NATIONAL ASSOCIATION OF REALTORS®

The Voice For Real Estate®

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HEARING BEFORE THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

ENTITLED

THE NEW REGULATORY GUIDANCE ON SUBPRIME HYBRID MORTGAGES: REGULATORS AND RESPONSE

STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®
MARCH 27, 2007

The National Association of REALTORS® (NAR) is pleased to submit our views to the House Financial Services Subcommittee on Financial Institutions and Consumer Credit for the hearing entitled, "The New Regulatory Guidance on Subprime Hybrid Mortgages: Regulators and Response." We commend Chairman Maloney, Representative Gillmor and members of the subcommittee for holding this hearing on the important issue of subprime hybrid mortgage products, which if not carefully underwritten, could place the borrower in a situation of greater risk of foreclosure and other financial harm.

The National Association of REALTORS®, "The Voice for Real Estate," is America's largest trade association representing more than 1.3 million members and five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,400 local associations or boards, and 54 state and territory associations of REALTORS®.

REALTORS® Want to Prevent Irresponsible and Abusive Lending

Irresponsible and abusive lending practices are a major problem for our nation's communities. While abusive lending occurs much too often in subprime markets, not all subprime loans are abusive or problematic. In fact, responsible subprime lenders have played an important role in helping millions of consumers achieve homeownership. Unfortunately, some lenders abuse their role and take advantage of vulnerable borrowers by charging extremely high interest rates and loan fees unrelated to risk, using aggressive sales tactics to steer consumers into unnecessarily expensive or inappropriate loan products, and advertising "teaser" interest rates (like the 2/28 or 3/27 adjustable rate mortgage) that steeply increase after the first few years of the loan. The consequences of abuses in the subprime market are higher foreclosures leading to the loss of a family's home and savings and increased vacancy rates which, in turn, can cause all homes in the neighborhood to lose value.

Real estate professionals have a strong stake in preventing abusive lending because:

- Abusive lending erodes confidence in the Nation's housing system.

- In a credit-driven economy, the legislative and regulatory response to lending abuses can go too far and inadvertently limit the availability of reasonable credit for prime as well as subprime borrowers.
- To the extent the response to abusive lending constrains the ability of the secondary mortgage market to provide liquidity for home finance, consumers will find it more difficult and expensive to buy a home.
- Citizens of communities, including real estate professionals, are harmed whenever abusive lending strips equity from homeowners, especially when the irresponsible lenders concentrate their activities on certain neighborhoods and create a downward cycle of economic deterioration.

Problems Connected to Abusive Lending

For years, we have all heard from both the industry and the regulators that there is no single definition of "predatory" lending because the term covers a wide range of abusive practices. Some practices may seem abusive for one borrower but not for another because everyone's circumstances are different. Abusive lenders often take advantage of first-time homebuyers and others who may be vulnerable. Some examples of problems with abusive loans include, but most certainly are not limited to:

- **High interest rates and fees.** Abusive lenders often charge extremely high interest and fees that are added into the total amount of the loan the borrower must repay. These lenders charge what they can get away with, not a fair amount based on the credit history of the borrower.

- **Broken promises/"bait and switch."** Sometimes home buyers are offered a new loan or a refinance of an existing loan that seems to meet all of their needs only to find that interest rates and fees have changed when they get to the closing table. Agreeing to last-minute changes can cost thousands of dollars and result in a loan they just can't afford.

- **Loans that start low and go high.** Adjustable rate loans are popular in today's market, but some loans, like the 2/28 or 3/27 mortgages which seem to be affordable at first, are likely to have steep cost increases in the future.

- **Loan "flipping."** Too many homeowners are persuaded to refinance their mortgage, sometimes repeatedly, when there is no real benefit. Even when a family receives some cash from a refinance, the gains should be weighed against the costs of excessive fees and a higher loan amount. Often a borrower has other options, such as obtaining a second mortgage instead of refinancing the entire existing mortgage.

- **Steering.** Some families who receive subprime loans could qualify for a much more affordable home loan, possibly even a prime loan. Abusive lenders use aggressive sales tactics to steer families into unnecessarily expensive loan products.

NAR Supports Amending HOEPA to Broaden and Strengthen its Coverage

NAR supports amending the Home Ownership and Equity Protection Act of 1994 (HOEPA), which establishes federal anti-predatory lending protections for high-cost mortgages. If Congress enacts significant HOEPA reform legislation, including many of the amendments listed below, NAR believes the result would be a significant reduction in irresponsible and abusive lending.

1. **Extend HOEPA to Purchase Money Mortgages.** The scope of HOEPA should be broadened to cover purchase money mortgages, and not be limited to refinancings and other loans taken out by existing homeowners. While abusive lending has been a particular problem in connection with refinancings by homeowners, homebuyers are also being victimized by problematic loans.

2. **Lower Triggers to Apply HOEPA to More Mortgages.** HOEPA applies to high-cost mortgages, measured in terms of high interest rates and high fees and points.

- The existing interest rate trigger should be lowered so HOEPA applies to more mortgages or lenders offer more lower cost mortgages, but the decision of exactly what level is appropriate will depend on the strength of the overall package of reforms. The current trigger for subordinate mortgages is 10 percent above the rate for comparable U.S. Treasury obligations. The Federal Reserve Board has exercised its discretion to lower the trigger to 8 percent for first mortgages.
- The definition of fees and points should be comprehensive (current law has too many exclusions), and the points and fees trigger should be set at about 5 percent of the loan. For example, the definition should include yield spread premiums and, if permitted, potential prepayment penalties. Some pending proposals would permit, in addition to the percentage cap, two bona fide discount points, which should be permitted, depending on the strength of the overall package of reforms.
- In addition, NAR recommends that Congress consider adding an additional HOEPA trigger based on excessive loan-to-value ratios, again with the details depending on the strength of the overall package of reforms. Since appraisal fraud—appraisals above the real market value of the property—may be coupled with abusive lending, NAR recognizes that an LTV trigger may have limited impact. NAR is on record in support of appraisals that are independent, unbiased, and objective for all segments of the market.

3. **Protections from Abusive Terms and Conditions.** NAR supports a strong package of HOEPA reforms that includes as many of the following protections for high-cost HOEPA mortgages (and, where noted, other mortgages) as possible:
   - Seek to bar **prepayment penalties** but for all mortgages, not just high-cost HOEPA mortgages. If a complete prohibition is not feasible, support shortening the maximum permissible time for prepayment penalties from five years to three or preferably fewer years and capping them at a reasonable amount.
   - **Cap the amount of fees and points that may be financed at about 5%, plus up to two bona fide discount points.** This would minimize the ability of abusive lenders to hide the true cost to the consumer by avoiding the need for them to pay for

excessive fees at settlement. Prohibit financing of fees and points in the case of a refinancing where the same lender made the loan being refinanced.

- Prohibit **single premium insurance** (or any equivalent)**.**
- Prohibit **mandatory arbitration clauses,** because of the need to offer borrowers with HOEPA mortgages stronger protections. (Mandatory arbitration clauses are becoming infrequent in the prime market because Fannie Mae and Freddie Mac no longer purchase mortgages with mandatory arbitration clauses, and other lenders have stopped including them in their mortgages as well.)
- Continue to prohibit lenders from engaging in a pattern or practice of lending without regard to the **ability of the borrower to repay the loan.**
- For **home improvement contractor loans,** continue to prohibit direct payments of loan proceeds to home improvement contractors, and make assignees and holders of HOEPA home improvement mortgages subject to the same claims a consumer has against the seller, contractor, broker, or creditor.
- Prohibit anyone from **encouraging default.**
- Prohibit **mortgage flipping—**refinancing within one year unless the refinancing provides a "reasonable net tangible benefit" to the borrower.
- Require lenders, each year, to provide **two free pay-off statements** within seven business days of the request.
- As a general rule, permit **modification and deferral fees** only when there is a change to a HOEPA loan that benefits the consumer.
- Require all institutional mortgage lenders to **report payment history** of borrowers on a monthly basis. Prime mortgage lenders typically already report payment histories to credit reporting agencies (credit bureaus), so imposing reporting on all lenders should not impose an additional regulatory burden on prime mortgage lenders.
- Retain prohibitions against **balloon mortgages** for mortgages with terms less than five years and against **negative amortization**.
- Require **counseling** for prospective borrowers, to be provided by independent, certified counselors.

4. **Assignee Liability.** NAR opposes any weakening of originator or assignee liability for HOEPA mortgages. There is no reason originators should not remain liable for violations of law they commit in connection with making a mortgage loan. As between an innocent borrower that risks losing the home and an innocent assignee in the secondary market that inadvertently purchases a HOEPA mortgage, the interests of the borrower should generally prevail. Fannie Mae, Freddie Mac, and others have policies against the purchase of HOEPA mortgages, and current law has not impaired the secondary market.

   HOEPA currently imposes liability on assignees of HOEPA mortgages and permits borrowers to defend against foreclosure based on defects in the mortgage, with limited exceptions. A HOEPA mortgagor in default cannot assert certain claims and defenses against an assignee that can demonstrate, by a preponderance of evidence, that a reasonable person could not determine that it had purchased a HOEPA mortgage, based on certain factors. But even where an assignee can make that showing, the mortgagor retains certain rights, including the right of rescission for certain violations.

   NAR supports proposals to strengthen HOEPA, so long as they would not disrupt the secondary market. For example, HOEPA should continue to include reasonable limits on the amount of damages a mortgagor can claim, and class action litigation should not be permitted.

NAR Supports Consumer Education

NAR is very concerned that some borrowers do not understand the significant risks associated with an abusive loan and do not know how to avoid them. Last year, NAR, in partnership with the Center for Responsible Lending, issued a consumer education brochure entitled, "How to Avoid Predatory Lending," a copy of which is attached to this statement. The brochure emphasizes how important it is for consumers to make sure they shop for the lowest-cost loan and ask questions like,

- What is my credit score? Can I have a copy of my credit report?
- What is the best interest rate today? Do I qualify?

- Is the loan's interest rate fixed or adjustable?
- What is the term (length) of the loan?
- What are the total loan fees?
- What is the total monthly payment? Does this include property taxes and insurance? If not, how much will I need each month for taxes and insurance?
- Is there an application fee? If so, what is it, and how much is refundable if I don't qualify?
- Are there any prepayment penalties? If so, what are they and how long do they last?

Conclusion

Irresponsible and abusive lending can be a disaster not only for the borrower and his or her family, but for the community as well. Problematic loans are often made in concentrated areas and are more likely to result in foreclosures. High foreclosures of single-family homes are a serious threat to neighborhood stability and community well-being. Foreclosures can lead to high vacancy rates which, in turn, can devastate the strength and stability of communities.

REALTORS® help families achieve the dream of homeownership. The National Association of REALTORS® supports responsible lending with increased consumer protections to ensure that the "dream" our members help fulfill does not turn into a family's worst nightmare. NAR stands ready to work with Congress on the important issue of risky mortgage products and we are happy to make available to your constituents our "How to Avoid Predatory Lending" consumer education brochure. Thank you.