NATIONAL ASSOCIATION OF REALTORS®

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July 20, 2010

Mr. Michael Barr
Undersecretary for Domestic Finance
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Submitted electronically to http://www.regulations.gov

RE: TREAS-DO-2010-0001, Public Input on Reform of the Housing Finance System

Dear Mr. Barr:

On behalf of more than 1.1 million REALTORS®, I am submitting comments of the National Association of REALTORS® (NAR) on the reformation of the U.S. housing finance system. REALTORS® recognize that our current housing finance structure with loans backed by the Federal Housing Administration (FHA) comprising up to 30% of the market, the Government-Sponsored Enterprises (GSEs) in conservatorship and controlling nearly 70% of the market, and little-to-no private capital in the marketplace is both undesirable and unsustainable.

Also, REALTORS® recognize the fragility of the housing market and the overall economy, where any misstep in the implementation of a new housing finance system will likely cause the derailment of our recovery and place the nation in a worse predicament. Therefore, REALTORS® urge the government, and our industry partners, to move forward deliberately, but cautiously, as we seek to reform the U.S. housing finance model.

NAR'S INPUT ON REFORMING THE HOUSING FINANCE SYSTEM

How should federal housing finance objectives be prioritized in the context of broader objectives of housing policy?

REALTORS® believe that the foundation of our economy is housing. Many business sectors have developed from it, and many more thrive because of it. In nearly all of our economic downturns, it has been housing that has pulled us through. Therefore, as we endeavor to reform and rebuild our housing system, REALTORS® believe that it is imperative for the government to have a continuing role in housing finance, for the purpose of supporting the following priority objectives:

1. Ensure an active secondary mortgage market by facilitating the flow of capital into the mortgage market for all types of housing, in all market conditions.

2. Seek to ensure affordable mortgage rates for qualified borrowers.

3. Establish: (a) reasonable housing affordability goals so all qualified borrowers, including low- and moderate-income households, have an opportunity to realize the dream of homeownership; and (b) reasonable multifamily rental housing affordability goals to increase the availability of financing for rental housing.

> REALTORS® believe that housing affordability goals should not provide incentives that are inconsistent with sustainable homeownership or sustainable rental housing. We warned of this risk in our comments in 2004 on HUD's proposed GSE goals that we believed then were too high and that appear to have played some part in the problems faced over the last few years in both the housing and mortgage markets.

4. Require any explicitly government-backed secondary mortgage market entity to pass on the advantage of its lower borrowing costs by making mortgages with lower rates and fees available to qualified borrowers.

5. Ensure mortgage availability throughout the nation.

6. Require sound underwriting standards consistent with NAR's Responsible Lending Principles adopted in May 2005 - refer to the question #6 response for additional detail.

7. Require the highest standards of transparency and soundness with respect to disclosure and structuring of mortgage related securities.

8. Ensure there is sufficient capital to support mortgage lending for all types of housing, in all market conditions.

9. Provide for rigorous oversight.

What role should the federal government play in supporting a stable well-functioning housing finance system and what risks, if any, should the federal government bear in meeting its housing finance objectives.

REALTORS® believe that secondary mortgage market GSE structure prior to conservatorship, with a private profit and public loss structure, was flawed and problematic. At the same time, our members recognize that there is a need for some level of government involvement in the housing finance sector in order to ensure it remains viable in volatile economic times. Therefore, REALTORS® believe a "government-chartered" structure is the best model for Fannie Mae's and Freddie Mac's replacement(s) in the secondary mortgage market because this structure establishes a separate legal identity from the federal government, while allowing it to serve an established public purpose (e.g. Import Export Bank of the United States).

Unlike a federal agency, government-chartered organizations are established to be politically independent and often are self-sustaining – not requiring appropriations from Congress. The ability of the entities to focus on their mission (in this case, provide liquidity to the housing market), without the need to chase risky opportunities in order to maximize profit, meets one of the conditions that our members hoped to accomplish.

Moreover, a government-chartered authority removes any ambiguity regarding the government's participation in the secondary mortgage market. REALTORS® believe that the government backing of this type of structure is required in order to instill confidence in potential investors of the entity's mortgage-backed securities (MBS). Without the confidence of these investors, the ability of the entity to raise capital for the purpose of providing liquidity to the secondary mortgage market will be limited.

Please note that REALTORS® also believe that the entity should not be operated as if the government / taxpayers are in the first lien position. This new structure should be self-sufficient (need no appropriations), price risk effectively to cover potential losses, and utilize any profits to establish a reserve to alleviate losses that occur in economic down turns – reducing substantial risk to the government and the taxpayer.

Our members believe that the conversion of Fannie Mae and Freddie Mac into this type of structure will pose the least amount of market disruption, and ensure a continual flow of capital to the secondary market during the transition period.

Should the government's approach differ across different segments of the market; if so, how?

The focus of our members' efforts with regard to the reformation of the U.S. housing finance system has been on the restructuring and rebuilding of the major secondary mortgage market participants, Fannie Mae and Freddie Mac. Again, REALTORS® recognize that a secondary mortgage market primarily comprised of the government is not sustainable or desirable. Our desire is to have private capital return the market, and have the government activity return to levels experienced during a normal market cycle.

How should the current organization of the housing finance system be improved?

REALTORS® believe that strong corporate governance and improved regulatory oversight will pay immediate dividends for our faltering housing finance system. An issue that many of our members indicate to be at the center of our housing finance system problems is the "politicalization" of the housing finance mission and the organizations that participate in the secondary mortgage market, Fannie Mae and Freddie Mac. Aside from removing their shareholder demands, any entities that arise to take the place of the GSEs should be "firewalled" from any political influence.

Our members believe that this can be accomplished by establishing the political independence of organizations through mandating that: (1) the CEO(s) will have fixed terms so they cannot be fired without cause, and (2) the entities will be self funded – having no need for ongoing appropriations.

Also, the governance structure should provide for a Chief Executive Officer to oversee daily operations, a Board of Directors with practical expertise to ensure effective and efficient operation, and an advisory board comprised of industry participants and consumer representatives to provide the organization, and its management, with real-time, front-line information regarding the authorities' effectiveness and advice on their operation. Moreover, the new secondary mortgage market entities must be permanent (e.g. they should not have an expiration date).

And lastly, there must be strong oversight of the entities (for example, by the Federal Housing Finance Agency – FHFA or its successor), that includes the providing of timely public reports to allow for continual evaluation of their performance by Congress and all others who are interested.

How should the housing finance system support sound market practices?

REALTORS® believe that just as improving governance and oversight will improve the housing finance system, so will an improvement in general business practices improve the safety and soundness of the secondary mortgage market, and ultimately the primary mortgage marketplace. Many of our members fear that Fannie Mae's and Freddie Mac's movement into business lines that were, at best, tangential to their housing mission, placed them, and our housing finance system in grave risk. Our members understand why they moved toward those business practices (i.e. to chase market share by purchasing riskier mortgages (including low-doc/no-doc Alt-A mortgages) in order to stay competitive with fully private financial institutions). However, the membership believes that organizations in their position would better serve the market by establishing higher business practice standards.

In order to accomplish this goal, REALTORS® believe that any reform of the housing finance system must adhere to the following market practice standards:

1. Establish sound and sensible underwriting standards for loans purchased and securitized in MBSs, loans purchased for portfolio, and MBS purchases by the successor(s) of GSEs.

2. Mandate that the GSEs' successors will retain and reinvest all excess revenue to accumulate capital in strong markets, to pursue a countercyclical policy in weaker markets, and to support the secondary market, provide for innovation, remain mission focused, and maintain their capacity.

> REALTORS® believe that it is prudent to have the new entities invest all excess capital earned in strong markets into a reserve fund so that it can pursue countercyclical activities in weaker markets, as well as store capital to prevent the need for taxpayer funds during economic downturns. Again, a primary goal of our members is to ensure that the government and taxpayers are not immediately on the hook when a downturn occurs.
>
> Also, in the current economic environment, as banks and other financial institutions are being encouraged to hold more capital against well performing assets, the new entities should set the industry standard, and be an exemplar of safe and sound operations.

3. Require the <u>primary</u> purpose of the GSEs' successors' portfolios will be to support their operations in both the single family and the multi-family housing markets. REALTORS® envision that the portfolio(s) should only be large enough to support business needs and, when necessary because of insufficient private investment in the mortgage market, and only to the extent needed, ensure a stable supply of capital consistent with market conditions.

> NAR believes that the entities should maintain a portfolio for the purpose of funding their daily operations, to use in a countercyclical fashion when the market turns down and private capital inevitably leaves the market place, as well as to test innovative products and house mortgages on products that are not easily securitized (e.g. multi-family housing loans and rural mortgages). The use of the portfolio will ensure that there is a continual flow of some capital into the secondary mortgage market during downturns thus preventing a complete collapse of the market place, as well as provide much needed capital to those portions of the housing market that don't traditionally have access to large amounts of private capital.
>
> Our members do not recommend placing a rigid limit on the size of the portfolio; however, they do indicate that the portfolio should only be large enough to support the authorities' business needs, allow for products that lack private market capital, and when necessary because of insufficient private investment, and only to the extent needed, ensure a stable supply of capital consistent with market conditions. REALTORS® insist that the portfolio size should not be driven by for-profit motives.

4. Price loan products based on risk. Housing affordability goals will assure that the entities serve a full range of borrowers directly by the GSEs or indirectly by programs assisted by the GSEs.

5. Standards must be set for the GSE successors' MBSs that establish transparency and verifiability for loans within the MBSs that are purchased or securitized by the government-chartered authorities.

6. The successors should only purchase and guarantee transparent and verifiable mortgage loans, and should only purchase derivatives as a limited option in order to manage risk, not to generate profit.

7. At least <u>two</u> GSE successor entities are required to avoid the risk a single entity would lose incentive to innovate and to be efficient.

<u>*What is the best way for the housing finance system to help ensure consumers are protected from unfair, abusive or deceptive practices?*</u>

REALTORS® have a strong stake in preventing abusive lending because, (1) abusive lending erodes confidence in the nation's housing system, (2) 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, and (3) citizens of communities, including REALTORS®, 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.

Our members support the general principle that all participants in the housing finance system 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 requirement on REALTORS®, who are required to treat everyone in the transaction honestly. In the past, we have encouraged policy makers to use such a standard of care as a guiding principle when drafting anti-predatory lending legislation and regulations rather than using the phrase to create a new federal duty that would be too general and, therefore, too difficult to enforce.

Therefore, to protect the consumer by creating an atmosphere of "good faith and fair dealings", REALTORS® believe the following responsible lending principles should be adhered to.

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 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 borrowers who can afford them, a majority of subprime 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.

- 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, insurance, and homeowner association/condominium fees. Similar to the exception for prime loans 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. 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.

[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.

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 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 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.

Do housing finance systems in other countries offer insights that can help inform U.S. reform choices?

REALTORS® believe that all financing tools, at our disposal, should be utilized as we further our efforts to reform and rebuild our housing finance system. A tool which our members desire to see integrated into our secondary mortgage market is the "covered bond." Our members recognize that this tool will not take the place of the housing finance system's use of, and dependence on, mortgage backed securities (MBS) as the primary generator of liquidity for our housing market. However, we do believe that the utilization of this tool, in tandem with MBS, can offer increased liquidity and safety in our secondary market.

Finally, REALTORS® urge caution as you review the potential benefits of housing models established in other countries. The primary instrument of the U.S. Housing Finance System is the 30-year, fixed rate mortgage, and according to research provided to NAR by economist, Susan Woodward, there is no evidence that a long-term fixed-rate residential mortgage loan would ever arise spontaneously without government urging. Ms. Woodward points out that a few developed countries have encouraged the use of amortizing long-term loans, but in all instances (save for Denmark), the loans have adjustable rates and recast every 5 years. She goes onto indicate that the United States is unique in supporting a residential mortgage that is long-term, amortizing, fixed-rate and pre-payable, and that Americans have come to view this product as one of their civil rights. Lastly, she highlights that in early 2000, when Former Federal Reserve Chairman, Alan Greenspan, hinted at its abandonment, the public outcry was such that he eagerly abandoned that position.

It is our belief that any proposed reform to the housing finance system that abolishes the 30-year, fixed rate mortgage will ultimately hurt the consumer by reducing their ability to participate in the housing market, which in turn will cause an increase in the cost of mortgage products for consumers who can participate in the market.

CONCLUSION

The National Association of REALTORS® support a secondary mortgage market model that includes some level of government participation, but that protects the taxpayer while ensuring that all creditworthy consumers have reasonable access to mortgage capital so that they too may attain the American Dream – homeownership.

If you would like to discuss our comments and concerns, please contact Anthony Hutchinson, NAR's Senior Policy Representative – Financial Services, at 202.383.1120 or thutchinson@realtors.org.

Sincerely yours,

Vicki Cox Golder

Vicki Cox Golder, CRB
2010 President,
National Association of REALTORS®