NATIONAL ASSOCIATION OF REALTORS®

The Voice For Real Estate®

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STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED FOR THE RECORD TO THE

UNITED STATES HOUSE COMMITTEE ON FINANCIAL SERVICES

HEARING REGARDING

EXPLORING THE BALANCE BETWEEN INCREASED CREDIT AVAILABILITY AND PRUDENT LENDING STANDARDS

MARCH 25, 2009

Introduction

On behalf of the 1.2 million members of the NATIONAL ASSOCIATION OF REALTORS® (NAR), 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, thank you for holding this hearing to gain clarity on the need for increasing credit availability while maintaining prudent lending standards.

As Congress considers reforms to the regulatory system for banks and financial institutions, including mortgage reform, REALTORS® believe that it is necessary to balance the need for prudent credit underwriting standards and maintaining an adequate flow of credit to consumers. REALTORS® have a vested interest in the financial sector implementing sound credit underwriting standards while ensuring the continual flow of credit because at the core of our business is the foundation of the national economy, real estate, which requires that consumers obtain a substantial level credit in order to facilitate their purchase.

If the ability of consumers to receive credit is unduly constrained, in particular credit to finance a home, then the ability of the housing sector, as well as the national economy to recover from the current economic crisis will be severely impaired. Therefore, NAR presents a set of principles that we have developed that focus on the responsible extension of credit for home purchases.

REALTORS® Support Efforts to Encourage Responsible Lending

Past irresponsible and abusive lending practices are largely responsible for the major problems that our nation's housing market and overall economy are currently experiencing. Some lenders abused their role and took 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 that steeply increased after the first few years of the loan and based their lending on artificially high appraisals. The consequence of these abuses in the housing market are high rates of foreclosures that have lead to the loss of families' homes and wealth, increased vacancy rates which, in turn, have caused homes in neighborhoods across our nation to lose value, and a destabilization of our overall economy.

REALTORS® have a strong stake in preventing abusive lending because:

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

- 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's Principles of Good Faith and Fair Dealings for all Mortgage Originators

As abuses in the housing market were becoming evident, NAR, in May 2005, adopted a set of "Responsible Lending Principles" that we have recently updated and shared with the members of the House Financial Services Subcommittee on Financial Institutions and Consumer Credit during their March 11th hearing titled, "Lending Reform: A Comprehensive Review of the American Mortgage System." As strong advocates of protections for consumers in the mortgage transaction, REALTORS® support the general principle that all mortgage originators should act in good faith and with fair dealings in a transaction, and treat all parties honestly. Here is a list of NAR's Responsible Lending Principles:

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.[1] 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 were 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 borrowers who can afford them, a majority of borrowers do not understand 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.[2] For the most part, regulatory guidelines have addressed these concerns.

- 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

1 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.
2 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.

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, insurance, and homeowner/condo fees. Similar to the exception for prime loans in some jurisdictions, borrowers that make at least a 20 percent down payment should have the option to budget for these payments independently.

2. Limit Stated Income/Stated Assets Underwriting. Because 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.

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. 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 by the end of the initial two-year "teaser" rate period without having to pay a prepayment penalty.

6. Improvements for Assessing 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 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.

Another public policy issue associated with credit histories is the failure of furnishers to report good payment histories to the consumer reporting agencies. NAR has heard reports that many problematic subprime lenders purposefully withhold information on timely mortgage payments from the credit bureaus in order to prevent their customer from refinancing with another lender. The result is obvious—the borrowers with no positive payment histories for their subprime loan keep treading the waters of high-interest rates and expensive credit products. NAR supports requiring all institutional mortgage lenders, or the mortgage servicers acting on their behalf, to report payment history of all borrowers to at least the three national credit bureaus on a monthly basis.

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 which is the best mortgage for their needs and circumstances, but they may only do so if they understand all the facts so they can make an informed decision. The following are suggested principles for consideration;

- 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.

9. Strengthen Appraiser Independence. NAR believes that the independence of appraisers should be strengthened to ensure that appraisals are based on sound and fair appraisal principles and are accurate. There are reports that appraisers have been pressured to meet targeted values or risk losing business. Appraisal pressure undermines the integrity of the mortgage lending process if the result is a mortgage loan made based on an inaccurate property valuation. NAR recommends the following measures to strengthen the appraisal process:

- Require lenders to inform each borrower of the method used to value the property in connection with the mortgage application, and give the borrower the right to receive a copy of each appraisal at no additional cost.

- Establish enhanced penalties against those who improperly influence the appraisal process. Those with an interest in the outcome of an appraisal should only request the appraiser to (1) consider additional information about the property; (2) provide further detail, substantiation, or explanation for the appraisal; and (3) correct errors.

- Provide federal assistance to states to strengthen regulatory and enforcement activities related to appraisals.

- Support enhanced education and qualifications for appraisers.

In addition to our Responsible Lending Principles, NAR believes that the following duties should be considered by policy makers when establishing minimum standards of care for all federally and state regulated mortgage originators:

1. A mortgage originator shall act in the borrower's best interest and in good faith toward the borrower.
2. Mortgage originators shall use reasonable care in performing duties.
    a. Reasonable care includes following strong underwriting standards that require verification of the borrower’s ability to repay the loan based on all its terms, including property taxes and insurance, without having to refinance or sell the home.
    b. Reasonable care also includes giving consideration to the totality of the borrower’s circumstances, including income, credit history, future income potential and other life or unique circumstances.
    c. Reasonable care does not require a mortgage originator to obtain a loan containing terms or conditions not available to the originator in their usual course of business, or to obtain a loan for the borrower from a broker or lender with whom the originator does not have a business relationship.
3. A mortgage originator shall not accept, give, or charge any undisclosed compensation or realize any undisclosed remuneration, either through direct or indirect means, that inures to the benefit of the mortgage originator on an expenditure made for the borrower.
4. Mortgage originators shall carry out all lawful instructions given by borrowers.
5. Mortgage originators shall disclose to borrowers all material facts of which the mortgage broker has knowledge which might reasonably affect the borrower's rights, interests, or ability to receive the borrower's intended benefit from the residential mortgage loan.
6. Mortgage originators shall account to a borrower for all the borrower's money and property received from the borrower.
7. Mortgage originators shall not pressure or improperly influence appraisers to meet targeted values.

Violations of a mortgage originator’s duty to act in good faith and with fair dealings should include:

- Making a loan where the loss of the home through sale or foreclosure is likely if the borrower is unable to refinance the mortgage or sell.
- Misrepresenting or concealing material factors, terms or conditions of the transaction.
- Making false statements or promises, fraud, dishonest dealing, negligence, and criminal convictions.
- Failing to disclose all material facts about a loan to a borrower or misrepresenting facts to a lender (such as knowingly misstating a borrower’s income) would also be actionable offenses.
- Not acting in the best interest of the borrower.
- Improperly refusing to issue a satisfaction of a mortgage loan.

Conclusion

Irresponsible and abusive lending is a disaster not only for the borrower and his or her family, but for the community and the national economy, as well. High foreclosures of single-family homes are a serious threat to neighborhood stability and community wellbeing. Foreclosures can lead to high vacancy rates which, in turn, can devastate the strength and stability of communities, and ultimately our economy.

Just as important as curbing the flexibilities that led to irresponsible and abusive lending is the need to ensure that an overcorrection does not occur impairing the flow of credit to consumers, particularly to those consumers interested in purchasing real estate. A balance between increasing the availability of credit to consumers while implementing and maintaining sound underwriting standards must be struck if our economy is to recover. NAR believes that now is the time for all of us – Congress and financial services and housing industry participants - to come together and forge a new partnership that will ensure the nation's consumers get the credit they require, while helping our financial institutions remain safe and sound.

The National Association of REALTORS®, its 1.2 million residential and commercial real estate practitioners, thank you for the opportunity to share our views, and we stand ready to work with Congress and our industry partners to facilitate a housing recovery that will bring our nation out of this economic nightmare.