NATIONAL ASSOCIATION OF REALTORS®

The Voice For Real Estate®

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HEARING BEFORE THE SENATE BANKING, HOUSING AND URBAN AFFAIRS SUBCOMMITTEE ON HOUSING, TRANSPORTATION, AND COMMUNITY DEVELOPMENT

ENTITLED

ENDING MORTGAGE ABUSE: SAFEGUARDING HOMEBUYERS

WRITTEN TESTIMONY OF PAT V. COMBS, ABR, CRS, GRI, PMN PRESIDENT

NATIONAL ASSOCIATION OF REALTORS®
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Chairman Schumer, Senator Crapo and Members of the Subcommittee, thank you for inviting me to testify today on the issue of protecting homebuyers from mortgage abuse. My name is Pat Combs, and I am the Vice President of Coldwell Banker-AJS-Schmidt, the second largest real estate company in Michigan. I have been a REALTOR® for over 35 years primarily specializing in buyer representation.

I am here to testify on behalf of our more than 1.3 million REALTOR® members who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors and others engaged in all aspects of the real estate industry. Members belong to one or more of some 1,400 local associations/boards and 54 state and territory associations of REALTORS®. We commend the committee for holding today's hearing on the very serious issue of mortgage abuse and public policy recommendations to protect our nation's homebuyers from harms way.

REALTORS® Want to Prevent Irresponsible and Abusive Lending

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, 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 and basing their lending on artificially high appraisals. 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. When 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. This is especially the case 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 made without sufficient regard to whether the borrower can afford the loan and avoid 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 February 7, 2007 Senate Banking, Housing, and Urban Affairs Committee hearing entitled, "Preserving the American Dream: Predatory Lending Practices and Home Foreclosures."

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. Instead, the focus is now 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

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

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.

- 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

[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.

"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. We will continue to 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 property 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 money left each month 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

[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.

payments, such as taxes and insurance. Similar to the escrow requirement exceptions for prime loans that exist in some jurisdictions, borrowers who 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 should be for borrowers whose incomes derive from hard-to-verify sources (such as self-employed borrowers).

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 large 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, paying off a student or car loans, another member of the household entering the work force, or an inheritance.

4. Anti-Mortgage Flipping Policy. NAR supports an anti-mortgage-flipping rule requiring mortgage originators making or arranging a refinance loan to verify that the new loan provides a significant benefit to the borrower.[4]. The lender should consider the circumstances of the borrower, as discussed above, as well as all terms of the new loan including taxes, insurance, fees and other costs of refinancing, prepayment penalties, and the new interest rate, compared to those of the refinanced loan.

5. Bar Prepayment Penalties. NAR opposes prepayment penalties for all mortgages. Prepayment penalties often 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. NAR supports

[4] One test often proposed is the loan must provide a "reasonable net tangible benefit" to the borrower.

ongoing efforts to take into account consumer payment history not typically considered, such as rent, utility, telephone, and other regular payments. We urge HUD, the regulators, the GSEs, and lenders to work to strengthen these efforts. Use of alternative credit histories 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 an option for the borrower to consider, if the borrower qualifies for such a product offered by the originator; and

- before application acceptance, disclose 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.

- 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 for a subprime borrower.

- 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. Doing so will 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, more affordable 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 ask "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 has 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.

Strengthen the Independence of Appraisers

NAR believes that the independence of appraisers should be strengthened to ensure that appraisals are based on sound, fair and accurate appraisal principles and reflect a property's true value. An overwhelming number of appraisers, upwards of 90%, have experienced pressure to meet targeted values. The pressure is often subtle with an appraiser being asked whether or not they can provide an appraisal to match a general price. Over 75% of appraisers report concerns that if they do not meet such requests, they will lose both the appraisal job and future business.[5] In addition, many appraisers fear that they may be black listed and/or erroneously reported to their state licensing and regulatory agency.

[5] National Appraisal Survey, October Research (2007).

NAR supports the following measures to strengthen the appraisal process in federally related transactions:

1. Consumer Disclosure: NAR recommends that lenders be required to inform a borrower of the methods used to value a property to determine the amount of the mortgage loan, and borrowers have the right to receive a copy of each value estimate or value opinion. Furthermore, lenders should be required to obtain a detailed site visit appraisal for properties financed with nontraditional mortgage products.

2. Penalties for Improper Appraisal Influence: Congress should consider civil penalties against those who would coerce, intimidate or otherwise influence the appraisal process to meet a targeted value. Parties with an interest in the outcome of an appraisal should be limited to requests that the appraiser, (1) consider additional, appropriate property information, (2) provide further detail, substantiation, or explanation for the value conclusion and (3) correct errors in the appraisal report.

3. Assist States to Improve Regulation of the Appraisal Industry: While the appraisal industry is regulated at the state level, the Appraisal Subcommittee sets appraisal qualifications and standards for federally related transactions. Thus, state regulatory agencies both license appraisers and certify appraisers for federally related transactions. NAR opposes expanding the authority of the Appraisal Subcommittee to issue binding regulations on states. However, NAR would support providing greater assistance to states for the purpose of strengthening regulatory and enforcement activities. For example, developing a grant program funded by an increase in the Appraisal Subcommittee roster fee would be a valuable resource for states.

4. Support Enhanced Education and Qualifications for Appraisers: The Appraisal Subcommittee, through its standards and qualifications authority, should recognize appraisers who have obtained special designations or training from professional appraisal organizations that are sponsors or affiliate sponsors of the Appraisal Foundation.

NAR believes that these four principles will help strengthen the appraisal process and ensure appraisal independence. These measures will provide the consumer added certitude that the appraised value of their purchase truly is a fair and accurate valuation.

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. Possible steps could include recasting 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 also 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. These abusive practices can contribute to, or even cause, delinquencies and foreclosures.

Strengthen Federal Programs to Provide Safe Financing Options

REALTORS® believe that FHA reform is critical to ensuring that borrowers with less than perfect credit have a safe, affordable mortgage alternative. The FHA program makes it possible for higher-risk, yet credit-worthy borrowers to get safe, affordable credit. By offering access to prime rate financing, FHA provides borrowers a means to achieve lower monthly payments – without relying on interest-only or "optional" payment schemes. FHA is also a leader in preventing foreclosures. In the year 2004 alone, more than 78,000 borrowers were able to retain their home through FHA's loss mitigation program; and two years later, nearly 90 percent of these borrowers are still in their homes. FHA products are safe, thanks to appropriate underwriting and loss-mitigation programs, and fairly priced without resorting to teaser rates or negative amortization.

In 1934 the Federal Housing Administration was established to provide consumers an alternative form of financing, during a lending crisis similar to that we are facing today.

At that time, short-term, interest-only and balloon loans were prevalent. When formed, FHA was a pioneer of mortgage products. FHA was the first to offer 30-fixed-rate financing at a time when loans were generally for less than five years. Unfortunately, FHA has not changed with the times and as a result has lost market share. Due to its loan limits, downpayment requirements, and antiquated pricing model, FHA is often simply unusable by homebuyers. We urge Congress to pass FHA reform, to offer borrowers a safer mortgage alternative and bring stability to local markets and local economies.

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, based on sound independent appraisals, 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, which is attached to the testimony. Thank you.