National Association of Home Builders

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August 1, 2011

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attn: Robert E. Feldman,
Executive Secretary
FDIC: RIN 3064-AD74
comments@FDIC.gov

Board of Governors of the
Federal Reserve System
20th Street & Constitution Ave, NW
Washington, DC 20551
Attn: Jennifer J. Johnson, Secretary
Federal Reserve: Docket No. R-1411
regs.comments@federalreserve.gov

Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552
Attn: Alfred M. Pollard, General
Counsel
FHFA: RIN 2590-AA43
RegComments@FHFA.gov

Department of Housing and Urban
Development
451 7th Street, SW
Room 10276
Washington, DC 20410–0500
Attn: Regulations Division,
Office of the General Counsel
HUD: FR-5504-P-01
www.regulations.gov

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn: Elizabeth M. Murphy, Secretary
SEC: File Number S7-14-11
Rule-comments@sec.gov

Office of the Comptroller of the
Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
OCC: Docket No. OCC-2011-0002
regs.comments@occ.treas.gov

Re: Credit Risk Retention; Proposed Rule

Dear Sir or Madam:

On behalf of the National Association of Home Builders (NAHB), I appreciate the opportunity to submit comments on the above-referenced proposed rule[1] issued jointly by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Securities and Exchange Commission and Department of Housing and Urban Development, (collectively, the "Agencies") to implement the credit risk retention requirements of section 15G of the Securities and Exchange Act of 1934 (15 U.S.C 780-11), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act", or the "Act").

[1] Credit Risk Retention, 76 Fed. Reg. 24090 (April 29, 2011) [hereinafter, "proposed rule"]

NAHB is a Washington-based trade association representing more than 160,000 members involved in a wide variety of housing activities, including the development and construction of single-family for-sale housing; the development, construction, ownership, and management of affordable and market-rate multifamily rental housing; and the development and construction of light commercial properties.

The ability of the home building industry to meet the demand for housing, including addressing affordable housing needs, and contribute significantly to the nation's economic growth is dependent on an efficiently operating housing finance system that provides adequate and reliable credit to home buyers and home builders at reasonable interest rates through all business conditions. The securitization of residential mortgage loans is a critical component of ensuring that sufficient capital exists for home loans and has allowed for a more consistent flow of credit throughout the country. Additionally, the commercial mortgage backed securities (CMBS) market has been an important component of the commercial real estate finance market, including financing of multifamily rental properties.

The proposed rule has far-ranging implications across the housing and development sectors. Each aspect of the proposed rule will have a significant impact. The narrow definition of a Qualified Residential Mortgage (QRM) would have a severe adverse impact on the availability and cost of residential mortgages. The proposed requirements on Qualified Commercial Real Estate (QCRE) loans would be virtually impossible to meet and would have a wide-spread and detrimental impact on financing the development of multifamily and commercial properties. The premium capture cash reserve account (PCCRA) has the potential to distort the securitization market and create a disincentive for private investors.

NAHB understands that establishing credit risk retention rules was required by the Dodd-Frank Act. However, NAHB is very concerned about the immediate impact this proposed rule will have at this precarious point in the economic recovery and the future implications of overly restrictive rules on future growth of the housing market and the entire economy. NAHB urges the Agencies to take the time to carefully craft these new regulations so as not to have a negative impact on residential and commercial real estate financing. Historically, residential investment and housing services have been on average a combined 17 to 18 percent of gross domestic product (GDP). While the share of GDP tends to vary over the business cycle, there is no denying that housing is a large portion of the national economy, and reworking the entire housing finance market should not be taken lightly. With so much at stake, these regulations should not be rushed.

For these reasons, NAHB requests that the proposed rule be withdrawn and re-proposed as an Advanced Notice of Proposed Rulemaking (ANPR). An ANPR is necessary given the implications and complexity of the proposed regulations under the Dodd-Frank Act. In this case, it would be appropriate for the Agencies to seek additional information from the public to assist them in framing a subsequent notice of rulemaking. Given the volume and detail of the public comments associated with the currently proposed regulation, it is likely that the final rule will differ materially from the proposed rule. Because of the probability that the final rule will not be a "logical outgrowth" of the original rule, it will be vulnerable to challenge based on inadequate notice without a new round of public comment.[2]

Overview

Section 941 of the Dodd-Frank Act[3] regulates credit risk retention by requiring loan originators and securitizers to hold at least five percent of the credit risk between them, with noted exemptions – one of which is the QRM exemption, discussed further below. The genesis of this risk retention requirement is the belief that the credit crisis occurred because lenders and securitizers did not have “skin in the game” and therefore did not ensure that the loans were sound and borrowers were creditworthy.

NAHB’s members have supported steps to ensure that mortgage lending occurs in a safe and sound manner, with appropriate underwriting, prudent risk management and sound consumer safeguards and disclosure. The housing system and the economy have been affected deeply by the consequences of inappropriate underwriting standards and risky loan features. The housing sector continues to suffer from the resulting foreclosures, which negatively impact demand from buyers and drive down home prices.

In addition, NAHB supports the exemptions created by the legislators for the QRM and the government-backed mortgage programs in order to ensure the flow of capital to the housing market through loans with features that historically have performed well. However, NAHB is very concerned that as a result of the proposed rule, additional capital will have to be retained by the lenders. The amount of capital will vary, but without the correct exemptions, the net effect will be to make securitization less effective and unnecessarily raise the cost of mortgages.

As we work together to bolster the housing finance system and ultimately the American economy, it is critical that we get these regulations correct because of the importance of housing in both economic and social terms. According to a poll[4] conducted on behalf of NAHB, home owners and non-owners alike consider owning a home essential to the American Dream despite the ups and downs of the housing market. The survey results show that Americans see beyond the immediate housing market to the enduring value of homeownership. An overwhelming 75 percent of the people who were polled said that owning a home is worth the risk of the fluctuations in the market, and 95 percent of the home owners said they are happy with their decision to own a home.

Even though the market is weak, people who do not own say they want to buy a house. Almost three-quarters of those who do not currently own a home, 73 percent, said owning a home is one of their goals. And among younger respondents who are most likely to be in the market for a home in the next few years, the percentages are even higher. However, saving for a downpayment and closing costs was cited as the biggest barrier to homeownership.

[2] *See Nat’l Mining Ass’n v. MSHA,* 116 F.3d 520, 531 (D.C. Cir. 1997).
[3] Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act” or the “Act”), Pub. L. No. 111-203, §941(b), 124 Stat. 1376, 1890 (2010)
[4] This national survey of 2,000 likely 2012 voters was conducted May 3-9, 2011 by Public Opinion Strategies of Alexandria, Va., and Lake Research Partners of Washington, D.C. It has a margin of error of +/-2.19%.

NAHB also notes that the proposed risk retention requirements have the potential to significantly affect the rental housing markets. Almost one-third of Americans live in rental housing, and demand for rental housing in the future is expected to increase. In particular, NAHB estimates that the aging of the "echo boom" generation will result in demand for between 300,000 and 400,000 multifamily housing units on average per year over the next ten years. The timing of this demand will depend on the pace of economic recovery, but the housing needs of these households will not be postponed indefinitely. The current average pace of multifamily housing starts of less than 120,000 annually is insufficient to meet this demand. Production of multifamily housing will undoubtedly increase above the current extraordinarily low levels. Therefore, it is important that the financing mechanisms and access to capital to support production of multifamily rental housing are available.

As the Agencies craft new rules governing the future of mortgage financing, these are important points to consider. When finalized, the proposed rule, and in particular the definition of a QRM, will determine the future of the mortgage market for years to come. NAHB urges the Agencies to consider the long-term ramifications of these rules on the market and not to place unnecessary restrictions on the housing sector based solely on today's economic conditions. Overly restrictive rules will prevent willing, creditworthy borrowers from entering the housing market even though owning a home remains an essential part of the American Dream.

Qualified Residential Mortgages

Overview

The definition of Qualified Residential Mortgage (QRM) is an important component of the risk retention rule. The Dodd-Frank Act specifies that the QRM definition is to be based on mortgage underwriting and product features that historically indicate a lower risk of default. The statute also notes the requirement that the QRM exemption shall "help to ensure high quality underwriting standards," "encourage appropriate risk management practices" and "improve the access of consumers and businesses to credit on reasonable terms, or otherwise be in the public interest and for the protection of investors."

In defining QRM, the Dodd-Frank Act directs the Agencies to consider:

1) documentation and verification of the financial resources relied upon to qualify the mortgagor;
2) standards with respect to (a) the residual income of the mortgagor after all monthly obligations; (b) the ratio of the housing payments of the mortgagor to the monthly income of the mortgagor; (c) the ratio of total monthly installment payments of the mortgagor to the income of the mortgagor;
3) product features and underwriting standards that mitigate the potential for payment shock on adjustable rate mortgages (ARMs);
4) mortgage guarantee insurance or other types of insurance or credit enhancement obtained at the time of origination, to the extent such insurance or credit enhancement reduces the risk of default; and

5) product features that prohibit or restrict the use of balloon payments, negative amortization, prepayment penalties, interest-only payments, and other features that have been demonstrated to exhibit a higher risk of borrower default.

<u>Summary of Proposed QRM Rule</u>

The proposed rule limits the definition of a QRM to a closed-end first-lien mortgage to purchase or refinance a one-to-four family property, at least one unit of which is the principal dwelling of the borrower, and includes the following very conservative underwriting standards:

- Borrowers must have a 20 percent downpayment for a purchase transaction. (Junior liens used to purchase a home and financing of closing costs would be prohibited. Acceptable sources of the downpayment include the borrower's savings/checking accounts, cash saved at home, stocks/bonds, and gifts including eligible downpayment assistance programs.)
- Loan-to-value (LTV) requirements would be 80 percent LTV for home purchase, 75 percent combined LTV for refinancing, and 70 percent LTV for cash-out refinancing. (The presence of certain junior liens, such as home equity loans, would be permitted in refinancing transactions.)
- Borrowers cannot be currently 30 or more days past due, in whole or in part, on any debt obligation or have been 60-days delinquent, in whole or in part, on any debt obligation within the preceding 24 months. Further, a borrower must not have been a debtor in a bankruptcy proceeding, had a property repossessed or foreclosed upon, engaged in a short sale or deed-in-lieu of foreclosure or been subject to state or federal judgment for collection of any unpaid debt within the preceding 36 months. (A safe harbor for the documentation and verification requirements is proposed if the originator obtains credit reports no more than 90 days before closing of the mortgage from at least two consumer reporting agencies confirming the accuracy of the information.)
- Borrower must have a debt-to-income ratio of no more than 28 percent for mortgage/housing debt and 36 percent for total debt.
- Restricts total points and fees to no more than three percent of the loan amount with an exception for third party charges not retained by the mortgage originator, creditor, or an <u>affiliate</u> of the creditor or mortgage originator. (emphasis added)

The proposed rule prohibits QRMs from having product features that add complexity and risk to mortgage loans, such as terms permitting negative amortization, interest-only payments, or significant interest rate increases. Both fixed rate and adjustable rate mortgages (ARMs) may qualify as a QRM. The Agencies proposed limiting the amount by which interest rates may increase on ARMs to two percent in any 12-month period and six percent over the life of the mortgage. Also, the proposal includes mortgage servicing requirements and would prohibit prepayment penalties.

Qualified Mortgages

On July 22, 2011, NAHB submitted comments on the proposed rule amending Regulation Z (Truth in Lending) to implement amendments to the Truth in Lending Act (TILA) made by the Dodd-Frank Act issued by the Board of Governors of the Federal Reserve System (the "Board")[5]. This proposed rule would implement statutory changes made by the Dodd-Frank Act that expand the scope of the Regulation Z ability-to-repay requirement to cover any consumer credit transaction secured by a dwelling. In addition, the proposal would establish standards for complying with the ability-to-repay requirement, by making a "qualified mortgage" (QM). NAHB's comment letter on the Board's proposal is attached for your reference.

The Dodd-Frank Act links the QM with the QRM by stating that the definition of a QRM can be "no broader than" the definition of a QM. As stated in the attached letter, NAHB supports a safe harbor for the qualified mortgage; since the QRM is intended to be a subset of the QM, this safe harbor would be applied to the QRM. Although the new Consumer Financial Protection Bureau (CFPB) is responsible for implementing the ability-to-repay standard, the link between QM and QRM is critical and should be taken into consideration in developing the risk retention rules.

In the proposed credit risk retention rule, the Agencies state that they "expect to monitor the rules adopted under TILA to define a QM and will review those rules to determine whether changes to the definition of QRM are necessary or appropriate to ensure that the definition of a QRM is 'no broader' that the definition of a QM…" NAHB believes that it would be imprudent to release final credit risk retention rules prior to finalizing the QM rule. The market will have to make major adjustments to accommodate the proposed rules, and the potential for changing or reopening the QRM standards to adjust to the QM would create a disruption in the markets as they try to implement these changes.

<u>NAHB Position: Proposed Narrow QRM Definition Will Harm the Housing Market</u>

NAHB appreciates the balance that the Dodd-Frank Act encapsulates when providing QRM as an exemption from the risk retention requirement. The importance of correctly defining the QRM exemption cannot be overstated. The final QRM definition will determine the availability and cost of mortgage credit. The QRM will likely become the new "conforming mortgage" with limited and more costly loans made to borrowers who do not meet the QRM requirements.

Given the importance of the QRM standard, NAHB strongly believes the proposed rule contains an unduly narrow definition of QRM that would seriously disrupt the housing market by making mortgages unavailable or unnecessarily expensive for many creditworthy borrowers. This extreme proposal could not have been put forward at a less opportune time. The housing market is still weak, with a significant overhang of unsold homes, and an equally large shadow inventory of distressed loans. A move to a larger downpayment standard at this juncture would cause renewed stress and uncertainty for borrowers who are seeking or are on the

[5] Regulation Z; Truth in Lending, 76 Fed. Reg. 27390 (May 11, 2011).

threshold of seeking affordable, sustainable homeownership. We believe a more balanced QRM exemption is imperative in light of the enormous potential impact it would have on the cost and availability of mortgage credit at this precarious point in the housing cycle.

It appears to NAHB that the Agencies did not give sufficient weight to statutorily required considerations in formulating their QRM proposal, which directed that the definition be based on objective, empirical data rather than subjective presumptions. The statute also requires a multifactor approach to establishing the parameters of the QRM in order to promote sound underwriting practices without arbitrarily restricting the availability of credit. The Agencies have admitted that they deliberately selected an extremely conservative approach to create a very limited QRM basket.

Creating an inordinately narrow QRM exemption would cause significant disturbance in the fragile housing market. Today's credit standards are tougher than they have been in decades. As a result, credit availability is extremely tight even for very well-qualified borrowers. NAHB strongly urges the Agencies to consider the negative ramifications of setting further limits on the availability of credit through a comparatively narrower QRM exemption. Under the proposed standard, millions of creditworthy borrowers would be deemed, by regulatory action, to be higher-risk borrowers. As a result, they would be eligible only for mortgages with higher interest rates and fees.

An overly restrictive QRM definition also would drive numerous current lenders from the residential mortgage market, including thousands of community banks, and enable only a few of the largest lenders to originate and securitize home loans. This sharp dilution of mortgage market competition would have a further adverse impact on mortgage credit cost and availability.

A QRM definition that is too narrow would prohibit many potential first-time homebuyers from buying a home, especially if the definition includes an excessively high minimum downpayment requirement. Repeat buyers and refinancers also would be adversely impacted if the QRM includes exceedingly high equity requirements. In other words, the important goal of clearing the historically high foreclosure inventory – a necessary condition for a stabilized housing market – will be undermined.

The purpose of the QRM is to create a robust underwriting framework that provides strong incentives for responsible lending and borrowing. Loans meeting these standards will assure investors that the loans backing the securities meet strong standards proven to reduce default experience. The exemption also will keep rates and fees lower on QRMs, which will provide incentives for borrowers to document their income and choose lower risk products. In turn, the market will evolve to establish the appropriate mixture of QRM to non-QRM borrowing.

The majority of industry participants (lenders, home builders, realtors, mortgage insurers), key consumer groups, and the sponsors of the QRM language in the Dodd-Frank Act support a broad QRM definition that would encompass the bulk of residential mortgages that meet the lower risk standards of full documentation, reasonable debt-to-income ratios and restrictions on risky loan features. In addition, most believe that loans with lower downpayments that have risk mitigating features, most notably mortgage insurance, should be included in the QRM exemption.

NAHB recommends the broadest criteria possible should be utilized in defining a QRM exemption that will ensure the safe and sound operation of the mortgage market while accommodating a wide range of viable mortgage borrowers.

Congressional Intent

By giving the QRM a narrow definition, the Agencies have acted contrary to clear Congressional intent under the Dodd-Frank Act. Quite simply, Congress could have, but did not, specify a clear minimum downpayment provision under the QRM definition.

By its plain meaning, the Dodd-Frank Act never directed the Agencies to incorporate a downpayment requirement as an element of the QRM definition. Congress has itself repudiated the use of a minimum downpayment as an element to the QRM. This intent is evident in both the Dodd-Frank Act's legislative history and recent statements by several Senators and Representatives from both parties.

Recently, members of Congress have explicitly and publicly reiterated this intent in letters to the Agencies. Through individual and joint letters, more than 50 Senators and 300 members of the House of Representatives told the Agencies that the QRM was intended to be a broad exemption from risk retention requirements limited to the considerations expressly outlined in the Act. The Senators explained that the proposed regulation imposes "unnecessarily tight downpayment restrictions [that] . . . unduly narrow the QRM definition and would necessarily increase consumer costs and reduce access to affordable credit." A letter from the House of Representatives articulated similar concerns, stating that "[t]he proposal to require a minimum 20 percent downpayment requirement under the QRM definition would reduce the availability of affordable mortgage capital for otherwise qualified consumers."

While it is hard to fathom a clearer enunciation of Congressional intent, the Dodd-Frank Act's legislative history also shows that the proposed rule has gone too far. The legislative history shows that Congress was seeking a broad exemption not constrained by a rigid downpayment requirement. In fact, the Senate expressly rejected an amendment that imposed a mandatory downpayment requirement.[6] The Senators were particularly concerned that even a five percent minimum downpayment requirement would adversely affect the ability of low- and moderate-income families to get mortgages.[7]

In this case, the evidence of Congressional intent stems both from the plain meaning of the statute and legislative history. Both statutory language and legislative history are the traditional tools of statutory construction, which "include examination of the text of the statute, dictionary definitions, cannons of construction, statutory structure, legislative purpose, and legislative history."[8]

[6] 156 Congressional Record S3574 (May 12, 2010).
[7] 156 Congressional Record S3518, and S3520.
[8] Ronald M. Levin, *A Blackletter Statement of Federal Administrative Law,* 54 Admin. L. Rev. 1, 37 (2002).

Because the Dodd-Frank Act exhaustively listed the appropriate components of the QRM, which did not include a minimum downpayment, the statute's plain language shows that the Agencies were not given discretion to add entirely new elements to the QRM.

<u>NAHB Comments on Proposed QRM Criteria</u>

NAHB is a member of the Coalition for Sensible Housing Policy, a diverse coalition of more than 40 consumer organizations, civil rights groups, lenders, real estate professionals, insurers and local governments. This coalition submitted a joint white paper as a formal comment letter to the Agencies on the proposed rule on August 1, 2011[9]. NAHB strongly supports the points covered in the white paper, a copy of which is attached. As per the white paper, NAHB agrees that the Agencies should redesign a QRM that comports with Congressional intent: encourage sound lending behaviors that support a housing recovery, attract private capital and reduce future defaults without punishing responsible borrowers and lenders.

The proposed rule contains several provisions in the definition for the QRM that concern NAHB. While a more thorough analysis is included in the joint comment letter, NAHB would like to reiterate several of our concerns. In particular, NAHB believes that the loan-to-value (LTV) thresholds, including the required 20 percent downpayment for home purchases, debt-to-income (DTI) ratios and credit history requirements are too conservative.

Downpayment

The downpayment requirement in particular will keep many creditworthy low- to moderate-income borrowers out of the housing market for years to come. As the data in the white paper show, it would take a family with the national median income of $50,474 approximately 16 years to save a 20 percent downpayment (plus closing costs) to purchase the median price home of $172,900 (2010 data). A 10 percent downpayment requirement is little better; it would take a median income family almost 10 years to save for a 10 percent downpayment[10]. These are conservative estimates that assume all savings go toward the downpayment and that the family is not also saving for retirement, education or other purposes. This excessive downpayment requirement does not serve the intended purpose of reducing the risk of default, as an increase in the downpayment requirement from five percent to 20 percent lowers default rates by less than one percent on average based upon recent historical loan performance data[11]. When strong underwriting standards are used, many creditworthy borrowers will be denied access to lower cost mortgage options for only a modest improvement in decreased default rates.

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[9] Coalition for Sensible Housing Policy, *Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery*, August 1, 2011.
[10] *Id*. at 5
[11] *Id.* at 6-7

Loan-to-Value Requirements for Refinancing

The increased LTV requirements for refinancing (75 percent) and cash-out refinancing (70 percent) will harm the markets that have been the most severely impacted by the economic downturn as borrowers will not be able to refinance out of current mortgages into more reasonable terms to avoid foreclosure. An analysis[12] of CoreLogic data has found that among U.S. homeowners with mortgages, 52 percent – 24.8 million homeowners – have less than 25 percent equity in their homes. In the six states with the highest percentage of homeowners who do not have 25 percent equity – Nevada, Arizona, Florida, Georgia, Michigan and Mississippi – more than six out of every ten homeowners with mortgages do not have at least 25 percent equity in their homes that would allow them to refinance with a lower rate QRM.

The analysis of the CoreLogic data clearly demonstrates that the Agencies' proposal on QRM will increase refinancing costs for millions of Americans. The data also show that even with a five percent minimum equity standard, almost 14 million existing homeowners with mortgages will be unable to obtain a QRM. For those borrowers that have already put significant "skin in the game" through downpayments and years of timely mortgage payments, only to see their equity eroded by the housing collapse, the proposed QRM definition would exclude these homeowners who would have to pay more. In effect, the proposed QRM would penalize families who have played by the rules, stayed current on their mortgage, and now need to refinance or relocate.

Insurance Products

For the benefit of low- to moderate-income borrowers, NAHB believes that any LTV requirements need to be well thought out and flexible when other safeguards are present. The statute specifically recommends that the Agencies consider loans that are covered at the time of origination by mortgage insurance (MI) or other types of insurance or credit enhancements, to the extent these protections reduce the risk of default, for eligibility under the QRM standard.

NAHB believes that MI should have been included as allowable under the QRM for loans with a downpayment of less than 20 percent. MI has provided consumers' access to well underwritten, lower downpayment loans making homeownership a reality for many low- and moderate-income families. MI also provides many benefits to the housing finance industry, including shared risk in the event of default and an additional and independent underwriting evaluation. Existing data reveal that loans carrying MI experience lower default rates primarily because of this additional underwriting step, or extra eyes, to the origination process.[13] In fact, the Federal Reserve Board acknowledges the benefits of mortgage insurance by allowing for MI in the proposed QM rule. Legislators also have recognized this enhancement in the Dodd-Frank Act and in letters to the Agencies.

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[12] Coalition for Sensible Housing Policy, *State by State Analysis of Proposed Federal Rule's Impact on Refinancing,* sensiblehousingpolicy.org
[13] Coalition for Sensible Housing Policy, *Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery*, July 11, 2011, p. 13.

NAHB also requests that the proposed definition of QRM include mortgages with LTV ratios above 80 percent, when they are properly underwritten and supported by home value insurance that is state-regulated and benefits both homeowners, by protecting a significant portion of their homes' values, and lenders, by protecting them in instances of foreclosure, through a combination of financial guaranty and credit insurance policies. Home value insurance is consistent with the Dodd-Frank Act's criteria for QRM which includes 'insurance and other credit enhancements at the time of origination to the extent such insurance or credit enhancement reduces the risk of default."

Debt-to-Income and Credit History

NAHB supports and strongly believes that improving the quality of mortgage underwriting will help stabilize the housing market and foster successful long-term homeownership for qualified borrowers. The market excesses that have occurred in the past merit regulatory changes aimed at more rational lending practices, greater lender accountability, and improved borrower safeguards. However, NAHB is extremely concerned that the proposed hard-coded standards for the debt-to-income (DTI) ratios and credit history represent an obsolete, single-factor approach to underwriting credit. Moreover, the proposed rule does not allow for any flexibility in meeting the terms of a QRM and does not allow for compensating factors. For instance, a larger downpayment does not offset a borrower's DTI or credit history. Underwriting is done on an individual loan basis, and the focus should be on sound underwriting principles.

According to analysis by the Federal Housing Finance Agency[14], less than 20 percent of the loans purchased by Fannie Mae and Freddie Mac from 1997 to 2009 would have met all of the QRM criteria. In 2009, a year of highly conservative underwriting standards, only 30 percent of loans purchased by the Enterprises would have met the proposed requirements. Nearly half of these non-QRM eligible loans in 2009 would have been excluded because of the proposed DTI criteria for a QRM.

Other aspects of the proposal, such as the proposed credit history, are also set at levels that will raise unnecessary barriers for creditworthy borrowers seeking the lower rates and preferred product features of the QRM. The strict credit history provisions are too rigid and do not allow for mitigating factors.

NAHB, as well as many other industry stakeholders and legislators in their comment letters on this proposed rule, suggest the Agencies embrace the Board's ability-to-repay standard as required under Title XIV of the Dodd-Frank Act. This approach has two benefits. First, it avoids creating multiple standards in federal rules for determining a borrower's ability-to-repay, and second, the Board's proposed rule adopts a more up-to-date and holistic approach to underwriting. The ability-to-repay regulations define a process for the creditor that allows flexibility for the borrower while holding the creditor accountable. There is no need for two standards which would create needless complexity, heighten compliance risks, and ultimately increase costs to borrowers. NAHB supports removing specific DTI ratios and consumer credit history standards from the QRM definition. Again, sound underwriting practices are

[14] Federal Housing Finance Agency, Mortgage Market Note 11-02, April 11, 2011

the most effective determinant of a borrower's willingness and ability to repay a mortgage and should be done on an individual loan basis.

Points and Fees

The Agencies include in the QRM definition "the restriction on points and fees for QMs contained in section 129C(b)(2)(A)(vii) of TILA" and "in order for a mortgage to be a QRM, the total points and fees payable by the borrower in connection with the mortgage transaction may not exceed three percent of the total loan amount, which would be calculated in the same manner as in Regulation Z." As referenced in the attached letter to the Board, NAHB believes that the current definition of fees and points discriminates against lenders with affiliates for no apparent reason. NAHB strongly supports an affiliate exception to the three percent cap so it allows consumers access and choice in determining their mortgage providers.

As part of the effort to build strong consumer relationships, many home builders and lenders have established settlement service affiliates, such as mortgage and title companies. These affiliates have been formed primarily to improve the likelihood that the financing of the home buying process occurs as promised and in a timely manner. These affiliates provide economic benefits to the consumers that far outweigh the income received from the partnerships in the business. Therefore, consumers directly benefit from affiliated relationships.

Requiring affiliate fees and points to be included in the three percent cap creates a disincentive for lenders to establish affiliated relationships which provide measurable benefits to consumers. For this reason NAHB strongly urges excluding fees and points from affiliated firms in the three percent cap, thereby giving equal treatment to affiliated and non-affiliated settlement service providers.

The CFPB has not released a final rule on Regulation Z. NAHB asks the Agencies to remove a distinct "points and fees" requirement from the QRM definition and instead incorporate by reference the fees and points calculation and definition that is ultimately adopted in the ability-to-repay regulations. Consistency is key to ensuring liquidity in the mortgage market. Having different rules on points and fees for QRM and non-QRM mortgages will be difficult to manage and will result in inefficiencies and increased costs, which will inevitably be passed onto borrowers.

Qualifying Appraisal

Accurate evaluations of collateral are critical in establishing the framework of a QRM, and NAHB supports the Agencies proposal that a QRM be supported by a written appraisal that conforms to generally accepted appraisal standards, as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP), the appraisal requirements of the Federal banking agencies, and applicable laws for evaluating loans. The Agencies go further and state that they "believe these requirements will help ensure that the appraisal is prepared by an independent third party with the experience, competence, and knowledge necessary to provide an accurate and objective valuation based on the property's actual physical condition."

However, NAHB is concerned that the Agencies are suggesting reducing the customary time for appraisals to be valid. In Subpart D (d)(11) the Agencies specify that a creditor must obtain "a written appraisal of the property securing the mortgage that was performed not more than 90 days prior to the closing of the mortgage transaction…" Currently the Federal Housing Administration, Fannie Mae and Freddie Mac have validity periods of 120 days, with processes for extending the period, which are already insufficient time periods for new home construction.

The Interagency Appraisal and Evaluation Guidelines determined that "the Agencies should allow an institution to use an existing appraisal or evaluation to support a subsequent transaction in certain circumstances." Therefore an institution should establish criteria for assessing whether an existing appraisal or evaluation continues to reflect the market value of the property (that is, remains valid). Such criteria will vary depending upon the condition of the property and the marketplace and the nature of the transaction."[15] NAHB suggests the Agencies follow their prior guidance and allow the institutions to determine the correct validity period for appraisals and that the institutions absolutely evaluate the "nature of the transaction" and provide home builders with sufficient timeframes for new construction.

NAHB also suggests the Agencies develop streamlined appraisal requirements for refinance transactions under certain limited circumstances. This flexibility in appraisal requirements will be an important resource for lenders to quickly assist qualified consumers who have been affected by the housing crisis and assist those homeowners who are in financial need that have behaved responsibly in handling their mortgage and other financial obligations avoid foreclosure.

Additional Valuation Approaches and Qualifications be Considered: The Agencies request comment on other valuation approaches to be considered in Question 122. The three approaches to valuation (Sales Comparison, Cost and Income) provide appraisers different methodologies to determine the value of a property. NAHB is of the opinion that the cost approach is underutilized and believes the Agencies should evaluate how the different methodologies are currently used and how all the approaches can be better applied to specific situations. For example, more complex appraisal approaches are needed for appraisals involving extreme economic conditions, new construction, and energy efficient valuations. Incorporating the cost approach could prove to be a particularly valuable method for establishing an accurate value of a newly constructed home built with energy efficient methods and technologies, upgrades, over-sized lots, and other improvements to the structure.

NAHB supports the Agencies' belief that the appraiser have the experience, competence, and knowledge necessary to provide an accurate and objective valuation. NAHB is concerned that a significant number of appraisers lack the required experience and knowledge required to establish values for residential lots and new home construction, and this lack of appraiser expertise in new home construction has resulted in inaccurate appraisals of newly built homes. NAHB encourages the establishment of minimum educational and experience qualifications for appraisers of new construction to ensure that lot values and building costs,

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[15] Interagency Appraisal and Evaluation Guidelines, Section XIV Validity of Appraisals and Evaluations, 75 Fed. Reg. 77461 (December 10, 2010)

including those for green building and other evolving new construction techniques, are fully considered in the valuation of new home construction.

An important element of solid underwriting principles is a full and accurate appraisal. NAHB has been at the center of appraisal issues, holding three Appraisal Summits in 2009 and 2010 and will hold a fourth Appraisal Summit in October 2011. NAHB has learned over these last few years that the way homes are valued can have a dramatic effect on home owners' mortgages, foreclosure rates, the health of banks and, ultimately, the condition of the U.S. economy. We would like to continue to work with the Agencies and industry stakeholders to find viable solutions to continuing problems in home valuations.

Loan Products

NAHB does support the Agencies proposal that certain mortgage products be prohibited from the QRM definition, such as interest-only payment terms and negative amortization loans. According to FHFA[16], for the 2005-2007 origination years, the requirement for product-type (no non-traditional and low documentation loans, or loans for houses not occupied by the owner) was the QRM risk factor that most reduced delinquency rates. These restrictions also are consistent with the QM provisions in the Dodd-Frank Act.

Impact on Government Housing Programs

The Act "exempts from the risk retention requirements any residential, multifamily, or health care facility mortgage loan asset, or securitization based directly or indirectly on such an asset that is insured or guaranteed by the United States or an agency of the United States." This exemption includes government housing programs administered by the Federal Housing Administration (FHA), U.S Department of Veterans Affairs (VA) and the U.S. Department of Agriculture's (USDA) Rural Development agency. These programs will undoubtedly be impacted by an overly narrow definition of a QRM, as borrowers who do not meet the QRM criteria would move to these programs in large numbers. This would unnecessarily move a significant number of mortgages from the private sector to the government, which would be counter-productive to a housing recovery.

NAHB believes the assumption that first-time home buyers and low-income borrowers would continue to have access to mortgages through these government housing programs may be overly optimistic. Recent changes to these programs have been proposed that may further limit the availability of credit. For instance, FHA has already implemented a series of policy changes over the past two years, including: restructuring FHA mortgage insurance premiums (MIP); underwriting changes, including updating credit score/downpayment guidelines; increasing lender enforcement; and strengthening condo guidelines. In addition, FHA published a Notice in July 2010[17], proposing to reduce seller concessions from six percent to three percent. Seller concessions are an important tool for providing access to

[16] Federal Housing Finance Agency, Mortgage Market Note 11-02, April 11, 2011
[17] Federal Housing Administration Risk Management Initiatives: Reduction of Seller Concessions and New Loan-to-Value and Credit Score Requirements, Fed. Reg. 75, 41217 (July 15, 2010)

affordable homeownership by reducing the upfront monies required. This rule has not yet been finalized, but a reduction in the limit on seller concessions will have a particularly negative effect on housing opportunities for first-time homebuyers.

Another example of more restrictions on government housing programs is the USDA announcement[18] that it will be raising fees on its Single Family Housing Guaranteed Loan Program (SFHGLP). For Fiscal Year (FY) 2012, an annual fee of 0.3 percent of the outstanding principal balance will be required in order that the SFHGLP may achieve subsidy neutrality. Rural Development is in the process of adopting a rule effective with loans obligated on or after October 1, 2011, under which all loan transactions will be subject to the annual fee. This change will increase the cost of borrowing for low-income and first-time home buyers.

Furthermore, without Congressional action the loan limits for FHA, Fannie Mae and Freddie Mac will be reduced beginning October 1, 2011 in many high cost areas. While NAHB is supportive of maintaining the higher loan limits, the upcoming scheduled change is an example of the government's attempt to reduce its footprint in the mortgage market potentially limiting the cost and availability of mortgage credit.

Many first-time and low- to moderate-income borrowers are likely not to meet the stringent QRM standard and may also not be eligible for the more restrictive government housing programs. The result will be that many creditworthy borrowers will not have any safe, affordable option for purchasing a home, which may have the unintended consequence of driving these borrowers into riskier product options with unfavorable payment terms and higher interest rates and fees.

<u>Cost of QRM</u>

Borrowers who cannot afford to put 20 percent down on a home and who are unable to obtain financing through a government program will be expected to pay a premium in the private market to offset the increased risk to lenders. As per the statute, loans that do not meet the stringent definition of a QRM will carry the burden of risk retention resulting in added costs for non-QRM mortgage loans that will be not be applied to QRM loans. The costs of retaining capital will undoubtedly be passed along to the borrower. While this cost differential is a widely accepted premise, the premium for a non-QRM loan is yet unknown.

Since the Agencies released the proposed rule, many entities have published estimates of the cost differential between a QRM and non-QRM loan, and these estimates vary by wide margins. For instance, the National Association of Realtors[19] estimates that non-QRM loans will cost as much as 80 to 185 basis points more than QRM loans. Moody's Analytics[20] estimates that a non-QRM 30-year fixed-rate mortgage will cost 75 to 100 basis points more than a QRM loan. NAHB economists

[18] Rural Development, Administrative Notice No 4551, February 3, 2011
[19] Coalition for Sensible Housing Policy, *Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery.* sensiblehousingpolicy.org, p. 8
[20] Mark Zandi and Cristian deRitis, Moody's Analytics Special Report, *Reworking Risk Retention*, June 20, 2011.

estimate the premium on a non-QRM loan to be 200 basis points[21]. FDIC estimates this difference will be less than half a percentage point. [22]

These varying estimates indicate that uncertainty persists throughout the market, and this uncertainty continues to undermine a housing recovery. The difference in opinions among recognized experts clearly shows that we are in unchartered waters. No one knows for sure how the market will price the non-QRM securities, but these added costs will be borne by those who can least afford it.

Fair Lending Concerns

NAHB is very concerned that the proposed narrow QRM standard will disproportionately affect borrowers with lower incomes and could have a disparate impact on minority consumers. These results may run afoul of existing fair lending requirements including the Fair Housing Act.[23] The impact of these requirements on the availability of mortgages to minority borrowers has not been adequately examined under the proposed regulations. Because minority borrowers generally have lower incomes and net worth than non-minority households, they are less likely to be able to save for the downpayment required for the average home. This will result in significantly lower homeownership rates among minority households. Because even creditworthy minority borrowers may not qualify for a QRM, they may find themselves disproportionately unable to obtain an affordable mortgage.

This may lead to the resurgence of “redlining” by lenders—denying mortgages to minority communities based on their racial composition. It is well-accepted that “the practice of denying the extension of credit to specific geographic areas due to the income, race, or ethnicity of its residents,” may violate federal civil rights laws, including the Fair Housing Act.[24]

Notably, the administration’s recent Housing Finance Reform Report emphasized the need to maintain housing finance availability to creditworthy borrowers in a variety of communities[25]. The report states that the administration will “work with Congress to ensure that *all* communities and families—including those in rural and economically distressed areas, as well as those that are low- and moderate-income—have the access to capital needed for sustainable homeownership . . .”[26] In other words, the federal government will continue to ensure that lenders are meeting their legal obligations to serve all communities. Thus, it is important that the Agencies reconcile

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[21] NAHB Press Release, *Twenty Percent Downpayment Rule Would Disrupt First-time Home Buyer Market*, March 29, 2011
[22] Government Accountability Office Report to Congressional Committees, *Mortgage Reform: Potential Impacts of Provisions in the Dodd-Frank Act on Homebuyers and the Mortgage Market*, July 2011
[23] The Fair Housing Act prohibits businesses engaged in residential real estate transactions, including “[t]he making… of loans or providing other financial assistance…secured by residential real estate,” from discriminating against any person on account of race. 42 U.S. C. § 3605(a), (b)(1)(B).
[24] *See United Cos. Lending Corp. v. Sargeant,* 20 F. Supp. 2d 192, 203 n. 5 (D. Mass. 1998) (citing S. Rep. No. 103-169, at 21 (1993)); *Swanson v. Citibank, N.A., et al.,* 614 F.3d 400, 405 (7th Cir. 2010) (holding that plaintiff had properly stated a Fair Housing Act claim for bank’s refusal to underwrite her loan).
[25] *Reforming America’s Housing Finance Market, A Report to Congress A Report to Congress* (February, 2011).
[26] *Id.* at 21.

the potential effect of the proposed QRM requirements with their intent and mandate to further affordable housing and fair lending goals. Prior to finalizing this rule, the Agencies should carefully consider the likelihood that the proposed QRM requirements could result in an influx of challenges under fair lending laws.

QRM Summary

NAHB supports a broad QRM definition that will encompass the bulk of residential mortgages that meet the lower risk standards of sound underwriting and restrictions on risky loan features. In addition, loans with lower downpayments with risk mitigating features, most notably mortgage insurance, should be included in the QRM exemption. To define QRM any narrower will likely deny mortgage credit to many qualified borrowers and irresponsibly impair the housing market and economic recovery.

Commercial Real Estate

The proposed rule covers all forms of assets that can be securitized, including commercial real estate (CRE), commercial loans and automobile loans. The proposed rule defines CRE loans as those secured by five or more residential units or by non-farm, non-residential real property, with the primary source of repayment to be derived from rental income or from the proceeds of the sale, refinancing, or permanent financing of the property. Land development and construction loans, loans on raw or unimproved land, loans to real estate investment trusts (REITs) and unsecured loans are excluded.

As required by the Dodd-Frank Act, the proposed rule sets forth the underwriting standards for what is presumed to be a low-risk loan; that is, a qualified commercial real estate loan (QCRE). Commercial mortgage backed securities (CMBS) that consist of QCRE loans would not be required to meet the five percent risk retention requirements.

Implications for Multifamily and Other CRE Finance

The structuring of risk retention requirements for CRE loans will have a significant impact on the CMBS market. While the CMBS market has only begun a modest recovery, at some point, it will once again be an important component of the commercial real estate finance market, including financing for multifamily rental properties. Portfolio lenders and life insurance companies do not have the capacity to meet the entire commercial market's demand for capital. Banks are limited by their balance sheets in the amount of CRE loans that can be held in portfolio. In addition, with the future of the government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac in flux and FHA struggling to meet the increased demands on its multifamily mortgage insurance programs, the importance of CMBS for multifamily cannot be overlooked.

The proposed standards and requirements will impact both new loans and existing loans in CMBS issues that need refinancing. Billions of dollars in CRE loans in CMBS will require refinancing in the next five years. Thus, it is important that the risk retention rules be structured to facilitate a liquid and functioning CMBS market, but one that is safe and transparent.

A key concern of NAHB is that risk retention requirements are structured to minimize the impact on borrower financing costs. The cost to borrowers of risk retention is unknown. Opinions range from very little expected additional cost to dramatic increases if the proposed risk retention structure is not modified to address a wide range of issues. To the extent that risk retention requirements raise multifamily financing costs, there will be an impact on rents. Higher rents have an immediate impact on renter households' budgets, but for aspiring homeowners, higher rents also mean that it will take longer to save for a downpayment on a home. In addition, for other types of commercial properties, higher rents affect companies' ability to grow, thus negatively impacting job creation.

<u>NAHB Comments on Proposed CRE Standards</u>

The proposed rule sets the following standards for a QCRE:

- Debt service coverage (DSC) of at least 1.7, although 1.5 would be permitted for properties with a demonstrated history of stable net operating income (NOI) over the past two years. To qualify for the lower DSC, the property must be residential with at least five units, and 75 percent of its NOI must be from residential rents.
- The combined LTV (CLTV) cannot be more than 65 percent. If the cap rate used in the appraisal is less than the 10-year interest rate swap rate plus 300 basis points, the maximum LTV is 60 percent to mitigate the effect of an artificially low cap rate.
- Fixed interest rate loans only; adjustable rates would be permitted if the borrower obtains a derivative product that effectively results in fixed-rate loan payments.
- Maturity must be at least 10 years.
- The loan payment amount must be based on a straight-line amortization over the term, not to exceed 20 years, with monthly payments for at least 10 years.

The Agencies state in the proposed rule that the vast majority of CRE loans will <u>not</u> meet the proposed underwriting standards for a QCRE loan. A paper released by Morgan Stanley states that if just three of the standards (the DSC, LTV and 20-year term) had been in effect over the years, only 0.4 percent of the conduit loans that have been securitized since the beginning of the CMBS market would have qualified. Thus, if implemented as proposed, most CMBS will require the full five percent risk retention.

NAHB does not support the proposed QCRE standards, because an overwhelming majority of loans will not be able to meet them. NAHB does not understand the purpose of proposing standards that exclude nearly all the loans in the market. NAHB does not object to a conservative approach to establishing the standards for QCRE loans, but we do object to an unreasonably stringent standard that results in a *de minimis* volume of QCRE loans. Adherence to a "one-size fits all" prescribed set of underwriting requirements that apply to a wide range of asset types does not guarantee that the loans will be "low-risk."

NAHB's specific comments are presented below.

Differentiate Asset Types

There is no distinction among the different asset types included in CRE loans; all assets (hotel, retail, multifamily, office, etc.) would have to meet the proposed underwriting requirements to be classified as a QCRE loan. However, comparing office, retail, hotel, industrial and multifamily loans to each other for underwriting purposes is not appropriate, given the significant differences among these asset classes in terms of property features, lease structures, tenant characteristics, etc. This "one-size fits all" approach places burdens on multifamily loans that is not justified, as these loans typically have more predictable cash flows and thus lower debt service coverage requirements compared to other commercial loans. The asset classes should be differentiated, and appropriate underwriting standards developed for each class.

Revise Underwriting Standards for the QCRE Loans

As mentioned above, the underwriting standards for QCRE loans are so stringent that even the Agencies state that most CRE loans will not meet them and, thus, the vast majority of CMBS will be subject to the five percent risk retention. Setting the standards in this manner does not incent originators to make low-risk loans because, as proposed, almost no loans can meet the requirements.

NAHB believes that the QCRE underwriting standards should be realistic and achievable and provide for a reasonable share of the CMBS market – not zero share. The Agencies should look to industry standards for performing properties as the basis for QCRE loans. The Agencies should undertake an analysis of the characteristics of performing properties in each asset class included in CMBS and set a QCRE standard for each based on its findings.

Multifamily Loans. Assuming multifamily assets are differentiated from other CRE asset classes, Fannie Mae's and Freddie Mac's (the "Enterprises") multifamily portfolios have performed extremely well, with default rates generally below one percent. The Enterprises have a track record of discipline in underwriting multifamily loans of all types and sizes. These standards meet the FHFA's requirements for safety and soundness, are transparent and ensure the flow of adequate capital for multifamily financing. For multifamily loans, underwriting standards similar to those applied by the Enterprises would prevent the reoccurrence of the large number of failures of multifamily loans that were not underwritten prudently in previous CMBS issues.

The proposed QCRE underwriting standards for debt service coverage and LTV requirements for multifamily loans should be revised to comport more generally with the Enterprises' underwriting standards. The Enterprises set DSC requirements based on multiple factors, including property type (targeted affordable, conventional rental, seniors, etc.) and geographic location. Thus, DSC may range from 1.15 to 1.40. Similarly, the Enterprises' LTV requirements vary, again depending on various factors including property type, geographic location, and term of the loan (e.g., five or seven years), thus ranging from 65 to 80 percent.

NAHB is not suggesting that the Agencies adopt the Enterprises' minimum standards, nor are we suggesting that the QCRE standards should conform exactly to the Enterprises' standards at any point in time. Rather, the Agencies should do a more thorough analysis of what factors should be considered in setting standards for "low-risk" loans using the Enterprises' performing portfolio as a guide.

Multifamily and Other CRE Loans. There should be no restrictions on floating interest rates, except to require an interest rate cap approved by the lender that would limit increases in debt service to a level that could continue to be supported by the property's income.

The amortization period for typical multifamily and commercial properties is 30 years, not 20 years, which is too short and would result in unnecessarily large monthly mortgage payments, which would push rents to unsustainable levels. Maturity dates of three, five and seven years are also industry practices, in contrast to the proposal requiring a maturity date of at least ten years following the closing date of the loan.

NAHB believes that the proposed requirements for DSC, LTV, floating interest rate, amortization term, and maturity date need to be modified as suggested above.

Allow Subordinate Financing

The proposed rule would prohibit a borrower from obtaining a loan secured by a junior lien on any property that serves as collateral for the CRE loans, unless such loan finances the purchase of machinery and equipment which are pledged as additional collateral for the loan. The proposed rule fails to consider that many multifamily and other commercial loans use multiple layers of financing, and it is not unusual to have subordinate loans. With such a restriction, borrowers could have trouble refinancing, repositioning properties or upgrading to higher energy efficiency standards. NAHB suggests that the Agencies revise this prohibition to allow for such circumstances.

Revise Ability to Repay Look Ahead

As proposed, the originator must conduct an analysis of the borrower's ability to repay all outstanding debt obligations over the two-year period following the origination of the loan, based on reasonable projections and including the new debt obligation. Most CRE loans, including multifamily, are non-recourse and thus it is not relevant to conduct this type of analysis. NAHB believes this requirement should be eliminated.

Allow Commingling of Qualified and Non-Qualified Commercial Loans

The Agencies have proposed a zero percent risk retention requirement only for asset-backed securities collateralized exclusively by commercial loans from qualifying loan exemptions as outlined in the proposed rule. A full five percent will have to be retained for securities that contain both qualified and non-qualified loans. NAHB believes that this requirement will negatively affect small and medium-sized banks as it will take too long to accumulate the volume of loans needed to undertake separate issuances. The five percent risk retention could be apportioned on a pro-rata basis, given the mix of qualifying and non-qualifying loans. Allowing such commingling would also reduce the pricing cliff effect between qualified and non-qualified loans.

Proposed Treatment of Fannie Mae and Freddie Mac

The Agencies specified that loans sold to Fannie Mae and Freddie Mac (the "Enterprises") will not be included in the risk retention requirement while they remain in conservatorship with explicit federal backing. NAHB supports the Agencies' determination that the Enterprises are already satisfying the proposed risk retention requirements. This determination will cushion the blow on the residential mortgage market and multifamily and commercial development.

The proposed rule states that the guaranty provided by an Enterprise while operating under the conservatorship or receivership of FHFA with capital support from the United States will satisfy the risk retention requirements of the Enterprise under section 15G of the Exchange Act with respect to the mortgage-backed securities issued by the Enterprise. This finding would also extend to an equivalent guaranty provided by a limited-life regulated entity that has succeeded to the charter of an Enterprise, and that is operating under the direction and control of FHFA under section 1367(i) of the Safety and Soundness Act, and will satisfy the risk retention requirements, provided that the entity is operating with capital support from the United States.

However, the rule goes further to say that "if either Enterprise or a successor limited-life regulated entity were to begin to operate other than as provided in the proposed rules, that Enterprise or entity would no longer be able to avail itself of the credit risk retention option…"

NAHB believes that it is premature to make a judgment on how a yet-to-be-determined "successor" entity should be treated under the risk retention rule. The future structure of the government-sponsored enterprises (GSEs) is still unknown. The administration released a high-level white paper which included three distinct options. There are several pieces of legislation introduced in this Congress that offer a wide range of options for new structures to succeed the Enterprises. Also, many industry stakeholders, including NAHB, have proposed ideas and recommendations for a successor to the current GSE structure. For the Agencies to prejudge how a new entity (or entities) should be treated with respect to risk retention rules is inappropriate.

While the statute does specify "the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation," the Act does not specify a "successor entity." NAHB appreciates that the Agencies plan to revisit the proposed rules after the future of the Enterprises becomes clearer, and NAHB urges the Agencies not to make a premature determination of how a currently undefined entity will be required to manage risk retention requirements.

State Housing Finance Agencies

NAHB appreciates that the proposed rule exempts loans and securities issued by states or any public instrumentality of a state, including housing bonds issued by state and local housing finance agencies (HFAs). NAHB suggests that this exemption and the QRM definition be broadened to include all mortgages financed by HFAs and the securities backed by such mortgages. As HFAs increasingly finance loans through a variety of means in addition to traditional mortgage revenue bonds, these mortgages also exhibit the same strong underwriting, responsible servicing, and strict oversight that form the basis for the proposed rule's municipal bond exemption. As HFAs continue to employ and expand such non-traditional financing methods to advance sustainable affordable homeownership opportunities, the risk retention exemption and QRM definition should support such efforts.

Risk Retention Structure and Requirements

NAHB's principal concern is the impact of risk retention on borrowers, but we believe it is in the best interest of all parties to ensure that the risk retention structure works effectively for all parties. The proposed rule provides for a variety of options that may be used by the securitizer to satisfy the risk retention requirements. Each of the proposed permitted forms of risk retention is subject to terms and conditions that the Agencies believe will help ensure that the sponsor or other eligible entity retains an economic exposure equal to at least five percent of the credit risk of the securitized assets. NAHB believes that the variety of proposed options to meet the risk retention requirements is positive, particularly the provision allowing for a third-party purchaser of the risk for CMBS, commonly referred to as the B-piece buyer. The B-piece buyer would retain the necessary first loss exposure to the underlying assets, instead of the sponsor of the CMBS transaction.

The Agencies should also consider allowing the risk retention structures currently used by the Enterprises in their multifamily programs; that is, the Fannie Mae Delegated Underwriting and Servicing Program and Freddie Mac's Program Plus and Multifamily K Certificate programs. Both Enterprises have a steady and successful track record in the multifamily market, and their securities are viewed as safe and desirable by investors. As mentioned previously, the Enterprises' multifamily portfolios have default rates of less than one percent, which is a compelling reason to give such risk structures consideration.

However, NAHB does have serious concerns about several of the risk retention proposals, the most important of which is the requirement to establish a premium capture cash reserve account (PCCRA). Other concerns are related to the B-piece buyer option for risk retention. There are numerous conditions which must be met by the B-piece buyer, some of which are viewed by industry stakeholders as unworkable.

NAHB's specific comments are as follows:

Eliminate the Premium Capture Cash Reserve Account (PCCRA)

The Agencies' concern that securitizers may try to compensate for the extra cost of risk retention by raising fees has prompted the proposed establishment of the PCCRA. Mortgage securitizers charge borrowers a higher interest rate than what is paid to the bond investors who purchase the securities. This excess spread covers the cost of originating and servicing the mortgages, helps build reserves used to cover defaults, and provides a return to the securitizers. Prior to the financial crisis, sponsors monetized the excess spread by selling premium or interest-only (IO) tranches to investors, thereby collecting the full discounted stream of income up front, even though the excess spread is collected over the life of the securities.

The Agencies state that, to achieve the goals of risk retention, they propose to adjust the required amount of risk retention to account for any excess spread that is monetized at the closing of a securitization transaction. The Agencies state that, otherwise, a sponsor could effectively negate or reduce the economic exposure it is required to retain under the proposed rule. The PCCRA would contain any excess spread amount immediately recognized as a gain on the sale of the underlying assets by the sponsor and does not allow the sponsor to monetize the spread in the form of premium gross proceeds or interest only (IO) bonds. The funds in the PCCRA would be subordinate to the other risk retention piece and would be used to cover losses. The PCCRA was not included as a requirement of risk retention in the Dodd-Frank Act.

There is wide-spread industry concern about the PCCRA requirement. Bank of America, in their comment letter to the Agencies on the proposed rule, estimates that the additional cost to borrowers directly attributable to the requirements of establishing the PCCRA would be almost 300 basis points[27]. There are accounting and capital implications that the Agencies have not taken into consideration in fashioning the PCCRA, which together have great potential for eliminating any incentive to securitize residential and commercial loans. If banks cannot or choose not to securitize because of the cost, and they are limited in what can be held on their balance sheets, liquidity in the finance markets will become constrained, driving up the costs of borrowing and limiting borrowers' access to credit. This is not the desirable outcome of risk retention.

The premium capture rule also fails to consider the costs associated with originating loans including hedging of interest rates during the period between the origination of a loan and its securitization. The inability to recapture this cost upfront would have a direct and adverse impact on consumers as the costs of hedging could prevent originators from offering consumers the ability to lock their loan rate at the time of application or if they do so at a substantially higher cost to the consumer. This could be devastating in a rising interest rate environment especially considering QRM's currently proposed inflexible underwriting guidelines. Ultimately, the outcome is higher costs to all consumers, particularly low- to moderate-income borrowers.

NAHB strongly urges the Agencies to eliminate the PCCRA. As proposed, the PCCRA has the potential to make 30-year fixed rate mortgage less attractive to

[27] Bank of America, *Comments on Credit Risk Retention Proposed Rule,* July, 13, 2011.

lenders and securitizers[28] and thereby, less available to borrowers. Although the Agencies were trying to address the potential for a securitizer to get around the risk retention requirement, in the end the PCCRA may only hurt home buyers by limiting mortgage options, increasing the cost of home financing and ultimately frustrating any chance for a housing recovery.

Modify Conditions for Third-Party Purchaser

The Agencies proposed that a third-party purchaser may not be affiliated with any other party to the transaction and cannot have control rights (such as acting as servicer or special servicer) unless there is an independent operating advisor (IOA). The IOA would be given the authority to take certain actions, which could cause conflict between it and the third-party buyer. For example, the IOA can recommend that the special servicer be replaced, and this decision can only be overturned if a majority of investors, in each class, votes to retain the servicer. Many industry experts believe that the IOA's role and responsibilities should be revisited to eliminate potential conflicts while ensuring that the intent of the IOA remains viable. NAHB urges the Agencies to consider how to modify the provisions related to the IOA accordingly.

Revise Prohibitions on the Transfer of the Retained Risk

The proposed rule would essentially require a B-piece buyer to hold its retained risk interest for the life of the securities. NAHB believes that this requirement will have a significant impact on the cost of risk retention. We suggest that the Agencies reconsider this requirement and instead allow for transfer to other qualified sponsors and establish a reasonable holding period.

Modify Conditions for Sharing of Risk Retention

The proposed rule permits a securitizer to offset (reduce) its risk retention amount by the amount of the asset-backed security interests or eligible horizontal residual interest, respectively, acquired by an originator of one or more of the securitized assets. However, the originator must acquire and retain at least 20 percent of the aggregate risk retention amount otherwise required to be retained by the sponsor, but the originator's share cannot be more than its pro-rata share of the CMBS. This requirement could negatively affect smaller mortgage originators who may not be able to produce enough loans between planned issues to meet the 20 percent requirement. This requirement should be revisited.

Conclusion

The proposed rule has far-ranging implications across the housing and development sectors. Each aspect of the proposed rule will have a significant impact. The narrow definition of a Qualified Residential Mortgage (QRM) would have a severe adverse impact on the availability and cost of residential mortgages. The proposed requirements on Qualified Commercial Real Estate (QCRE) loans would be virtually

[28] Mark Zandi and Cristian deRitis, Moody's Analytics Special Report, *Reworking Risk Retention*, June 20, 2011.

impossible to meet and would have a wide-spread and detrimental impact on financing the development of multifamily and commercial properties. The premium capture cash reserve account (PCCRA) has the potential to distort the securitization market and create a disincentive for private investors.

NAHB urges the Agencies to follow Congressional intent and define QRMs in a manner consistent with the above-noted time-tested criteria to ensure that qualified borrowers are not excluded from the QRM definition. A broadly defined QRM is essential to the housing recovery and long-term health of the housing finance markets. NAHB strongly urges against unnecessary limits that have not been proven in ensuring a healthy housing finance industry. Unnecessary constraints on the QRM exemption will irresponsibly provide a more costly mortgage market and reduce mortgage capital access.

NAHB appreciates the opportunity to comment on the Agencies' Proposed Rule on Credit Risk Retention. If you should have any questions about our comments or would like additional information, please contact Jessica Lynch, NAHB's Assistant Vice President of Regulatory Affairs, at 202-266-8401 or jlynch@nahb.org.

Sincerely,

David L. Ledford
Senior Vice President
Regulatory Affairs

Attachments (2)