance of their neighborhoods in a manner above that of a homeowner who does not live in a community association. It also means that the value of their property and its marketability are linked to the overall financial health of the community association in which they live. As result, CAI member comments have a uniquely informed perspective that will benefit regulators.
Amidst agency discussion and justification for the decisions taken in crafting the proposed rule, the proposed rule seeks public comment on 174 issues. Public comment on the proposed rule must be received by August 1, 2011. This survey was a mechanism for participation by CAI members in the QRM rule making process.

Survey Process

CAI's Proposed Mortgage Regulation Member Survey contained 12 questions on the topic of the QRM standard. The survey was sent to all CAI members. The survey was open May 20-31, 2011. A total of 331 members responded. 10 questions contained multiple choice answers, and 3 of those questions allowed for the respondent to provide their own comment, limited to 300 words. Respondents were asked to exclusively provide their comments on 2 questions.

A QRM Frequently Asked Questions document was attached to the member survey request. The FAQ was created by the CAI's Government and Public Affairs Department and may be found here.

Survey Highlights

- 67 percent of the respondents believe that federal regulators need to be careful moving forward to make sure Americans can still afford to buy a home.

- 61.5 percent of the respondents believe that requiring a 20 percent down payment would create too great a hurdle for most potential homebuyers to overcome.

- 55.7 percent of the respondents disagree with the requirement that only owner occupied properties may qualify for the QRM standard.

- 55.5 percent of the respondents feel full walkthrough appraisals should only be required for purchase mortgages and should not be required for refinance mortgages.

- Respondents do support the QRM proposal to ban or restrict certain types of mortgage practices, including:
    - Negative amortization (60.1 percent)
    - Prepayment penalties (59.8 percent)
    - Balloon payments (43.3 percent)

- 69.8 percent of the respondents feel that requiring borrowers to finance closing costs, in addition to a 20 percent minimum down payment is unnecessary and unrealistic.

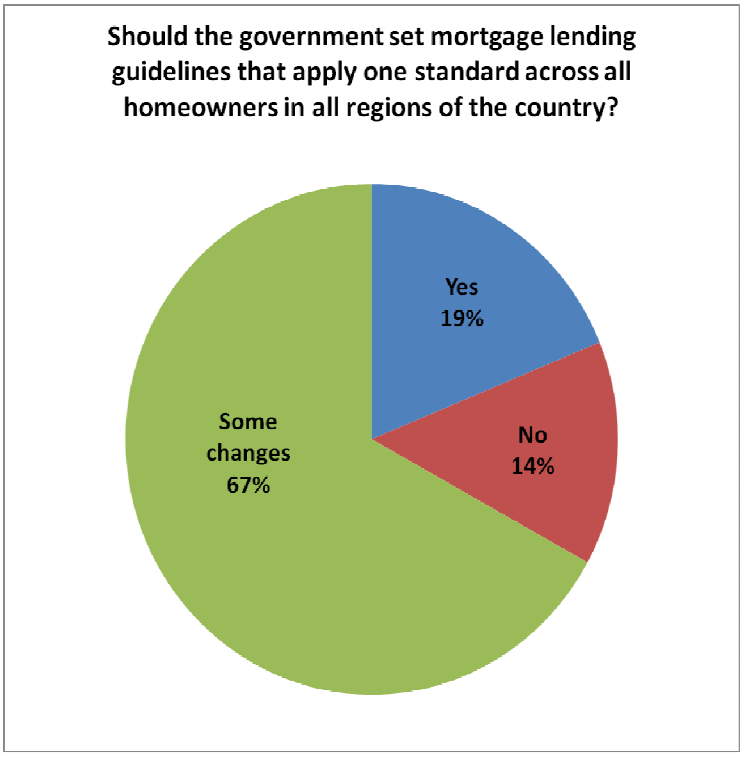
- 51.9 percent of the respondents disagree with the new limitations in the proposed QRM standard on retained equity

- Respondents are supportive of the QRM proposal to disqualify buyers from mortgages if the buyer:
    - Had property repossessed in the prior 36 months (75.9 percent)
    - Reported bankruptcy, short-sale, or deed-in-lieu of foreclosure in the prior 36 months (74.1 percent)
    - Were subject to a court order to repay a debt in the prior 36 months (59 percent)

- 63.6 percent of the respondents believe the borrower should have a direct right of appeal with the lender on an issue that disqualified the borrower from meeting the QRM standard.

- 60.5 percent of the respondents feel federal banking regulators have not struck an appropriate balance in crafting the proposed QRM standard.

Survey Findings

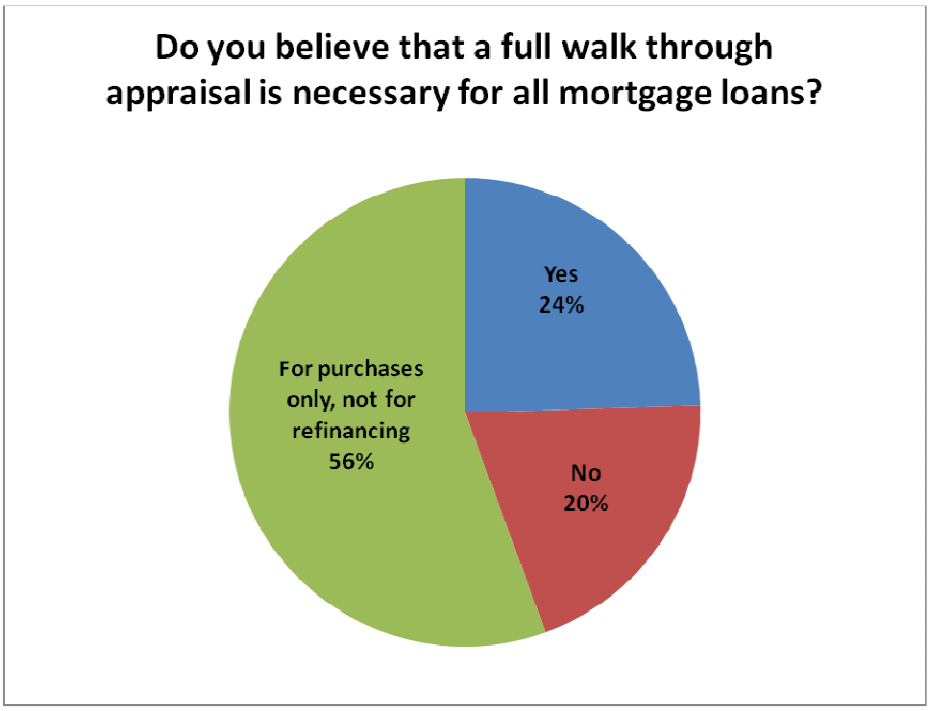


In addition, some respondents provided their own responses to the question of whether they believe the federal government should set standard mortgage lending guidelines. The most common responses were:

- The federal government should not over regulate the industry with a one-size-fits-all lending standard (9).
- The federal government should not be involved at all, as lending is between the buyer and private sector (8).
- The federal government should heavily regulate private lenders (6).

Respondents were asked if they agreed with the requirement that only owner occupied properties may qualify for the QRM standard. 55.7 percent of the respondents do not agree with the requirement. 44.3 percent of the respondents agree with the requirement.

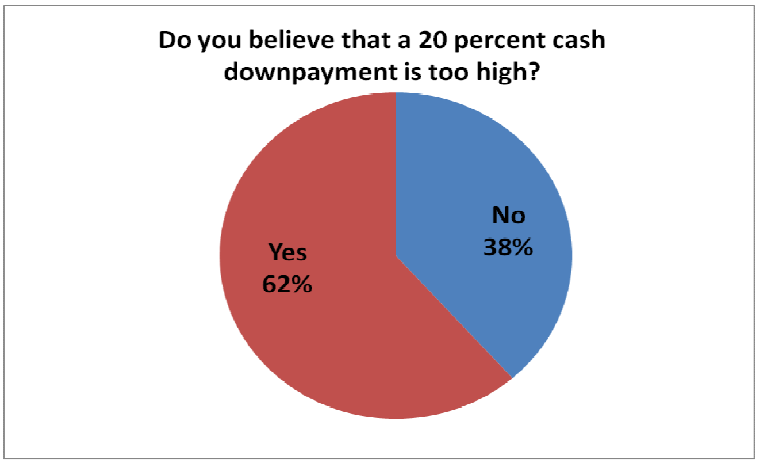
Respondents were asked if they agree with the QRM standard of interest rate limitation on Adjustable Rate Mortgages (ARMs). 78.4 percent of the respondents agree with the QRM's standard of interest rate limitations on ARMs. 21.6 percent of the respondents do not agree with these limitations.



Which loan terms should be banned?

Negative amortization	60.1%
Prepayment penalties	59.8%
Balloon payments	43.6%
Interest only payments	39.9%
Combined interest points and loan fees exceeding 3 percent of the loan	39.3%
Loans longer than 30 years or less than 12 months	31.6%
I believe all of these loan terms should be prohibited in the QRM standard	20.2%
No, all these forms of mortgages are useful provided the terms and rules are fair and reasonable.	17.5%

Respondents were asked whether they feel borrowers should be able to finance closing costs. 69.8 percent of the respondents feel borrowers should be able to finance closing costs. 30.2 percent of the respondents agree that closing costs should not be financed.



In addition, respondents were asked whether the U.S. Department of Housing and Urban Development's suggested minimum 10 percent down payment applied with mandatory mortgage insurance is a more appropriate standard, or if they had a better solution. 39.9 percent of the respondents provided their idea of the best policy solution. Below were the most common answers:

- The 20 percent down payment is too high; buyers with excellent credit, stable job history and proper mortgage insurance should qualify for the 10 percent down payment (41).
- Mortgages are very individualized and the market should set the standard not the federal government, so the government should not intervene (12).
- The down payment should vary with the borrower's income-to-debt ratio and credit history (12).

Respondents were asked if they feel the new limitations in the proposed QRM standard on retained equity are appropriate. 51.9 percent of respondents feel these limitations are not appropriate, because many borrowers need access to the equity in their homes for legitimate purposes. 48.1 percent of the respondents feel these limitations are appropriate, because equity is one of the leading indicators in mortgage default, and homeowners with more equity are less likely to default on their mortgage.

What Negative Credit History Terms Should Disqualify a Borrower from Meeting the QRM Standard?	
Borrower(s) had property repossessed in the prior 36 months.	75.9%
Borrower(s) has a reported bankruptcy, short-sale, deed-in-lieu of foreclosure in the prior 36 months.	74.1%
Borrower(s) was subject to a court order to repay a debt in the prior 36 months.	59.0%
Borrower(s) has one or more 60-day delinquency noted in a credit report in the prior 24 months.	34.6%
Borrower(s) has one or more 30-day delinquency on any existing debt.	6.2%

Respondents were asked if they feel federal banking regulators have struck an appropriate balance in crafting the proposed QRM standard. 60.5 percent of the respondents believe the federal banking regulators have not struck an appropriate balance, and regulators need to rethink the QRM proposal and come back with a policy that will promote responsible lending and homeownership. 39.5 percent of the respondents believe the federal banking regulators have struck an appropriate balance, and the higher standards will mean better loans, with more stable communities and lower foreclosure rates. Respondents provided their own response to whether the federal banking regulators have struck an appropriate balance in crafting the proposed QRM standard. The following were the most general comments:

- The federal government should not be involved.
- There needs to be room for case-by-case scenarios.
- The federal government has not done enough to regulate lenders and the industry.
- More requirements should be made against the borrowers.

60.5 percent of the respondents feel federal banking regulators have not struck an appropriate balance in crafting the proposed QRM standard.

Finally, respondents were asked if there were any important issues related to the QRM standard that were not covered in CAI's Proposed Mortgage Regulation Member Survey. The following were the two most common questions:

- What steps are being put forward to limit predatory lending practices in the United States?
- What QRM standards regulate the banks and lending institutions?