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The Voice For Real Estate®

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

ENTITLED

THE ROLE OF THE SECONDARY MARKET IN SUBPRIME MORTGAGE LENDING

STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®
MAY 8, 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 Role of the Secondary Market in Subprime Mortgage Lending." We commend Chairman Maloney, Representative Gillmor and members of the subcommittee for holding this hearing on the important issue of the secondary market for subprime residential mortgages and public policy recommendations to curtail abusive lending. Securitization plays an important role in ensuring liquidity to our nation's housing finance system and keeping the secondary market strong and sound is in everyone's interest.

Securitization plays an important role in ensuring liquidity to our nation's housing finance system. Securitization activities by both the newer private secondary market players and the more mature government sponsored enterprises have allowed the majority of Americans to become homeowners. Both sectors have the accompanying responsibility of ensuring that its efforts are designed to also keep these families in their homes. Keeping the secondary market strong, sound and acting in the best interests of those it seeks to serve is in everyone's interest.

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®.

<u>REALTORS® Want to Prevent Irresponsible and Abusive Lending</u>

Irresponsible and abusive lending practices are a major problem for our nation's communities. While responsible subprime lenders have played an important role in helping millions of consumers achieve homeownership, abusive lending occurs much too often in subprime markets. Unfortunately, some lenders have abused their role and taken 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 consequence of abuses in the subprime market is higher rates of foreclosures leading to the loss of families' homes and savings and increased vacancy rates which, in turn, can cause all homes in a 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.

- Legislative and regulatory responses to lending abuses that go too far can inadvertently limit the availability of reasonable credit for prime as well as subprime borrowers in a credit-driven economy.

- To the extent responses to abusive lending constrain 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 irresponsible lenders concentrate their activities in certain neighborhoods and create a downward cycle of economic deterioration.

NAR Supports 8 Key Responsible Lending Principles

NAR supports (a) keeping fair and affordable mortgage products available for borrowers with imperfect credit; and (b) eliminating abusive and problematic mortgages that are made without sufficient regard to whether the borrower can afford the loan and that can lead too often to foreclosure. Specifically, NAR supports a detailed list of improvements to the Home Ownership and Equity Protection Act of 1994(HOEPA) which were included in our submitted statement for the March 27, 2007 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."

However, with 2.2 million American households projected to lose their homes and as much as $164 billion due to foreclosures in the subprime mortgage market,[1] the public policy debate has grown far beyond how to fix HOEPA, and instead is focused on how to keep people in their homes and how to prevent this subprime "mess" from happening again.

NAR supports the general principle that all mortgage originators should act in "good faith and with fair dealings" in a transaction and treat all parties honestly. NAR's Code of Ethics already imposes a similar obligation on REALTORS®, who are required to treat everyone in the transaction honestly. NAR encourages legislators to use such a standard of care as a guiding principle when drafting anti-predatory lending legislation rather than using the phrase to create a new federal duty that would be too general and, therefore, too difficult to enforce.

1. Affordability. NAR supports strong underwriting standards that require all mortgage originators to verify the borrower's ability to repay the loan based on all its terms, including taxes and insurance, without having to refinance or sell the home.[2] Lenders should consider all relevant facts, including the borrower's income, credit history, future income potential, and other life circumstances. Lenders should not makes loans to borrowers that make loss of the home through sale or foreclosure likely if the borrower is unable to refinance the mortgage or sell.

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[1] Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners, Center for Responsible Lending (December 2006).

[2] The limited exceptions to this general principle would include prime borrowers with sufficient verifiable assets to handle a balloon mortgage or a significant jump in mortgage payment.

- Underwriting Subprime Loans with "Teaser Rates." Some subprime loans are structured with a significant jump in monthly payments often resulting in "payment shock" for the borrower. While these mortgages may be a reasonable choice for subprime borrowers who can afford them, a majority of subprime borrowers do not have the resources to deal with or an understanding of the unique terms and conditions of these risky mortgage products that can result in a significant "payment shock." Therefore, lenders (including mortgage brokers) should exercise more caution when underwriting such loans to subprime borrowers to make sure the borrower is able to afford the mortgage. Examples of these risky mortgage products include loans with a short-term interest "teaser" rate for the first two or three years (known as 2/28s and 3/27s), loans with an initial interest-only period, and mortgages that negatively amortize.[3]

  NAR will carefully monitor the debate on underwriting standards for subprime loans and will support policies consistent with the goal of assuring that, taking into account all relevant circumstances, borrowers, who have demonstrated the financial capacity to meet their mortgage obligations, continue to have access to mortgage loans made by responsible lenders.

- Reasonable Debt-to-Income Ratio. NAR supports requiring lenders to make subprime loans that have a reasonable debt-to-income ratio. Borrowers should have enough residual income after making their monthly mortgage payment, including taxes and insurance, to meet their needs for food, utilities, clothing, transportation, work-related expenses, and other essentials. Requiring underwriting at a fully amortizing, fully indexed rate is meaningless if the lender uses such high debt-to-income ratios that the family doesn't have enough income remaining to pay for other necessities.

- Escrow/Reserve for Payment of Taxes and Insurance. Lenders that make subprime mortgage loans should generally require that the monthly payment include an amount to be held by the mortgage servicer in an escrow/reserve/impound account for the payment of the borrower's periodic payments, such as taxes and insurance. Similar to the escrow requirement exceptions for prime loans that exist in some jurisdictions, borrowers that make at least a 20 percent downpayment should have the option to budget for these payments independently.

2. Limit Stated Income/Stated Assets Underwriting. Since mortgages underwritten based on "stated income" and/or "stated assets" (also known as "no income verification" or "no doc" loans) typically have higher rates, lenders making subprime loans should, as a general rule, underwrite loans based on verified income and assets. The main exception

[3] Negative amortization ordinarily results if the mortgage permits a borrower to pay less than the interest on the mortgage for a limited time, in which case the difference is added to the total amount of the loan the borrower must repay.

should be for borrowers whose incomes derive from hard-to-verify sources (such as self-employed borrowers and borrowers in the "cash economy").

3. Flexibility for Life Circumstances. NAR believes that a standard for determining a borrower's ability to repay must be flexible to accommodate borrowers with unique circumstances, such as:

- ✓ Borrowers who have demonstrated the ability to make monthly payments, over a long term, that are higher than underwriting standards would otherwise allow. Lenders should consider, for example, the borrower's history of making rent and student loan payments.
- ✓ Borrowers with high assets but low income who, for cash management or other financial planning reasons, elect a mortgage with a monthly payment that their current income is not sufficient to cover.
- ✓ Borrowers who anticipate a jump in income or assets due to life events such as graduation, completion of professional training, completion of payment obligations for student or car loans, another member of the household entering the work force when young children start school, or an inheritance.

4. Anti-Mortgage Flipping Policy. NAR supports an anti-mortgage-flipping rule requiring mortgage originators making or arranging for a loan that refinances an existing residential mortgage to verify that the new loan provides a significant benefit to the borrower (one test often proposed is the loan must provide a "reasonable net tangible benefit" to the borrower). The lender should consider the circumstances of the borrower, as discussed above, all terms of the new loan including taxes and insurance, the fees and other costs of refinance, prepayment penalties, and the new interest rate compared to that of the refinanced loan.

5. Bar Prepayment Penalties. Under the 2005 policy, NAR opposes prepayment penalties for all mortgages. Prepayment penalties often work to trap borrowers in loans they cannot afford by making it too expensive to refinance. If complete prohibition of prepayment penalties is not feasible, NAR supports permitting prepayment penalties for the shortest time and the lowest amount possible. For example, a borrower in a 2/28 mortgage should be able to refinance at the end of the initial two-year "teaser" rate period without having to pay a prepayment penalty.

6. Alternative Factors for Measuring Creditworthiness. Borrowers with little or no credit history, as traditionally measured, usually have lower credit scores and must pay more every month for their mortgage than those with higher scores. Even if such a borrower is able to qualify for a mortgage, it may be one that has negative amortization or provides for a significant jump in payments after an initial teaser rate period. NAR supports ongoing efforts to take into account consumer payment history not typically considered, such as rent, utility, telephone, and other regular payments and urges HUD, the regulators, the GSEs, and lenders to work to strengthen these efforts. Use of alternative credit approaches will be especially beneficial for low- and moderate-income first-time homebuyers and borrowers with problematic loans that need to refinance their mortgage to avoid foreclosure.

7. Mortgage Choice for Borrowers. NAR supports requiring mortgage originators to offer borrowers one or more mortgages with interest rates and other fees that appropriately reflect the borrower's credit risk. It remains the responsibility of borrowers to decide upon the best mortgage for their needs and circumstances, but they can only do so if they understand all the facts so they can make an informed decision. The following are suggested principles for consideration of Congress and the regulators:

- For originators who offer nontraditional mortgage products, the originator should:
    - offer all borrowers a choice of several significantly different mortgage options;
    - include at least one traditional loan product as one of the options for the borrower to consider, if the borrower qualifies for such a product offered by the originator; and
    - before application acceptance, disclose information about the maximum potential payment over the life of the loan and the date the initial payment will increase to a fully amortizing, fully indexed payment amount.

- For subprime borrowers, originators that offer FHA-insured mortgages or VA home loan guaranty mortgages should consider whether these types of mortgages should be offered as an appropriate option.

- If the originator does not offer mortgages with rates and fees appropriate for the borrower's credit risk, the originator should inform the borrower a lower interest rate may be available from another originator or that the borrower may wish to seek housing counseling, to allow the borrower an opportunity to shop elsewhere or receive counseling before proceeding. For example, a prime borrower that applies for a loan to a lender that only makes subprime loans should be advised that other options may be available.

- For loans originated by a mortgage broker, the broker should offer mortgage options that are among the lowest-cost products appropriate for the borrower.

8. Enforcement/Remedies. NAR supports enactment of strong remedies and penalties for abusive acts by mortgage originators. Among the options for consideration are:

- Criminal penalties similar to those under RESPA.

- Civil penalties similar to those under RESPA.

- Assignee liability that balances the need to protect innocent borrowers with problematic loans against the risk that increasing the liability of innocent holders of mortgages in the secondary market could reduce the availability of mortgage credit.

- Prohibition of mandatory arbitration clauses that bar victims' access to court.

Responsible Lending Principles Should Apply to Wall Street

NAR appreciates that Wall Street investors, facing the implosion of numerous subprime lenders, a surge in foreclosure filings and record delinquency rates, are now requiring better underwriting and increasing pricing for subprime loans. However, some would argue, "too little too late" or "what prevents an investor from relaxing standards once subprime headlines have passed?"

NAR recognizes the impracticality of requiring investors to look at each loan file in a securitized pool to determine whether the mortgage originator appropriately verified the borrower's ability to repay the loan based on all its terms. However, we do believe that loan purchasers have an obligation during the course of their due diligence review to ensure that the lender is making safe, sound and responsible loans, using appropriate underwriting standards and a strong internal control system.

NAR urges secondary market participants to use our 8 Key Responsible Lending Principles as guidance during the course of due diligence in the acquisition of whole loans or loan pools. We believe that effective due diligence policies applied prior to the loan purchase would curb the ability of abusive lenders to pawn problematic loans off on the secondary market.

Foreclosure Avoidance and Mitigation

NAR supports legislative, regulatory, and private-sector foreclosure avoidance and mitigation efforts. We urge lenders, especially lenders that have made loans without considering the ability of the borrower to make payments under the loan, to act promptly to help borrowers resolve the problem, including through recasting of the mortgage, forbearance, favorable refinancing, waiving of prepayment penalties, and other appropriate tools. Prompt action will almost always be in the best interests of the lender, as well.

NAR also supports increased funding for programs that provide financial assistance, counseling, and consumer education to borrowers to help them avoid foreclosure or minimize its impact. We believe that Congress and the regulators should examine alleged abuses by mortgage servicers, some of whom are engaging in predatory servicing by imposing unjustified high fees on borrowers, which can contribute to, or even cause, delinquencies and foreclosures.

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 and our “Learn How to Avoid Foreclosure and Keep Your Home” brochure that we will release next week. Thank you.