

**NATIONAL ASSOCIATION OF REALTORS®  
ENHANCED SUBPRIME LENDING POLICY**

**April 12, 2007**

**I. NAR's 2005 Subprime Lending Policy**

NAR supports (a) keeping fair and affordable mortgage products available for borrowers with imperfect credit and (b) eliminating problematic loans that are made without sufficient regard to whether the borrowers can afford them and that too often lead to foreclosure. On May 14, 2005, NAR's Board of Directors approved a subprime lending policy that takes a three-pronged approach:

- **Support Stronger Anti-Predatory Lending Legislation and Regulations.**  
NAR supports a detailed list of improvements to the Home Ownership and Equity Protection Act of 1994 (HOEPA). While NAR recognizes that not every item on the list will be included in legislation or regulations, NAR will only support proposals that take a strong stand against predatory lending.
- **Foster Consumer Education.**  
NAR encourages REALTORS® to:
  - Help consumers to locate and qualify for fair and affordable financing, as early as possible in the process, by working with existing programs and community groups.
  - Refer consumers to information about financial literacy in general and about how to avoid predatory lending in particular.
  - Refer consumers, where appropriate, to reputable counseling organizations that provide credit and homebuying information and advice.
- **Build on the Public Awareness Campaign.**  
NAR's public awareness campaign includes as a key message: "Talk to a REALTOR® First." REALTORS® should use their central position in the home purchase transaction to help consumers become more financially literate and avoid predatory lending.

This enhancement builds on, and is consistent with, the 2005 policy.

**II. Why Do REALTORS® Seek to Prevent Abusive Lending?**

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.

- To the extent the response to abusive lending constrains the ability of the secondary mortgage market to provide liquidity for home finance, consumers will find it more difficult and expensive to buy a home.
- 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.

### **III. Need to Enhance NAR Policy**

Everyone interested in homeownership has seen recent media coverage publicizing the poor performance of subprime and Alt-A mortgages (including hybrid adjustable rate mortgages (ARMs)—2/28s and 3/27s, payment option ARMs, interest-only mortgages, stated income underwriting, and no downpayment mortgages). Consumer advocates and public policy makers have asserted that the poor performance of these subprime loans could have been avoided if mortgage brokers and lenders had safer underwriting standards. The media reports have also covered efforts by federal regulators and Congress to develop new regulations and laws to prevent abusive subprime lending practices.

Facing a projected 2.2 million American households losing their homes and as much as \$164 billion due to foreclosures in the subprime mortgage market,<sup>1</sup> the public policy debate has grown far beyond how to fix HOEPA. This enhanced policy statement builds on NAR's 2005 policy to address underwriting of subprime mortgages in general, enforcement, and foreclosure avoidance and mitigation.

While some in the media may have over-dramatized the situation, the basic facts are not in dispute. A number of subprime lenders that made problematic loans have gone out of business. The delinquency rate for subprime loans is more than 13 percent and 4.5 percent are in foreclosure. Wall Street investors are now requiring better underwriting and increasing the pricing for subprime loans. Federal and state banking regulators have issued guidelines to tighten the underwriting standards for nontraditional mortgages and recently proposed similar guidelines for subprime mortgages. Finally, a number of Members of Congress, including House Financial Services Chairman Barney Frank and Senate Banking Committee Chairman Chris Dodd, have indicated a willingness to enact new laws to protect consumers from irresponsible lenders.

### **IV. 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 legislators to use such a standard of care as a guiding principle when drafting anti-predatory lending legislation rather than using the phrase to create a new federal duty that would be too general and, therefore, too difficult to enforce.

---

<sup>1</sup> Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners, Center for Responsible Lending (December 2006).

**A. Affordability.** NAR supports strong underwriting standards that require all mortgage originators to verify the borrower's ability to repay the loan based on all its terms, including taxes and insurance, without having to refinance or sell the home.<sup>2</sup> 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.<sup>3</sup>

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.

- The federal and state banking regulators have proposed guidelines providing for underwriting of subprime mortgages at a fully amortizing payment using a fully indexed rate.<sup>4</sup> Freddie Mac has already announced it will only buy subprime adjustable rate mortgages that are underwritten at the fully-indexed and fully-amortizing rate, for mortgages originated on or after September 1, 2007.
- Congress, the regulators, the government-sponsored enterprises (the GSEs—Fannie Mae and Freddie Mac), and lenders are in the best position to identify the most appropriate standard, after what will no doubt be a vigorous public policy debate.

---

<sup>2</sup> 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.

<sup>3</sup> 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.

<sup>4</sup> A fully amortizing payment is a payment that results in paying off the balance of the loan at the end of its term, without a balloon payment or negative amortization. A fully indexed payment is the payment that applies after the expiration of the teaser rate, based on the index plus the applicable margin (it may take several adjustments after expiration of the teaser rate to reach the fully indexed payment because of caps on payment increases).

- NAR believes it is abusive to underwrite subprime loans that include potential “payment shock” based solely on the initial payment amount under the loan.
- **Reasonable Debt-to-Income Ratio.** NAR supports requiring lenders to make subprime loans that have a reasonable debt-to-income ratio. Borrowers should have enough residual income after making their monthly mortgage payment, including taxes and insurance, to meet their needs for food, utilities, clothing, transportation, work-related expenses, and other essentials. Requiring underwriting at a fully amortizing, fully indexed rate is meaningless if the lender uses such high debt-to-income ratios that the family doesn’t have enough income remaining to pay for other necessities.
- **Escrow/Reserve for Payment of Taxes and Insurance.** Lenders that make subprime mortgage loans should generally require that the monthly payment include an amount to be held by the mortgage servicer in an escrow/reserve/impound account for the payment of the borrower’s periodic payments, such as taxes and insurance. Similar to the exception for prime loans in some jurisdictions, borrowers that make at least a 20 percent downpayment should have the option to budget for these payments independently.

**B. 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. The main exception should be for borrowers whose incomes derive from hard-to-verify sources (such as self-employed borrowers and borrowers in the “cash economy”).

**C. Flexibility for Life Circumstances.** NAR believes that a standard for determining a borrower’s ability to repay must be flexible to accommodate borrowers with unique circumstances, such as:

- Borrowers who have demonstrated the ability to make monthly payments, over a long term, that are higher than underwriting standards would otherwise allow. Lenders should consider, for example, the borrower’s history of making rent and student loan payments.
- Borrowers with high assets but low income who, for cash management or other financial planning reasons, elect a mortgage with a monthly payment that their current income is not sufficient to cover.
- Borrowers who anticipate a jump in income or assets due to life events such as graduation, completion of professional training, completion of payment obligations for student or car loans, another member of the household entering the work force when young children start school, or an inheritance.

**D. 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.

**E. Bar Prepayment Penalties.** Under the 2005 policy, 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. If complete prohibition of prepayment penalties is not feasible, NAR supports permitting prepayment penalties for the shortest time and the lowest amount possible. For example, a borrower in a 2/28 mortgage should be able to refinance at the end of the initial two-year “teaser” rate period without having to pay a prepayment penalty.

**F. Alternative Factors for Measuring 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. Even if such a borrower is able to qualify for a mortgage, it may be one that has negative amortization or provides for a significant jump in payments after an initial teaser rate period. NAR supports ongoing efforts to take into account consumer payment history not typically considered, such as rent, utility, telephone, and other regular payments and urges HUD, the regulators, the GSEs, and lenders to work to strengthen these efforts. Use of alternative credit approaches will be especially beneficial for low- and moderate-income first-time homebuyers and borrowers with problematic loans that need to refinance their mortgage to avoid foreclosure.

**V. Mortgage Choice for Borrowers.** NAR supports requiring mortgage originators to offer borrowers one or more mortgages with interest rates and other fees that appropriately reflect the borrower’s credit risk. It remains the responsibility of borrowers to decide which is the best mortgage for their needs and circumstances, but they may only do so if they understand all the facts so they can make an informed decision. The following are suggested principles for consideration of Congress and the regulators:

- For originators who offer nontraditional mortgage products, the originator should:
  - offer all borrowers a choice of several significantly different mortgage options;
  - include at least one traditional loan product as one of the options for the borrower to consider, if the borrower qualifies for such a product offered by the originator; and
  - before application acceptance, disclose information about the maximum potential payment over the life of the loan and the date the initial payment will increase to a fully amortizing, fully indexed payment amount.
- For subprime borrowers, originators that offer FHA-insured mortgages or VA home loan guaranty mortgages should consider whether these types of mortgages should be offered as an appropriate option.

- If the originator does not offer mortgages with rates and fees appropriate for the borrower's credit risk, the originator should inform the borrower a lower interest rate may be available from another originator or that the borrower may wish to seek housing counseling, to allow the borrower an opportunity to shop elsewhere or receive counseling before proceeding. For example, a prime borrower that applies for a loan to a lender that only makes subprime loans should be advised that other options may be available.
- For loans originated by a mortgage broker, the broker should offer mortgage options that are among the lowest-cost products appropriate for the borrower.

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

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

**VII. GSE, FHA, and VA Loans.**

- **Regional Adjustments to GSE Conforming Loan Limits (and, Indirectly, FHA and VA Loan Limits)** NAR supports legislation to authorize regional adjustments to Fannie Mae and Freddie Mac conforming loan limits for high cost metropolitan areas as a matter of simple equity for American families residing in these markets.
  - The current cap on the size of mortgages that the GSEs can purchase makes it harder for families in high cost markets to own their own homes because it restricts their access to low cost, low downpayment mortgages.
  - Regional adjustments will help more low- and moderate-income working families qualify for conforming GSE loans and FHA and VA mortgages. FHA and VA loan limits are tied to the GSE conforming ceiling.
  - Veterans, teachers, firefighters, and police officers are examples of working families who stand to benefit.
- **FHA Modernization.** NAR supports pending legislation to modernize and revitalize the Federal Housing Administration (FHA) mortgage insurance programs.
  - A modernized FHA can provide subprime borrowers with a safe and affordable alternative to problematic loans and help bring stability to the whole subprime market.
  - FHA mortgages can help meet the demand for subprime mortgages and help fill the gap in the mortgage market left by the decline of subprime and nontraditional products.
  - A few simple changes can make a big difference. NAR supports increasing FHA loan limits, allowing risk-based pricing of mortgage insurance premiums, and reducing downpayment requirements to reflect today's mortgage market.

- **Refinancing.** NAR urges the GSEs, HUD, and VA to explore ways to further help borrowers with problematic loans refinance into a fair and affordable GSE, FHA, or VA mortgage. For example, a waiver of their requirement that the borrower be current on his or her existing mortgage would help borrowers refinance out of problematic loans.

**VIII. Foreclosure Avoidance and Mitigation.** NAR supports mortgage lender, legislative, regulatory, and private-sector foreclosure avoidance and mitigation efforts.

- NAR urges lenders, especially lenders that have made loans without considering the ability of the borrower to make payments under the loan, to act promptly to help borrowers resolve the problem, including through recasting of the mortgage, forbearance, favorable refinancing, waiving of prepayment penalties, and other appropriate tools. Prompt action is often in the best interests of the lender, as well.
- NAR supports increased funding for programs that provide financial assistance, counseling, and consumer education to borrowers to help them avoid foreclosure, or minimize its impact.
- Congress and the regulators should examine alleged abuses by mortgage servicers, some of whom are engaging in predatory servicing by imposing unjustified high fees on borrowers, which can contribute to, or even cause, delinquencies and foreclosures.
- NAR supports an amendment to the Tax Code to change the tax treatment of homeowners when the lender forgives some of a homeowner's mortgage debt.
  - Under current law, when a lender forgives all or some of a mortgage debt on owner-occupied residential real estate, the amount of the forgiven debt is imputed as income to the borrower and taxed as ordinary income, even though the borrower receives no cash.
  - For example, if a lender forgives a portion of the remaining principal obligation when a property is sold for less than the outstanding amount of the mortgage, the forgiven amount is taxable income for the seller. Similarly, if a lender forecloses on a mortgage and does not require the borrower to pay any remaining balance on the loan after the lender sells the property, the borrower must treat the amount of the unpaid debt as income.
  - NAR believes that it is inappropriate to tax borrowers who have suffered a substantial economic loss and cannot afford to pay taxes on this phantom income.
  - NAR supports relief only with respect to the portion of the mortgage debt attributable to the home's original purchase price (plus capital improvements).