EXHIBIT FOR THE AGENDA OF THE
2010 CONVENTIONAL FINANCE AND LENDING COMMITTEE
NATIONAL ASSOCIATION OF REALTORS®
2010 REALTORS® CONFERENCE
Motion to Adopt NAR Credit Policy

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10/17/2010

MOTION OF THE CONVENTIONAL FINANCE AND LENDING COMMITTEE
For consideration on November 5, 2010

THAT NAR ADOPT A CREDIT POLICY TO INCREASE MORTGAGE LENDING TO QUALIFIED BORROWERS

Moved, That NAR adopt the following policy urging mortgage lenders, the Federal Housing Administration (FHA), the government-sponsored enterprises (Fannie Mae and Freddie Mac or the GSEs), and federal regulators to reassess and amend their credit policies in order to increase lending to qualified homebuyers, including the specific policy changes recommended by NAR.
Rationale: Mortgage lenders, FHA, the GSEs, and federal regulators have responded to the housing crisis by imposing so many safeguards that there is little risk to making new loans. The GSEs and FHA have a public mission to provide mortgage liquidity to qualified home buyers, including low- and moderate-income families and first-time homebuyers. This mission is being impaired by unnecessarily restrictive limits on the availability of credit. Private lenders are making hardly any mortgage loans not insured by FHA or purchased by the GSEs, creating a significant imbalance in the mortgage market now dominated by government-related lending. These extremely tight credit policies are significantly delaying the recovery of the housing market and the economy as a whole. All involved need to consider taking on additional, but not undue, risk to help jump-start the recovery.

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PROPOSED NAR CREDIT POLICY

LENDERS, FHA, THE GSEs, AND FEDERAL REGULATORS SHOULD REASSESS AND AMEND THEIR CREDIT POLICIES

SO MORE QUALIFIED BORROWERS ARE APPROVED FOR MORTGAGES

THE PROBLEM

The housing and mortgage markets have over-corrected, and one of the problems holding back the recovery is excessively tight credit policy.

What started as a problem with subprime, predatory loans became a systemic problem affecting all segments of the mortgage and housing markets. There were many problems. Lenders made subprime loans to prime borrowers. They also made loans to borrowers who were believed to be prime borrowers without verifying their income or carefully assessing the value of the property. Home values rose far faster than incomes. Mortgage-backed securities received triple A credit ratings based on overly optimistic projections of the performance of their underlying collateral (for example, Alt-A, subprime, and even prime loans). The Nation experienced a serious recession with high unemployment that resulted in less demand for homes and lower home values. Investors were no longer willing to invest in private label securities—mortgage backed securities without a federal guarantee. As a result, many homeowners are unable to afford their mortgages, and are unable to refinance or sell them. A short sale or a foreclosure too often is the only option.

Lenders responded to these problems by refusing to make loans unless they could sell them to Fannie Mae or Freddie Mac (the government sponsored enterprises, or GSEs) or have them insured by FHA. Combined, the GSEs and FHA account for more than 90 percent of the mortgage market. For the last several years, lenders have made hardly any non-GSE/non-FHA loans because there was no private label secondary mortgage market and these purely private loans had to be held in the lenders' own portfolios.

Also in response to these problems, the GSEs and FHA have taken steps to strengthen their underwriting. Freddie Mac purchases almost no loans with a loan-to-value ratio (LTV) of more than 80 percent if the borrower has a FICO score of less than 700. Approximately 60 percent of the loans purchased by Freddie Mac have a LTV at or below 80 percent and a FICO score of more than 750. In calendar year 2009, 36% of FHA borrowers had a FICO score of 620-679 and 49% had a credit score of 680 to 850, the maximum score, indicating a significant boost in the quality of FHA-insured loans.

In contrast to the middle years of the decade when a very large proportion of potential borrowers were able to qualify for loans with loan-to-value ratios even higher than 100 percent, now it can be very difficult to qualify without excellent credit. The credit

and lending communities and federal regulators should reassess the entire credit structure and look for ways to increase the availability of credit to qualified borrowers who are good credit risks. The inadvertent response to "risk layering" has been "safety layering" where so many safeguards are being imposed that there is little risk to making new loans. The current book of business at the GSEs and FHA is sometimes referred to as "pristine." NAR believes pristine loans are the result of excessively tight underwriting, not sound business practices. The GSEs and FHA have a public mission to provide mortgage liquidity to qualified home buyers, including low- and moderate-income families and first-time homebuyers. This mission is being impaired by limits on the availability of credit. NAR calls on all involved to reassess and amend their policies accordingly. This will not only help individual, well-qualified potential borrowers, but also the entire housing market which currently suffers from an excess supply of housing and unduly tight underwriting criteria.

NAR has identified the following specific recommendations as a starting point for adjusting the current unduly restrictive credit policies.

SPECIFIC RECOMMENDATIONS

1. Education and Counseling

NAR will make information about the credit policies of lenders, the FICO Corporation, and the credit reporting industry available to REALTORS® and consumers. Topics should include the importance of good credit, how FICO scores are determined and how to increase them, how to recover after an adverse credit event, and how to find a fair and affordable mortgage.

NAR will publish one or more brochures on credit issues, including a Spanish version, and make them available for (i) review online by any interested person, (ii) downloading and printing from the NAR website without charge, and (iii) purchase, at cost, from the REALTOR® store. Similar information should also be made available on the www.HouseLogic.com website. REALTORS® may use these brochures and other information to help educate clients and other consumers about credit.

NAR reaffirms existing NAR policy that opposes mandatory counseling for all borrowers. Mandatory counseling raises concerns about the capacity of the counseling community (and the risk of major delays in closings) and the cost and quality of the counseling.

NAR has already posted information on Realtor.org on (i) the computation of FICO scores and the impact of adverse credit events on scores, and (ii) the impact of adverse credit events on the ability of a consumer to qualify for a loan to purchase another

home. See: http://www.realtor.org/government_affairs/gapublic/fincredissues.

NAR will discuss with FHA, the GSEs, and others in the lender community the possibility of rewarding borrowers with lower rates or costs if they complete financial literacy and credit training with an accredited counseling agency.

2. Impact of Lowering Available Lines of Credit and Increasing Utilization Rates on FICO Scores

When a credit card issuer reduces a consumer's line of credit or a mortgage lender reduces a consumer's home equity line of credit (HELOC), there may be an effect on the consumer's FICO score. In determining a FICO score, 30 percent is based on "amounts owed," including whether a person is using a high percentage of the available line of credit. FICO research shows that consumers with a high debt load and a high utilization rate pose a greater credit risk.

A FICO Corporation study covering April to October 2009 shows that during that period, 14 percent of consumers experienced a reduction in their lines of credit. About 1/3 of these had their credit lines reduced because of a "risk trigger" but the remainder had no credit event that caused the reduction. Over a period of years, a very large number of consumers will be affected by reductions in their lines of credit.

NAR urges FICO to amend its formulas to avoid harming consumers whose utilization rates increase because their available lines of credit is reduced without a risk trigger related to the particular consumer. For example, FICO could ignore the utilization rate for such consumers or compute the score as if the available lines of credit had not been reduced. Although the FICO study shows that the scores of most of those affected stayed within 20 points of the prior score, in today's tight underwriting environment, even one point can mean the difference between qualifying for a loan or not, or qualifying for an FHA down payment of 3.5 percent or 10 percent. With respect to consumers where the lower available lines of credit results in problems with their ability to handle their finances due to an emergency, late payments will very soon result in a lower score so lenders will in most cases be able to take that into account.

3. Impact of Adverse Credit Events on the Ability to Purchase Another Home

FHA, Fannie Mae, and Freddie Mac each have policies on the impact of adverse credit events on the ability of consumers to purchase another home. These policies are summarized in NAR's chart on that subject, attached to this report.

NAR urges FHA, Fannie Mae, and Freddie Mac to assess these policies at least semi-annually to determine whether they should be adjusted. Where research shows that borrowers who qualify for a shorter waiting period after an adverse credit event, due to extenuating circumstances, as determined pursuant to underwriting policies of the lender,Extenuating circumstances may include life events such as a job loss, a divorce, or an illness. are performing well on their loans, the GSEs should reduce the waiting period further until it determines that the risk of default increases to an unacceptable level.

FHA takes a more flexible approach than Fannie and Freddie which have specific waiting periods that may be shortened by a specified amount for extenuating circumstances. NAR urges the GSEs to adopt the FHA approach:

- If the borrower was not in default at the time of the short sale, FHA allows the borrower may qualify for an FHA loan without a waiting period. While few borrowers are likely to fall into this category, if they have succeeded in staying current on their loans, they should be able to requalify as soon as they have the financial capacity to purchase another home.

- If the borrower was in default at the time of the short sale, FHA requires a 3 year wait, but the lender has the discretion to reduce the waiting period if it documents extenuating circumstances and the borrower has re-established good credit. Giving the lender this discretion enhances both the ability of borrowers to obtain a new loan and the safety and soundness of the loan.

- In the case of a deed-in-lieu of foreclosure or a foreclosure, FHA requires a 3 year waiting period, but the lender has the discretion to reduce the waiting period if it documents extenuating circumstances and the borrower has re-established good credit.

4. Need to Change Reporting and Treatment of Loan Modifications/Payment Plans

Lenders sometimes agree to approve a loan modification or a payment plan for a borrower. The benefit to lenders is they may avoid a foreclosure and minimize their loss, and the benefit to borrowers is they may be able to keep their home. While the borrower’s credit is damaged, sometimes they can rebuild it by meeting their new payment obligations. This is only possible, however, if a lender reports the loan modification as the same loan with changes. Some lenders report loan modifications with a Code (“AC”) that indicates “partial payment—not paid as originally agreed.”) In November 2009, the credit reporting agencies (the CRAs, Equifax, Experian, and TransUnion) started to allow a new code (“CN”) that means “loan modified under a Federal government plan.” The FICO scoring formula does not recognize the CN code. NAR urges FICO to study the credit risk performance of consumers whose

loans are modified under a Federal government plan and modify the FICO formula accordingly.

FICO has advised NAR that its research shows that borrowers not paying as originally agreed are more likely to become seriously delinquent in the near future. NAR questions the assumption that borrowers who agree to a loan modification or a payment plan for credit obligations they can no longer afford but who then demonstrate their ability to handle the modified payments are higher credit risks. NAR urges FICO to study the credit risk performance of these consumers and modify the FICO formula accordingly.]

NAR urges the credit and lending communities and federal regulators to adopt reasonable, uniform reporting of loan modifications so if borrowers make on-time payments for a reasonable period their payments are reported as “paid as agreed.” This recognizes that both parties agreed to the loan modification, that it has, in effect, replaced the prior loan, and that the consumer is working to restore good credit. Continuing to report payments indefinitely as “not paid as originally agreed” makes it difficult if not impossible for the borrower to begin to reestablish good credit until the loan is fully repaid. Refinancing will be practically impossible. The borrower may never be able to move to another home because the borrower’s credit will never be good enough to qualify for another mortgage. The current variations in reporting means consumers are treated inconsistently and, accordingly, the system is viewed as being unfair. All of these effects are against the interest of every party involved and the housing market itself.

5. Adverse Impact of Requiring a Borrower to Be Delinquent before Being Considered for a Loan Modification, Short Sale, or Deed-in-Lieu of Foreclosure

Many lenders and investors (those who own the mortgages) require that borrowers be delinquent before considering them for a loan modification, a short sale, or a deed-in-lieu of foreclosure. Especially at the beginning of the current mortgage crisis, lenders simply had too few servicing staff to handle the burgeoning workload. They used a triage system by putting consumers who were at least 90 days delinquent at the top of the pile, and that category was replenished before they ever got to those with defaults of less than 90 days. Too often, these staffing shortages continue today. Others impose this policy as a way to avoid strategic defaults. The Freddie Mac version of the Home Affordable Foreclosure Avoidance Program (HAFA) requires that its borrowers be at least 60 days delinquent before they may be considered for a short sale or deed-in-lieu of foreclosure. Freddie Mac apparently thinks this is the best way to make sure the borrower has a real hardship that justifies special treatment.

The result has been significant, but unnecessary, damage to the credit of many

consumers. REALTORS® report to NAR their clients' frustrations about this policy. Some homeowners have struggled to stay current by using savings or working two jobs but are unable to continue to do so. The result is they receive less favorable consideration by lenders and investors than those who do not make extraordinary efforts to minimize default.

NAR urges the lending community and government regulators to modify their policies to minimize the impact of these financial crises on the credit history of the borrowers. If consumers are able to minimize the extent of their defaults, they will be able to rebuild their credit and requalify for another loan more quickly. This will have the added benefit to the community of increasing demand for housing and stabilizing their local housing markets.

6. <u>Strategic Defaults</u>

Press reports indicate that a significant number of borrowers who owe more on their mortgages than their homes are now worth, but who can afford to pay their mortgages, are nevertheless opting to default, sometimes after first buying another home. This action is usually referred to as a strategic default.

NAR believes that borrowers who have the financial ability to meet their mortgage obligations should do so.

NAR urges the lending industry (including the FHA, the GSEs, and lenders) to adopt or retain, as appropriate, underwriting policies that take into consideration extenuating circumstances of the prospective borrower. For example, it should be possible for a borrower to qualify for a new mortgage more easily and faster if extenuating circumstances, as determined pursuant to underwriting policies of the lender, Extenuating circumstances may include life events such as a job loss, a divorce, or an illness. occurred that led to the borrower's loan default. It is appropriate for a borrower whose default is not due to extenuating circumstances to be required to take more time to repair their credit history and qualify for new credit.

NAR has prepared, and posted for its members, a chart on the "Impact of Adverse Credit Events on the Ability of Consumers to Purchase Another Home" (see attached). The chart compares FHA, Fannie, and Freddie rules that take into account extenuating circumstances for borrowers who experience a short sale, a deed-in-lieu of foreclosure, a foreclosure, or a bankruptcy. NAR recommends that these entities study the impact of their current policies and make underwriting even more flexible if they determine that borrowers with extenuating circumstances are performing well with respect to their new loan.

7. Need for Research on the Impact of Credit Policies on Underserved Groups

NAR will assess whether there is existing research on the impact of current credit policies on underserved groups, and, if not, conduct its own research. Not all groups have the same "culture" with respect to the use of credit. Some have thin files because they are not aware of their credit options, choose not to use credit to avoid potential misuse, are young and do not have a long credit history, or only have payment history related to cell phone and utility bills and rent. Others live in extended families where the household has a very high capacity to handle its financial needs and obligations, but find it difficult to qualify for a loan.

NAR continues to urge lenders to rely on non-traditional credit histories in underwriting loans for potential borrowers with thin credit files to determine if they are good credit risks. In addition, depending on the results of the research, NAR will urge FICO, other credit score providers, and the lending industry to amend their policies to avoid denying credit to borrowers who are good credit risks, but don't otherwise fit a traditional model.

8. Free Credit Scores

Section 1100F of the Dodd-Frank Act gives consumers the right to a free copy of their credit scores if a creditor takes an adverse action based on information contained in a consumer credit report. Previously, consumers only had the right to a free copy of their credit report in the case of an adverse action—and annually, if they requested a copy—but not the credit score in either case.

NAR, whenever an opportunity to amend the Fair Credit Reporting Act arises, will support legislation to give all consumers the right to receive a free copy of their credit score from each national credit reporting agency (Experian, TransUnion, and Equifax) at the same time they receive a free copy of their credit report provided on request. Giving all consumers a right to receive a free copy of their credit score will avoid confusion and increase transparency with respect to consumer credit. Many consumers think they already have this right. Others are misled by sites that promise a free credit score but entice consumers into agreeing to monthly charges. Avoiding the need to distinguish between two classes of consumers—those that qualify for a free report and those that do not—will also make administration of the statutory free disclosure requirements easier for the credit reporting agencies.