NATIONAL ASSOCIATION of REALTORS®

500 New Jersey Avenue, N.W.

Washington, DC 20001-2020

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STATEMENT OF

GARY THOMAS
2013 PRESIDENT
NATIONAL ASSOCIATION OF REALTORS®

TO THE

UNITED STATE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

HEARING TITLED

HOUSING FINANCE REFORM: ESSENTIALS OF A FUNCTIONING HOUSING FINANCE SYSTEM FOR CONSUMERS

OCTOBER 29, 2013

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EQUAL HOUSING OPPORTUNITY

INTRODUCTION

Chairman Johnson, Ranking Member Crapo, and members of the Committee; my name is Gary Thomas. I am a second generation real estate professional in Villa Park, California. I have been in the business for more than 35 years and have served the industry in countless roles. I currently serve as the 2013 President of the National Association of REALTORS® (NAR).

I am here to testify on behalf of the one million members of the National Association of REALTORS®. We thank you for the opportunity to present our views on housing finance reform and the essentials of a functioning housing finance system for consumers.

STATE OF HOUSING

It is no secret that real estate is the linchpin of our nation's economy. The housing sector accounts for roughly 18 percent of GDP and research has shown the social and financial benefits to all Americans. As our economy slowly improves from the Great Recession, the U.S. housing market will be key to this recovery. Our nation will not return to full employment and robust economic health unless the real estate market makes a broad-based and lasting comeback. Fortunately, the U.S. housing market recently has shown some promising signs.

Housing has been instrumental in pulling the economy out of the Great Recession, substantially contributing to our nation's economic growth since 2011. Home sales, housing prices, and residential construction have increased during this time, supported by low mortgage rates and improved consumer confidence in both the housing market and overall economy. In the past two years, home prices have gone up 20 percent, pushing up the value of household real estate to $18.6 trillion at the end of the 2nd quarter of this year. Additionally, home sales were 10.7 percent higher in September 2013 than a year earlier with 5.29 million homes sold, but were well below the 7.23 million homes sold in August 2005, delinquency and foreclosure rates remain well above the historic norms, and more than 7 million homeowners remain under water on their mortgages. Also, the residential construction industry has recovered almost half a million jobs of the 2.3 million lost during the recession; however, it continues to lag behind as a job creation engine.

While these figures are promising, the housing market clearly remains far from healthy. Maintaining momentum in the housing market is particularly crucial right now. Sustaining the housing market rebound will increase economic and job growth, as it has in past U.S. economic recoveries.

CHALLENGES FACING THE HOUSING RECOVERY

While home prices have increased 14.7 percent over the 12-month period ending in August 2013, they are still 7.6 percent lower than in August of 2006. Today, home prices have led to positive gains in the net worth of homeowners, $18.6 trillion of which is saved up in residential real estate. Rising home prices have enabled many owners to refinance into more stable positions and cut the number of underwater homeowners by nearly half, but have also put pressure on potential home buyers who have not yet completed their home purchase. Home sales rose 13.2 percent from August of 2012 to August of 2013, but are 24.2 percent below the level from August of 2006.

In addition to increases in home prices, mortgage rates have begun their ascent from historically unprecedented lows. While mortgage rates have stabilized recently due to the Federal Reserve's delay in the tapering of asset purchases, expectations for a healing housing market and recovering economy point to higher mortgage rates ahead. These two factors combined with meager increases in family income are squeezing the affordability of homes. Affordability has plunged 18 percent to the lowest level since 2006. While affordability remains above historic levels, a swift reduction will undoubtedly have an impact on buyer options and psychology.

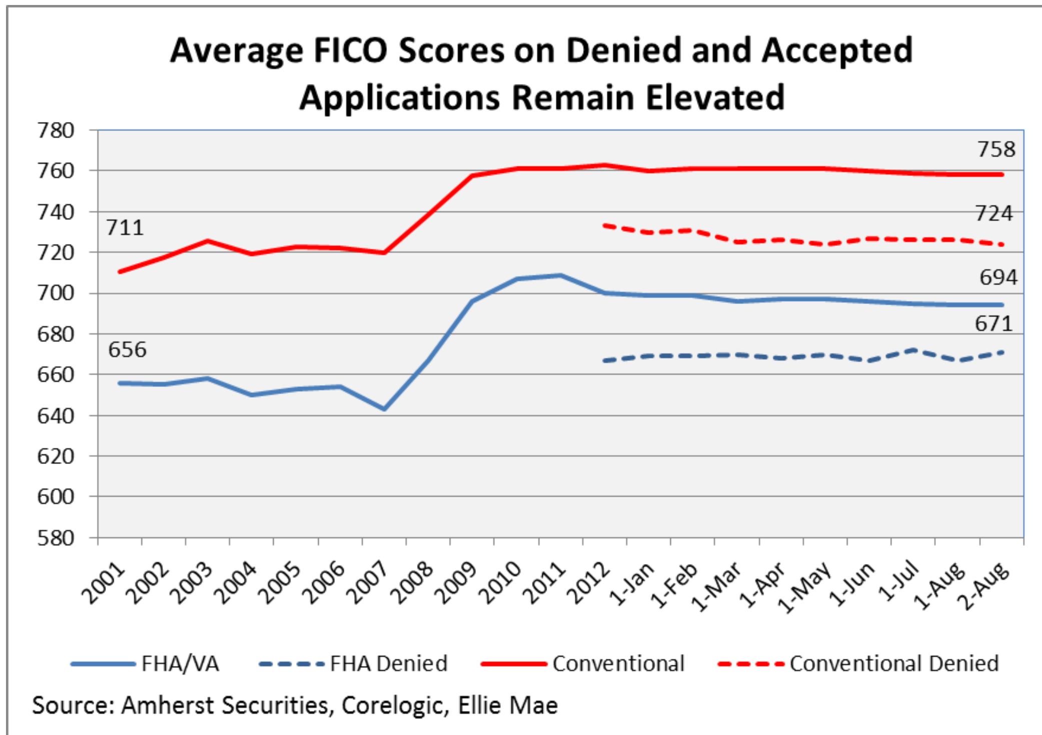

Figure 1

Access to credit continues to be tight as lenders remain leery of taking on risk. While the average FICO score on conventional, purchase mortgages crept lower in recent months, this partially reflects the increased willingness of private mortgage insurers to back high FICO, high LTV mortgages. However, the average accepted FICO on FHA purchase production has fallen as well, while the average FICO for a rejected loan in both spaces increased. This pattern suggests that these changes are linked to a shift of production from the FHA to the GSE, but not an expansion of the credit box. As depicted above, the average FICO scores for accepted applications of both conventional and FHA production remain roughly 50 points higher than in 2001, a period predating the loosening of underwriting standards.

What is holding back credit? There is already turbulence in the regulatory environment for mortgage lending. In January 2014, many changes stemming from the Dodd-Frank Act will go into effect, including the "ability-to-repay" requirements. The risk retention (QRM) regulations remain in flux. Adding even more confusion and uncertainty in this environment runs the risk of reversing progress being made in the economic recovery. The non-pecuniary costs of adverse impacts to reputation have weighed on lenders. Another significant factor has been the uncertainty surrounding the use of representation and warranty clauses by both private market investors as well as the Government Sponsored Entities (GSEs) to indemnify against loan defaults, even for minor errors. The result has been a pull back by lenders to a position where the probability of default is far lower than historic norms.

NAR is also very concerned with the impact that growing student loan debt will have on the ability of consumers to access mortgage credit, particularly impacting first time homebuyers. Specifically, the changing regulatory landscape of mortgage finance compounded with increased student debt will contribute to an already tight lending environment by imposing standards that are even more strict.

Americans burdened with growing monthly debt payments will have restricted access to mortgage credit under the QM rule. Though the rule includes a reasonable 43 percent total debt-to-income standard, rising

student debt payments and a weak labor market may have a long term impact on the ability of first time homebuyers to qualify for a mortgage under this standard.

An additional concern is that consumers unable to save for a down payment due to growing debt burdens will be denied access to the most reasonable loan terms under the proposed "QRM+" definition that imposes a minimum 30 percent downpayment requirement and rigid credit standards will deny millions of Americans access to the lowest cost and safest mortgages.

Barriers to Homeownership for Minorities & Future Buyers

As depicted below, the decline in homeownership between 2004 and 2012 was disproportionatly borne by African Americans, buyers aged 44 and under, and families earning less than or equal to the median family income. As homeownership is one of the main vehicles for building equity over one's lifetime, the decline in homeownership will have a lasting effect on access to education, healthcare, and retirement for these groups.

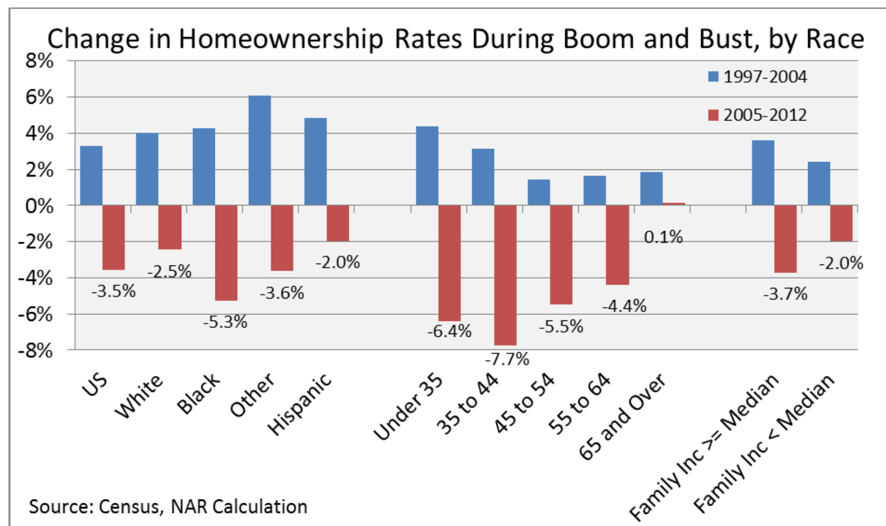

Figure 2

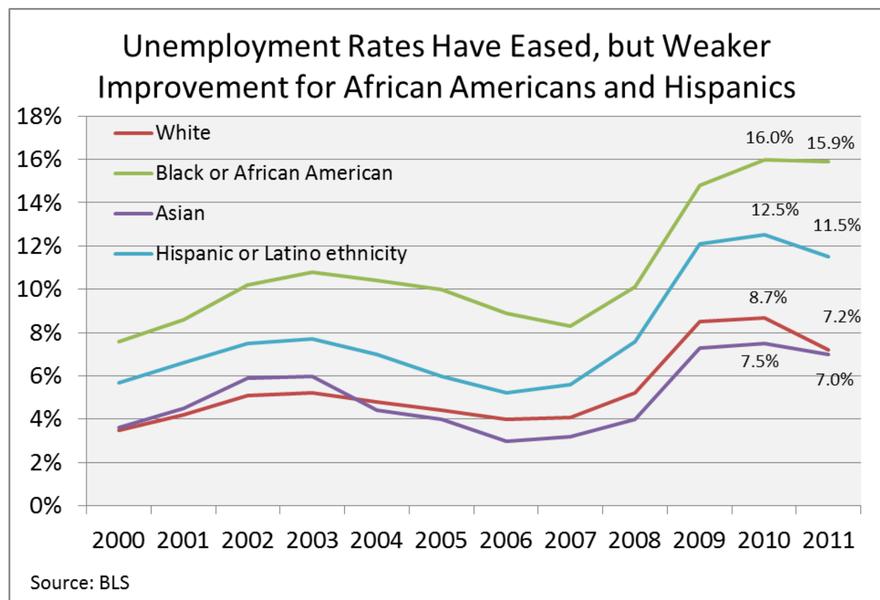

Figure 3

Futhermore, the recession took a toll on all racial groups, but between 2010 and 2011, the decline in unemployment was skewed toward Whites and to a lesser extent Asians, but both of those groups were at lower levels of unemployment. The unemployment rate for African Americans only fell 0.1 percent over this period and was at more than double the unemployment rate. Likewise, income growth has also been a problem. The median real income for Whites fell 6.2 percent between 2007 and 2012, while it fell 10.7 percent for Blacks and 11.0 percent for Hispanics.[1]

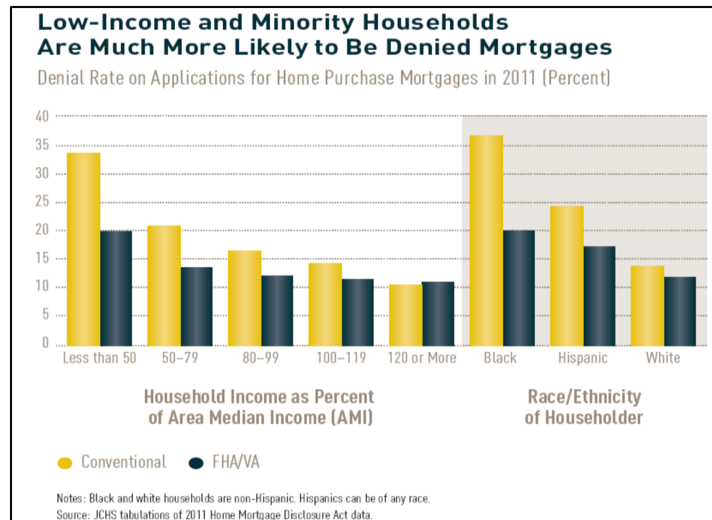

Figure 4

As noted earlier, credit conditions tightened dramatically in the post-recession environment for structural reasons. As depicted above, rejection rates on mortgages applications in 2011 were disproportionaly higher for African Americans, Hispanic Americans and lower income earners, particularly those earning less than half of the area median income. While rejection rates improved modestly in the 2012 HMDA data, the wide gap between racial groups was persistent with non-Hispanic Whites' rejection rate of 11.6 percent less than half the 32.0 percent rate for African Americans and the 20.5 percent for Hispanic Whites. The sharp drop in employment and incomes combined with lender overlays on loans financed by the US government or through Fannie Mae or Freddie Mac have constrained access to credit and the housing recovery for minorities, young buyers, and low and moderate earners. In short, these groups are missing out on the strongest affordability conditions in decades and this pattern may persist going forward.

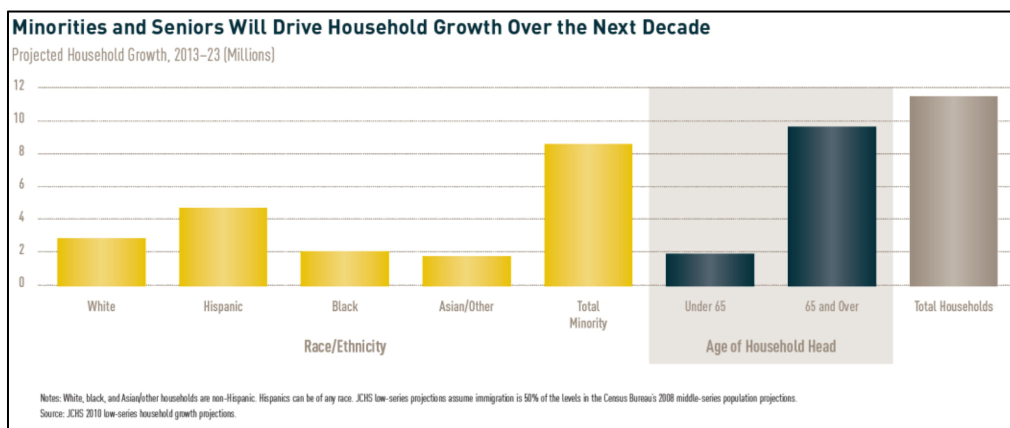

Figure 5

[1] US Census Bureau (2012).

There is a strong correlation between household formation and the choice to purchase a home. Researchers at the Harvard Joint Center for Housing Studies[2] estimate that the number of households will grow by nearly 12 million between 2013 and 2023. Of these, more than 8 million or nearly 70 percent will be minority households. Given the sharp decline in homeownership, slow improvement in employment conditions, and disproportionate impact of tight underwriting, these groups will face headwinds to participation in the housing and homeownership recovery over the coming decade.

PRINCIPLES FOR A ROBUST U.S. HOUSING MARKET

Some of the challenges we face today were caused and perpetuated by a flawed housing finance system, which REALTORS® agree needs to be reformed. We applaud the Committee for beginning the discussion on housing finance reform. As policymakers decide how to restructure the secondary mortgage finance market, it is critical that the future system continue to be a reliable and affordable source of mortgage capital for creditworthy consumers in all types of markets and to avoid a major disruption to the nation's economy that would result from a collapse of the private housing finance sector. In order to achieve these goals, the future housing finance system should embody the following elements:

- **An efficient and adequately regulated secondary market is essential to providing affordable mortgages to consumers.** The secondary market, where mortgages are securitized, is an important and reliable source of capital for lenders and therefore for consumers. Without a secondary market, mortgage interest rates would be unnecessarily higher and unaffordable for many Americans. In addition, a poorly functioning secondary market will impede both recovery in housing sector and the overall economy.

- **The old GSE system with private profits and taxpayer loss must be replaced**. The current GSEs (Fannie Mae and Freddie Mac) should be replaced with government-chartered, non-shareholder owned entity(s) that are subject to sufficient regulations on product, revenue generation and usage, and retained portfolio practices in a way that ensures they can accomplish their mission to support long-term mortgage financing and protect the taxpayer.

- **Reforms should ensure a strong, efficient financing environment for homeownership and rental housing**. The mission of the new entity must include providing access to mortgage financing for consumers who have the demonstrated ability to sustain homeownership. Creditworthy consumers require a steady flow of mortgage funding that, during economic downturns, only government participation in the secondary mortgage market can provide.

- **The government must clearly, and explicitly, offer a guarantee of mortgage instruments facilitated by the entity(s) that meet the Qualified Mortgage (QM) standards**. This is essential to ensure qualified, creditworthy borrowers have access to affordable mortgage credit. Without government backing, consumers will pay much higher mortgage interest rates and mortgages may at times not be readily available at all—as has happened in the jumbo and commercial real estate loan sectors. Taxpayer risk would be mitigated through the use of mortgage insurance on loan products with a loan-to-value ratio higher than 80 percent, or through other fees paid to the government.

- **The new entity(s) should guarantee or insure a wide range of safe, reliable mortgage products**. These mortgage products include 15-year and 30-year fixed rate loans, traditional adjustable-rate mortgages (ARMs), and other products that have stood the test of time and for which American homeowners have demonstrated a strong "ability to repay."

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[2] Harvard Joint Center for Housing Studies, "The State of the Nation's Housing 2013."

- **The new framework should provide a self-sufficient mechanism whereby safe, sound, transparent, and insured Mortgage Backed Securities (MBS) may be packaged and sold**. There must be an option for an explicit government guarantee of insurance for all offered MBS within the secondary mortgage market. The creation of a not-for-profit "utility" facility is needed to receive, package, sell and guarantee MBS. The entity should operate with similar insurance and enforcement components as the FDIC. This option must minimize taxpayer exposure.

- **Sound and sensible underwriting standards must be established**. It is critical to establish standardized, sound underwriting principles and products that provide the foundation for responsible, credit worthy borrowers to be able to achieve homeownership goals. For additional safety, these standards must also be applied to securities (MBSs) purchased for portfolio (to a limited extent).

- **The entity(s) should price loan products or guarantees based on risk**. In addition, the new entities must set standards for the MBS they guarantee that ensure transparency and verifiability for loans within the MBSs.

- **A structure must ensure that solid, verifiable, current loan level data is available to investors that empowers and enables them to conduct their own risk analysis**. There is a strong consensus among multiple market participants that solid loan level data is the essential foundation on which to rebuild the private mortgage security industry. Investors want to be able to conduct their own analysis. With properly structured loan level data the mortgage collateral supporting a regulated, securitized instrument can be evaluated in terms of a verifiable, current predictable instrument of cash flow and thus will attract private capital.

- **The reformed entities must have a separate legal identity from the federal government but serve a public purpose**. Given the appropriate structure, the entities will have considerable political independence and be self-sustaining unlike a federal agency.

- **The new entity(s) should remain politically independent**. Political independence of the entities is mandatory for successful operation. CEOs should have fixed terms so they cannot be fired without cause, and they should not be allowed to lobby. Additionally, the entities should be self-funded instead of receiving ongoing appropriations.

- **To increase the use of covered bonds, particularly in the commercial real estate arena, the entities should pilot their use in multifamily housing lending**. The entities should explore the use of covered bonds as an additional method to provide additional mortgage capital for residential housing. The entities should be allowed to pave the way for innovative or alternative finance mechanisms that meet safety criteria.

- **There must be strong oversight of the entities**. The new entities should be overseen by the Federal Housing Finance Agency (FHFA) or a successor agency that would make timely reports to allow for continual evaluation of the entities' performance.

- **The new system must restore investor confidence and trust in the Representations and Warranties via the standardization of pooling and servicing contracts**. Standardization of Representations and Warranties is imperative. Pooling and Servicing Agreements (PSAs) must be simple with clear terms and definitions so they are easily understood by investors. They must have clear disclosures of any deviations from "Federal Best Practice Standards", clearly define "buy back" rules, and servicer operational policies must be consistent with their fiduciary duties to the investor.

GOVERNMENT GUARANTEE

As indicated on a number of occasions, NAR supports a comprehensive approach to restructuring the secondary mortgage market, including winding down Fannie Mae and Freddie Mac (the government sponsored enterprises, or GSEs), but believes any new secondary market entity replacing the enterprises must have an explicit government guarantee to ensure the availability of affordable credit products for all creditworthy individuals and families.

REALTORS® agree with lawmakers that taxpayers should be protected, private capital must return to the housing finance market, and that the size of government participation in the housing sector should decrease if the market is to function properly. However, REALTORS® believe that it is extremely unlikely that any secondary mortgage market structure that does not include government backing could support the existing mortgage funding needs of the United States housing sector. Make no mistake; the tremendous size of this systemically important market can neither be supported solely by lending from insured bank deposits nor from private investors that would be required to take on additional risk.

Legislation that relies only on private guarantees to operate the secondary mortgage market will find that, in extreme economic conditions, private capital will retreat from the market. A federal guarantee is essential to ensure borrowers have access to affordable mortgage credit. Without government backing, creditworthy consumers will pay much higher mortgage interest rates and mortgages may at times not be readily available — as has happened in jumbo and manufactured housing real estate loan markets in the aftermath of the crisis.

In both instances, non-government backed mortgage capital became nearly non-existent, which prohibited qualified borrowers from access to the funds required to purchase a home. Although private capital is slowly returning to these markets, it has taken many years.

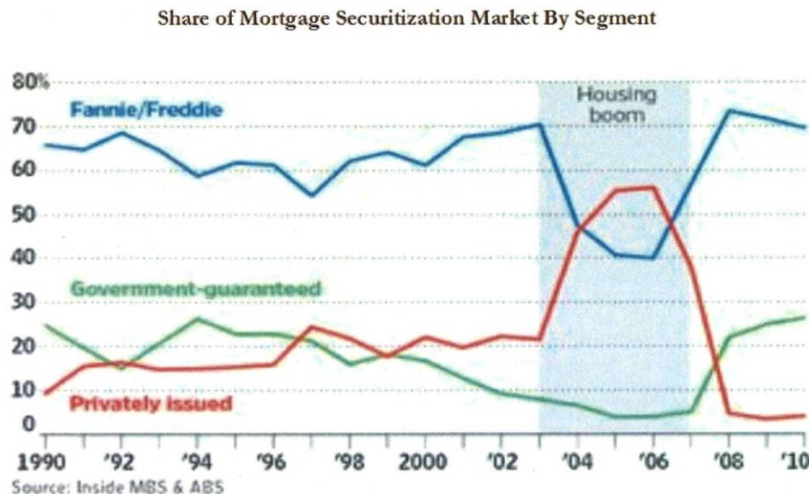

Figure 6

The lack of financing put downward pressure on home values, increasing the number of homeowners whose mortgages exceed the value of their home, and increasing foreclosures. As illustrated in Figure 6, if no government-backed entity existed as private mortgage capital fled to the sidelines in recent years, the housing market would have come to a complete halt and thrown our nation into a deeper recession, or even a depression.

When the economy turns down, private capital flees the marketplace, and should that occur in the residential market it would come to an abrupt and nearly complete halt. Should that happen in a fully private residential mortgage market space, the results for the entire economy – because of the plethora of peripheral industries that support and benefit from the residential housing market – would be catastrophic.

REALTORS® believe that full privatization is not an effective option for a secondary market because private firms' business strategies will focus on optimizing revenues and profits. This model would foster mortgage products that are more aligned with the business' goals (e.g. based upon significant financial risk-taking) than in the best interests of the nation's housing policy and consumers.

Homeownership is a significant driver of employment opportunity. Jobs are created in the numerous businesses that are all part of the housing industry (e.g. home renovation, remodeling, and furnishing). We must endeavor to support this founding pillar of our society and economy so that our nation can begin to move toward recovery, instead of lingering in our current economic malaise.

THE 30-YEAR FIXED-RATE MORTGAGE

Unique to the U.S. housing finance sector is the availability of affordable, long-term fixed-rate mortgages. The 30-year fixed rate mortgage is the bedrock of the U.S housing finance system. And now, more than ever, consumers are seeking fixed rate 30-year loans because they are easily understood and offer a predictable payment schedule.

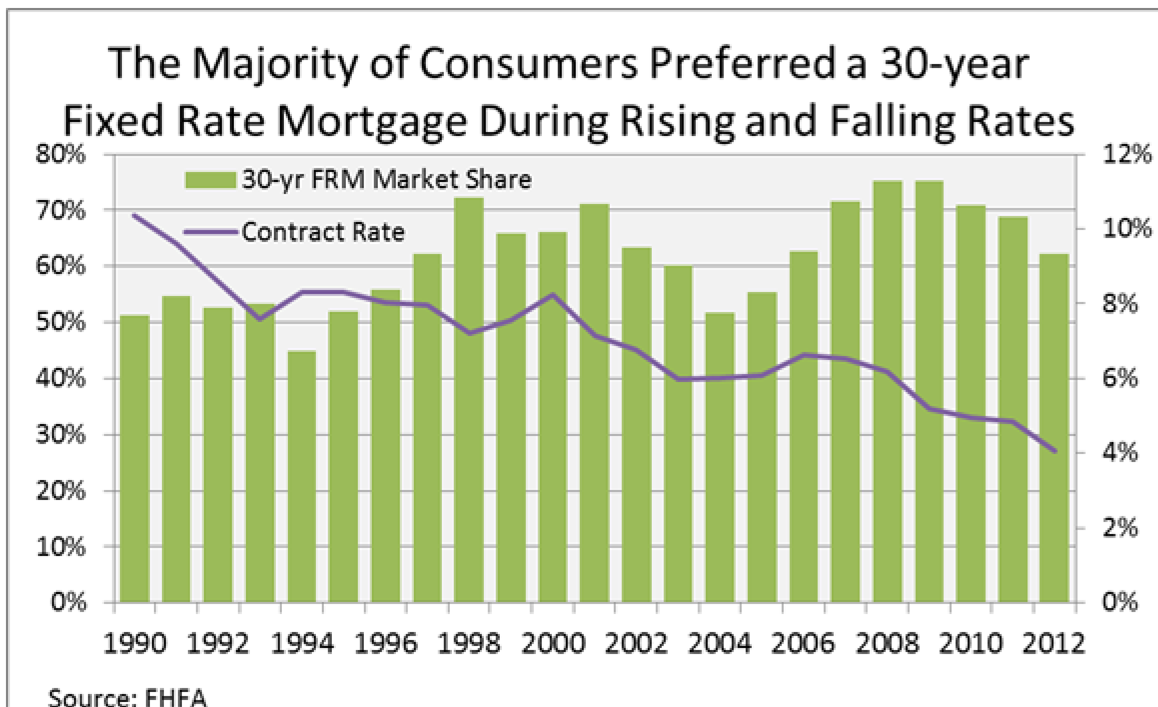

Figure 7

As discussed above, REALTORS® believe that full privatization is not an effective option for our secondary mortgage market because private firms' business strategies will focus on optimizing their revenue/profit generation. We believe that this would lead to the elimination of long-term, fixed rate mortgage products (e.g. 30-year fixed-rate mortgage), and an increase in the costs of mortgages to consumers. At this time, when our economic recovery teeters on the edge of full recovery, activities that force further constriction of economic activity should be even more strongly resisted.

According to research by economist Dr. Susan Woodward, there is no evidence that a long-term fixed-rate residential mortgage loan would arise spontaneously without government impetus. Dr. Woodward points out that a few developed countries have encouraged the use of amortizing long-term loans, but in nearly all instances (save for Denmark) where they do exist, the loans have adjustable rates and recast every 5 years or require large down payments and significant prepayment penalties. She goes on to point out that the United States is unique in having 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. Dr. Woodward points out that in early 2000, when Former Federal Reserve Chairman, Alan Greenspan, hinted at its abandonment, the public outcry was such that he quickly abandoned that position.

We are particularly concerned by data that suggests that, should the 30-year fixed rate mortgage cease to be available, older owners who tend to stay in their home longer, would be the most affected. Rising interest rates for these homeowners (who are also paying for their children's college, saving for retirement, or living on a fixed income) would then also cause them to suffer from higher mortgage payments. While the average tenure in a home has hovered around 6 years, that statistic has increased to 9 years since 2010 and is likely to increase as mortgage rates increase and make it more difficult for owners to trade up and undermine incentives to move.

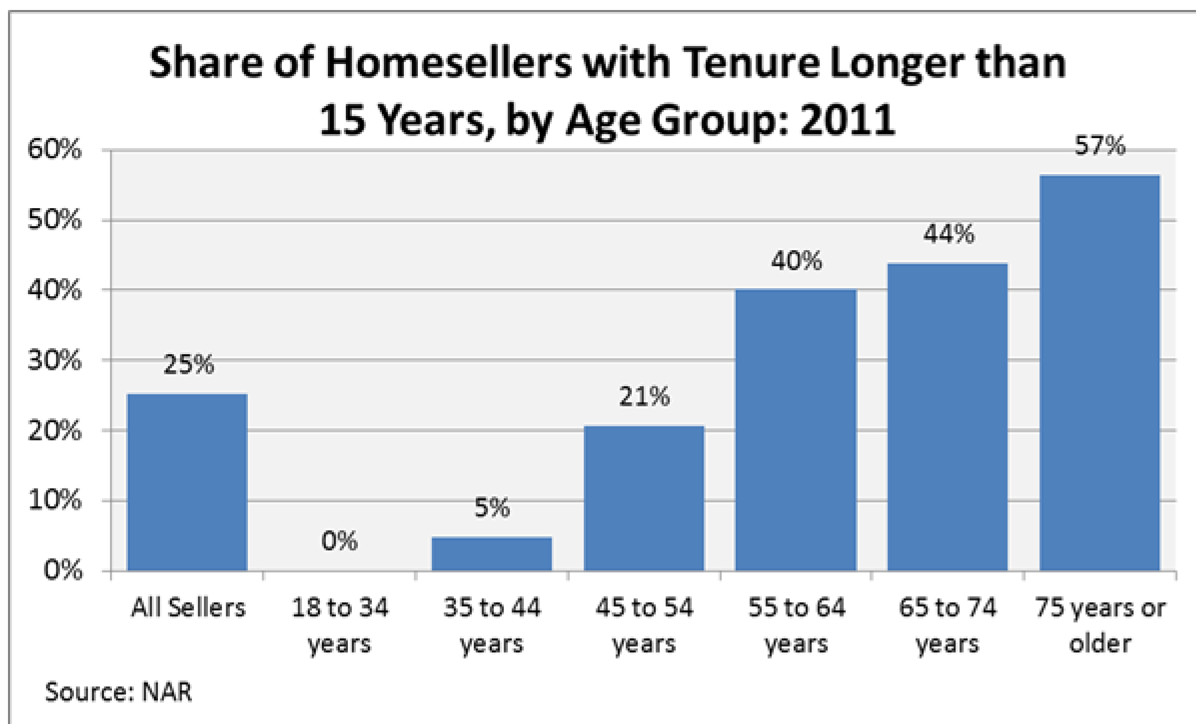

Figure 8

Additionally, while others have suggested that a 30 year mortgage builds equity slower, borrowers forced into a mortgage with a shorter duration face a significant loss in purchasing power. Consider an individual earning approximately $52,000 who purchases a $208,000 home (the May 2013 median home price) with 10 percent down:

Duration	Interest Rate	Payment (PITI)
30 year	4.07%	$1,160
15 year	3.17%	$1,540

With a 30-year mortgage, the consumer's total mortgage debt to income (DTI) would be 26 percent; with a 15 year mortgage, this measure of affordability jumps to 35 percent. To achieve the same DTI with a 15-year mortgage, the purchase price would have to be reduced to $144,444.

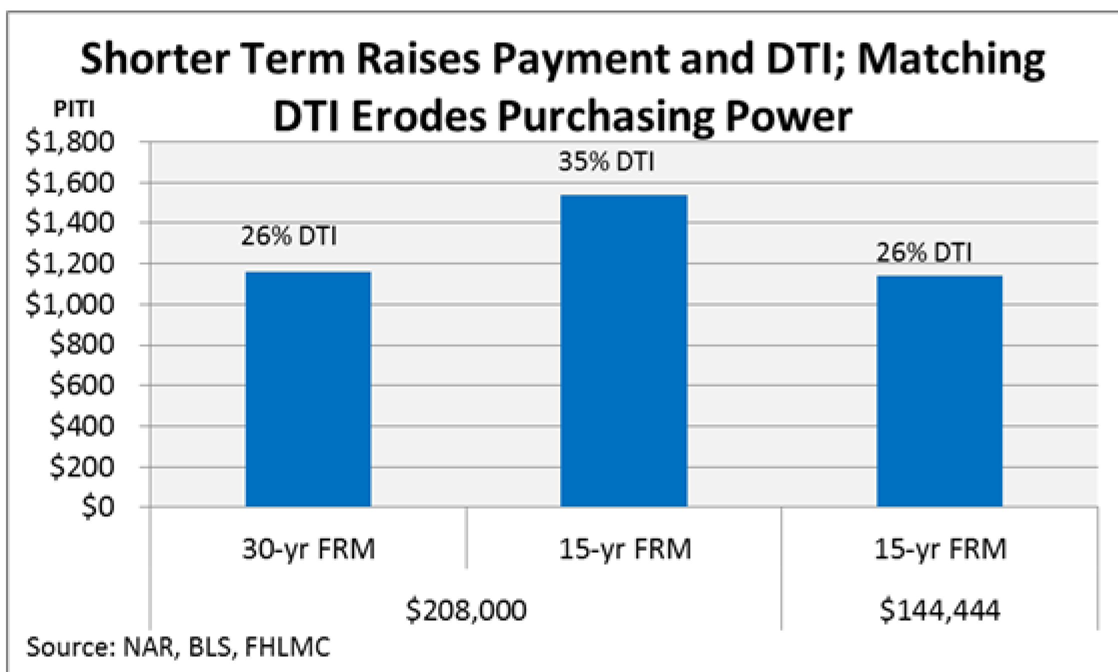

Figure 9

NAR UNDERWRITING RECOMMENDATIONS

REALTORS® share the goal of attracting private capital to the mortgage market while ensuring that creditworthy families, including those unable to afford a large down payment, are not unnecessarily excluded from homeownership opportunities. Rather than focusing on downpayments, NAR believes Congress should center its attention on strong underwriting standards, which are vital for a robust housing finance market.

We are generally supportive of the Consumer Finance Protection Bureau's (CFPB's) Qualified Mortgage (QM) rule and believe this standard should be used to define the Qualified Residential Mortgage (QRM) in any future housing finance system. We believe this approach achieves the twin objectives of protecting the marketplace while ensuring borrowers have access to safe mortgages. Investors will remain confident they can rely on the quality of mortgages underlying securitizations and creditworthy borrowers will be able to obtain access to conventional financing for safe, sustainable mortgages. At the same time, it also assures that loans with the highest risk – those with the product features explicitly excluded by QM – will also be subject to the risk retention rules for asset backed securities. In releasing the re-proposed rule, regulators expressed valid concerns that establishing divergent standards for QM and QRM loans could result in an increase in complexity, regulatory burden and compliance costs that will be passed on to borrowers in the form of higher interest rates and restrictive credit standards.

NAR strongly opposes the alternative "QRM+" approach in the proposed rule, which would require borrowers to make a 30 percent down payment to obtain a QRM loan. Such a restriction along with unduly difficult credit standards will restrict access to mortgage credit for far too many creditworthy borrowers.

In contrast, the data below indicates that the underwriting and loan product limitations that are mandated for QM loans effectively limit the risk of default without excluding large numbers of creditworthy borrowers. For this reason, those standards also protect investors and should be the QRM standard as well.

Current Rule: Proper Balance

In August 2013, the six Federal Regulators published a revised proposed rule that would equate QRM with the soon-to-be implemented "ability-to-repay" Qualified Mortgage (QM) and underwriting standards issued by the CFPB.

Under the QM standard, which was finalized earlier this year and will take effect in 2014, loans must meet product features and underwriting standards to qualify. Borrowers must document the income used to qualify for a loan, and creditors must verify this and other important borrower qualifications. Borrowers cannot have debt-to-income ratios above 43 percent (unless it meets Fannie Mae, Freddie Mac, or Federal Housing Administration underwriting criteria for seven years or until GSE reform). Loans with risky product features most closely associated with the housing crisis such as negative amortization, interest-only payment features, or loans with amortizations longer than 30 years are excluded from the QM definition.

In synchronizing both definitions, the revised rule encourages safe and financially prudent mortgage financing while also ensuring creditworthy homebuyers have access to safe mortgage financing with lower risk of default. In addition, consistency between both standards reduces regulatory burden and gives mortgage professionals much-needed clarity and consistency in the application of the important mortgage standards required pursuant to Dodd-Frank.

By equating the QRM with the QM, regulators have provided clear rules that allow for robust markets that meet the needs of creditworthy borrowers in a safe and sound manner. The new proposed QRM will reduce the risk of default and delinquency as illustrated below.

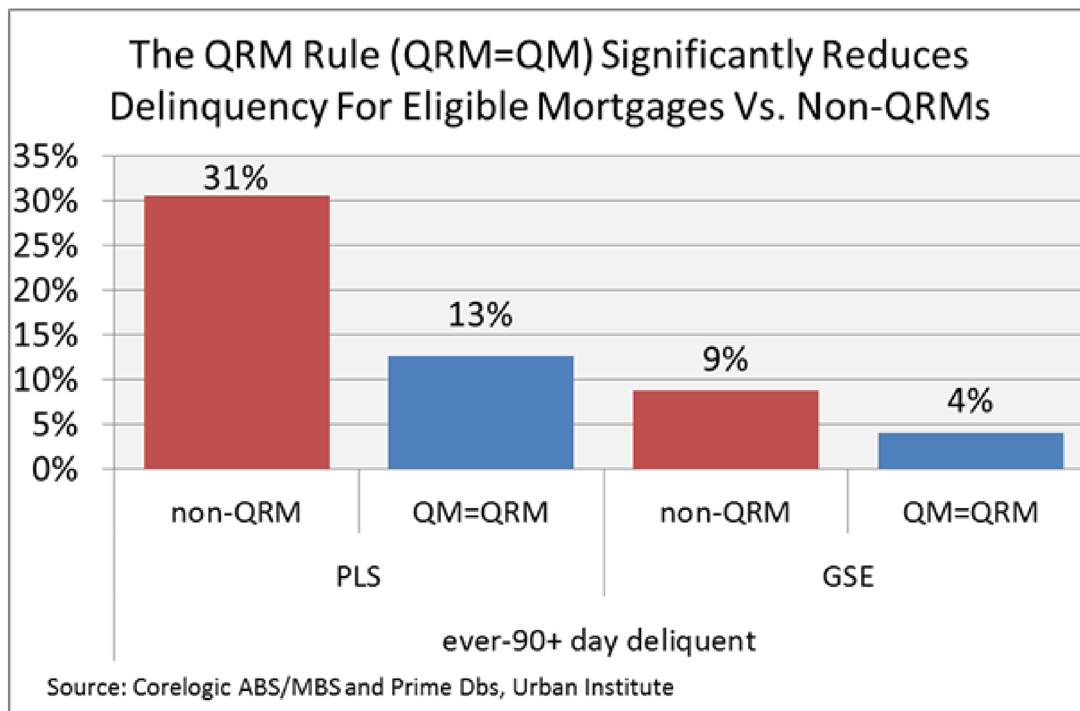

Figure 10

An Urban Institute analysis[3] of mortgages in private label securities originated in or prior to 2013 found that the "ever 90-day delinquency rate" (loans that have ever been 90 days or more delinquent) for all loans that did not meet the re-proposed QRM standard was 30.6 percent.

The delinquency rate for purchase and refinance loans that met the new QRM proposal was nearly two thirds lower at 12.6 percent.[4] Loans purchased by Freddie Mac and Fannie Mae that met the re-proposed QRM standard had default rates of 4.1 percent as compared to 8.7 percent for mortgages that did not qualify for QM status.

The study's authors point out that using an alternative measure of performance such as the 180-day delinquency rate or a measure of default would more accurately portray borrower behavior. The delinquency rates for PLS and GSE mortgages originated over this same period that fell 180 days or more delinquent were 7.87 percent and 1.43 percent, respectively. Furthermore, as pointed out by researchers at the UNC Center for Community Capital, several recent studies of performance for QM and non-QM loans vary in scope by time frame and mortgage features included, but all indicate that the QM standard significantly reduces risk, while providing broader access to credit than a QRM that includes a down payment requirement.[5]

The alignment of the QM definition with the QRM definition results in a construct that excludes risky product features and low or no-documentation lending that are closely correlated with increased probability of default. Appropriately, the definition of QM is not limited based on down payment. Although data shows that the risk of default increases somewhat as down payments decrease, this correlation is not significant enough to necessitate the inclusion of a downpayment requirement in QRM. Much like the private market operates today, investors can choose to package QRMs based on down payments if they choose to. Aligning QRM with QM allows market participants to assess and allocate risk within boundaries that will ensure stability to the market and a wide degree of credit access.

Recent market trends show that the QRM rule is unlikely to lead to a flood of zero down payment loans, as some critics of the proposed rule have suggested. Creditors currently are requiring borrowers to put significant amounts down in order to qualify for a loan before any risk retention rules are in effect. Both Fannie Mae and Freddie Mac recently raised their minimum down payments for most loans to five percent, and charge significant premiums and require mortgage insurance for those with down payments below 20 percent. The inclusion of a down payment requirement in the QRM rule is therefore unnecessary. Nonetheless, if it were included it would set a rigid standard not amenable to adjustment by individual securitizers based on experience and market trends. Moreover, it would give the government's imprimatur to an underwriting factor. That was not Congress's intent and would exclude far too many borrowers from QRM loans.

As Laurie Goodman of the Urban Institute states, "The default rate for 95 to 97 percent LTV mortgages is only slightly higher than for 90 to 95 LTV mortgages, and the default rate for high FICO loans with 95 to 97

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[3] *See* Laurie Goodman and Ellen Seidman and Jun Zhu, "QRM, Alternative QRM: Loan default rates," The Urban Institute, MetroTrends Blog (October 17, 2013) (available at http://blog.metrotrends.org/2013/10/qrm-alternative-qrm-loan-default-rates/?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+MetrotrendsBlog+%28MetroTrends+Blog%29).

[4] To account for prepayment penalties, the authors of the Urban Institute's study filtered from their QM definition mortgages with prepayment penalties incurred more than three years after origination, but they were unable to screen those mortgages with penalties that exceeded the limit of 2 percent of the amount prepaid. Likewise, data limitations precluded their ability to screen hybrid ARM products for a maximum rate reset in the first 5 years. Mortgages with these features may have been screened from the QM definition for other reasons, but some were likely included and thus estimates for delinquency rates should be considered conservative.

[5] Reid, Carolina and Quertia, Roberto, "Risk, Access, and the QRM Reproposal." UNC Center for Community Capital, September 2013.

LTV ratios is *lower* than the default rate for low FICO loans with 90 to 95 percent LTV ratios. . . . For mortgages with an LTV ratio above 80 percent, credit scores are a better predictor of default rates than LTV ratios."[6]

Alternative: A Step Backwards

In the revised proposal, the regulators ask for comment on the merits of a adding a 30 percent down payment and credit requirements in addition to QM as an alternative for QRM. This proposal is a response to the overwhelming opposition voiced to the original proposed rule's requirement for a 20 percent down payment, as well as its proposed question of a 10 percent alternative.

However, combining the definitions of QM and QRM together will make thorough underwriting and low risk mortgages the overwhelming standard in the market, without imposing down payment requirements above and beyond what lenders, insurers and investors will already continue to require. Large down payment requirements would raise the cost of credit [7] for a large pool of would-be homebuyers.

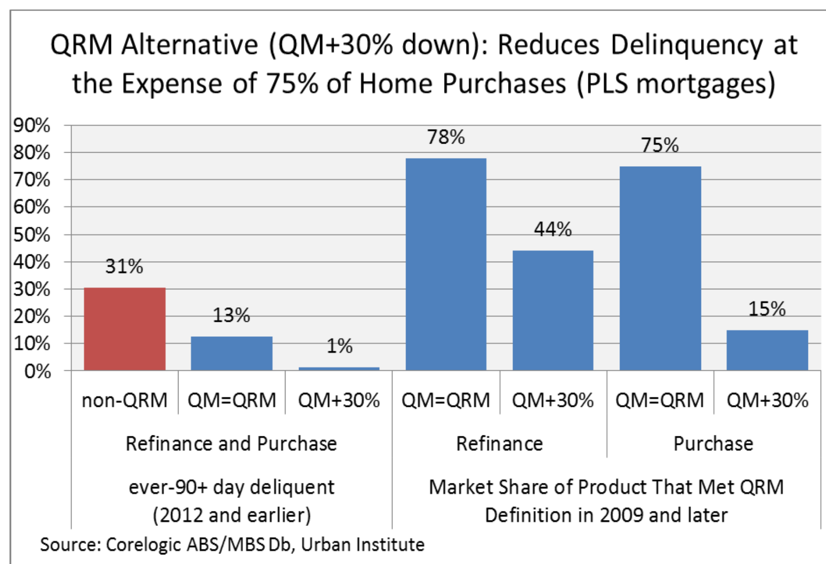

Figure 11

As the graph above indicates, for mortgages in private label securities overlaying the 30 percent down payment and additional credit requirements on top of generally defining QRM as QM would reduce the risk of default for QRMs from 13 percent to one percent but it would significantly reduce the portion of the market that is QRM and exempt from the higher cost of risk retention, particularly on the purchase side which would decline from 75 percent to 15 percent.

[6] *See* Laurie Goodman and Taz George, "Fannie Mae reduces its max LTV to 95: Does the data support the move?," The Urban Institute, MetroTrends Blog (September 24, 2013) (available at http://blog.metrotrends.org/2013/09/fannie-mae-reduces-max-ltv-95-data-support-move/).

[7] *See* 78 Fed. Reg. 183, 58013 (September 20, 2013).

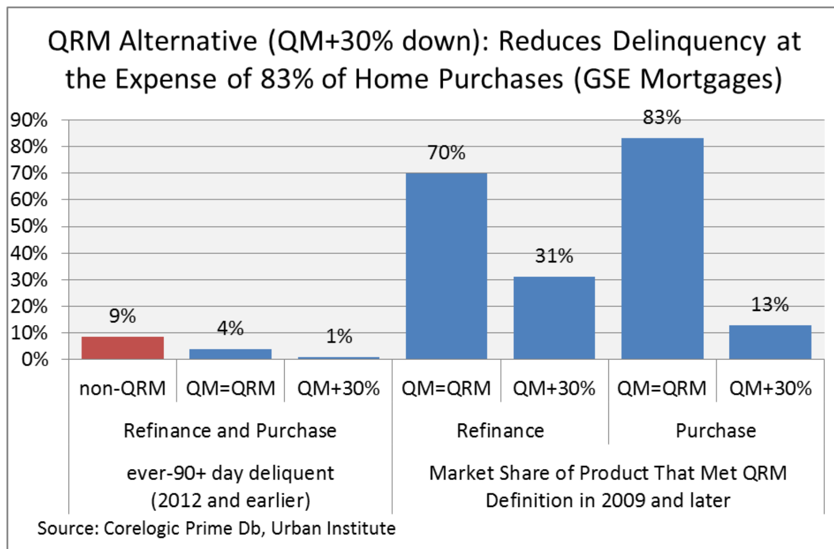

Figure 12

Likewise, as depicted above the delinquency rate for purchase and refinance originations purchased by the GSEs that met the alternative QRM requirement was 4.1 percent as compared to 1 percent for mortgages that just met the QM standard. However, the impact on market share of purchase mortgages originated after 2009 is more dramatic as the eligible share of the market falls from 83 percent to 13 percent.

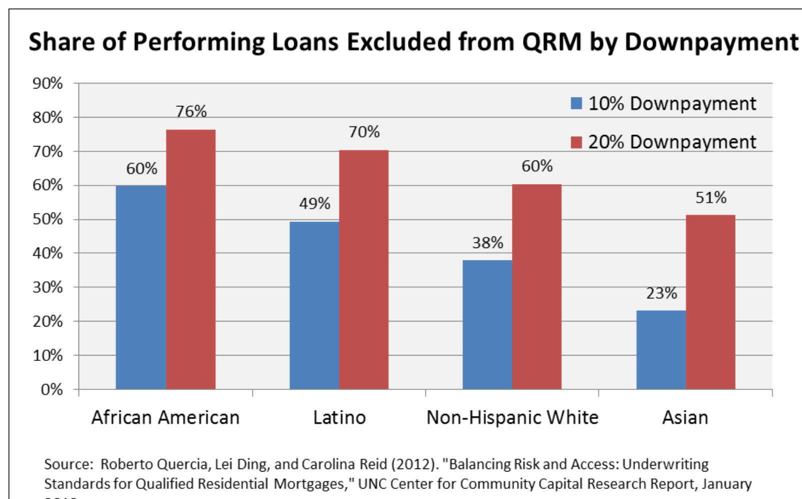

Figure 13

Furthermore, as highlighted in prior research, the impact of a 10 percent or 20 percent down payment would be disproportionately borne by borrowers of color. The impact would only increase for a 30 percent down payment. First time buyers are also constrained by down payments. On average, 92 percent of first time home buyers put down less than 30 percent between 2006 and 2012.

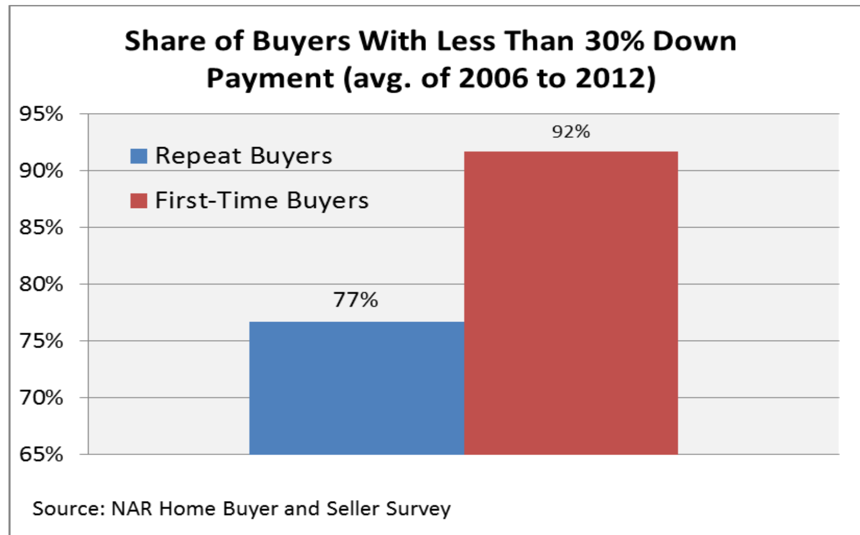

Figure 14

As indicated by the proposed rule, a cost of up to 30 basis points would be passed onto the consumer under the proposed alternative. While some dispute this estimate as being understated, even this cost could add up to billions of dollars on an annual basis, constraining consumer spending and homeownership, which would have implications for the greater economy. Alternatively, consumers might opt for a cheaper 100 percent government guaranteed FHA alternative, which instead of drawing more private capital back into the mortgage market – a stated goal of the Administration and many in Congress – would have the unintended consequence of driving more activity to the government-insured program. For those potential buyers who choose to save the required down payment, the time to save is staggering as indicated in the chart below.

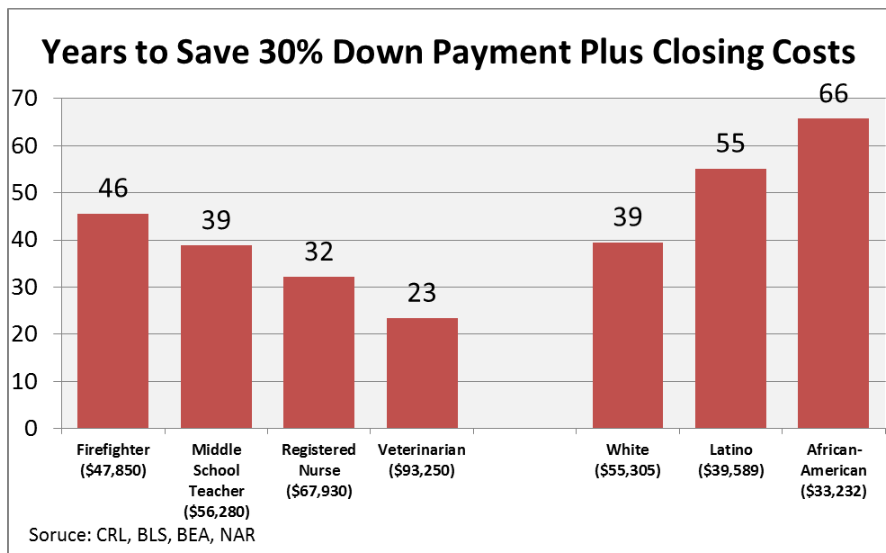

Figure 15

Summary

Should the proposed 'preferred' QRM rule that tracks the QM rule be finalized, federal regulators would take a big step forward in strengthening the housing market and economy while also adequately addressing the root causes of the crisis (i.e. lapses in solid underwriting and the introduction/misuse of complex loan products). The proposed alternative that requires borrowers to put down 30 percent to qualify for a QRM loan will constrain the availability of private mortgages for many creditworthy borrowers. Additionally, the

high down payment requirement in the alternative proposal would limit access to otherwise high quality mortgages with lower down payments, restricting credit that will be needed to meet the housing credit needs of a rising generation of new households, without providing a commensurate increase in risk reduction for investors.

In summary, by synchronizing the definition of QRM with QM, the revised rule will encourage safe and financially prudent mortgage lending, while also creating more opportunities for private capital to reestablish itself as part of a robust and competitive mortgage market. Most importantly, it will help ensure creditworthy homebuyers have access to safe mortgage financing with lower risk of default in any new housing finance system.

PROPOSED CORKER-WARNER LEGISLATION

We applaud Senators Corker (TN) and Warner (VA) for laying the foundation for housing finance reform with the introduction of S. 1217, the "Housing Finance Reform and Taxpayer Protection Act of 2013," which includes many of our suggested reform elements. The legislation provides for an explicit government guarantee, which should ensure the availability of long term fixed-rate mortgage products such as the 30 year fixed-rate mortgage. NAR appreciates this significant step forward in the reform discussion because Corker-Warner is a move away from principles, and delves into the inner workings of the system that must be addressed in order for real reform to occur. With that said, we recognize that this proposed legislation is a work in progress and additional issues must be addressed. In that spirit, there are pieces of the legislation that do offer some concern to REALTORS®.

Below are the areas of the legislation that concern NAR members:

- The 5 percent down payment requirement;
- Significant reduction in loan limits;
- The issue of who will step in to ensure that lending continues when an economic downturn occurs should private capital decide not to take the first loss position of the credit-risk sharing mechanism developed by the FMIC;
- Ensuring access to the system for small lenders and credit unions and that their costs are in-line with those of the larger lenders;
- The reduction to zero of the entities portfolio; and
- Using fair value accounting principles for evaluating the mortgage insurance fund.

Increased Downpayment

REALTORS® believe that there should be flexibility in down payment for purchasing a home. Having a hard and fast requirement for how much downpayment someone needs to have, could preclude creditworthy borrowers who have an issue saving the required amount, from purchasing a home they could otherwise afford. Therefore, we believe the 5 percent down payment requirement should be removed from the legislation.

While the size of the downpayment does have an effect, the relationship is small and pales in comparison with the magnitude to other factors such as underwriting, product features, and credit scores. Increasing the downpayment, however, does have a significant impact on the ability of households looking to buy a home to do so. In theory, a higher downpayment should help to protect the lender or insurer against the potential default by requiring more "skin in the game" from the buyer. However, an analysis by researchers at the Urban Institute[8] has shown that loans with lower downpayments performed better than some high

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[8] *See* Laurie Goodman and Taz George, "Fannie Mae reduces its max LTV to 95: Does the data support the move?", The Urban Institute, MetroTrends Blog (September 24, 2013).

downpayment mortgages over the period from 1999 to 2012. As depicted in Figure 16, mortgages with LTVs between 97 percent and 95 percent and credit scores above 700 significantly outperformed mortgages originated with credit scores below 700, but which had down payments greater than 20 percent. Furthermore, mortgages with down payments less than 5 percent performed roughly the same or better than those with a downpayment of 5 percent to 10 percent.

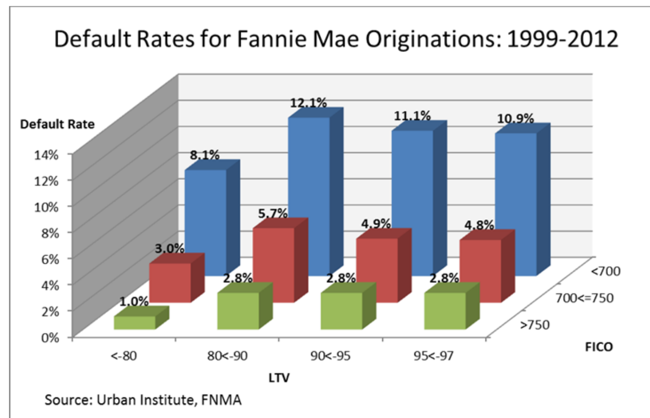

Figure 16

A small increase in downpayment can have a large impact on a borrower at the margin. Borrowers already must commit 3.5 percent cash (FHA) at closing in addition to closing costs, which is nearly $6,000 for a median priced home sale. Increasing the downpayment will remove homeownership options for many American families.

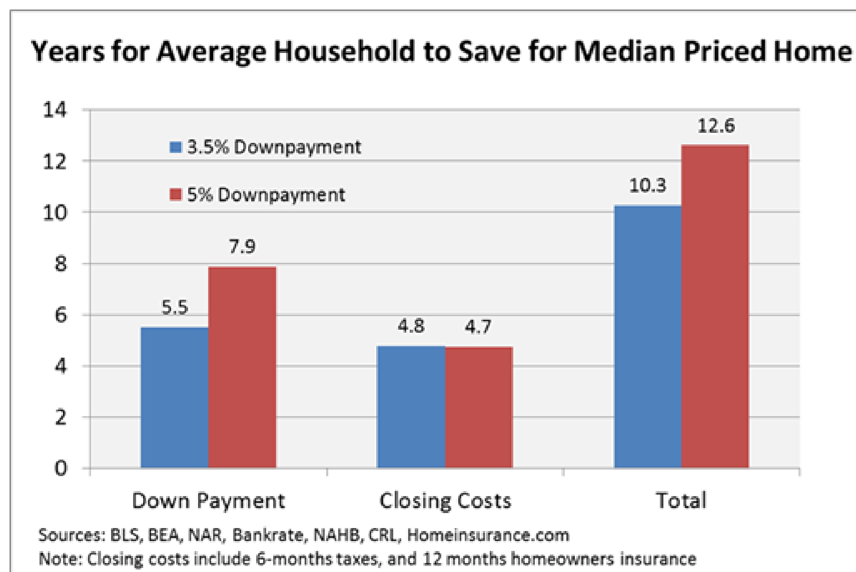

Figure 17

The size of the required downpayment also has a significant impact on the timing of a family's home purchase. At a 3.5 percent downpayment, the average buyer has to save 10.3 years to come up with the necessary downpayment for a median priced home. A simple increase in required downpayment from 3.5 percent to 5 percent will require the average buyer to save for an additional 2.3 years (from 10.3 years to 12.6 years). This estimate assumes that life events like having children, or taking care of family members don't divert their savings. (See Figure 17)

Homeownership is an important means for building wealth through structured equity payments for most households. However, recent trends towards higher downpayment in the traditional market have resulted in a higher share of home buyers using funds designated for retirement (such as IRAs, pensions, and 401ks) as a means of funding their downpayment. (See Figure 18)

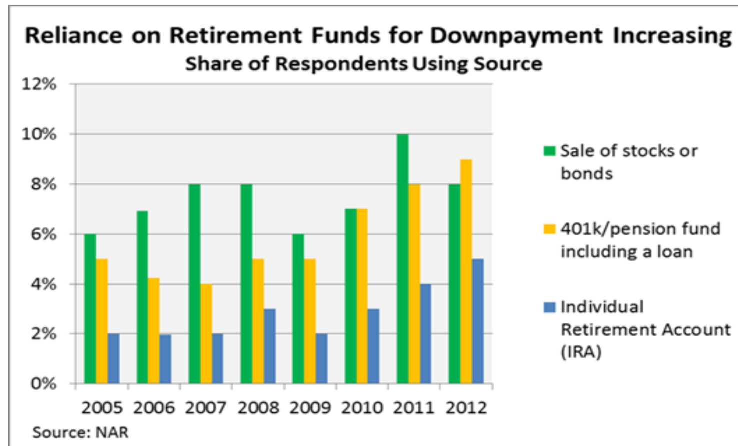

Figure 18

The impact of increasing the downpayment is greater on minorities than on whites, who are more likely to have received an inheritance or assistance from their family. A study by researchers at the University of North Carolina's Center for Community Capital demonstrated that for loans made during 2004 – 2008, a 10 percent down payment would have made a mainstream mortgage out of reach for 60 percent of African-Americans and 50 percent of Latino borrowers who were current on their mortgage.[9] More than 52 percent of African Americans and 45.8 percent of Hispanics relied on a downpayment less than 5 percent, compared to only 33.4 percent of other purchasers. (See Figure 19)

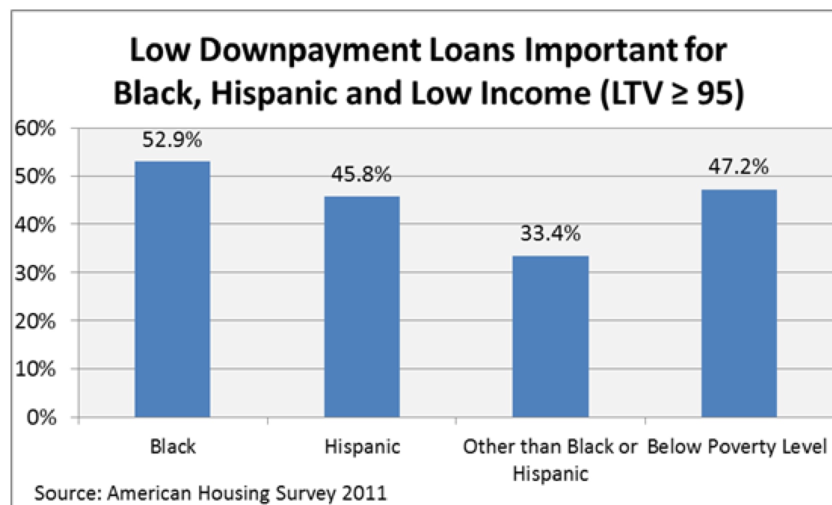

Figure 19

Low downpayments are not just important for first-time buyers. Repeat buyers also use low-downpayment loans, and could also be disenfranchised by this legislation. (See Figure 20)

[9] Roberto G. Quercia, Lei Ding, Carolina Reid. "Balancing Risk and Access: Underwriting Standards for Qualified Residential Mortgages." UNC for Community Capital. January 2012.

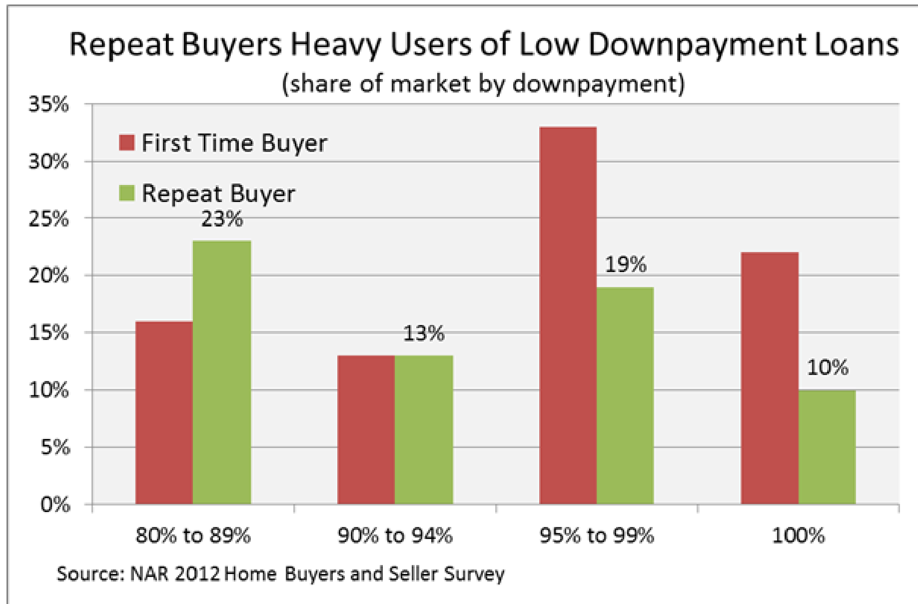

Figure 20

Loan Limits

NAR strongly opposes lowering of the loan limits at this time, especially in high cost markets. Lowering the loan limits to exclude very high cost markets will leave a significant number of first-time home buyers, middle income, and middle market relocation consumers at the mercy of a jumbo loan market that typically require substantially higher down payments at higher costs than the conventional conforming space.

Moreover, lowering the loan limits restricts liquidity and makes mortgages more expensive for households nationwide. Without the additional liquidity created by maintaining loan limits at current levels, families will have to pay more to purchase homes, face the possibility that they will not be able to obtain financing at any price or find it more difficult or impossible to refinance problematic loans into safer, more affordable mortgages.

First Loss Position of Private Capital

In addition to the 5 percent downpayment provision in the Corker-Warner legislation, we are concerned with mandating a covered security to have a credit risk-sharing structure under which private investors first loss coverage is no less than 10 percent of the value of the security. While NAR wants to see more private capital at risk in the housing finance system, we are concerned the arbitrary first loss percentage will inhibit private investors from participating in the secondary mortgage market, especially during periods of economic distress. We have seen what happens first hand during the current economic crisis, and without the current government support, lending would be near non-existent.

Well known economists such as Mark Zandi,[10] Phillip Zwagel, and Laurie Goodman have suggested that 4-5 percent is more than adequate to weather future economic downturns, while preserving lower mortgage rates for borrowers. However, these findings are of limited value since they do not examine whether private capital will flee the market in the event of another downturn as it has consistently done throughout history.

We recommend striking the mandatory 10 percent first loss position and replacing it with language directing the Federal Mortgage Insurance Corporation (FMIC) to study and determine, in conjunction with all market participants, the appropriate level for private investors first loss position. Language in this section must also

[10] Mark Zandi has stated 5 percent is a sufficient first loss position for private investors.

provide for some form of a government guarantee, if private capital decides not to be in the first loss position and lending falls below levels prior to enactment of this legislation.

Access for Small Lenders

The Corker-Warner legislation requires the FMIC to establish a cooperative called the FMIC Mutual Securitization Company, whose purpose is to securitize eligible guaranteed loans and provide a cash window for smaller lending institutions. However, this does not assure that this will work in practice due to factors such as the difficulty in capitalizing the co-op or in operating it in a way that provides for a competitive outlet. We recommend that language be added to the Corker-Warner bill that ensures the cooperative provides a competitive cash window for small lenders. Steps may include alternative efforts to capitalize the co-op or to directly have the federal government operate a securitization outlet.

We also suggest including language that establishes transparency in the capital requirements for approval of issuers. It is a rational concept that issuers have sufficient capital to ensure that they can carry out their responsibilities. However, such standards should be transparent and should be reasonably related to the financial responsibilities and not set indiscriminately at excessive levels.

In addition, we recommend the addition of language that references small originators to ensure issuers serve smaller lenders in addition to traditional banks.

We also suggest that further discussion take place and language be considered to prevent mortgage market concentration, to ensure there are a sufficient number of issuers. The legislation requires the FMIC to ensure that there is at least one issuer approved to serve securitization needs for smaller lenders. To protect against several large lenders dominating the market, the FMIC should be required to ensure that there are a "sufficient number" of issuers that serve smaller lenders.

Lastly, we believe the cap on issuer market share should be removed and be replaced with language allowing the FMIC Director to make the determination of whether a cap is necessary. This will ensure for competition amongst all potential market participants in the federally guaranteed securitization market, while not precluding those who make a business determination to take a broader role in serving the mortgage market.

Portfolio Reductions

We oppose completely eradicating the portfolio of the GSEs as it will leave product that does not meet investor requirements with no market, thus no liquidity. Manufactured housing fits in this space; since the collapse of the ABS market in which that product traded, there has been limited activity. The manufactured housing market is still recovering, and will be gravely hampered if no one/mechanism is in place to provide liquidity to that specialized, yet affordable, housing product.

Fair Value Accounting

Finally, NAR opposes the use of Fair Value Accounting to determine the cost of the Mortgage Insurance Fund. Market conditions change and, therefore, a fair value accounting analysis is only as good as the day it is performed and only if the assets were to be sold at fire-sale prices. We would strike this section and recommend the FMIC to be required to use the same method utilized by OMB to account for the asset value of the mortgages held by the GSEs. This will provide continuity, and a more accurate assessment of the product insured by the facility.

CONCLUSION

The U.S. housing sector is in the midst of recovering from the worst economic downturn since the Great Depression. Home prices and sales, as well as household wealth, are all up from a year ago. While this industry continues to face many headwinds such as higher interest rates, affordability challenges, and

increased government regulations, maintaining the housing recovery will be key to boosting economic and job growth, as it has in past recoveries.

Any restructure of the secondary mortgage market must ensure that there is mortgage capital in all markets at all times and under all economic conditions. We believe the only way to achieve this goal is through a secondary mortgage finance system that includes an explicit government guarantee that safeguards the availability of long-term, fixed-rate mortgage products such as the 30 year fixed-rate mortgage.

We believe the Corker-Warner legislation provides a good framework for reform in our housing finance market, which is necessary to encourage private capital and ensure creditworthy Americans always have access to affordable mortgage capital. We look forward to working with the Committee to ensure any future reform of the secondary mortgage market will protect and preserve the American Dream of homeownership for all responsible and hardworking Americans.