National Association of Home Builders

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August 1, 2011

Federal Deposit Insurance Corporation
550 17th Street, NW
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Attn: Robert E. Feldman,
Executive Secretary
FDIC: RIN 3064-AD74
comments@FDIC.gov

Board of Governors of the
Federal Reserve System
20th Street & Constitution Ave, NW
Washington, DC 20551
Attn: Jennifer J. Johnson, Secretary
Federal Reserve: Docket No. R-1411
regs.comments@federalreserve.gov

Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552
Attn: Alfred M. Pollard, General
Counsel
FHFA: RIN 2590-AA43
RegComments@FHFA.gov

Department of Housing and Urban
Development
451 7th Street, SW
Room 10276
Washington, DC 20410–0500
Attn: Regulations Division,
Office of the General Counsel
HUD: FR-5504-P-01
www.regulations.gov

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn: Elizabeth M. Murphy, Secretary
SEC: File Number S7-14-11
Rule-comments@sec.gov

Office of the Comptroller of the
Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
OCC: Docket No. OCC-2011-0002
regs.comments@occ.treas.gov

Re: Credit Risk Retention; Proposed Rule

Dear Sir or Madam:

On behalf of the National Association of Home Builders (NAHB), I appreciate the opportunity to submit comments on the above-referenced proposed rule[1] issued jointly by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Securities and Exchange Commission and Department of Housing and Urban Development, (collectively, the "Agencies") to implement the credit risk retention requirements of section 15G of the Securities and Exchange Act of 1934 (15 U.S.C 780-11), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act", or the "Act").

[1] Credit Risk Retention, 76 Fed. Reg. 24090 (April 29, 2011) [hereinafter, "proposed rule"]

NAHB is a Washington-based trade association representing more than 160,000 members involved in a wide variety of housing activities, including the development and construction of single-family for-sale housing; the development, construction, ownership, and management of affordable and market-rate multifamily rental housing; and the development and construction of light commercial properties.

The ability of the home building industry to meet the demand for housing, including addressing affordable housing needs, and contribute significantly to the nation's economic growth is dependent on an efficiently operating housing finance system that provides adequate and reliable credit to home buyers and home builders at reasonable interest rates through all business conditions. The securitization of residential mortgage loans is a critical component of ensuring that sufficient capital exists for home loans and has allowed for a more consistent flow of credit throughout the country. Additionally, the commercial mortgage backed securities (CMBS) market has been an important component of the commercial real estate finance market, including financing of multifamily rental properties.

The proposed rule has far-ranging implications across the housing and development sectors. Each aspect of the proposed rule will have a significant impact. The narrow definition of a Qualified Residential Mortgage (QRM) would have a severe adverse impact on the availability and cost of residential mortgages. The proposed requirements on Qualified Commercial Real Estate (QCRE) loans would be virtually impossible to meet and would have a wide-spread and detrimental impact on financing the development of multifamily and commercial properties. The premium capture cash reserve account (PCCRA) has the potential to distort the securitization market and create a disincentive for private investors.

NAHB understands that establishing credit risk retention rules was required by the Dodd-Frank Act. However, NAHB is very concerned about the immediate impact this proposed rule will have at this precarious point in the economic recovery and the future implications of overly restrictive rules on future growth of the housing market and the entire economy. NAHB urges the Agencies to take the time to carefully craft these new regulations so as not to have a negative impact on residential and commercial real estate financing. Historically, residential investment and housing services have been on average a combined 17 to 18 percent of gross domestic product (GDP). While the share of GDP tends to vary over the business cycle, there is no denying that housing is a large portion of the national economy, and reworking the entire housing finance market should not be taken lightly. With so much at stake, these regulations should not be rushed.

For these reasons, NAHB requests that the proposed rule be withdrawn and re-proposed as an Advanced Notice of Proposed Rulemaking (ANPR). An ANPR is necessary given the implications and complexity of the proposed regulations under the Dodd-Frank Act. In this case, it would be appropriate for the Agencies to seek additional information from the public to assist them in framing a subsequent notice of rulemaking. Given the volume and detail of the public comments associated with the currently proposed regulation, it is likely that the final rule will differ materially from the proposed rule. Because of the probability that the final rule will not be a "logical outgrowth" of the original rule, it will be vulnerable to challenge based on inadequate notice without a new round of public comment.[2]

Overview

Section 941 of the Dodd-Frank Act[3] regulates credit risk retention by requiring loan originators and securitizers to hold at least five percent of the credit risk between them, with noted exemptions – one of which is the QRM exemption, discussed further below. The genesis of this risk retention requirement is the belief that the credit crisis occurred because lenders and securitizers did not have "skin in the game" and therefore did not ensure that the loans were sound and borrowers were creditworthy.

NAHB's members have supported steps to ensure that mortgage lending occurs in a safe and sound manner, with appropriate underwriting, prudent risk management and sound consumer safeguards and disclosure. The housing system and the economy have been affected deeply by the consequences of inappropriate underwriting standards and risky loan features. The housing sector continues to suffer from the resulting foreclosures, which negatively impact demand from buyers and drive down home prices.

In addition, NAHB supports the exemptions created by the legislators for the QRM and the government-backed mortgage programs in order to ensure the flow of capital to the housing market through loans with features that historically have performed well. However, NAHB is very concerned that as a result of the proposed rule, additional capital will have to be retained by the lenders. The amount of capital will vary, but without the correct exemptions, the net effect will be to make securitization less effective and unnecessarily raise the cost of mortgages.

As we work together to bolster the housing finance system and ultimately the American economy, it is critical that we get these regulations correct because of the importance of housing in both economic and social terms. According to a poll[4] conducted on behalf of NAHB, home owners and non-owners alike consider owning a home essential to the American Dream despite the ups and downs of the housing market. The survey results show that Americans see beyond the immediate housing market to the enduring value of homeownership. An overwhelming 75 percent of the people who were polled said that owning a home is worth the risk of the fluctuations in the market, and 95 percent of the home owners said they are happy with their decision to own a home.

Even though the market is weak, people who do not own say they want to buy a house. Almost three-quarters of those who do not currently own a home, 73 percent, said owning a home is one of their goals. And among younger respondents who are most likely to be in the market for a home in the next few years, the percentages are even higher. However, saving for a downpayment and closing costs was cited as the biggest barrier to homeownership.

[2] *See Nat'l Mining Ass'n v. MSHA,* 116 F.3d 520, 531 (D.C. Cir. 1997).
[3] Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or the "Act"), Pub. L. No. 111-203, §941(b), 124 Stat. 1376, 1890 (2010)
[4] This national survey of 2,000 likely 2012 voters was conducted May 3-9, 2011 by Public Opinion Strategies of Alexandria, Va., and Lake Research Partners of Washington, D.C. It has a margin of error of +/-2.19%.

NAHB also notes that the proposed risk retention requirements have the potential to significantly affect the rental housing markets. Almost one-third of Americans live in rental housing, and demand for rental housing in the future is expected to increase. In particular, NAHB estimates that the aging of the "echo boom" generation will result in demand for between 300,000 and 400,000 multifamily housing units on average per year over the next ten years. The timing of this demand will depend on the pace of economic recovery, but the housing needs of these households will not be postponed indefinitely. The current average pace of multifamily housing starts of less than 120,000 annually is insufficient to meet this demand. Production of multifamily housing will undoubtedly increase above the current extraordinarily low levels. Therefore, it is important that the financing mechanisms and access to capital to support production of multifamily rental housing are available.

As the Agencies craft new rules governing the future of mortgage financing, these are important points to consider. When finalized, the proposed rule, and in particular the definition of a QRM, will determine the future of the mortgage market for years to come. NAHB urges the Agencies to consider the long-term ramifications of these rules on the market and not to place unnecessary restrictions on the housing sector based solely on today's economic conditions. Overly restrictive rules will prevent willing, creditworthy borrowers from entering the housing market even though owning a home remains an essential part of the American Dream.

Qualified Residential Mortgages

<u>Overview</u>

The definition of Qualified Residential Mortgage (QRM) is an important component of the risk retention rule. The Dodd-Frank Act specifies that the QRM definition is to be based on mortgage underwriting and product features that historically indicate a lower risk of default. The statute also notes the requirement that the QRM exemption shall "help to ensure high quality underwriting standards," "encourage appropriate risk management practices" and "improve the access of consumers and businesses to credit on reasonable terms, or otherwise be in the public interest and for the protection of investors."

In defining QRM, the Dodd-Frank Act directs the Agencies to consider:

1) documentation and verification of the financial resources relied upon to qualify the mortgagor;
2) standards with respect to (a) the residual income of the mortgagor after all monthly obligations; (b) the ratio of the housing payments of the mortgagor to the monthly income of the mortgagor; (c) the ratio of total monthly installment payments of the mortgagor to the income of the mortgagor;
3) product features and underwriting standards that mitigate the potential for payment shock on adjustable rate mortgages (ARMs);
4) mortgage guarantee insurance or other types of insurance or credit enhancement obtained at the time of origination, to the extent such insurance or credit enhancement reduces the risk of default; and

5) product features that prohibit or restrict the use of balloon payments, negative amortization, prepayment penalties, interest-only payments, and other features that have been demonstrated to exhibit a higher risk of borrower default.

Summary of Proposed QRM Rule

The proposed rule limits the definition of a QRM to a closed-end first-lien mortgage to purchase or refinance a one-to-four family property, at least one unit of which is the principal dwelling of the borrower, and includes the following very conservative underwriting standards:

- Borrowers must have a 20 percent downpayment for a purchase transaction. (Junior liens used to purchase a home and financing of closing costs would be prohibited. Acceptable sources of the downpayment include the borrower's savings/checking accounts, cash saved at home, stocks/bonds, and gifts including eligible downpayment assistance programs.)
- Loan-to-value (LTV) requirements would be 80 percent LTV for home purchase, 75 percent combined LTV for refinancing, and 70 percent LTV for cash-out refinancing. (The presence of certain junior liens, such as home equity loans, would be permitted in refinancing transactions.)
- Borrowers cannot be currently 30 or more days past due, in whole or in part, on any debt obligation or have been 60-days delinquent, in whole or in part, on any debt obligation within the preceding 24 months. Further, a borrower must not have been a debtor in a bankruptcy proceeding, had a property repossessed or foreclosed upon, engaged in a short sale or deed-in-lieu of foreclosure or been subject to state or federal judgment for collection of any unpaid debt within the preceding 36 months. (A safe harbor for the documentation and verification requirements is proposed if the originator obtains credit reports no more than 90 days before closing of the mortgage from at least two consumer reporting agencies confirming the accuracy of the information.)
- Borrower must have a debt-to-income ratio of no more than 28 percent for mortgage/housing debt and 36 percent for total debt.
- Restricts total points and fees to no more than three percent of the loan amount with an exception for third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator. (emphasis added)

The proposed rule prohibits QRMs from having product features that add complexity and risk to mortgage loans, such as terms permitting negative amortization, interest-only payments, or significant interest rate increases. Both fixed rate and adjustable rate mortgages (ARMs) may qualify as a QRM. The Agencies proposed limiting the amount by which interest rates may increase on ARMs to two percent in any 12-month period and six percent over the life of the mortgage. Also, the proposal includes mortgage servicing requirements and would prohibit prepayment penalties.

Qualified Mortgages

On July 22, 2011, NAHB submitted comments on the proposed rule amending Regulation Z (Truth in Lending) to implement amendments to the Truth in Lending Act (TILA) made by the Dodd-Frank Act issued by the Board of Governors of the Federal Reserve System (the "Board")[5]. This proposed rule would implement statutory changes made by the Dodd-Frank Act that expand the scope of the Regulation Z ability-to-repay requirement to cover any consumer credit transaction secured by a dwelling. In addition, the proposal would establish standards for complying with the ability-to-repay requirement, by making a "qualified mortgage" (QM). NAHB's comment letter on the Board's proposal is attached for your reference.

The Dodd-Frank Act links the QM with the QRM by stating that the definition of a QRM can be "no broader than" the definition of a QM. As stated in the attached letter, NAHB supports a safe harbor for the qualified mortgage; since the QRM is intended to be a subset of the QM, this safe harbor would be applied to the QRM. Although the new Consumer Financial Protection Bureau (CFPB) is responsible for implementing the ability-to-repay standard, the link between QM and QRM is critical and should be taken into consideration in developing the risk retention rules.

In the proposed credit risk retention rule, the Agencies state that they "expect to monitor the rules adopted under TILA to define a QM and will review those rules to determine whether changes to the definition of QRM are necessary or appropriate to ensure that the definition of a QRM is 'no broader' that the definition of a QM…" NAHB believes that it would be imprudent to release final credit risk retention rules prior to finalizing the QM rule. The market will have to make major adjustments to accommodate the proposed rules, and the potential for changing or reopening the QRM standards to adjust to the QM would create a disruption in the markets as they try to implement these changes.

<u>NAHB Position: Proposed Narrow QRM Definition Will Harm the Housing Market</u>

NAHB appreciates the balance that the Dodd-Frank Act encapsulates when providing QRM as an exemption from the risk retention requirement. The importance of correctly defining the QRM exemption cannot be overstated. The final QRM definition will determine the availability and cost of mortgage credit. The QRM will likely become the new "conforming mortgage" with limited and more costly loans made to borrowers who do not meet the QRM requirements.

Given the importance of the QRM standard, NAHB strongly believes the proposed rule contains an unduly narrow definition of QRM that would seriously disrupt the housing market by making mortgages unavailable or unnecessarily expensive for many creditworthy borrowers. This extreme proposal could not have been put forward at a less opportune time. The housing market is still weak, with a significant overhang of unsold homes, and an equally large shadow inventory of distressed loans. A move to a larger downpayment standard at this juncture would cause renewed stress and uncertainty for borrowers who are seeking or are on the

[5] Regulation Z; Truth in Lending, 76 Fed. Reg. 27390 (May 11, 2011).

threshold of seeking affordable, sustainable homeownership. We believe a more balanced QRM exemption is imperative in light of the enormous potential impact it would have on the cost and availability of mortgage credit at this precarious point in the housing cycle.

It appears to NAHB that the Agencies did not give sufficient weight to statutorily required considerations in formulating their QRM proposal, which directed that the definition be based on objective, empirical data rather than subjective presumptions. The statute also requires a multifactor approach to establishing the parameters of the QRM in order to promote sound underwriting practices without arbitrarily restricting the availability of credit. The Agencies have admitted that they deliberately selected an extremely conservative approach to create a very limited QRM basket.

Creating an inordinately narrow QRM exemption would cause significant disturbance in the fragile housing market. Today's credit standards are tougher than they have been in decades. As a result, credit availability is extremely tight even for very well-qualified borrowers. NAHB strongly urges the Agencies to consider the negative ramifications of setting further limits on the availability of credit through a comparatively narrower QRM exemption. Under the proposed standard, millions of creditworthy borrowers would be deemed, by regulatory action, to be higher-risk borrowers. As a result, they would be eligible only for mortgages with higher interest rates and fees.

An overly restrictive QRM definition also would drive numerous current lenders from the residential mortgage market, including thousands of community banks, and enable only a few of the largest lenders to originate and securitize home loans. This sharp dilution of mortgage market competition would have a further adverse impact on mortgage credit cost and availability.

A QRM definition that is too narrow would prohibit many potential first-time homebuyers from buying a home, especially if the definition includes an excessively high minimum downpayment requirement. Repeat buyers and refinancers also would be adversely impacted if the QRM includes exceedingly high equity requirements. In other words, the important goal of clearing the historically high foreclosure inventory – a necessary condition for a stabilized housing market – will be undermined.

The purpose of the QRM is to create a robust underwriting framework that provides strong incentives for responsible lending and borrowing. Loans meeting these standards will assure investors that the loans backing the securities meet strong standards proven to reduce default experience. The exemption also will keep rates and fees lower on QRMs, which will provide incentives for borrowers to document their income and choose lower risk products. In turn, the market will evolve to establish the appropriate mixture of QRM to non-QRM borrowing.

The majority of industry participants (lenders, home builders, realtors, mortgage insurers), key consumer groups, and the sponsors of the QRM language in the Dodd-Frank Act support a broad QRM definition that would encompass the bulk of residential mortgages that meet the lower risk standards of full documentation, reasonable debt-to-income ratios and restrictions on risky loan features. In addition, most believe that loans with lower downpayments that have risk mitigating features, most notably mortgage insurance, should be included in the QRM exemption.

NAHB recommends the broadest criteria possible should be utilized in defining a QRM exemption that will ensure the safe and sound operation of the mortgage market while accommodating a wide range of viable mortgage borrowers.

Congressional Intent

By giving the QRM a narrow definition, the Agencies have acted contrary to clear Congressional intent under the Dodd-Frank Act. Quite simply, Congress could have, but did not, specify a clear minimum downpayment provision under the QRM definition.

By its plain meaning, the Dodd-Frank Act never directed the Agencies to incorporate a downpayment requirement as an element of the QRM definition. Congress has itself repudiated the use of a minimum downpayment as an element to the QRM. This intent is evident in both the Dodd-Frank Act's legislative history and recent statements by several Senators and Representatives from both parties.

Recently, members of Congress have explicitly and publicly reiterated this intent in letters to the Agencies. Through individual and joint letters, more than 50 Senators and 300 members of the House of Representatives told the Agencies that the QRM was intended to be a broad exemption from risk retention requirements limited to the considerations expressly outlined in the Act. The Senators explained that the proposed regulation imposes "unnecessarily tight downpayment restrictions [that] . . . unduly narrow the QRM definition and would necessarily increase consumer costs and reduce access to affordable credit." A letter from the House of Representatives articulated similar concerns, stating that "[t]he proposal to require a minimum 20 percent downpayment requirement under the QRM definition would reduce the availability of affordable mortgage capital for otherwise qualified consumers."

While it is hard to fathom a clearer enunciation of Congressional intent, the Dodd-Frank Act's legislative history also shows that the proposed rule has gone too far. The legislative history shows that Congress was seeking a broad exemption not constrained by a rigid downpayment requirement. In fact, the Senate expressly rejected an amendment that imposed a mandatory downpayment requirement.[6] The Senators were particularly concerned that even a five percent minimum downpayment requirement would adversely affect the ability of low- and moderate-income families to get mortgages.[7]

In this case, the evidence of Congressional intent stems both from the plain meaning of the statute and legislative history. Both statutory language and legislative history are the traditional tools of statutory construction, which "include examination of the text of the statute, dictionary definitions, cannons of construction, statutory structure, legislative purpose, and legislative history."[8]

[6] 156 Congressional Record S3574 (May 12, 2010).
[7] 156 Congressional Record S3518, and S3520.
[8] Ronald M. Levin, *A Blackletter Statement of Federal Administrative Law,* 54 Admin. L. Rev. 1, 37 (2002).

Because the Dodd-Frank Act exhaustively listed the appropriate components of the QRM, which did not include a minimum downpayment, the statute's plain language shows that the Agencies were not given discretion to add entirely new elements to the QRM.

NAHB Comments on Proposed QRM Criteria

NAHB is a member of the Coalition for Sensible Housing Policy, a diverse coalition of more than 40 consumer organizations, civil rights groups, lenders, real estate professionals, insurers and local governments. This coalition submitted a joint white paper as a formal comment letter to the Agencies on the proposed rule on August 1, 2011[9]. NAHB strongly supports the points covered in the white paper, a copy of which is attached. As per the white paper, NAHB agrees that the Agencies should redesign a QRM that comports with Congressional intent: encourage sound lending behaviors that support a housing recovery, attract private capital and reduce future defaults without punishing responsible borrowers and lenders.

The proposed rule contains several provisions in the definition for the QRM that concern NAHB. While a more thorough analysis is included in the joint comment letter, NAHB would like to reiterate several of our concerns. In particular, NAHB believes that the loan-to-value (LTV) thresholds, including the required 20 percent downpayment for home purchases, debt-to-income (DTI) ratios and credit history requirements are too conservative.

Downpayment

The downpayment requirement in particular will keep many creditworthy low- to moderate-income borrowers out of the housing market for years to come. As the data in the white paper show, it would take a family with the national median income of $50,474 approximately 16 years to save a 20 percent downpayment (plus closing costs) to purchase the median price home of $172,900 (2010 data). A 10 percent downpayment requirement is little better; it would take a median income family almost 10 years to save for a 10 percent downpayment[10]. These are conservative estimates that assume all savings go toward the downpayment and that the family is not also saving for retirement, education or other purposes. This excessive downpayment requirement does not serve the intended purpose of reducing the risk of default, as an increase in the downpayment requirement from five percent to 20 percent lowers default rates by less than one percent on average based upon recent historical loan performance data[11]. When strong underwriting standards are used, many creditworthy borrowers will be denied access to lower cost mortgage options for only a modest improvement in decreased default rates.

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[9] Coalition for Sensible Housing Policy, *Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery*, August 1, 2011.
[10] *Id*. at 5
[11] *Id.* at 6-7

Loan-to-Value Requirements for Refinancing

The increased LTV requirements for refinancing (75 percent) and cash-out refinancing (70 percent) will harm the markets that have been the most severely impacted by the economic downturn as borrowers will not be able to refinance out of current mortgages into more reasonable terms to avoid foreclosure. An analysis[12] of CoreLogic data has found that among U.S. homeowners with mortgages, 52 percent – 24.8 million homeowners – have less than 25 percent equity in their homes. In the six states with the highest percentage of homeowners who do not have 25 percent equity – Nevada, Arizona, Florida, Georgia, Michigan and Mississippi – more than six out of every ten homeowners with mortgages do not have at least 25 percent equity in their homes that would allow them to refinance with a lower rate QRM.

The analysis of the CoreLogic data clearly demonstrates that the Agencies' proposal on QRM will increase refinancing costs for millions of Americans. The data also show that even with a five percent minimum equity standard, almost 14 million existing homeowners with mortgages will be unable to obtain a QRM. For those borrowers that have already put significant "skin in the game" through downpayments and years of timely mortgage payments, only to see their equity eroded by the housing collapse, the proposed QRM definition would exclude these homeowners who would have to pay more. In effect, the proposed QRM would penalize families who have played by the rules, stayed current on their mortgage, and now need to refinance or relocate.

Insurance Products

For the benefit of low- to moderate-income borrowers, NAHB believes that any LTV requirements need to be well thought out and flexible when other safeguards are present. The statute specifically recommends that the Agencies consider loans that are covered at the time of origination by mortgage insurance (MI) or other types of insurance or credit enhancements, to the extent these protections reduce the risk of default, for eligibility under the QRM standard.

NAHB believes that MI should have been included as allowable under the QRM for loans with a downpayment of less than 20 percent. MI has provided consumers' access to well underwritten, lower downpayment loans making homeownership a reality for many low- and moderate-income families. MI also provides many benefits to the housing finance industry, including shared risk in the event of default and an additional and independent underwriting evaluation. Existing data reveal that loans carrying MI experience lower default rates primarily because of this additional underwriting step, or extra eyes, to the origination process.[13] In fact, the Federal Reserve Board acknowledges the benefits of mortgage insurance by allowing for MI in the proposed QM rule. Legislators also have recognized this enhancement in the Dodd-Frank Act and in letters to the Agencies.

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[12] Coalition for Sensible Housing Policy, *State by State Analysis of Proposed Federal Rule's Impact on Refinancing,* sensiblehousingpolicy.org

[13] Coalition for Sensible Housing Policy, *Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery*, July 11, 2011, p. 13.

NAHB also requests that the proposed definition of QRM include mortgages with LTV ratios above 80 percent, when they are properly underwritten and supported by home value insurance that is state-regulated and benefits both homeowners, by protecting a significant portion of their homes' values, and lenders, by protecting them in instances of foreclosure, through a combination of financial guaranty and credit insurance policies. Home value insurance is consistent with the Dodd-Frank Act's criteria for QRM which includes 'insurance and other credit enhancements at the time of origination to the extent such insurance or credit enhancement reduces the risk of default."

Debt-to-Income and Credit History

NAHB supports and strongly believes that improving the quality of mortgage underwriting will help stabilize the housing market and foster successful long-term homeownership for qualified borrowers. The market excesses that have occurred in the past merit regulatory changes aimed at more rational lending practices, greater lender accountability, and improved borrower safeguards. However, NAHB is extremely concerned that the proposed hard-coded standards for the debt-to-income (DTI) ratios and credit history represent an obsolete, single-factor approach to underwriting credit. Moreover, the proposed rule does not allow for any flexibility in meeting the terms of a QRM and does not allow for compensating factors. For instance, a larger downpayment does not offset a borrower's DTI or credit history. Underwriting is done on an individual loan basis, and the focus should be on sound underwriting principles.

According to analysis by the Federal Housing Finance Agency[14], less than 20 percent of the loans purchased by Fannie Mae and Freddie Mac from 1997 to 2009 would have met all of the QRM criteria. In 2009, a year of highly conservative underwriting standards, only 30 percent of loans purchased by the Enterprises would have met the proposed requirements. Nearly half of these non-QRM eligible loans in 2009 would have been excluded because of the proposed DTI criteria for a QRM.

Other aspects of the proposal, such as the proposed credit history, are also set at levels that will raise unnecessary barriers for creditworthy borrowers seeking the lower rates and preferred product features of the QRM. The strict credit history provisions are too rigid and do not allow for mitigating factors.

NAHB, as well as many other industry stakeholders and legislators in their comment letters on this proposed rule, suggest the Agencies embrace the Board's ability-to-repay standard as required under Title XIV of the Dodd-Frank Act. This approach has two benefits. First, it avoids creating multiple standards in federal rules for determining a borrower's ability-to-repay, and second, the Board's proposed rule adopts a more up-to-date and holistic approach to underwriting. The ability-to-repay regulations define a process for the creditor that allows flexibility for the borrower while holding the creditor accountable. There is no need for two standards which would create needless complexity, heighten compliance risks, and ultimately increase costs to borrowers. NAHB supports removing specific DTI ratios and consumer credit history standards from the QRM definition. Again, sound underwriting practices are

[14] Federal Housing Finance Agency, Mortgage Market Note 11-02, April 11, 2011

the most effective determinant of a borrower's willingness and ability to repay a mortgage and should be done on an individual loan basis.

Points and Fees

The Agencies include in the QRM definition "the restriction on points and fees for QMs contained in section 129C(b)(2)(A)(vii) of TILA" and "in order for a mortgage to be a QRM, the total points and fees payable by the borrower in connection with the mortgage transaction may not exceed three percent of the total loan amount, which would be calculated in the same manner as in Regulation Z." As referenced in the attached letter to the Board, NAHB believes that the current definition of fees and points discriminates against lenders with affiliates for no apparent reason. NAHB strongly supports an affiliate exception to the three percent cap so it allows consumers access and choice in determining their mortgage providers.

As part of the effort to build strong consumer relationships, many home builders and lenders have established settlement service affiliates, such as mortgage and title companies. These affiliates have been formed primarily to improve the likelihood that the financing of the home buying process occurs as promised and in a timely manner. These affiliates provide economic benefits to the consumers that far outweigh the income received from the partnerships in the business. Therefore, consumers directly benefit from affiliated relationships.

Requiring affiliate fees and points to be included in the three percent cap creates a disincentive for lenders to establish affiliated relationships which provide measurable benefits to consumers. For this reason NAHB strongly urges excluding fees and points from affiliated firms in the three percent cap, thereby giving equal treatment to affiliated and non-affiliated settlement service providers.

The CFPB has not released a final rule on Regulation Z. NAHB asks the Agencies to remove a distinct "points and fees" requirement from the QRM definition and instead incorporate by reference the fees and points calculation and definition that is ultimately adopted in the ability-to-repay regulations. Consistency is key to ensuring liquidity in the mortgage market. Having different rules on points and fees for QRM and non-QRM mortgages will be difficult to manage and will result in inefficiencies and increased costs, which will inevitably be passed onto borrowers.

Qualifying Appraisal

Accurate evaluations of collateral are critical in establishing the framework of a QRM, and NAHB supports the Agencies proposal that a QRM be supported by a written appraisal that conforms to generally accepted appraisal standards, as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP), the appraisal requirements of the Federal banking agencies, and applicable laws for evaluating loans. The Agencies go further and state that they "believe these requirements will help ensure that the appraisal is prepared by an independent third party with the experience, competence, and knowledge necessary to provide an accurate and objective valuation based on the property's actual physical condition."

However, NAHB is concerned that the Agencies are suggesting reducing the customary time for appraisals to be valid. In Subpart D (d)(11) the Agencies specify that a creditor must obtain "a written appraisal of the property securing the mortgage that was performed not more than 90 days prior to the closing of the mortgage transaction…" Currently the Federal Housing Administration, Fannie Mae and Freddie Mac have validity periods of 120 days, with processes for extending the period, which are already insufficient time periods for new home construction.

The Interagency Appraisal and Evaluation Guidelines determined that "the Agencies should allow an institution to use an existing appraisal or evaluation to support a subsequent transaction in certain circumstances." Therefore an institution should establish criteria for assessing whether an existing appraisal or evaluation continues to reflect the market value of the property (that is, remains valid). Such criteria will vary depending upon the condition of the property and the marketplace and the nature of the transaction."[15] NAHB suggests the Agencies follow their prior guidance and allow the institutions to determine the correct validity period for appraisals and that the institutions absolutely evaluate the "nature of the transaction" and provide home builders with sufficient timeframes for new construction.

NAHB also suggests the Agencies develop streamlined appraisal requirements for refinance transactions under certain limited circumstances. This flexibility in appraisal requirements will be an important resource for lenders to quickly assist qualified consumers who have been affected by the housing crisis and assist those homeowners who are in financial need that have behaved responsibly in handling their mortgage and other financial obligations avoid foreclosure.

Additional Valuation Approaches and Qualifications be Considered: The Agencies request comment on other valuation approaches to be considered in Question 122. The three approaches to valuation (Sales Comparison, Cost and Income) provide appraisers different methodologies to determine the value of a property. NAHB is of the opinion that the cost approach is underutilized and believes the Agencies should evaluate how the different methodologies are currently used and how all the approaches can be better applied to specific situations. For example, more complex appraisal approaches are needed for appraisals involving extreme economic conditions, new construction, and energy efficient valuations. Incorporating the cost approach could prove to be a particularly valuable method for establishing an accurate value of a newly constructed home built with energy efficient methods and technologies, upgrades, over-sized lots, and other improvements to the structure.

NAHB supports the Agencies' belief that the appraiser have the experience, competence, and knowledge necessary to provide an accurate and objective valuation. NAHB is concerned that a significant number of appraisers lack the required experience and knowledge required to establish values for residential lots and new home construction, and this lack of appraiser expertise in new home construction has resulted in inaccurate appraisals of newly built homes. NAHB encourages the establishment of minimum educational and experience qualifications for appraisers of new construction to ensure that lot values and building costs,

[15] Interagency Appraisal and Evaluation Guidelines, Section XIV Validity of Appraisals and Evaluations, 75 Fed. Reg. 77461 (December 10, 2010)

including those for green building and other evolving new construction techniques, are fully considered in the valuation of new home construction.

An important element of solid underwriting principles is a full and accurate appraisal. NAHB has been at the center of appraisal issues, holding three Appraisal Summits in 2009 and 2010 and will hold a fourth Appraisal Summit in October 2011. NAHB has learned over these last few years that the way homes are valued can have a dramatic effect on home owners' mortgages, foreclosure rates, the health of banks and, ultimately, the condition of the U.S. economy. We would like to continue to work with the Agencies and industry stakeholders to find viable solutions to continuing problems in home valuations.

Loan Products

NAHB does support the Agencies proposal that certain mortgage products be prohibited from the QRM definition, such as interest-only payment terms and negative amortization loans. According to FHFA[16], for the 2005-2007 origination years, the requirement for product-type (no non-traditional and low documentation loans, or loans for houses not occupied by the owner) was the QRM risk factor that most reduced delinquency rates. These restrictions also are consistent with the QM provisions in the Dodd-Frank Act.

Impact on Government Housing Programs

The Act "exempts from the risk retention requirements any residential, multifamily, or health care facility mortgage loan asset, or securitization based directly or indirectly on such an asset that is insured or guaranteed by the United States or an agency of the United States." This exemption includes government housing programs administered by the Federal Housing Administration (FHA), U.S Department of Veterans Affairs (VA) and the U.S. Department of Agriculture's (USDA) Rural Development agency. These programs will undoubtedly be impacted by an overly narrow definition of a QRM, as borrowers who do not meet the QRM criteria would move to these programs in large numbers. This would unnecessarily move a significant number of mortgages from the private sector to the government, which would be counter-productive to a housing recovery.

NAHB believes the assumption that first-time home buyers and low-income borrowers would continue to have access to mortgages through these government housing programs may be overly optimistic. Recent changes to these programs have been proposed that may further limit the availability of credit. For instance, FHA has already implemented a series of policy changes over the past two years, including: restructuring FHA mortgage insurance premiums (MIP); underwriting changes, including updating credit score/downpayment guidelines; increasing lender enforcement; and strengthening condo guidelines. In addition, FHA published a Notice in July 2010[17], proposing to reduce seller concessions from six percent to three percent. Seller concessions are an important tool for providing access to

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[16] Federal Housing Finance Agency, Mortgage Market Note 11-02, April 11, 2011
[17] Federal Housing Administration Risk Management Initiatives: Reduction of Seller Concessions and New Loan-to-Value and Credit Score Requirements, Fed. Reg. 75, 41217 (July 15, 2010)

affordable homeownership by reducing the upfront monies required. This rule has not yet been finalized, but a reduction in the limit on seller concessions will have a particularly negative effect on housing opportunities for first-time homebuyers.

Another example of more restrictions on government housing programs is the USDA announcement[18] that it will be raising fees on its Single Family Housing Guaranteed Loan Program (SFHGLP). For Fiscal Year (FY) 2012, an annual fee of 0.3 percent of the outstanding principal balance will be required in order that the SFHGLP may achieve subsidy neutrality. Rural Development is in the process of adopting a rule effective with loans obligated on or after October 1, 2011, under which all loan transactions will be subject to the annual fee. This change will increase the cost of borrowing for low-income and first-time home buyers.

Furthermore, without Congressional action the loan limits for FHA, Fannie Mae and Freddie Mac will be reduced beginning October 1, 2011 in many high cost areas. While NAHB is supportive of maintaining the higher loan limits, the upcoming scheduled change is an example of the government's attempt to reduce its footprint in the mortgage market potentially limiting the cost and availability of mortgage credit.

Many first-time and low- to moderate-income borrowers are likely not to meet the stringent QRM standard and may also not be eligible for the more restrictive government housing programs. The result will be that many creditworthy borrowers will not have any safe, affordable option for purchasing a home, which may have the unintended consequence of driving these borrowers into riskier product options with unfavorable payment terms and higher interest rates and fees.

<u>Cost of QRM</u>

Borrowers who cannot afford to put 20 percent down on a home and who are unable to obtain financing through a government program will be expected to pay a premium in the private market to offset the increased risk to lenders. As per the statute, loans that do not meet the stringent definition of a QRM will carry the burden of risk retention resulting in added costs for non-QRM mortgage loans that will be not be applied to QRM loans. The costs of retaining capital will undoubtedly be passed along to the borrower. While this cost differential is a widely accepted premise, the premium for a non-QRM loan is yet unknown.

Since the Agencies released the proposed rule, many entities have published estimates of the cost differential between a QRM and non-QRM loan, and these estimates vary by wide margins. For instance, the National Association of Realtors[19] estimates that non-QRM loans will cost as much as 80 to 185 basis points more than QRM loans. Moody's Analytics[20] estimates that a non-QRM 30-year fixed-rate mortgage will cost 75 to 100 basis points more than a QRM loan. NAHB economists

[18] Rural Development, Administrative Notice No 4551, February 3, 2011
[19] Coalition for Sensible Housing Policy, *Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery.* sensiblehousingpolicy.org, p. 8
[20] Mark Zandi and Cristian deRitis, Moody's Analytics Special Report, *Reworking Risk Retention*, June 20, 2011.

estimate the premium on a non-QRM loan to be 200 basis points[21]. FDIC estimates this difference will be less than half a percentage point. [22]

These varying estimates indicate that uncertainty persists throughout the market, and this uncertainty continues to undermine a housing recovery. The difference in opinions among recognized experts clearly shows that we are in unchartered waters. No one knows for sure how the market will price the non-QRM securities, but these added costs will be borne by those who can least afford it.

<u>Fair Lending Concerns</u>

NAHB is very concerned that the proposed narrow QRM standard will disproportionately affect borrowers with lower incomes and could have a disparate impact on minority consumers. These results may run afoul of existing fair lending requirements including the Fair Housing Act.[23] The impact of these requirements on the availability of mortgages to minority borrowers has not been adequately examined under the proposed regulations. Because minority borrowers generally have lower incomes and net worth than non-minority households, they are less likely to be able to save for the downpayment required for the average home. This will result in significantly lower homeownership rates among minority households. Because even creditworthy minority borrowers may not qualify for a QRM, they may find themselves disproportionately unable to obtain an affordable mortgage.

This may lead to the resurgence of "redlining" by lenders—denying mortgages to minority communities based on their racial composition. It is well-accepted that "the practice of denying the extension of credit to specific geographic areas due to the income, race, or ethnicity of its residents," may violate federal civil rights laws, including the Fair Housing Act.[24]

Notably, the administration's recent Housing Finance Reform Report emphasized the need to maintain housing finance availability to creditworthy borrowers in a variety of communities[25]. The report states that the administration will "work with Congress to ensure that *all* communities and families—including those in rural and economically distressed areas, as well as those that are low- and moderate-income—have the access to capital needed for sustainable homeownership . . ."[26] In other words, the federal government will continue to ensure that lenders are meeting their legal obligations to serve all communities. Thus, it is important that the Agencies reconcile

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[21] NAHB Press Release, *Twenty Percent Downpayment Rule Would Disrupt First-time Home Buyer Market*, March 29, 2011
[22] Government Accountability Office Report to Congressional Committees, *Mortgage Reform: Potential Impacts of Provisions in the Dodd-Frank Act on Homebuyers and the Mortgage Market*, July 2011
[23] The Fair Housing Act prohibits businesses engaged in residential real estate transactions, including "[t]he making… of loans or providing other financial assistance…secured by residential real estate," from discriminating against any person on account of race. 42 U.S. C. § 3605(a), (b)(1)(B).
[24] *See United Cos. Lending Corp. v. Sargeant,* 20 F. Supp. 2d 192, 203 n. 5 (D. Mass. 1998) (citing S. Rep. No. 103-169, at 21 (1993)); *Swanson v. Citibank, N.A., et al.,* 614 F.3d 400, 405 (7th Cir. 2010) (holding that plaintiff had properly stated a Fair Housing Act claim for bank's refusal to underwrite her loan).
[25] *Reforming America's Housing Finance Market, A Report to Congress A Report to Congress* (February, 2011).
[26] *Id.* at 21.

the potential effect of the proposed QRM requirements with their intent and mandate to further affordable housing and fair lending goals. Prior to finalizing this rule, the Agencies should carefully consider the likelihood that the proposed QRM requirements could result in an influx of challenges under fair lending laws.

QRM Summary

NAHB supports a broad QRM definition that will encompass the bulk of residential mortgages that meet the lower risk standards of sound underwriting and restrictions on risky loan features. In addition, loans with lower downpayments with risk mitigating features, most notably mortgage insurance, should be included in the QRM exemption. To define QRM any narrower will likely deny mortgage credit to many qualified borrowers and irresponsibly impair the housing market and economic recovery.

Commercial Real Estate

The proposed rule covers all forms of assets that can be securitized, including commercial real estate (CRE), commercial loans and automobile loans. The proposed rule defines CRE loans as those secured by five or more residential units or by non-farm, non-residential real property, with the primary source of repayment to be derived from rental income or from the proceeds of the sale, refinancing, or permanent financing of the property. Land development and construction loans, loans on raw or unimproved land, loans to real estate investment trusts (REITs) and unsecured loans are excluded.

As required by the Dodd-Frank Act, the proposed rule sets forth the underwriting standards for what is presumed to be a low-risk loan; that is, a qualified commercial real estate loan (QCRE). Commercial mortgage backed securities (CMBS) that consist of QCRE loans would not be required to meet the five percent risk retention requirements.

Implications for Multifamily and Other CRE Finance

The structuring of risk retention requirements for CRE loans will have a significant impact on the CMBS market. While the CMBS market has only begun a modest recovery, at some point, it will once again be an important component of the commercial real estate finance market, including financing for multifamily rental properties. Portfolio lenders and life insurance companies do not have the capacity to meet the entire commercial market's demand for capital. Banks are limited by their balance sheets in the amount of CRE loans that can be held in portfolio. In addition, with the future of the government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac in flux and FHA struggling to meet the increased demands on its multifamily mortgage insurance programs, the importance of CMBS for multifamily cannot be overlooked.

The proposed standards and requirements will impact both new loans and existing loans in CMBS issues that need refinancing. Billions of dollars in CRE loans in CMBS will require refinancing in the next five years. Thus, it is important that the risk retention rules be structured to facilitate a liquid and functioning CMBS market, but one that is safe and transparent.

A key concern of NAHB is that risk retention requirements are structured to minimize the impact on borrower financing costs. The cost to borrowers of risk retention is unknown. Opinions range from very little expected additional cost to dramatic increases if the proposed risk retention structure is not modified to address a wide range of issues. To the extent that risk retention requirements raise multifamily financing costs, there will be an impact on rents. Higher rents have an immediate impact on renter households' budgets, but for aspiring homeowners, higher rents also mean that it will take longer to save for a downpayment on a home. In addition, for other types of commercial properties, higher rents affect companies' ability to grow, thus negatively impacting job creation.

<u>NAHB Comments on Proposed CRE Standards</u>

The proposed rule sets the following standards for a QCRE:

- Debt service coverage (DSC) of at least 1.7, although 1.5 would be permitted for properties with a demonstrated history of stable net operating income (NOI) over the past two years. To qualify for the lower DSC, the property must be residential with at least five units, and 75 percent of its NOI must be from residential rents.
- The combined LTV (CLTV) cannot be more than 65 percent. If the cap rate used in the appraisal is less than the 10-year interest rate swap rate plus 300 basis points, the maximum LTV is 60 percent to mitigate the effect of an artificially low cap rate.
- Fixed interest rate loans only; adjustable rates would be permitted if the borrower obtains a derivative product that effectively results in fixed-rate loan payments.
- Maturity must be at least 10 years.
- The loan payment amount must be based on a straight-line amortization over the term, not to exceed 20 years, with monthly payments for at least 10 years.

The Agencies state in the proposed rule that the vast majority of CRE loans will <u>not</u> meet the proposed underwriting standards for a QCRE loan. A paper released by Morgan Stanley states that if just three of the standards (the DSC, LTV and 20-year term) had been in effect over the years, only 0.4 percent of the conduit loans that have been securitized since the beginning of the CMBS market would have qualified. Thus, if implemented as proposed, most CMBS will require the full five percent risk retention.

NAHB does not support the proposed QCRE standards, because an overwhelming majority of loans will not be able to meet them. NAHB does not understand the purpose of proposing standards that exclude nearly all the loans in the market. NAHB does not object to a conservative approach to establishing the standards for QCRE loans, but we do object to an unreasonably stringent standard that results in a *de minimis* volume of QCRE loans. Adherence to a "one-size fits all" prescribed set of underwriting requirements that apply to a wide range of asset types does not guarantee that the loans will be "low-risk."

NAHB's specific comments are presented below.

Differentiate Asset Types

There is no distinction among the different asset types included in CRE loans; all assets (hotel, retail, multifamily, office, etc.) would have to meet the proposed underwriting requirements to be classified as a QCRE loan. However, comparing office, retail, hotel, industrial and multifamily loans to each other for underwriting purposes is not appropriate, given the significant differences among these asset classes in terms of property features, lease structures, tenant characteristics, etc. This "one-size fits all" approach places burdens on multifamily loans that is not justified, as these loans typically have more predictable cash flows and thus lower debt service coverage requirements compared to other commercial loans. The asset classes should be differentiated, and appropriate underwriting standards developed for each class.

Revise Underwriting Standards for the QCRE Loans

As mentioned above, the underwriting standards for QCRE loans are so stringent that even the Agencies state that most CRE loans will not meet them and, thus, the vast majority of CMBS will be subject to the five percent risk retention. Setting the standards in this manner does not incent originators to make low-risk loans because, as proposed, almost no loans can meet the requirements.

NAHB believes that the QCRE underwriting standards should be realistic and achievable and provide for a reasonable share of the CMBS market – not zero share. The Agencies should look to industry standards for performing properties as the basis for QCRE loans. The Agencies should undertake an analysis of the characteristics of performing properties in each asset class included in CMBS and set a QCRE standard for each based on its findings.

Multifamily Loans. Assuming multifamily assets are differentiated from other CRE asset classes, Fannie Mae's and Freddie Mac's (the "Enterprises") multifamily portfolios have performed extremely well, with default rates generally below one percent. The Enterprises have a track record of discipline in underwriting multifamily loans of all types and sizes. These standards meet the FHFA's requirements for safety and soundness, are transparent and ensure the flow of adequate capital for multifamily financing. For multifamily loans, underwriting standards similar to those applied by the Enterprises would prevent the reoccurrence of the large number of failures of multifamily loans that were not underwritten prudently in previous CMBS issues.

The proposed QCRE underwriting standards for debt service coverage and LTV requirements for multifamily loans should be revised to comport more generally with the Enterprises' underwriting standards. The Enterprises set DSC requirements based on multiple factors, including property type (targeted affordable, conventional rental, seniors, etc.) and geographic location. Thus, DSC may range from 1.15 to 1.40. Similarly, the Enterprises' LTV requirements vary, again depending on various factors including property type, geographic location, and term of the loan (e.g., five or seven years), thus ranging from 65 to 80 percent.

NAHB is not suggesting that the Agencies adopt the Enterprises' minimum standards, nor are we suggesting that the QCRE standards should conform exactly to the Enterprises' standards at any point in time. Rather, the Agencies should do a more thorough analysis of what factors should be considered in setting standards for "low-risk" loans using the Enterprises' performing portfolio as a guide.

Multifamily and Other CRE Loans. There should be no restrictions on floating interest rates, except to require an interest rate cap approved by the lender that would limit increases in debt service to a level that could continue to be supported by the property's income.

The amortization period for typical multifamily and commercial properties is 30 years, not 20 years, which is too short and would result in unnecessarily large monthly mortgage payments, which would push rents to unsustainable levels. Maturity dates of three, five and seven years are also industry practices, in contrast to the proposal requiring a maturity date of at least ten years following the closing date of the loan.

NAHB believes that the proposed requirements for DSC, LTV, floating interest rate, amortization term, and maturity date need to be modified as suggested above.

Allow Subordinate Financing

The proposed rule would prohibit a borrower from obtaining a loan secured by a junior lien on any property that serves as collateral for the CRE loans, unless such loan finances the purchase of machinery and equipment which are pledged as additional collateral for the loan. The proposed rule fails to consider that many multifamily and other commercial loans use multiple layers of financing, and it is not unusual to have subordinate loans. With such a restriction, borrowers could have trouble refinancing, repositioning properties or upgrading to higher energy efficiency standards. NAHB suggests that the Agencies revise this prohibition to allow for such circumstances.

Revise Ability to Repay Look Ahead

As proposed, the originator must conduct an analysis of the borrower's ability to repay all outstanding debt obligations over the two-year period following the origination of the loan, based on reasonable projections and including the new debt obligation. Most CRE loans, including multifamily, are non-recourse and thus it is not relevant to conduct this type of analysis. NAHB believes this requirement should be eliminated.

Allow Commingling of Qualified and Non-Qualified Commercial Loans

The Agencies have proposed a zero percent risk retention requirement only for asset-backed securities collateralized exclusively by commercial loans from qualifying loan exemptions as outlined in the proposed rule. A full five percent will have to be retained for securities that contain both qualified and non-qualified loans. NAHB believes that this requirement will negatively affect small and medium-sized banks as it will take too long to accumulate the volume of loans needed to undertake separate issuances. The five percent risk retention could be apportioned on a pro-rata basis, given the mix of qualifying and non-qualifying loans. Allowing such commingling would also reduce the pricing cliff effect between qualified and non-qualified loans.

Proposed Treatment of Fannie Mae and Freddie Mac

The Agencies specified that loans sold to Fannie Mae and Freddie Mac (the “Enterprises”) will not be included in the risk retention requirement while they remain in conservatorship with explicit federal backing. NAHB supports the Agencies’ determination that the Enterprises are already satisfying the proposed risk retention requirements. This determination will cushion the blow on the residential mortgage market and multifamily and commercial development.

The proposed rule states that the guaranty provided by an Enterprise while operating under the conservatorship or receivership of FHFA with capital support from the United States will satisfy the risk retention requirements of the Enterprise under section 15G of the Exchange Act with respect to the mortgage-backed securities issued by the Enterprise. This finding would also extend to an equivalent guaranty provided by a limited-life regulated entity that has succeeded to the charter of an Enterprise, and that is operating under the direction and control of FHFA under section 1367(i) of the Safety and Soundness Act, and will satisfy the risk retention requirements, provided that the entity is operating with capital support from the United States.

However, the rule goes further to say that “if either Enterprise or a successor limited-life regulated entity were to begin to operate other than as provided in the proposed rules, that Enterprise or entity would no longer be able to avail itself of the credit risk retention option…”

NAHB believes that it is premature to make a judgment on how a yet-to-be-determined “successor” entity should be treated under the risk retention rule. The future structure of the government-sponsored enterprises (GSEs) is still unknown. The administration released a high-level white paper which included three distinct options. There are several pieces of legislation introduced in this Congress that offer a wide range of options for new structures to succeed the Enterprises. Also, many industry stakeholders, including NAHB, have proposed ideas and recommendations for a successor to the current GSE structure. For the Agencies to prejudge how a new entity (or entities) should be treated with respect to risk retention rules is inappropriate.

While the statute does specify “the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation,” the Act does not specify a “successor entity.” NAHB appreciates that the Agencies plan to revisit the proposed rules after the future of the Enterprises becomes clearer, and NAHB urges the Agencies not to make a premature determination of how a currently undefined entity will be required to manage risk retention requirements.

State Housing Finance Agencies

NAHB appreciates that the proposed rule exempts loans and securities issued by states or any public instrumentality of a state, including housing bonds issued by state and local housing finance agencies (HFAs). NAHB suggests that this exemption and the QRM definition be broadened to include all mortgages financed by HFAs and the securities backed by such mortgages. As HFAs increasingly finance loans through a variety of means in addition to traditional mortgage revenue bonds, these mortgages also exhibit the same strong underwriting, responsible servicing, and strict oversight that form the basis for the proposed rule's municipal bond exemption. As HFAs continue to employ and expand such non-traditional financing methods to advance sustainable affordable homeownership opportunities, the risk retention exemption and QRM definition should support such efforts.

Risk Retention Structure and Requirements

NAHB's principal concern is the impact of risk retention on borrowers, but we believe it is in the best interest of all parties to ensure that the risk retention structure works effectively for all parties. The proposed rule provides for a variety of options that may be used by the securitizer to satisfy the risk retention requirements. Each of the proposed permitted forms of risk retention is subject to terms and conditions that the Agencies believe will help ensure that the sponsor or other eligible entity retains an economic exposure equal to at least five percent of the credit risk of the securitized assets. NAHB believes that the variety of proposed options to meet the risk retention requirements is positive, particularly the provision allowing for a third-party purchaser of the risk for CMBS, commonly referred to as the B-piece buyer. The B-piece buyer would retain the necessary first loss exposure to the underlying assets, instead of the sponsor of the CMBS transaction.

The Agencies should also consider allowing the risk retention structures currently used by the Enterprises in their multifamily programs; that is, the Fannie Mae Delegated Underwriting and Servicing Program and Freddie Mac's Program Plus and Multifamily K Certificate programs. Both Enterprises have a steady and successful track record in the multifamily market, and their securities are viewed as safe and desirable by investors. As mentioned previously, the Enterprises' multifamily portfolios have default rates of less than one percent, which is a compelling reason to give such risk structures consideration.

However, NAHB does have serious concerns about several of the risk retention proposals, the most important of which is the requirement to establish a premium capture cash reserve account (PCCRA). Other concerns are related to the B-piece buyer option for risk retention. There are numerous conditions which must be met by the B-piece buyer, some of which are viewed by industry stakeholders as unworkable.

NAHB's specific comments are as follows:

Eliminate the Premium Capture Cash Reserve Account (PCCRA)

The Agencies' concern that securitizers may try to compensate for the extra cost of risk retention by raising fees has prompted the proposed establishment of the PCCRA. Mortgage securitizers charge borrowers a higher interest rate than what is paid to the bond investors who purchase the securities. This excess spread covers the cost of originating and servicing the mortgages, helps build reserves used to cover defaults, and provides a return to the securitizers. Prior to the financial crisis, sponsors monetized the excess spread by selling premium or interest-only (IO) tranches to investors, thereby collecting the full discounted stream of income up front, even though the excess spread is collected over the life of the securities.

The Agencies state that, to achieve the goals of risk retention, they propose to adjust the required amount of risk retention to account for any excess spread that is monetized at the closing of a securitization transaction. The Agencies state that, otherwise, a sponsor could effectively negate or reduce the economic exposure it is required to retain under the proposed rule. The PCCRA would contain any excess spread amount immediately recognized as a gain on the sale of the underlying assets by the sponsor and does not allow the sponsor to monetize the spread in the form of premium gross proceeds or interest only (IO) bonds. The funds in the PCCRA would be subordinate to the other risk retention piece and would be used to cover losses. The PCCRA was not included as a requirement of risk retention in the Dodd-Frank Act.

There is wide-spread industry concern about the PCCRA requirement. Bank of America, in their comment letter to the Agencies on the proposed rule, estimates that the additional cost to borrowers directly attributable to the requirements of establishing the PCCRA would be almost 300 basis points[27]. There are accounting and capital implications that the Agencies have not taken into consideration in fashioning the PCCRA, which together have great potential for eliminating any incentive to securitize residential and commercial loans. If banks cannot or choose not to securitize because of the cost, and they are limited in what can be held on their balance sheets, liquidity in the finance markets will become constrained, driving up the costs of borrowing and limiting borrowers' access to credit. This is not the desirable outcome of risk retention.

The premium capture rule also fails to consider the costs associated with originating loans including hedging of interest rates during the period between the origination of a loan and its securitization. The inability to recapture this cost upfront would have a direct and adverse impact on consumers as the costs of hedging could prevent originators from offering consumers the ability to lock their loan rate at the time of application or if they do so at a substantially higher cost to the consumer. This could be devastating in a rising interest rate environment especially considering QRM's currently proposed inflexible underwriting guidelines. Ultimately, the outcome is higher costs to all consumers, particularly low- to moderate-income borrowers.

NAHB strongly urges the Agencies to eliminate the PCCRA. As proposed, the PCCRA has the potential to make 30-year fixed rate mortgage less attractive to

[27] Bank of America, *Comments on Credit Risk Retention Proposed Rule,* July, 13, 2011.

lenders and securitizers[28] and thereby, less available to borrowers. Although the Agencies were trying to address the potential for a securitizer to get around the risk retention requirement, in the end the PCCRA may only hurt home buyers by limiting mortgage options, increasing the cost of home financing and ultimately frustrating any chance for a housing recovery.

<u>Modify Conditions for Third-Party Purchaser</u>

The Agencies proposed that a third-party purchaser may not be affiliated with any other party to the transaction and cannot have control rights (such as acting as servicer or special servicer) unless there is an independent operating advisor (IOA). The IOA would be given the authority to take certain actions, which could cause conflict between it and the third-party buyer. For example, the IOA can recommend that the special servicer be replaced, and this decision can only be overturned if a majority of investors, in each class, votes to retain the servicer. Many industry experts believe that the IOA's role and responsibilities should be revisited to eliminate potential conflicts while ensuring that the intent of the IOA remains viable. NAHB urges the Agencies to consider how to modify the provisions related to the IOA accordingly.

<u>Revise Prohibitions on the Transfer of the Retained Risk</u>

The proposed rule would essentially require a B-piece buyer to hold its retained risk interest for the life of the securities. NAHB believes that this requirement will have a significant impact on the cost of risk retention. We suggest that the Agencies reconsider this requirement and instead allow for transfer to other qualified sponsors and establish a reasonable holding period.

<u>Modify Conditions for Sharing of Risk Retention</u>

The proposed rule permits a securitizer to offset (reduce) its risk retention amount by the amount of the asset-backed security interests or eligible horizontal residual interest, respectively, acquired by an originator of one or more of the securitized assets. However, the originator must acquire and retain at least 20 percent of the aggregate risk retention amount otherwise required to be retained by the sponsor, but the originator's share cannot be more than its pro-rata share of the CMBS. This requirement could negatively affect smaller mortgage originators who may not be able to produce enough loans between planned issues to meet the 20 percent requirement. This requirement should be revisited.

Conclusion

The proposed rule has far-ranging implications across the housing and development sectors. Each aspect of the proposed rule will have a significant impact. The narrow definition of a Qualified Residential Mortgage (QRM) would have a severe adverse impact on the availability and cost of residential mortgages. The proposed requirements on Qualified Commercial Real Estate (QCRE) loans would be virtually

[28] Mark Zandi and Cristian deRitis, Moody's Analytics Special Report, *Reworking Risk Retention*, June 20, 2011.

impossible to meet and would have a wide-spread and detrimental impact on financing the development of multifamily and commercial properties. The premium capture cash reserve account (PCCRA) has the potential to distort the securitization market and create a disincentive for private investors.

NAHB urges the Agencies to follow Congressional intent and define QRMs in a manner consistent with the above-noted time-tested criteria to ensure that qualified borrowers are not excluded from the QRM definition. A broadly defined QRM is essential to the housing recovery and long-term health of the housing finance markets. NAHB strongly urges against unnecessary limits that have not been proven in ensuring a healthy housing finance industry. Unnecessary constraints on the QRM exemption will irresponsibly provide a more costly mortgage market and reduce mortgage capital access.

NAHB appreciates the opportunity to comment on the Agencies' Proposed Rule on Credit Risk Retention. If you should have any questions about our comments or would like additional information, please contact Jessica Lynch, NAHB's Assistant Vice President of Regulatory Affairs, at 202-266-8401 or jlynch@nahb.org.

Sincerely,

David L. Ledford
Senior Vice President
Regulatory Affairs

Attachments (2)

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July 22, 2011

Jennifer J, Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Reference: Docket No. R-1417
Regulation Z; Truth in Lending
Proposed Rule; Request for Public Comment

Dear Ms. Johnson:

On behalf of the 160,000 members of the National Association of Home Builders (NAHB), I welcome the opportunity to respond to the request for comment, issued by the Board of Governors of the Federal Reserve System (Board) regarding the proposed rule amending Regulation Z (Truth in Lending) to implement amendments to the Truth in Lending Act (TILA) made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act, or Act).

The proposal would implement statutory changes made by the Dodd-Frank Act that expand the scope of the Regulation Z ability-to-repay requirement to cover any consumer credit transaction secured by a dwelling. In addition, the proposal would establish standards for complying with the ability-to-repay requirement, by making a "qualified mortgage" (QM).

Background

Concerns have been raised about creditors originating mortgage loans without regard to a consumer's ability to repay the loan. Over the past several years, these concerns were intensified as mortgage delinquencies and foreclosure rates increased dramatically, caused in part by the loosening of underwriting standards and increased use of risky products. NAHB members have been affected deeply by the consequences of these loose underwriting standards and risky loan features. The housing industry continues to suffer from the resulting foreclosures, which negatively impact demand from buyers and drive down home prices.

Congress enacted the Truth in Lending Act (TILA) in 1968 to promote the informed use of consumer credit, with enhanced disclosures required for loans secured by consumers' homes and to permit consumers to rescind certain transactions that involve their principal dwelling. TILA is implemented by the Federal Reserve Board's Regulation Z, 12 CRF Part 226. Building upon these consumer protections, Congress passed the Home Ownership and Equity Protection Act (HOEPA) in 1994 which amended TILA. HOEPA defines a class of “high-cost mortgages” which include home-secured refinancing and closed-end home equity loans (not home-purchase loans) with annual percentage rates or total points and fees exceeding prescribed thresholds. HOEPA also created an “ability to repay” standard and established three special remedies for violations of its provisions. The Board implemented HOEPA requirements in 1995 and revised some of these regulations in 2001, and issued other supervisory guidance regarding nontraditional and subprime mortgages in the mid-2000s.

The Board issued a Final HOEPA Rule in 2008 to address the growth of a variety of financial products. This final rule defined a new class of “higher-priced mortgage loans” (HPML) as a consumer credit transaction secured by the consumer’s principal dwelling with an APR that exceeds the average prime offer rate (APOR) for a comparable transaction, as of the date the interest rate is set, by 1.5 or more percentage points for loans secured by a first lien on the dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on the dwelling.

Specifically, the 2008 HOEPA Rule:

- Prohibits a creditor from extending a higher-priced mortgage loan based on the collateral and without regard to the consumer’s repayment ability;
- Prohibits a creditor from relying on income or assets to assess repayment ability unless the creditor verifies such amounts using third-party documents that provide reasonably reliable evidence of the consumer’s income and assets; and
- Provides certain restrictions on prepayment penalties for high-cost mortgages and higher-priced mortgage loans.

In 2010, the Dodd Frank Act amended TILA to provide consumer protections for mortgages, including ability-to-repay requirements, with the purpose of assuring that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans. The legislative language builds on the 2008 HOEPA Final Rule and extends its application to all residential mortgages. The Act:

- Expands coverage of the ability-to-repay requirements to any consumer credit transaction secured by a dwelling, except an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan.
- Prohibits a creditor from making a mortgage loan unless the creditor makes a reasonable and good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the loan according to its terms, and all applicable taxes, insurance, and assessments.
- Provides a presumption of compliance with the ability-to-repay requirements if the mortgage is a “qualified mortgage” (QM) which does not contain certain risky features and limits points and fees on the loan.

- Prohibits prepayment penalties unless the mortgage is a prime, fixed-rate qualified mortgage, and the amount of the prepayment penalty is limited.
- Creates special remedies for violations of TILA Section 129C.

Summary of Proposed Rule

The Board published a Notice of Proposed Rulemaking (NPR) implementing the ability-to-repay and qualified mortgage provisions of the Dodd-Frank Act on May 11, 2011[1]. Rulemaking authority for these provisions transferred to the Consumer Financial Protection Bureau (CFPB) on July 21, 2011. The Board will transfer comments on the Proposed Rule to CFPB who will issue the final rule.

The Board's proposal provides four options for complying with the ability-to-repay requirement.

1. General Ability-to-Repay Standard

   A creditor can meet the general ability-to-repay standard by:

   - Considering and verifying the following eight underwriting factors: current or reasonably expected income or assets; current employment status; the monthly payment on the mortgage; the monthly payment on any simultaneous mortgage; the monthly payment for mortgage-related obligations; current debt obligations; the monthly debt-to-income ratio, or residual income; and credit history.
   - Underwriting the payment for an adjustable-rate mortgage based on the fully indexed rate.

2. Qualified Mortgage

   A creditor can originate a "qualified mortgage," which provides special protection from liability based on the alleged failure to comply with the "ability to repay standard." Consistent with the Dodd-Frank Act, the Proposed Rule defines a QM as a mortgage that meets the following requirements:

   - The loan does not provide for negative amortization, interest-only payments, or a balloon payment, or have a loan term exceeding 30 years.
   - The total points and fees do not exceed 3% of the total loan amount (with exceptions for smaller dollar amount loans).
   - The income or assets relied upon in making the ability-to-repay determination are considered and verified.
   - The underwriting of the mortgage (1) is based on the maximum interest rate that may apply in the first five years, (2) uses a payment schedule that fully amortizes the loan amount over the loan term, or the outstanding principal

[1] 76 Fed. Reg. 27390 - 27506 (May 11, 2011).

balance over the remaining term as of the date the rate adjusts to the maximum, and (3) takes into account any mortgage-related obligations.

The Board explains in the preamble to the Proposed Rule that it is not clear under the Dodd-Frank Act whether Congress intended to establish a safe harbor or a rebuttable presumption of compliance.[2] Due to statutory ambiguity, the Board has proposed two alternatives for meeting the QM standard.

Alternative 1 would operate as a legal safe harbor and define a "qualified mortgage" based on the criteria listed in the Act and outlined above.

Alternative 2 would provide a rebuttable presumption of compliance and would define a "qualified mortgage" as including the criteria listed under Alternative 1 as well as additional underwriting requirements from the general ability-to-repay standard. Thus, under Alternative 2, the creditor would also have to consider and verify:

- The consumer's employment status,
- The monthly payment for any simultaneous mortgage,
- The consumer's current debt obligations,
- The monthly debt-to-income ratio or residual income, and
- The consumer's credit history.

3. Balloon-Payment Qualified Mortgage

A creditor operating predominantly in rural or underserved areas can originate a balloon-payment qualified mortgage. This option is meant to preserve access to credit for consumers located in rural or underserved areas where creditors may originate balloon loans to hedge against interest rate risk for loans held in portfolio. Under this option, a creditor can make a balloon-payment qualified mortgage with a loan term of five years or more by complying with the requirements for a qualified mortgage and underwriting the mortgage based on the scheduled payment, except for the balloon payment.

4. Refinancing of a Non-Standard Mortgage

A creditor can refinance a "non-standard mortgage" with risky features into a more stable "standard mortgage." This option is meant to preserve consumers' access to streamlined refinancings that materially lower their payments. Under this option, a creditor complies by:

- Refinancing the consumer into a "standard mortgage" that has limits on loan fees and that does not contain certain features such as negative

[2] 76 Fed. Reg. 27396 (May 11, 2011).

amortization, interest-only payments, or a balloon payment;

- Considering and verifying the underwriting factors listed in the general ability-to-repay standard, except the requirement to consider and verify the consumer's income or assets; and
- Underwriting the "standard mortgage" based on the maximum interest rate that can apply in the first five years.

NAHB Supports Balancing Mortgage Lending Standards and Consumer Protections

NAHB appreciates that the Board has initiated a dialogue on how the regulatory system should bolster mortgage lending standards and consumer protections in the mortgage marketplace. The market excesses that have occurred in the past merit regulatory changes aimed at more rational lending practices, greater lender accountability, and improved borrower safeguards.

NAHB believes that loans should be prudently underwritten and adequately disclosed. Stronger requirements related to borrower's ability-to-repay are needed to diminish the rate of borrower defaults. Such changes will also help reduce the probability of additional damaging economic consequences associated with widespread foreclosures that we have witnessed over the last few years due to previous breakdowns in the mortgage process. NAHB believes it is critical that mortgage lending reforms are imposed in a manner that causes minimum disruptions to the mortgage markets, while ensuring consumer protections. Great care must be taken to avoid further adverse changes in liquidity and affordability.

In early 2007, NAHB, concerned with the state of housing finance, passed policy and began working with other stakeholders in the housing and mortgage lending/investment industries as well as Congress and federal, state and local financial institution regulators to find and implement effective solutions to problems in the mortgage markets, while ensuring that the regulation of mortgage products and practices does not unnecessarily disrupt the mortgage lending process, limit consumer financing options or increase the cost or reduce the availability of responsible mortgage credit.

NAHB encouraged then, and adamantly supports today, continued mortgage market innovation to improve housing affordability and expand homeownership opportunities as long as these loans have appropriate features and are prudently underwritten to ensure that the form of financing is appropriate for the borrower, the market and that consumers are fully aware of the features and risks of the loan.

It is critical, as we work together to bolster housing finance and ultimately the American economy, that we get this correct because Americans value homeownership. According to a poll[3] conducted on behalf of NAHB, home owners

[3]This national survey of 2,000 likely 2012 voters was conducted May 3-9, 2011 by Public Opinion Strategies of Alexandria, Va., and Lake Research Partners of Washington, D.C. It has a margin of error of +2.19%.

and non-owners alike consider owning a home essential to the American Dream despite the ups and downs of the housing market. The survey results show that Americans see beyond the immediate housing market to the enduring value of homeownership. An overwhelming 75 percent of the people who were polled said that owning a home is worth the risk of the fluctuations in the market, and 95 percent of the home owners said they are happy with their decision to own a home.

Even though the market is weak, people who don't own say they want to buy a house. Almost three-quarters of those who do not currently own a home, 73 percent, said owning a home is one of their goals. And among younger respondents who are most likely to be in the market for a home in the next few years, the percentages are even higher. However, saving for a downpayment and closing costs was cited as the biggest barrier to homeownership.

At present, much attention is being directed toward another proposed rule mandated by the Dodd-Frank Act, Credit Risk Retention including the definition of a qualified residential mortgage (QRM), published by the Office of the Comptroller of the Currency; the Board; Federal Deposit Insurance Corporation; U.S. Securities and Exchange Commission; Federal Housing Finance Agency; and Department of Housing and Urban Development. While much attention has focused on the QRM rulemaking it is even more essential that the definition of the QM loan and the ability-to-repay standards are well structured and properly implemented. The QM will most likely govern the type of mortgages made in the future, given that the QRM cannot be broader than the QM.

As the various agencies craft new rules governing the future of mortgage financing, it is important to remember that these decisions will determine the future of the mortgage market for years to come. NAHB urges the Board to consider the long-term ramifications of these rules on the market, and not to place unnecessary restrictions on the housing market based solely on today's economic conditions. Overly restrictive rules will prevent willing, creditworthy borrowers from entering the housing market even though owning a home remains an essential part of the American Dream.

Public Opinion Strategies is a national political and public affairs research firm based in Alexandria, Va. Founded in 1991, it has conducted more than 6 million interviews with voters and consumers in all 50 states and over two dozen foreign countries. Lake Research Partners is a leading public opinion and political strategy research firm providing expert research-based strategy for campaigns, issue advocacy groups, foundations, unions and non-profit organizations.

NAHB Comments on the Board's Proposed Rule

NAHB Recommendation for a Strong Safe Harbor

The proposed rule establishes various compliance options for determining whether the creditor has met the ability-to-repay requirements. The Dodd-Frank Act provides special protection from liability for creditors who make QM's.

As noted previously, the Board has determined that the Dodd-Frank Act is unclear on whether the QM protection is intended to be a safe harbor or a rebuttable presumption of compliance. The Board determined that there are sound policy reasons for interpreting a QM as providing either a safe harbor or a presumption of compliance. Due to the statutory ambiguity and competing concerns the Board is proposing two alternatives for the QM standard.

The first alternative defines the QM based on the criteria listed in the Dodd-Frank Act and would operate as a safe harbor and an alternative to complying with the general ability-to-repay standard. Under this alternative, the creditor would not be required to consider and verify the borrower's employment status, the payment of any simultaneous loans that the creditor is aware of or has reason to know about, the borrower's current obligations or credit history. In addition, this alternative does not include requirements to consider the borrower's debt-to-income ratio or residual income.

The second alternative defines a QM to include the requirements listed in the Dodd-Frank Act as well as the other underwriting requirements that are in the general ability-to-repay standard. This definition provides a presumption of compliance that could be rebutted by the consumer. The drawback of this approach is that it provides little legal certainty for the creditor, and thus, little incentive to make a QM. NAHB is concerned that the second alternative may reduce credit liquidity if conservative lenders establish criteria stricter than the presumption's standards to minimize litigation risk.

After carefully considering the proposed alternatives for the QM, NAHB supports the creation of a bright line safe harbor to define the QM to best ensure safer, well documented, and underwritten loans without limiting the availability, or increasing the costs of credit to borrowers. NAHB supports a QM safe harbor definition that promotes liquidity by providing consumers stronger protections than currently proposed by the Board and provides lenders definitive lending criteria that reduces excessive litigation exposure. The safe harbor should incorporate specific ability-to-repay standards. To strengthen the safe harbor definition, NAHB suggests the Board/CFPB evaluate the eight general ability-to-repay underwriting criteria and other general underwriting factors that are based on widely accepted underwriting standards. The final rule should provide creditors with discretion to responsibly adapt debt-to-income or residual income requirements based on changing markets, and not impose a rigid numerical standard. This should be sufficiently objective to make sound underwriting and credit decisions. NAHB recommends that the regulators work with NAHB and other industry stakeholders to develop a workable safe harbor.

NAHB believes this construct would provide the strongest incentive for lenders to operate within its requirements and allow lenders the ability to provide sustainable mortgage credit to the widest array of qualified borrowers. Just as important, the safe harbor will protect consumers by allowing focused litigation to determine whether the safe harbor requirements have be met. This should provide strong incentives for lenders who best serve consumers while maintaining clear avenues to enact severe penalties for lenders who do not.

It is important to note that the establishment of a safe harbor under the QM does not eliminate lender liability in any meaningful way. Failure to meet stringent underwriting requirements under the QM will result in the loss of the safe harbor. All penalty provisions under the Dodd-Frank Act would apply, as would traditional lender liability claims such as the duty of good faith and fair dealing.

Consumers must have access to a responsible and sustainable housing credit market so as we bolster lending regulations to avoid past excess we must be prudent to not create an environment where mortgage loans are subject to unnecessary heightened litigation risks. Excessive litigation risks and severe penalties for violating the ability-to-repay standards would cause uncertainty resulting in liquidity issues for the entire population and could cause low to moderate income and minority populations to suffer disproportionally.

Points and Fees

The Dodd-Frank Act defines a QM as a loan for which, among other things, the total points and fees do not exceed three percent of the total loan amount. Consistent with the Act, the Board’s proposal revises Regulation Z to define “points and fees” to now include: (1) Certain mortgage insurance premiums in excess of the amount payable under Federal Housing Administration (FHA) provisions; (2) All compensation paid directly or indirectly by a consumer or creditor to a loan originator; and (3) the prepayment penalty on the covered transaction, or on the existing loan if it is refinanced by the same creditor. The proposal provides exceptions to the calculation of points and fees for: (1) Any bona fide third party charge not retained by the creditor, loan originator, or an affiliate of either (2) certain bona fide discount points.

The Board is not proposing an exemption for fees paid to creditor-affiliated settlement services providers because Congress appears to have rejected excluding from points and fees real estate-related fees where a creditor would receive indirect compensation as a result of obtaining distributions of profits from an affiliated entity based on the creditor’s ownership interest in compliance with RESPA.

Discrimination Against Affiliates Harms Consumers

The current definition of fees and points discriminates against lenders with affiliates for no apparent reason. NAHB strongly supports reinstating the affiliate exception so it allows consumers access and choice in determining their mortgage providers.

Both home builders and lenders have a strong interest in establishing and maintaining long term positive relationships with consumers who are looked to for repeat business and referrals, which is not possible unless consumers are satisfied with their experiences. Consumers will only refer their friends and relatives when they believe they have been treated fairly and received excellent value for their investment.

As part of the effort to build strong consumer relationships, many home builders and lenders have established settlement service affiliates, such as mortgage and title companies. Collectively, these relationships have successfully facilitated home purchases for consumers by obtaining mortgages and providing settlement services for hundreds of thousands, perhaps millions, of consumers over a span of more than a decade.

These affiliates have been formed primarily to improve the likelihood that the financing of the home buying process occurs as promised and in a timely manner. These affiliates provide economic benefits to the consumers that far outweigh the income received from the partnerships in the business. Therefore, consumers directly benefit from affiliated relationships.

In the conditions that have prevailed during the past few years, where mortgage financing has become unstable and uncertain, these relationships have taken on greater importance. The affiliate relationship fosters a high degree of accountability between the companies, which leads to well-coordinated, efficient transactions that decrease the likelihood of any “surprises” for the consumer.

Many times affiliated settlement service providers are more efficient because they have integrated platforms that facilitate communication and enable them to achieve a quicker, more streamlined closing process. In a December 2010 Harris Survey of recent and prospective buyers, respondents said that using affiliates saves them money (78%), makes the home buying process more manageable and efficient (75%), prevents things from “falling through the cracks” (73%) and is more convenient (73%) than using separate services. This response is consistent with data from similar surveys in 2008 and 2002.

Requiring affiliate fees and points to be included in the 3 percent cap creates a disincentive for lenders to establish affiliated relationships, which as mentioned above, provide measurable benefits to consumers. For this reason NAHB strongly urges excluding fees and points from affiliated firms in the 3 percent cap, thereby giving equal treatment to affiliated and non-affiliated settlement service providers.

Mortgage Insurance

NAHB applauds the Board's acknowledgement of the benefits of mortgage insurance. Mortgage insurance (MI) has provided consumer's access to, well underwritten, lower downpayment loans making homeownership a reality for many consumers including low- and moderate-income families. MI also provides many benefits to the housing finance industry including shared risk in the event of default and an additional and independent underwriting evaluation. Existing data reveals that loans carrying MI experience lower default rates primarily because of this additional underwriting step, or extra eyes, to the origination process.[4]

<u>Balloon Payments</u>

NAHB supports the Board in exercising the authority provided under the Dodd-Frank Act to provide an exception to the definition of a QM for a balloon-payment made by a creditor that meets the criteria set forth in the Act. Consumers in rural and underserved areas must have access to credit and in their communities sometimes the only source of credit available may originate from community banks. Because community banks typically hold these loans in portfolio a balloon mortgage is necessary to provide the banks a means of hedging against interest rate risk.

<u>Refinance of Non-Standard Mortgage</u>

NAHB supports the proposal to exempt creditors of refinancing a non-standard mortgage, under certain limited circumstances, from the requirement to verify income and assets in determining whether a consumer has the ability to repay a covered transaction. This flexibility in underwriting will be an important resource for consumers who have been affected by the housing crisis and assist those homeowners who are in financial need that have behaved responsibly in handling their mortgage and other financial obligations avoid foreclosure.

Seller Financing

The Proposed Rule adopts the definition of mortgage originator in Section 1401(2) of the Dodd-Frank Act, which excludes builders from seller-financing exemption for the sale of three properties in any twelve-month period. NAHB recognizes that the Act's definition of mortgage originator includes every seller-financing builder that constructed or acted as a contractor on a residence that they are selling, and that the provisions of the current rule will not change the language of the Act. However, NAHB is compelled to voice the concerns of many of our members who have engaged in seller-financing transactions, often not by choice, but out of economic necessity. In hard economic times, such as these, home buyers' lending options diminish and builders are required to provide viable financing options for their customers.

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[4] Coalition for Sensible Housing Policy, *Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery*, July 11, 2011, p. 13.

Frequently these builders are small businesses that have few employees to undertake additional mortgage processing requirements. These small businesses will not be able to afford to employ professional underwriters, and if they are then unable to use seller-financing, the economic impact will be severe. For this reason, it is recommended that any final rule contain a small business exception from standard underwriting requirements. NAHB recommends that the Board/CFPB consider using the U.S. Small Business Administration's classifications which classifies construction companies as small if they have average annual receipts under $33.5 million.

Fair Lending Concerns

While NAHB supports the general principle of ability-to-repay, we are concerned the proposed QM requirements could have a disparate impact on minority consumers, who are less likely to be offered mortgage products under the QM's more stringent underwriting requirements. These results may run afoul of existing fair lending requirements including the Fair Housing Act.[5] The impact of these requirements on the availability of mortgages to minority borrowers has not been adequately examined under the proposed regulations.

Because mortgages originated under the QM will be disproportionately offered to more affluent consumers, the availability of safe mortgage products may actually decline in many minority communities. The General Accountability Office acknowledged that the QM criteria may increase the cost and restrict the availability of mortgages to lower income and minority borrowers.[6] These restrictions will necessarily limit lender's discretion. Because these consumers most eligible for a QM will be disproportionately more affluent, this lack of discretion will necessarily have a disparate impact on minority consumers.

Further, the ability of lenders to offer products outside of the qualified mortgage will be limited by the penalties for failure to comply with the ability-to-repay standards. Section 1416 of the Dodd-Frank Act allows for special statutory damages in addition to actual damages. This severe penalty may lead to the resurgence of "redlining" by lenders—denying mortgages to minority communities based on their racial composition. It is well-accepted that "the practice of denying the extension of credit to specific geographic areas due to the income, race, or ethnicity of its residents,"

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[5] The Fair Housing Act prohibits businesses engaged in residential real estate transactions, including "[t]he making… of loans or providing other financial assistance…secured by residential real estate," from discriminating against any person on account of race. 42 U.S. C. § 3605(a), (b)(1)(B).

[6] The report also examined five QM criteria to determine whether loans made over the past nine years would still be made under the criteria. The report determined that 25 to 42 percent of past mortgages would not meet an illustrative 41 percent debt service-to-income ratio. *See Potential Impacts of provisions in the Dodd-Frank Act on Homebuyers and the Mortgage Market*, GAO Report to Congressional Committees, 19-32 (July 2011).

may violate federal civil rights laws, including the Fair Housing Act.[7]

These concerns run counter to the CFPB's stated charge to promote access to affordable loan products. Notably, the administration's recent Housing Finance Reform Report emphasized the need to maintain housing finance availability to creditworthy borrowers in a variety of communities[8]. The report states that the administration will "work with Congress to ensure that *all* communities and families—including those in rural and economically distressed areas, as well as those that are low- and moderate-income—have the access to capital needed for sustainable homeownership . . ."[9] In other words, the federal government will continue to ensure that lenders are meeting their legal obligations to serve all communities. Thus, it is important that the CFPB reconcile the potential effect of the QM requirements with their intent and mandate to further affordable housing and fair lending goals.

Because the CFPB has taken on the bulk of oversight for a wide range of fair lending statutes, it will bear the brunt of the fair lending impacts of the qualified mortgage requirement. Therefore, prior to finalizing this rule, the CFPB should carefully consider the likelihood that the QM requirements could result in an influx of challenges under fair lending laws.

Conclusion

The Dodd-Frank Act authorized significant changes to mortgage lending practices. The ability-to-repay rules and the standards for a qualified mortgage may be the most important as it will form the foundation for mortgage lending for years to come. The QM rule is enormously complex and interlinks with numerous other regulatory standards.

NAHB appreciates the opportunity to comment on the Board's Proposed Rule on the Ability to Repay and QM standards. NAHB urges the Board/CFPB to consider the long-term ramifications of these rules, and not to place unnecessary restrictions on the housing market. NAHB strongly believes that the ability-to-repay standards must balance both consumer and industry interests. Consumers must have access to affordable credit and responsible lenders should be able to operate in an environment without excessive litigation.

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[7] *See United Cos. Lending Corp. v. Sargeant,* 20 F. Supp. 2d 192, 203 n. 5 (D. Mass. 1998) (citing S. Rep. No. 103-169, at 21 (1993)); *Swanson v. Citibank, N.A., et al.,* 614 F.3d 400, 405 (7th Cir. 2010) (holding that plaintiff had properly stated a Fair Housing Act claim for bank's refusal to underwrite her loan).
[8] *See Reforming America's Housing Finance Market, A Report to Congress A Report to Congress* (February, 2011).
[9] *Id.* at 21.

If you should have any questions about our comments or would like additional information, please contact Steve Linville, NAHB's Director for Single Family Finance, at 202-266-8597 or slinville@nahb.org.

Sincerely,

David L. Ledford

David L. Ledford
Senior Vice President
Housing Finance and Land Development

COALITION FOR SENSIBLE HOUSING POLICY

PROPOSED QUALIFIED RESIDENTIAL MORTGAGE DEFINITION HARMS CREDITWORTHY BORROWERS WHILE FRUSTRATING HOUSING RECOVERY

AS SUBMITTED TO THE FEDERAL REGULATORS ON AUGUST 1, 2011

Coalition for Sensible Housing Policy

August 1, 2011

Honorable Ben S. Bernanke
Chairman
Board of Governors of the
Federal Reserve System
Washington, DC 20551

Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
Washington, DC 20429

Mr. Edward J. DeMarco
Acting Director
Federal Housing Finance Agency
Washington, DC 20552

Honorable Mary L. Shapiro
Chairman
Securities and Exchange Commission
Washington, DC 20549

Honorable Shaun Donovan
Secretary
Department of Housing & Urban Development
Washington, DC 20410

Mr. John G. Walsh
Acting Comptroller
Office of the Comptroller of the Currency
Washington, DC 20219

Re: Interagency Proposed Rule on Credit Risk Retention

- OCC: Docket No. OCC-2011-0002 regs.comments@occ.treas.gov
- Federal Reserve: Docket No. R-1411 regs.comments@federalreserve.gov
- FDIC: RIN 3064-AD74 comments@FDIC.gov
- SEC: File Number S7-14-11 Rule-comments@sec.gov
- FHFA: RIN 2590-AA43 RegComments@FHFA.gov
- HUD: FR-5504-P-01 via www.regulations.gov

Ladies and Gentlemen:

The attached paper is a corrected version of our July 11, 2011 submission. The corrections are to Table 3 and the associated references in the text regarding the proportion of borrowers that would be ineligible for a QRM. The original submission inadvertently included borrowers with less than 5% down payments in the proportion of borrowers that would be ineligible for a QRM by increasing the down payment from 5% to 10%, and from 5% to 20%. Please accept this as our official submission, and please remove the prior letter and substitute this one on the agency websites.

The Coalition for Sensible Housing Policy is a diverse coalition of 44 consumer organizations, civil rights groups, lenders, real estate professionals, insurers and local governments that have joined together to submit the attached white paper as our formal comment letter to the proposed risk retention rule required by Section 941 of the Dodd Frank Act (P.L. 111-203). Most of the members of the coalition will be submitting their own comment letters on the broader risk retention rule, in addition to this joint submission. However, the organizations in the coalition share deep concerns about the unduly narrow definition of the Qualified Residential Mortgage (QRM).

We are particularly concerned about the consequences of establishing a high down payment requirement of 10% or 20% (or more for refinances) as well as unnecessarily restrictive debt-to-income and rigid credit history requirements. Without significant changes to the narrow QRM definition, we believe the rule would raise the cost of mortgages and reduce access for creditworthy borrowers, while frustrating the nation’s fragile housing recovery.

Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery

Prepared by:
The Coalition for Sensible Housing Policy

American Bankers Association	**Mortgage Insurance Companies of America**
American Escrow Association	**NAACP**
American Financial Services Association	**National Association of Federal Credit Unions**
American Land Title Association	**National Association of Hispanic Real Estate Professionals**
American Rental Property Owners and Landlords Association	**National Association of Home Builders**
Asian Real Estate Association of America	**National Association of Human Rights Workers**
Black Leadership Forum	**National Association of Neighborhoods**
Center for Responsible Lending	**National Association of Real Estate Brokers**
Colorado Mortgage Lenders Association	**National Association of REALTORS®**
Community Associations Institute	**National Community Reinvestment Coalition**
Community Mortgage Banking Project	**National Fair Housing Alliance**
Community Mortgage Lenders of America	**National Housing Conference**
Community Reinvestment Coalition of North Carolina	**National NeighborWorks Association**
Consumer Federation of America	**National Urban League**
Council Of Federal Home Loan Banks	**National Real Estate Investors Association**
Credit Union National Association	**North Carolina Institute for Minority Economic Development**
Enterprise Community Partners, Inc.	**Real Estate Services Providers Council**
HomeFree USA	**Real Estate Valuation Advocacy Association**
Independent Community Bankers of America	**Realty Alliance**
International Association of Official Human Rights Agencies	**Texas Bankers Association**
Louisiana Bankers Association	**U.S. Conference of Mayors**
Mortgage Bankers Association	**Worldwide ERC**

Proposed QRM Harms Creditworthy Borrowers While Frustrating Housing Recovery

Summary

As part of the financial reform legislation, Congress designed a clear framework for improving the quality of mortgage lending and restoring private capital to the housing market. To discourage excessive risk taking, Congress required securitizers to retain five percent of the credit risk on loans packaged and sold as mortgage securities. However, because across-the-board risk retention would impose significant costs on responsible, creditworthy borrowers, legislators also created an exemption for "Qualified Residential Mortgages," defined to include mortgages with product features and sound underwriting standards that have been proven to reduce default.[1]

Congressional objectives would not be served if the good loans the legislation seeks to encourage were inaccessible to many creditworthy borrowers. Thus, Congress directed the regulators to balance the need for credit standards against the need to improve access to credit, providing that exemptions from the risk retention rules shall "… improve the access of consumers and businesses to credit on reasonable terms, or otherwise be in the public interest and for the protection of investors." [2]

Unfortunately, regulators have drafted proposed Qualified Residential Mortgage (QRM) rules that upset the important balance contemplated by Congress. Rather than creating a system of penalties to discourage bad lending *and* incentives for appropriate lending, regulators have developed a rule that is too narrowly drawn. Of particular concern are the provisions of the proposal mandating high down payments. Other aspects of the proposal – such as the proposed debt-to-income ratios and credit standards – will also raise unnecessary barriers for creditworthy borrowers seeking the lower rates and preferred product features of the QRM.

The proposed QRM exemption requires a high down payment – proposed at 10 or 20 percent, with even higher levels of minimum equity required for refinancing **– despite the fact that Congress *considered and rejected* establishing minimum down payments precisely because these loans have been shown to perform well when accompanied by strong underwriting and safe, stable product features. In fact, the three sponsors of the QRM provision have sent letters to the regulators saying that they intentionally did not include down payment requirements in the QRM.[3]**

[1] The statutory framework for the QRM requires the regulators to evaluate underwriting and product features that historical data indicate result in lower risk of default, including: documentation requirements; monthly payment-to-income standards; payment shock protections; restrictions or prohibitions on negative amortization, interest-only and other risky features; and mortgage insurance coverage or other credit enhancements obtained at origination to the extent they reduce default risk.

[2] Section 15G(e)(2)(B) of the Securities and Exchange Act of 1934 (15 U.S.C. 78(a) et. seq.), as added by Section 941(b) of the Dodd-Frank Act.

[3] See, for example, February 16, 2011 letter from Senators Landrieu, Hagan and Isakson to the QRM regulators stating "although there was discussion about whether the QRM should have a minimum down payment, in negotiations during the drafting of our provision, we intentionally omitted such a requirement." Emphasis added. See also February 16, 2011 op ed by Sen. Isakson in The Hill: "In fact, we debated and specifically rejected a minimum down payment standard for the Qualified Residential Mortgage."

Requiring down payments of 10 or 20 percent is deemed by some as "getting back to basics." However, well-underwritten low down payment home loans have been a significant and safe part of the mortgage finance system for decades. The proposed QRM exemption ignores these data and imposes minimum down payments of 10 or 20 percent, and equity requirements for refinancing borrowers of 25 percent or 30 percent.

As a result, responsible consumers who maintain good credit and seek safe loan products will be forced into more expensive mortgages under the terms of the proposed rule simply because they do not have 10 or 20 percent in down payment or even more equity for refinancing. These mortgages will be more expensive for consumers because the capital and other costs of retaining risk will be passed onto them, if the private market chooses to offer loans outside of the QRM standard at all. **In other words, the proposal unfortunately penalizes qualified, low-risk borrowers**.

The QRM should be redesigned to align with Congressional intent: **encourage sound lending behaviors that reduce future defaults without harming responsible borrowers and lenders.** With respect to credit availability for high loan-to-value lending, the statute specifically recommends that the regulators consider for eligibility for the QRM standard, loans that are covered at the time of origination by mortgage insurance or other credit enhancements, to the extent these protections reduce the risk of default. The Congressional mandate to craft exemptions from risk retention to "improve access to credit on reasonable terms" calls for a QRM definition that makes QRM loans accessible to a broad range of borrowers, without exclusions based on down payment or other unduly restrictive criteria.

Consumer Impact of Proposed QRM

By imposing excessively high down payment standards regulators are denying millions of responsible borrowers access to the lowest rate loans with the safest loan features. The only beneficiaries of the proposed QRM definition are those consumers with higher incomes who can afford to make large down payments or who already have ample equity in their homes.

Based on the most recent available data on income, home prices, and savings rates, it would take 9.5 years for the typical American family to save enough money for a 10 percent down payment, and fully 16 years to save for a 20 percent down payment (Table 1), assuming that the family directs *every penny* of savings toward a down payment, and nothing for their children's education, retirement, or a "rainy day." Families saving for these other necessities will have to wait much longer. For example, a median income family that sets aside $1000 per year of its savings for college tuition or retirement would need nearly 9 years to save for even a 3.5 percent down payment.

A 10 or 20 percent down payment requirement for the QRM means that even the most creditworthy and diligent first-time homebuyer cannot qualify for the lowest rates and safest products in the market. Even 10 percent down payments create significant barriers for borrowers, especially in higher cost markets (See Attachment 1). This will significantly delay or deter aspirations for home ownership, or require first-time buyers to seek government-guaranteed loan programs or enter the non-QRM market, with higher interest rates and potentially riskier product features without adding a commensurately greater degree of sustainability overall.

Table 1
Years for Median Income Family to Save for Down Payment
(Assuming all savings are directed toward home purchase)

	20% Down Payment	10% Down Payment	5% Down Payment	3.5% Down Payment
2010 Median Sales Price	$172,900	$172,900	$172,900	$172,900
Down payment + Closing Costs (est. @ 5% of loan amount)	$41,496	$25,071	$16,858	$14,394
# of Years Needed to Save @ National Savings Rate (5.2% of gross household income = $2,625 per year)	16 years	9.5 years	6.5 years	5.5 years

Sources: Home Sales Price: NAR 2010 median sales price for condos and single-family homes. Household Income: NAR estimate of 2010 median before-tax household income ($50,474). Personal Savings Rate: Estimated as a percentage of gross income based on 2010 data from the Bureau of Economic Analysis, *Personal Income and Outlays.* These figures are conservative because they assume 100% of family savings are dedicated towards a down payment and closing costs.

Minority households will be particularly hard hit by the proposed narrow QRM standard. As highlighted in a recent paper by Lewis Ranieri and Ken Rosen, these families already have significantly lower before tax family incomes and net worth than white households, which translate into sharply lower homeownership rates.[4] Ranieri and Rosen note that current underwriting standards are already unduly restrictive, and that private capital, along with the GSEs and FHA, should be "encouraged to return to active lending for all creditworthy borrowers." Unfortunately, the proposed QRM cuts sharply against this important recommendation.

The impact of the proposed rule on existing homeowners with mortgages is also harmful. Based on data from CoreLogic's quarterly "negative equity" analysis, nearly 25 million current homeowners would be denied access to a lower rate QRM to refinance their home because they do not currently have 25 percent equity in their homes (Table 2). Many of these borrowers have paid their mortgages on time for years, only to see their equity eroded by a housing crash and the severe recession. Even with a 5 percent minimum equity standard, almost 14 million existing homeowners with mortgages – many undoubtedly with solid credit records – will be unable to obtain a QRM. In short, the proposed rule moves creditworthy, responsible homeowners into the higher cost non-QRM market.

[4] Plan B, A Comprehensive Approach to Moving Housing, Households and the Economy Forward; April 4, 2011, by Lewis Ranieri, Ken Rosen, Andrea Lepcio and Buck Collins. Figure 14 shows that minority households in 2007 had median before tax family income of about $37,000, compared to about $52,000 for white families. Similarly, Figure 15 shows minority family net worth in 2007 of almost $30,000, compared to more than $170,000 for white families.

Table 2
Equity Position of U.S. Homeowners with Mortgages

47.9 million U.S. homeowners with mortgages:	**30% equity**	**25% equity**	**20% equity**	**10% equity**	**5% equity**
# with less than…	27.5 million	24.8 million	21.9 million	16.3 million	13.5 million
% with less than…	57%	52%	46%	34%	28%

Source: Community Mortgage Banking Project; based on data from CoreLogic Inc.

As now narrowly drawn, the QRM rule ignores compelling data that demonstrate that sound underwriting and product features, like documentation of income and type of mortgage, have a larger impact on reducing default rates than high-down payments.

An analysis of loan performance data from CoreLogic's servicing database[5] on loans originated between 2002 and 2008 shows that **boosting down payments in 5 percent increments has only a negligible impact on default rates, but it significantly reduces the pool of borrowers that would be eligible for the QRM standard.** Table 3 and Attachment 2 show the default performance of a sample QRM definition based on the following attributes of loans: Fully documented income and assets; fixed-rate loans, or 7-year or greater initial period ARMs; no negative amortization; no interest only loans; no balloon payments; 41 percent total debt-to-income ratio; mortgage insurance on loans with 80 percent or greater loan-to-value ratios; and maturities no greater than 30 years. These sample QRM criteria were applied to more than 20 million loans originated between 2002 and 2008, and default performance is measured by origination year through the end of 2010.

While loans with 5% down payments (or 5% equity) are certainly riskier than loans with 20% down/equity, the data in Table 3 and the chart in Attachment 2 show that low down payment loans that follow the strong underwriting and product standards outlined above can be exempted from risk retention without exposing investors or the broader housing market to undue risk. In other words, once you apply the strong underwriting standards in the sample QRM definition, moving from a 5 percent to a 10 percent down payment requirement reduces the overall default experience by an average of only two- to three-tenths of one percent for each cohort year. However, the increase in the minimum down payment from 5 percent to 10 percent would eliminate from 4 to 7 percent of borrowers from qualifying for a lower rate QRM loan. Similarly, increasing the minimum down payment even further to 20 percent, as proposed in the QRM rule, would amplify this disparity by knocking 15 to 20 percent of borrowers out of QRM eligibility, with only small improvement in default performance of about eight-tenths of one percent on average. This lopsided result compromises the intent of the QRM provision in Dodd-Frank, which is to assure clear alignment of interests between consumers, creditors and investors without imposing unreasonable barriers to financing of sustainable mortgages.

[5] Source: Vertical Capital Solutions of New York, an independent valuation and advisory firm, conducted this analysis using loan performance data maintained by First American CoreLogic, Inc. on over 30 million mortgages originated between 2002 and 2008.

Table 3
Sample QRM Analysis: Impact of Raising Down Payments Requirements on Default Rates and Borrower Eligibility

Origination Year	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Reduction in default rate* by increasing QRM down payment **from 5% to 10%**	0.2%	0.1%	0.3%	0.3%	0.2%	0.5%	0.2%
Proportion of borrowers **not eligible** for QRM by moving from 5% to 10% Down	5.2%	4.3%	5.5%	4.6%	4.8%	6.7%	5.7%
Reduction in default rate* by increasing QRM down payment **from 5% to 20%**	0.6%	0.3%	0.7%	0.8%	0.8%	1.6%	0.6%
Proportion of borrowers **not eligible** for QRM by moving from 5% to 20% Down	16.9%	14.5%	19.4%	19.2%	19.1%	20.1%	18.0%

* Default = 90 or more days delinquent, plus in process of foreclosure, plus loans foreclosed.
Source: Data from CoreLogic, Inc. Analysis by Vertical Capital Solutions for Genworth Financial and the Community Mortgage Banking Project.

Rather than simply comparing default risk on 5 percent down loans to 20 percent down loans, this analysis takes into account the impact on the performance of the entire cohort of the sample QRMs that would result from moving from a 5 percent minimum down payment requirement on QRMs, to a 10 percent and a 20 percent minimum down payment requirement. The bottom line is that requiring a 10 or 20% down payment as an overlay to already-strong underwriting standards produces only minor improvement in market-wide default performance, but has a significant adverse impact on access by creditworthy borrowers to the lower rates and safe product features of the QRM. **The coalition believes this is an unnecessary trade-off that would have a disproportionate impact on moderate income and minority families and would undermine efforts to create a sustainable housing recovery**.

Housing Market Impact of Proposed QRM

Strong and sustainable national economic growth will depend on creating the right conditions needed for a housing recovery. The high minimum down payment/equity requirements and other narrow provisions of the proposed QRM will impair the ability of millions of households to qualify for low-cost financing, and could frustrate efforts to stabilize the housing market. To date, regulators have not provided an estimate of the cost of risk retention to the consumer. This should be done before finalizing any rule that could have such a significant adverse impact.

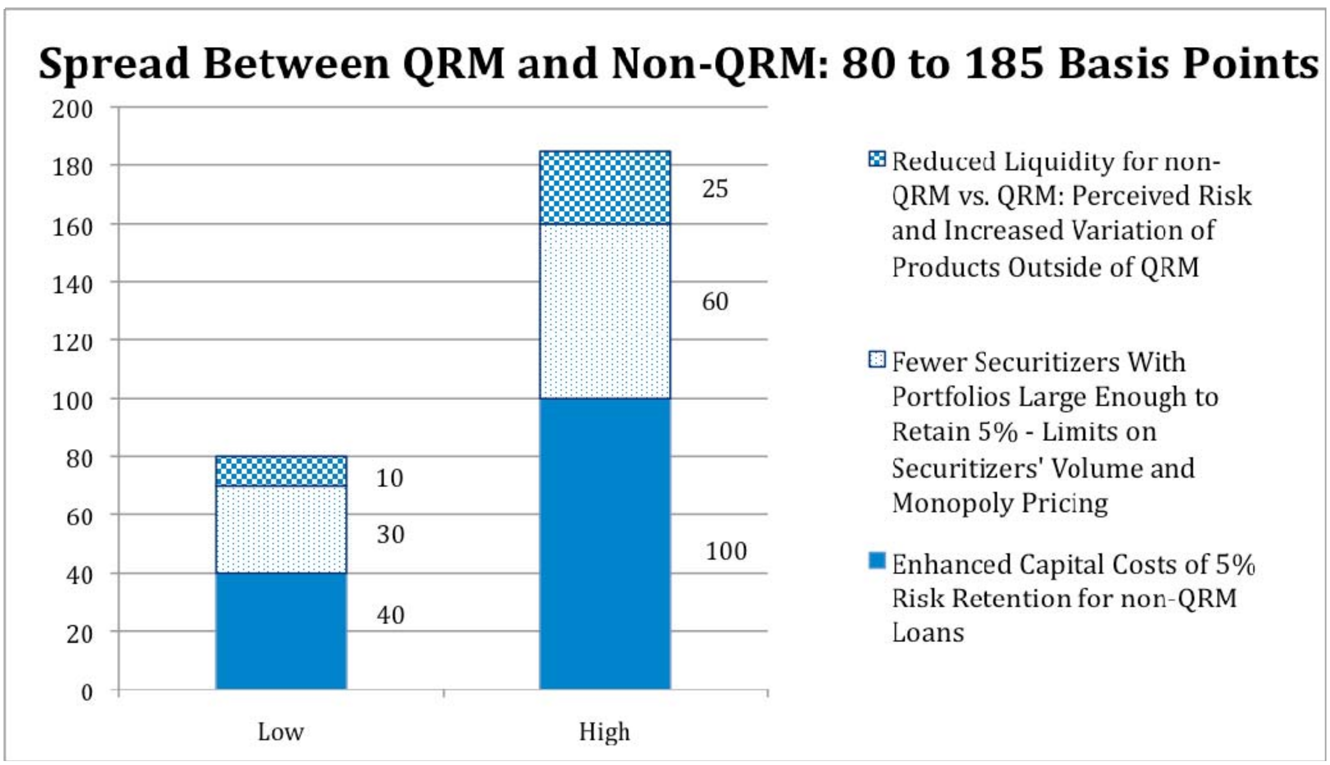
The regulators have informally suggested that risk retention will result in “only” a 10 to 15 basis point increase in rates for non-QRMs compared to exempt QRMs (although no methodology for this estimate is provided).[6] However, most private estimates of the cost of risk retention on non-QRMs are several orders of magnitude higher.

[6] *“FDIC's Bair Would Rather Eliminate QRM From Risk Retention Rule,”* American Banker, June 10, 2011.

For example, a National Association of REALTORS® (NAR) analysis indicates a much higher cost of risk retention than the regulators' calculations. According to NAR (see Chart 1), risk retention could raise rates for non-QRMs – the predominant product in the market under the proposed rule – by as much as 80 to 185 basis points. Similarly, a June 20, 2011 analysis by Mark Zandi of Moody's Analytics estimates "conservatively" that borrowers of non-QRM mortgages would be saddled with interest rates 75 to 100 basis points higher than QRM-eligible borrowers.[7] In other words, today's 4.5 percent contract rate for a 30-year fixed-rate loan that did not meet the QRM requirements would become a 5.25 percent rate, at best, and could go as high as 6.35 percent based on these estimated ranges.

A one-percentage point increase in interest rates could be devastating to a fragile housing market. According to estimates from the National Association of Home Builders, every 1 percentage point increase in mortgage rates (e.g., from 4.5 percent to 5.5 percent) means that 4 million households would no longer be able to qualify for the median-priced home. In terms of actual housing activity, the Zandi analysis (page 6) translates this impact as follows: "… a 100-basis point increase in 30-year fixed mortgage rates reduces the pace of new- and existing-home sales by nearly 425,000 units per year, lowers median existing-house prices by 8.5%, and drops the homeownership rate by a full percentage point." Moreover, any increase in rates that results from broad application of risk retention to most borrowers would be *in addition to* a general increase in interest rates forecast by most economists over the next 12-18 months.

Chart 1



Source: NAR estimates. See http://economistsoutlook.blogs.realtor.org/2011/06/17/qrm-higher-mortgage-rates-on-the-horizon/ for additional details.

[7] Mark Zandi and Cristian deRitis, Moody's Analytics Special Report, "Reworking Risk Retention," June 20, 2011.

The impact of the proposed definition of QRM would not be as severe as outlined here, since many borrowers would obtain exempt FHA loans or, until the GSE loan exemption is removed, GSE loans. However, these substitutions run contrary to the objectives of policy makers seeking to restore private capital and reduce dependence on federal guarantees in the mortgage market (as noted in more detail in the next section). As a result, when policies designed to shrink the FHA and GSE footprint are implemented, the full adverse effects outlined here of the narrow QRM will be felt.

In addition, the proposed narrow QRM definition will exacerbate conditions in markets already hardest hit by the housing crisis. For example, the five states most adversely impacted by the proposed QRM rule are Nevada, Arizona, Georgia, Florida and Michigan (see Table 4). As a result of price declines already suffered in these states, at least two out of three homeowners do not have at least 25 percent equity in their homes that would allow them to refinance with lower rate QRM. Six out of ten would not be able to move and put 20 percent down on their next home.

For those borrowers that have already put significant "skin in the game" through down payments and years of timely mortgage payments, only to see their equity eroded by the housing collapse, the proposed QRM definition tells them they are not "gold standard" borrowers and they will have to pay more. In effect, **the proposed QRM would penalize families who have played by the rules, stayed current on their mortgage, scraped each month to pay their bills and now need to refinance or relocate.**

Table 4
Proportion of Existing Homeowners with Mortgages Not Meeting QRM Equity Requirements
Top 5 States with Highest Percentages

State:	Proportion of homeowners with less than **30% equity**	…less than **25% equity**	… less than **20% equity**
Nevada	85%	83%	80%
Arizona	75%	72%	68%
Georgia	71%	65%	59%
Florida	70%	66%	63%
Michigan	68%	64%	59%

Source: Community Mortgage Banking Project, data from CoreLogic Inc.

With major regional housing markets ineligible for lower cost QRMs under the proposed rule, many states and metropolitan areas that have seen the sharpest price declines will face higher interest rates, reduced investor liquidity, and fewer originators able or willing to compete for their business. These areas face long-term consignment to the non-QRM segment of the market.

It is important to emphasize that the adverse impact of the proposed narrow QRM is entirely unnecessary. Well-underwritten low-down payment loans can and should play an essential role in a sustained housing recovery. As Zandi noted in a prior report on the QRM issue, "low down payment mortgages that are well underwritten have historically experienced manageable default rates, even under significant economic or market stress."[8] In his recent paper on the proposed rule, Zandi

[8] Moody's Analytics Special Report, "The Skinny on Skin in the Game," March 8, 2011, by Mark Zandi, page 3.

concludes, "The risk-retention rules being proposed are unlikely to meaningfully improve securitization's incentive problem. At the same time, they will raise borrowing costs significantly for many homebuyers and make loans difficult to get for others."[9]

Market Structure

The proposed narrow QRM rule discourages development of a renewed, robust and diversified private lending market. Under the restrictive QRM rule, the vast majority of loans will be non-QRMs subject to the higher costs of risk retention, yet it is not clear whether investors will view risk retention as providing sufficient protection that would encourage them to invest significantly in non-QRM mortgage securities.

Moreover, with a statutory exemption for FHA and VA, government-backed loans will have a significant market advantage over fully private loans. As a result, the proposed rule will delay, or even halt, the return of fully private capital back into the market. This is contrary to the purpose of the QRM. Mortgage securitization pioneer Lew Ranieri has strongly supported efforts to reform the securitization process and improve the incentive structures in the market, but in response to the proposed rule, Ranieri has said: "The proposed very narrow QRM definition will allow very few potential homeowners to qualify. As a result, it will complicate the withdrawal of the Government's guarantee of the mortgage market. I fear it will also delay the establishment of broad investor confidence necessary for the re-establishment of the RMBS market."[10]

Although the treatment of the GSEs in the proposed rule mitigates the immediate adverse impact of the rule on the housing market, it is not a viable long-term solution, and does little to establish the certainty needed for a strong private secondary mortgage market to develop based on sound underwriting principles and product standards. Rather than rely solely on a short-term fix, the regulators should follow Congressional intent and establish a broadly available QRM that will create incentives for responsible liquidity that will flow to a broad and deep market for creditworthy borrowers.[11]

Finally, it is not clearly evident that risk retention itself will attract investors to securitizations backed by non-QRMs. If investors do not find non-QRM securities attractive, or issuers find that the costs of the risk retention rule render securitization unviable, the large non-QRM market created by the rule will be dominated by portfolio lending. This likely means reduced market liquidity, a shift away from 30-year fixed rate loans, and a move toward more portfolio products like ARMs and hybrid ARMs (e.g., a fixed rate for 5 years that converts to a one year ARM).

If this occurs, the risk retention rule is likely to increase systemic risk rather than relieve it. By creating such a narrow QRM market, the capital required to make loans outside of the QRM (which would be most loans made today) will simply not be available to most community-based lenders. The result will be even further concentration of mortgage lending in a small number of institutions, reducing competition and increasing systemic risk.[12]

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[9] "Reworking Risk Retention," June 20, 2011, page 1.

[10] RISMedia, April 8, 2011, "Diverse Groups Respond to Proposed Rule for Qualified Residential Mortgages"

[11] For a complete analysis, see "What Was the Legislative Intent Behind the QRM" by Ray Natter, June 2011; http://www.bsnlawfirm.com/newsletter/OP0611_3.pdf

[12] According to National Mortgage News, by the end of 2010, five large banking institutions controlled 60 percent of all single-family mortgage originations.

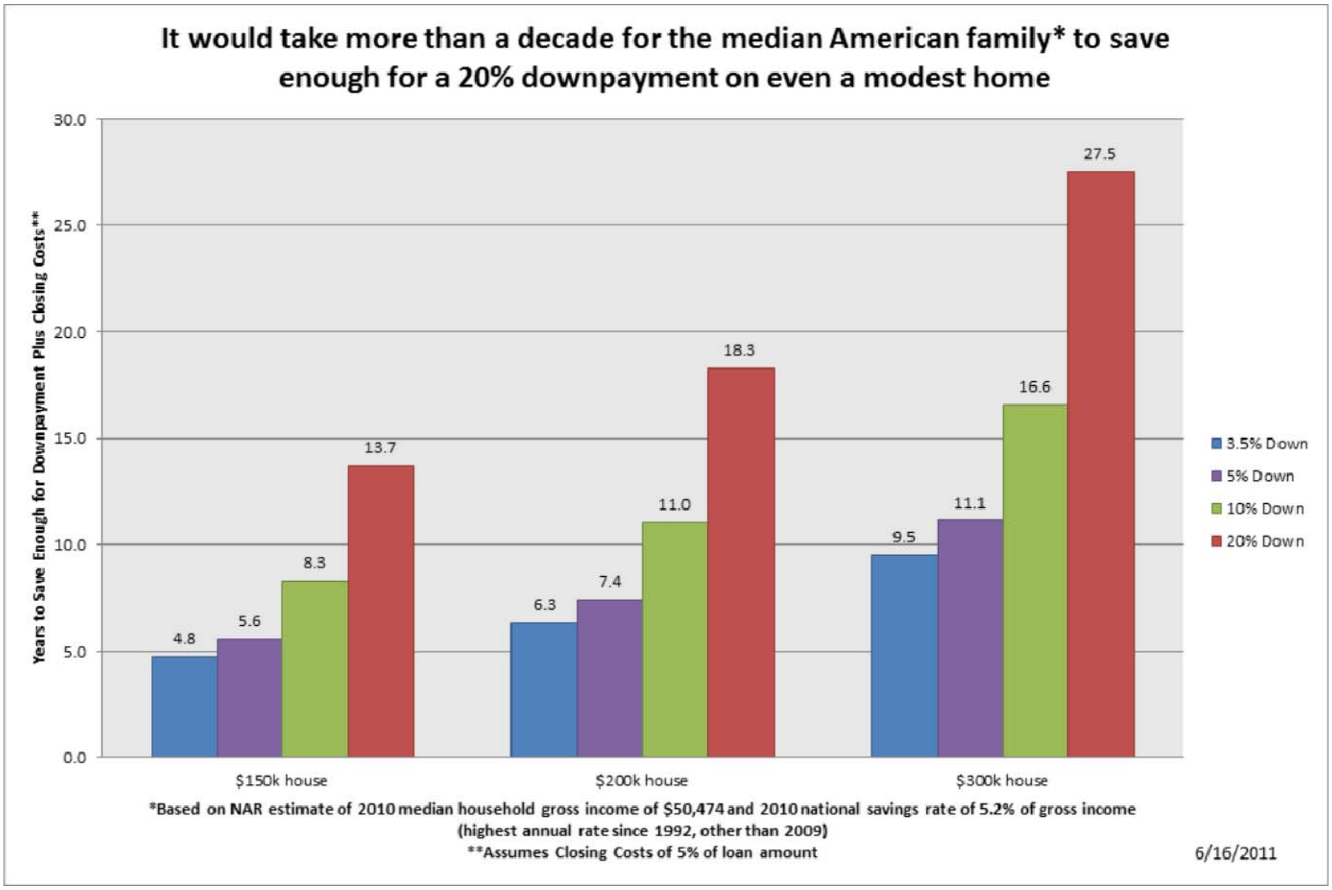
Conclusion

The proposed QRM rule is misaligned with three key pillars of Congressional intent:

- **For consumers,** the QRM was intended to provide creditworthy borrowers access to well-underwritten products at good prices. Although Congress intended for QRMs to be accessible to a broad range of borrowers, the regulators acknowledge that they crafted this rule to make the QRM "a very narrow slice" of the market. Despite specific Congressional rejection of down-payment requirements in the QRM legislative provisions, a fact attested to by the QRM sponsors, the regulators have insisted upon a punitive down payment requirement, even when confronted with ample historical loan performance data that show that low down payment loans perform well provided the loan has been properly underwritten and has consumer-friendly features.
- **For the housing market,** the statutory intent of the QRM was to provide a framework for responsible liquidity provided by private capital that would be broadly available to support a housing recovery. However, the QRM definition in the proposed rule will force the vast majority of both first-time and existing homeowners to face potentially significantly higher interest rates, or to postpone purchases and refinances.
- **For the structure of the housing finance market,** the QRM was intended to help shrink the government presence in the market, restore competition and mitigate the potential for further consolidation of the market. Again, the proposed rule is likely to have the opposite impact.

Regulators should redesign a QRM that comports with Congressional intent: **encourage sound lending behaviors that support a housing recovery, attract private capital and reduce future defaults without punishing responsible borrowers and lenders.**

ATTACHMENT 1



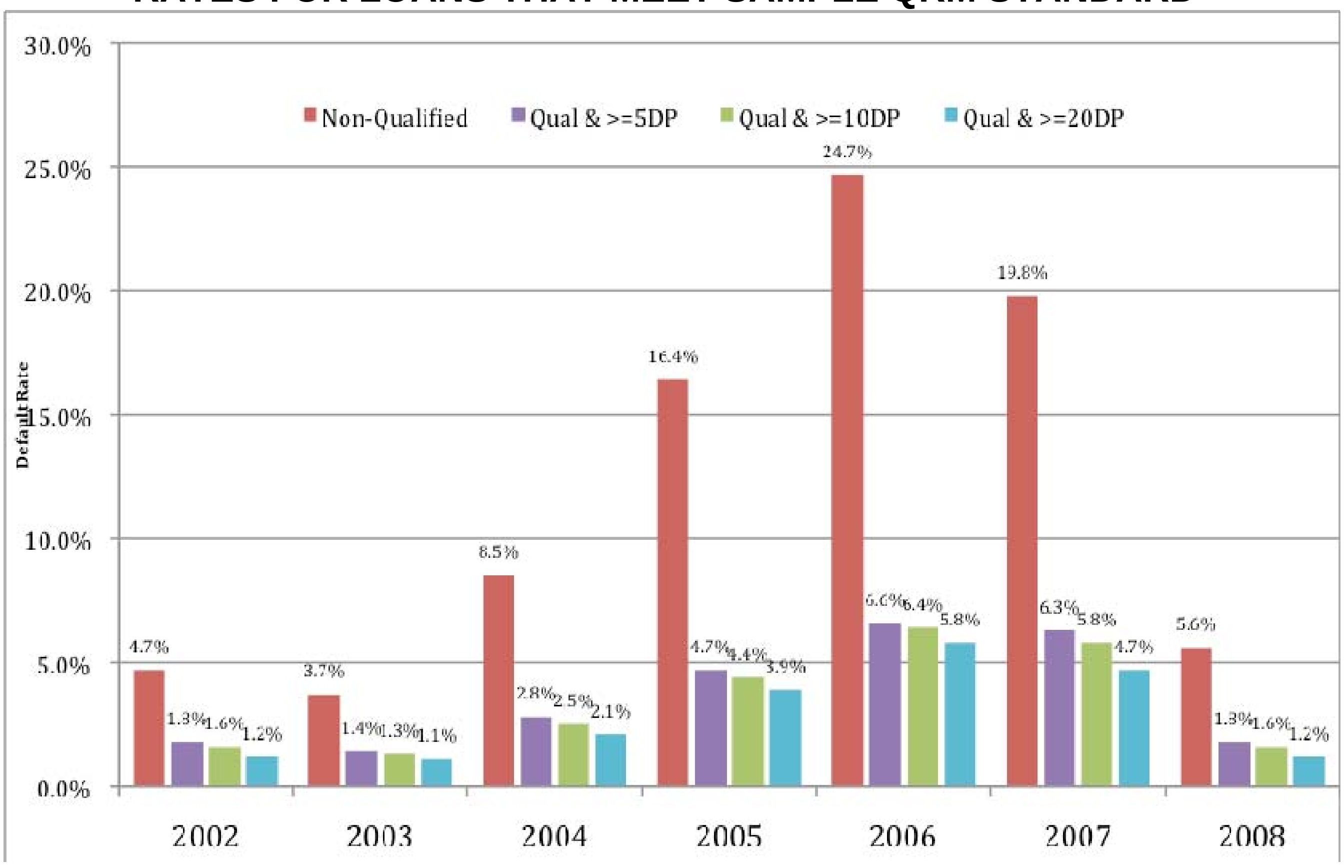
Source: National Association of REALTORS®

ATTACHMENT 2

Low Down Payments not a Major Driver of Default when Underwritten Properly

The red bar shows the performance of mortgages originated from 2002 – 2008 that do not meet all of the standards and features outlined below in the note. The other bars show the performance of mortgages that meet all of the sample QRM product and underwriting features. Within this second group of "QRM" bars, the blue bar shows how loans performed that met all these standards, plus had a 20 percent down payment or more; the green bar shows loans that the met all the standards plus had a down payment of at least a 10%; the purple bar shows these loans with at least 5% down. Naturally, loans with strong standards and at least 20% down performed best. However, the chart also shows clearly that lower down payment loans can be included in a strong QRM framework without exposing investors or the broader market to excessive risk.

IMPACT OF INCREASING MINUMUM DOWNPAYMENT ON DEFAULT RATES FOR LOANS THAT MEET SAMPLE QRM STANDARD



Source: Vertical Capital Solutions of New York, an independent valuation and advisory firm conducted this analysis using loan performance data maintained by First American CoreLogic, Inc. on over 30 million mortgages originated between 2002 and 2008. Note: Default rates are by origination year, through the end of 2009. Default means 90 or more days delinquent, plus in process of foreclosure, plus loans foreclosed. The sample QRM in this analysis is based on fully documented income and assets; fixed-rate or 7-year or greater ARMs; no negative amortization; no interest only loans; no balloon payments; 41% total debt-to-income ratio; mortgage insurance on loans with 80% or greater loan-to-value ratios; and maturities no greater than 30 years.