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expanding economic opportunity

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Comments on Proposed Rule:
Credit Risk Retention, Docket ID: OCC-2010-0002

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Comments on Proposed Rule:
Credit Risk Retention, Docket No. R-1411

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Comments on Proposed Rule:
Credit Risk Retention, RIN 3064-AD74

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Comments on Proposed Rule:
Credit Risk Retention, File Number S7-14-11

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Comments on Proposed Rule:
Credit Risk Retention, RIN 2590-AA43

The Honorable Shaun Donovan
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July 29, 2011

Dear Chairman Schapiro,

The Corporation for Enterprise Development (CFED) is a national, nonpartisan nonprofit organization that works to expand economic opportunity to all Americans by promoting asset-building efforts that expand access to homeownership, education, entrepreneurship and retirement. CFED is grateful to have this opportunity to comment on the interagency Proposed Rules on Credit Risk Retention, issued pursuant to the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 (PL 111-203).

Our comments address the following specific questions identified in the Proposed Rule published on March 31, 2011:

106. Is the overall approach taken by the Agencies in defining a QRM appropriate?

Dodd-Frank requires the Agencies to define QRM according to "underwriting and product features that historical loan performance data indicate result in a lower risk of default." The Agencies have followed that mandate but in certain areas have interpreted the statute too narrowly. While the overall approach to defining QRM is appropriate, CFED requests the Agencies to reconsider their specific positions on the minimum required loan-to-value (LTV) ratios and minimum down payments, to further study and potentially revise the proposed requirements for debt-to-income (DTI) and payment-to-income (PTI) ratios.

108. What impact, if any, might the proposed QRM standards have on pricing, terms, and availability of non-QRM residential mortgages, including to low and moderate income borrowers?

As currently written, QRM standards are likely to significantly increase the price and decrease the availability of non-QRM residential mortgages. This will have a particularly negative impact on low- and moderate-income (LMI) buyers, especially those who would seek a manufactured home in a land lease community. JP Morgan Securities estimates that interest rates on non-QRM loans that are subject to 5% risk retention will increase by three percentage points;[1] Moody's Analytics estimates that the increase will be 75 to 100 basis points;[2] the National Association of Realtors estimates it at 80 to 185 basis points.[3]

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[1] "Securitized Products Weekly." JP Morgan Securities, Inc. December 11, 2009.

[2] Zandi, Mark and Cristian deRitis. "Reworking Risk Retention." Moody's Analytics. June 20, 2011.

Regardless of which estimate turns out to be closest, the QRM standards as currently written will cause most LMI buyers to be priced out of the non-QRM market, but they will be unlikely to be able to save enough money to make the high down payment required for QRM loans.

The Center for Responsible Lending estimates, based on 2009 data, that it would take a family with median income 14 years of saving $3,000 per year to accumulate the cash equivalent to a 20% down payment plus 5% closing costs on a home at the median national sale price.[4] Even this estimate is optimistic: the median savings rate is currently at a 20 year high of 5.8%, far below the 7.5% assumed in the 14 year calculation. Moreover, the burden would be even greater for African-American and Latino households, which have lower median incomes and familial wealth than the general population. Based on 2009 data, in order to save a 20% down payment in 14 years, the average African American family would have to save 11.5% of income and the average Latino family would have to save 9.9% of income. These are such high barriers that most LMI families and significant percentages of minority families would find homeownership completely out of reach.

CFED has long promoted successful homeownership models for low-income families; none require 20% or even 10% down payments. Our recent study, "Weathering the Storm: Have IDAs helped low-income families avoid foreclosure?"[5] found that despite low down payment savings, low-income families were able to access fixed rate, low-interest mortgages. These borrowers experienced lower default and foreclosure rates compared to other low-income borrowers. This finding is consistent with evaluations of individual IDA programs that assist low-income families to achieve sustainable homeownership. In addition, community land trusts, shared equity mortgage programs, down payment assistance programs with second liens and other innovative approaches to affordable housing finance have successfully provided homeownership opportunities without requiring high down payments. The Agencies should allow enough flexibility within the QRM guidelines for these types of proven strategies for affordable housing finance to qualify.

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[3] "Proposed Qualified Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery." Coalition for Sensible Housing Policy. June 22, 2011.

[4] Montezemolo, Susanna. "Don't Mandate Large Down Payments on Home Loans." Center for Responsible Lending. February 25, 2011. http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/low-downpayment-factsheet-final.pdf.

[5] Rademacher, Ida, Megan Gallagher, Signe-Mary McKernan, Caroline Ratcliffe and Kasey Wiedrich. "Weathering the Storm: Have IDAs Helped Low-Income Homebuyers Avoid Foreclosure?" Corporation for Enterprise Development and the Urban Institute. April 2010. http://cfed.org/assets/pdfs/WeatheringTheStorm_Final.pdf.

110. The Agencies seek comment on all aspects of the proposed definition of a QRM, including the specific terms and conditions discussed in the following section.

Since 2005, CFED has been addressing problems in the manufactured housing sector through the Innovations in Manufactured Homes (I'M HOME) initiative. I'M HOME develops, promotes and implements market- and policy-based strategies to help manufactured home owners gain financial security and build assets. I'M HOME's goal is to enable millions of owners of manufactured homes to enjoy the same benefits of homeownership as those realized by owners of site-built homes. Our work with I'M HOME and the initiative's partners informs our recommendations on improvements that should be made to the final rule to ensure that manufactured homes are not unfairly prevented from qualifying for QRM.

One aspect of the proposed definition of QRM that CFED applauds is that it specifically includes manufactured homes among the properties that can qualify for QRM loans, as well as homes on leasehold that have the stability of land tenure provided by a long-term lease. The final rule should clarify that a homeowner's membership or share in a homeowners' cooperative or association meets these long-term lease requirements when the homeowners' cooperative or association owns the land and provides the member or shareholder with a perpetual or proprietary lease.[6]

Although the Uniform Law Commission of the National Conference of State Legislatures is currently developing a uniform law for the titling of manufactured homes as real property, many states do not allow manufactured homes to be titled as real property when they are sited on leased land. For this and other reasons, chattel loans make up the vast majority of loans that are backed by manufactured homes. These loans feature higher interest rates, reduced borrower rights when in default, and a less competitive, more restricted lending market. A 20-year repayment term is common for chattel loans. Well-qualified buyers with conventional loans can access prime rates, while the same buyers with chattel loans will pay at least two to five percentage points above prime. Although conventional mortgage loans are often better for borrowers, they are not always feasible; it is critical that the final rule allow high quality, "safe chattel" loans to qualify as QRM.

Proper underwriting of chattel loans can result in a similar level of excellent loan performance that investors would expect from residential mortgage loans. These

[6] It is, however, important to note that many owners of manufactured homes located in communities (sometimes called "mobile home parks") are unable to secure long-term leases on the land from the community owner. These homeowners face an extremely constrained financing environment and the proposed rule will likely exacerbate that problem. CFED urges the Agencies to consider the impact of all housing finance rules and regulations on manufactured housing communities.

manufactured housing-specific underwriting characteristics include long-term land tenure; appraisal requirements; and proper notice and ability to cure defaults prior to repossession. The proposed rule includes only long-term land tenure; the final rule should specify the additional manufactured housing-specific underwriting characteristics in order to ensure that the chattel loans that can qualify as QRM are those most advantageous to borrowers.

Accommodating the Unique Needs of Manufactured Homes in Communities

Finally, CFED urges the Agencies to consider and accommodate the unique financing and underwriting needs of manufactured homes that are located in communities. We support the Agencies' decision to allow residential mortgages consisting of chattel loans on manufactured homes on leased land to qualify, under certain circumstances, as QRM. We encourage the Agencies to address these loans directly in the final rule and add a few additional underwriting requirements for them.

First, homeowners should have the explicit right to make an onsite sale of the home to new owners while maintaining similar rent rates and land lease terms.

Community residents should also have a collective right of first refusal and opportunity to purchase the community land in a cooperative if the investor-owner should decide to sell the community for any reason.

Finally, lenders should be required to consider whether the land lease contract includes protection against arbitrary rent increases. Land lease contracts should tie rent increases to a published, consumer price index so that they do not rise at a rate so precipitous that homeowners' equity is undermined.

These recommendations are based on the experience of the New Hampshire Community Loan Fund's Cooperative Home Loan Program. The program only lends in resident-owned cooperative of manufactured home communities where the residents have long-term land tenure and protections against rent increases. Over its nine years of operation, the Cooperative Home Loan Program has experienced only a 0.53% loss rate.[7] This rate is remarkable in comparison to nearly any portfolio of single-family mortgages, but is especially notable when compared to the nearly 20% default rate on chattel loans on manufactured homes.

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[7] See: "New Hampshire Community Loan Fund Annual Report 2010." Accessed online at: http://www.communityloanfund.org/sites/communityloanfund.org/files/whoweare/pubs/annreports/uploads/annualreport_10.pdf.

117(a). Should the Agencies include minimum credit score thresholds as an additional or alternative QRM standard?

No, the Agencies should not include a minimum credit score threshold as a QRM standard. As noted in the Proposed Rule, a minimum credit score standard would

> require reliance on credit scoring models developed and maintained by privately owned entities and such models may change materially at the discretion of such entities. There also may be inconsistencies across the various credit scoring models used by consumer reporting agencies, as well as among different scoring models used by a single provider.[8]

One example of the way that different scoring models could harm some low-income borrowers is in the lack of inclusion of comprehensive data on payment of utilities and telecommunications bills. CFED has long advocated full-file reporting, including both on-time and late payments of these bills. At present, Transunion collects this data and incorporates it into its Vantage Score in some geographic markets. The Vantage Score seems to be more comprehensive than the FICO score in other ways as well. Given these variations, CFED agrees with the Agencies' decision not to mandate a specific credit score threshold.

Full-file reporting by utilities and telecoms has been adopted slowly and unevenly due to regulatory uncertainty and variations in state laws. We strongly encourage the Agencies to promote full-file reporting. Research by PERC[9] demonstrates that full-file reporting dramatically increases the ability to generate credit scores for up to 70 million no and thin-file customers. While most households see no change in their score due to full-file reporting, research demonstrates dramatic increases in prime scores for young people, renters, Latinos, African Americans and widows when an alternative score is calculated with full payment data for utility and telecom bills. If full-file reporting became the norm, currently underrepresented groups would more easily be able to demonstrate and improve their creditworthiness, including in applications for mortgage loans.

These are valid and appropriate reasons for relying on the series of "derogatory factors" identified in the proposed rule. We are pleased that the Agencies recognize that credit scoring is a dynamic market; identifying a specific threshold would limit innovation in risk scoring.

[8] Proposed Rule: Credit Risk Retention. Federal Deposit Insurance Corporation RIN 3064-AD74. March 31, 2011. http://fdic.gov/news/board/29Marchno2.pdf. Page 114.
[9] See: http://perc.net/content.

119(a). The Agencies request comment on all aspects of the proposed rules' limits on the payment terms of a QRM.

It is appropriate to prohibit from QRM those loans that have interest-only payments, negative amortization, balloon payments (defined as scheduled payments of principal and interest that are "more than twice as large as any earlier scheduled payment of principal and interest"[10]) and prepayment penalties. It is also appropriate to prohibit adjustable-rate mortgages that allow the annual interest rate to increase by more than two percent in any 12-month period and/or by more than six percent over the life of the mortgage.

120. The Agencies seek comment on the appropriateness of the proposed LTV and combined LTV ratios for the different types of mortgage transactions.

The proposed LTV ratios for purchase loans, term and rate refinance loans, and cash-out refinance loans are inappropriate and should be revised before the Agencies publish the final rule.

Requiring a maximum LTV of 80% and down payment of 20% plus closing costs will lock millions of home buyers out of the market,[11] preventing them from accessing one of the most fundamental cornerstones of wealth and asset building. The 20% minimum down payment mandated by a maximum LTV of 80% will have serious negative consequences on the availability and affordability of mortgage loans as well as impede the recovery of the still-struggling housing market; these requirements will not, however, significantly reduce the risk of default. Affordable housing advocates and leading firms within the mortgage industry agree that high minimum down payments "are not a significant factor in reducing defaults compared to other underwriting and product features."[12]

Research shows that mandating large down payments will significantly shrink the mortgage finance market while delivering negligible improvement in loan performance. A white paper from the Center for Responsible Lending, Community Mortgage Banking Project, Mortgage Bankers Association, Mortgage Insurance Companies of America,

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[10] Proposed Rule: Credit Risk Retention. Page 117.

[11] See: "Proposed QRM Harms Creditworthy Borrowers and Housing Recovery." Center for Responsible Lending, Community Mortgage Banking Project, Mortgage Bankers Association, Mortgage Insurance Companies of America, National Association of Home Builders, National Association of Realtors. April 14, 2011. www.mbaa.org/files/ResourceCenter/MIRA/**QRM**WhitePaper.pdf.

[12] "Proposed QRM Harms Creditworthy Borrowers and Housing Recovery." Center for Responsible Lending, Community Mortgage Banking Project, Mortgage Bankers Association, Mortgage Insurance Companies of America, National Association of Home Builders, National Association of Realtors. April 14, 2011. www.mbaa.org/files/ResourceCenter/MIRA/**QRM**WhitePaper.pdf.

National Association of Home Builders and the National Association of Realtors of data from CoreLogic Inc. reveals that down payment is not a significant default risk for well-underwritten loans originated between 2002 and 2008.[13] The loans analyzed were fully documented for income and assets; fixed-rate or 7 year or greater adjustable rate loans; no negative amortization; no interest-only payments; maturities no greater than 30 years; DTI no greater than 41%; and mortgage insurance on loans with 80% LTV or higher. For loans originated in 2002, changing the minimum down payment requirement from 5% to 20% would have eliminated 19.2% of all borrowers but only reduced the default rate by 0.6%. Raising the minimum down payment from 5% to 10% would have eliminated 7.8% of borrowers and reduced the default rate by 0.2%.

Even for loans originated in 2007, the height of the housing bubble, 20% down payments would not have significantly improved the default rate. Raising the minimum down payment requirement from 5% to 20% would have eliminated 28.2% of all borrowers but only reduced the default rate by 1.6%. Raising the minimum down payment from 5% to 10% would have eliminated 14.7% of borrowers and reduced the default rate by 0.5%. The cost of 20% down payments—locking millions of qualified, credit-worthy borrowers out of homeownership—is too high, particularly given the marginal benefit of improving default rates by less than 2% under the scenario that is least reflective of today's lending environment.

Mark Zandi, Chief Economist at Moody Analytics and a leading national expert on housing and mortgage finance, had similar findings on an analysis of data from MGIC, the nation's largest mortgage insurer.[14] The default rates on high-quality loans originated in 2006 and 2007 and insured by MGIC ranged from 1.3% for loans with 20% down payments to 4.0% for loans with 5% down payments. Zandi concludes, "while there is no question that larger down payments correlate with better loan performance, low down payment mortgages that are well underwritten have historically experienced manageable default rates, even under significant economic or market stress."[15] His final recommendation is that "mortgage loans with standard private mortgage insurance and a minimum down payment of 5% should be considered QRMs, provided all other conditions are met."

Even in today's highly cautious mortgage market, the majority of well-qualified borrowers could not qualify for a QRM loan. Testifying before Congress on the proposed rule, Henry V. Cunningham, chair of the Mortgage Bankers Association Residential Board of Directors, stated: "I'm an independent mortgage banker operating in North Carolina… We ran an

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[13] "Proposed QRM Harms Creditworthy Borrowers and Housing Recovery."
[14] Zandi, Mark and Cristian deRitis. "Special Report: The Skinny on Skin in the Game." Moody Analytics. March 11, 2011. www.economy.com/mark-zandi/documents/QRM_030911.pdf.
[15] Zandi, Mark and Cristian deRitis. "Special Report: The Skinny on Skin in the Game."

analysis on our 2010 book of business, and 58% of our purchase loans and 74% of our refinances would not have met QRM standards. This is astonishing because 97% of our mortgages were fixed-rate."[16]

Perhaps the most serious reason to reconsider requiring down payments of 20% and higher in order to achieve a maximum LTV of 80% is that these standards are inconsistent with Congressional intent. The statute requires that QRM be defined according to loan and borrower characteristics that data indicate have a low risk of default. The list of specific features which the Agencies were required to consider does not include LTV or down payment. Furthermore, members of Congress involved in writing the legislation have made clear that a minimum down payment standard is explicitly outside of Congressional intent. Senators Johnny Isakson (R-GA), Kay Hagan (D-NC) and Mary Landrieu (D-LA) authored the QRM section of Dodd-Frank. Senator Isakson said, "we debated and specifically rejected a minimum down-payment standard for the Qualified Residential Mortgage."[17] Senator Hagan's response to the LTV requirement in the proposed rule was similarly negative: "A rigid, across-the-board down payment requirement would unnecessarily prevent middle-class, first-time homebuyers from getting affordable mortgages."[18]

We strongly urge the Agencies to revise the QRM requirements on LTV ratios and minimum down payments for purchase loans and refinance loans. Given that legislators did not want minimum down payments to be included among QRM requirements, CFED recommends eliminating them from the final rule. If the Agency does include a minimum down payment standard in the final rule's definition of QRM, Mr. Zandi's recommendation is sound: a 5% down payment paired with standard mortgage insurance/credit enhancement should qualify as QRM, as long as this is inclusive of shared equity second liens, IDAs and other proven, sustainable homeownership approaches.

> 121. The Agencies request comment on the proposed amount and acceptable sources of funds for the borrower's down payment.

Further clarification is needed regarding the proposed acceptable sources of funds for the borrower's down payment. The proposed rule stipulates that acceptable sources of funds

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[16] Cunningham, Henry V. "Testimony on the Implications and Consequences of the Proposed Rule on Risk Retention." Submitted to the Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services, United States House of Representatives. April 14, 2011. http://www.mortgagebankers.org/NewsandMedia/PressCenter/76305.htm.

[17] Isakson, Johnny. "Don't Penalize Qualified, Responsible Homebuyers." *The Hill*. February 15, 2011. http://thehill.com/opinion/op-ed/144347-dont-penalize-qualified-responsible-homebuyers.

[18] "Hagan Comments on Proposed Qualified Residential Mortgage Rule." Press Release. Office of Senator Kay Hagan. March 29, 2011. http://hagan.senate.gov/?p=press_release&id=1082.

include "savings and checking accounts, cash saved at home, stocks and bonds, and gifts, including eligible down payment assistance programs."[19] The HUD Handbook, which the proposed rule says should guide lenders in identifying acceptable down payment assistance programs, does not include specifics beyond that the assistance should come from a nonprofit organization. This in itself is insufficient because state and local government entities also play a critical role in the design and delivery of down payment assistance programs. The final rule should be amended to include loans made by public housing finance agencies among those eligible for QRM status.

The Agencies should also clarify in the final rule general characteristics of acceptable down payment programs so as not to disrupt or cause unnecessary uncertainty among the numerous providers of down payment assistance to LMI and first-time homebuyers across the United States. For example, Individual Development Accounts (IDAs) are common sources of down payment assistance; would these and other matched savings programs be acceptable sources of funds? We strongly suggest that the matching funds provided by an IDA program should be seen as a gift. In addition, funds provided by a qualified IDA program that is also providing the loan should be allowed as long as the program is run by a Housing Finance Agency or nonprofit receiving federal or state funds for their matched savings program.

The final rule should also clarify that shared or limited equity mortgage programs, community land trusts, second liens provided by public housing finance agencies and/or nonprofit organizations, and other innovative forms of ownership that target LMI and first-time homebuyers are acceptable sources of funds. Unfortunately, under the proposed rule, second liens that are structured to enhance affordability and sustainability—through mechanisms such as loan forgiveness over time, repayment of the second lien only upon sale of the home, repayment at a below-market-interest rate, or repayment on a deferred schedule—are ineligible to qualify as QRM. Loans made affordable through reductions in sale price below the market valuation paired with restrictions on resale prices would also be ineligible to be QRM unless the borrower provides an additional 20% down payment. The final rule should allow the public equity invested to lower the home price to satisfy the QRM requirements.

These strategies for delivering homebuyer assistance do not make the loans unsafe. Research demonstrates that such programs often perform better than the mortgage market in aggregate. For example, according to the National Housing Conference, loans made by Community Land Trusts had a default rate of just 0.6% at the end of 2009, far below the mortgage market-wide rate of 4.6% in default. A 2010 study by the Urban Institute found

[19] Proposed Rule: Credit Risk Retention. Page 125.

that each of the shared equity programs it surveyed had a lower foreclosure rate than the rate for all homes in the program's geographic area.[20] Accordingly, these types of affordable homeownership assistance should be eligible for QRM status.

> <u>123. The Agencies seek comment on the appropriateness of the proposed front-end ratio limit of 28 percent and the proposed back-end ratio limit of 36 percent.</u>

The proposed DTI and PTI ratios may be too strict and should be more carefully studied before the Agencies issue the final rule on Credit Risk Retention.

Thank you for the opportunity to comment on this proposed rule. Ensuring that the right lending products are available to borrowers of all incomes and backgrounds is critical to decreasing our nation's wealth gap and enabling low-income families to achieve financial self-reliance.

Sincerely,

Andrea Levere

Andrea Levere
President

[20] Temkin, Kenneth, Bret Theodos and David Price. "Balancing Affordability and Opportunity: An Evaluation of Affordable Homeownership Programs with Long-term Affordability Controls." The Urban Institute. October 2010. http://www.urban.org/uploadedpdf/412244-balancing-affordabiliity.pdf. Page 28.