

Responsible Lending Policy

Why Do REALTORS® Seek To Prevent Abusive Lending

May 2017

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

- Abusive lending erodes confidence in the nation's housing system.
- 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.
- 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.

Responsible Lending Principles

NAR supports the general principle that all mortgage originators 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. NAR encourages policy makers to use such a standard of care as a guiding principle when drafting anti-predatory lending legislation and regulations.

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, insurance, and homeowners association (HOA) fees, 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 make loans to borrowers that make loss of the home through sale or foreclosure likely if the borrower is unable to refinance the mortgage or sell.

- Underwriting Subprime Loans with “Teaser Rates.” Some subprime loans 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 subprime 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. Examples of these risky mortgage products include loans with a short-term interest “teaser” rate for the first two or three years (known as 2/28s and 3/27s), loans with an initial interest only period, and mortgages that negatively amortize.²

¹ The limited exceptions to this general principle would include prime borrowers with sufficient verifiable assets to handle a balloon mortgage or a significant jump in mortgage payment.

² Negative amortization ordinarily results if the mortgage permits a borrower to pay less than the interest on the mortgage for a limited time, in which case the difference is added to the total amount of the loan the borrower must repay.

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NAR will carefully monitor the debate on underwriting standards for subprime loans and will support policies consistent with the goal of assuring that borrowers who have demonstrated the financial capacity to meet their mortgage obligations, taking into account all relevant circumstances, continue to have access to mortgage loans made by responsible lenders.

- **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 does not 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 service in an escrow/reserve/impound account for the payment of the borrower's periodic payments, such as taxes and insurance. Similar to the exception for prime loans in some jurisdictions, borrowers that make at least a 20 percent down payment should have the option to budget for these payments independently.

2. Limit Stated Income/Stated Assets Underwriting. Because mortgages underwritten based on “stated income” and/or “stated assets” (also known as “no income verification” or “no doc” loans) typically have higher rates, lenders making subprime loans should, as a general rule, underwrite loans based on verified income and assets, with adequate provisions for borrowers whose incomes derive from hard-to-verify sources (such as self-employed borrowers).

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.

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- Borrowers who anticipate a jump in income or assets due to life events such as graduation, completion of professional training, completion of payment obligations for student or car loans, another member of the household entering the work force when young children start school or an inheritance.

4. Anti-Mortgage Flipping Policy. NAR Supports an anti-mortgage flipping rule requiring mortgage originators making or arranging for a loan that refinances an existing residential mortgage to verify that the new loan provides a significant benefit to the borrower (one test often proposed is the loan must provide a “reasonable net tangible benefit” to the borrower). The lender should consider the circumstances of the borrower, as discussed above, all terms of the new loan including taxes and insurance, the fees and other costs of refinance, prepayment penalties, and the new interest rate compared to that of the refinanced loan.

5. Bar Prepayment Penalties. NAR opposes prepayment penalties for all mortgages. Prepayment penalties often work to trap borrowers in loans they cannot afford by making it too expensive to refinance.

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 regulators, the Consumer Financial Protection Bureau (CFPB), the Government-Sponsored Enterprises (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.

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 timely basis.

7. Mortgage Choice for Borrowers. NAR supports requiring mortgage originators to offer borrowers 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:

- Advise borrower that they may want to seek housing counseling to better understand their options;

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- Offer all borrowers a choice of several significantly different mortgage options;
- If a borrower qualifies, at least one traditional loan or any federally insured mortgage (i.e. FHA, VA, USDA loan) product should be included in the borrower's options; and
- Before application acceptance, disclose information about the terms of the loan including but not limited to the maximum potential payment over the life of the loan and the date the initial payment will increase.

8. Enforcement/Remedies. NAR supports enactment of strong remedies and penalties for abusive acts by mortgage originators. Among the options for consideration are:

- Enforcement actions by the CFPB.
- Criminal penalties similar to those under RESPA.
- Civil penalties similar to those under RESPA.
- Assignee liability that balances the need to protect innocent borrowers with problematic loans against the risk that increasing the liability of innocent holders of mortgages in the secondary market could reduce the availability of mortgage credit.
- Prohibition of mandatory arbitration clauses that bar victims' access to court.

9. Improved Consumer Mortgage Disclosures. Lenders have a responsibility to ensure that consumers understand the loans they receive, including their terms and all costs. Consistent with this principle, NAR supports the Consumer Finance Protection Bureau's (CFPB's) "Know Before You Owe" (KBYO or TRID) mortgage initiative that improves consumer disclosures under *the Real Estate Settlement Procedures Act* (RESPA) and the *Truth in Lending Act* (TILA) that help consumers more fully understand the services they are receiving and the cost of each service when getting a mortgage. NAR supports the ability of consumers to easily compare their loan estimate they receive when they apply for the loan to their closing disclosure at settlement.

10. Clarify Appraiser Independence. NAR supports credible, independent valuations of real property, which are a critical component to the mortgage transaction and help ensure the health of the overall real estate industry. NAR understands lender use of Appraisal Management Companies (AMCs) is one means to ensure appraiser independence rules are met under the requirements of Dodd-Frank, but also supports alternatives to AMCs, which achieve the same result. NAR encourages lenders to partner only with entities and individuals that conform to the Uniform Standards of Professional Appraisal Practice (USPAP).