8 February 2011

Ms. Deborah Slade-Horsey
Vice President, Single Family Risk Policy
Federal National Mortgage Association
3900 Wisconsin Avenue, N.W.
Washington, D.C. 20016-2892

Re: My letters of 7 December 2009 and 16 March 2010

Dear Ms. Slade-Horsey,

I appreciate the time you and your staff have spent with me, and for the clarifications of FNMA qualification standards you have provided. I am pleased to report that after twenty months and nine different lenders we were finally able to refinance our mortgage to *lower* the payment. I apologize in advance for the length and complexity of this letter, but I hope that by identifying some of the obstacles we faced, in particular the restrictive guidelines and policies imposed in your name, you and your partners in government may be able to find solutions which will benefit future applicants. Mortgage refinancing was addressed during the Conference on the Future of Housing Finance last August; at the end of this letter I offer a few recommendations of my own.

Our experience, confirmed by numerous articles, including, for example the *Washington Post* ("Fannie Mae to Tighten Lending Standards," by Dina El Boghdady, November 26, 2009), *The New York Times* ("Interest Rates Are Low, but Banks Balk at Refinancing," by David Streitfeld, December 12, 2009), and *Reuters* ("Qualified? Home lenders saying not so fast," Al Yoon, October 17, 2010), indicates that there is persistent and widespread misunderstanding and/or misinterpretation of FNMA qualification guidelines. What is most distressing is that lenders appear to have adopted policies that extend well beyond minimizing actual risk to reducing or eliminating all perceived, or perhaps "invented" risk. Irresponsible lending contributed to our economic problems, but I believe that irrationally conservative underwriting may be stalling the recovery.

The central problem is the highly restrictive process by which "income" can be documented, and when it is derived from sources other than wage or salary, the process can become complicated. For example, the lender we started with declined the application for insufficient debt-to-income (DTI), stating that we had not been receiving Social Security for a "sufficient" period of time. I was not aware that FNMA advises lenders to consider this income at risk. The real difficulties began when, after a subsequent lender also declined for inadequate DTI, I noted that dividends reinvested into my Individual Retirement Account (IRA) were income not reflected on the tax return. I was advised that an IRA could be considered *only* if withdrawals were being made. The withdrawal, however, had to be in place for one year, supposedly in accordance with FNMA guidelines, and the rate of withdrawal had to ensure the asset would last five years. I immediately established an IRA withdrawal for use in future applications.

The next lender required only two months of IRA withdrawals, but we still did not meet DTI. Their product was a ten year interest-only ARM, a near-perfect match to our specific needs, but we were required to qualify at the future fully amortized (principal and interest) rate using *current* income, with no opportunity to demonstrate the anticipated future income that gave us the confidence to choose this ARM. The requirement, intended to avoid "payment shock" at reset, is supposedly well-known, but was news to me, and I carefully re-read the extensive disclosures to see if I had missed it. I had not; nor was it revealed as a requirement until 12 weeks into the process. Moreover, it appeared to directly contradict one of the disclosures, a brochure from the Federal Reserve titled, "Interest-Only Mortgage Payments and Payment-Option ARMs - Are They for You?" This booklet contains, in the section "When might an I-O mortgage payment or a payment-option ARM be right for you?" the answer that "You have modest current income but are reasonably certain your income will go up in the future." There is not even the *implication* of a need to qualify at the outyear rate.

On the same day that application was declined, I leaned that an asset could be depleted in as little as three years, again citing FNMA. Disturbingly, however, I learned of this three year "rule" not from the lender, but from *The New York Times*: "Both Fannie and Freddie have always required that borrowers have enough income to pay for the loan on closing day — and the lender must document that the income is likely to continue for at least three years." ("Need a Mortgage? Don't Get Pregnant," by Tara Siegel Bernard, July 19, 2010). <u>Only when confronted</u> did the lender then acknowledge this policy; volunteering that potential solution was considered "investment advice." After adjusting the IRA withdrawal, we finally met DTI, but were still declined because my computation of the three year continuation was, in their view, flawed. Despite numerous inquiries, my "error" was never explained, nor was I given an opportunity to rectify it. A secondary reason for the decline was that their appraiser was unable to identify adequate comparable sales. This was not a problem for any other lender.

So to increase qualifying "income" I first had to establish an IRA withdrawal, then increase that withdrawal to meet yet another lender's interpretation of the same guideline. It is important to note that these funds were never needed to meet *actual* expenses; their only purpose was to satisfy a formula. They were simply redeposited into *non tax-advantaged* accounts. This is hardly sound financial management, and the notion that funds withdrawn from an IRA and transferred to another investment account constitute "income" is simply absurd. Further, in my case the IRA represented only about 25% of our total invested assets, but lenders are apparently not permitted to attribute an income stream to the withdrawal of principal from non-employment-related liquid assets. Allowing this would have obviated the need to set up the artificial and financially irresponsible IRA withdrawal. I suspect many retirees are in similar situations, and I hope that this will continue to be an area of emphasis as you refine your guidance for lenders.

The fact that this IRA withdrawal was not needed to meet actual expenses illustrates the fundamental problem with FNMA DTI standards. To attempt to meet these standards we have been required to "manufacture" gross incomes in the $100,000 range. After principal, interest, taxes and insurance (PITI), the formula dictates that we require on the order of $65,000 (115% of our state's median household income) to satisfy our remaining obligations. After PITI, the *actual* nondiscretionary expenses of this particular retired military couple with cost-of-living adjustment-protected income and full health care are about half that, and we live quite comfortably. We require *no* withdrawal of principal from our invested assets to meet those expenses. Let me repeat that. No withdrawal of principal. Not from an IRA. Not from any other invested asset. If FNMA guidelines can be modified to relate an applicant's actual requirements to the qualification process, you will have done a great service to many prospective borrowers. In this case much of the exercise of "documenting" qualifying "income" was an unnecessary sham.

Beyond the issue of documenting income, we encountered a number of other problems. I have already mentioned "not receiving Social Security long enough" as a justification worthy of Lewis Carroll. The most curious, however, was the requirement by two of the lenders that as a condition of approval we had "dissolve" our "business" and obtain certification to that effect from our accountant. Our "business?" A retirement hobby of breeding and showing dogs, for which we can show certain expenses as losses for tax purposes. Despite the "dissolution" of the "business," our actual expenses remain the same (or were we expected to euthanize our dogs?). I doubt that FNMA believes the solution to irresponsible lending is to require applicants to pay more Federal Income Tax than required. In a somewhat related issue, one lender was prepared to decline the application having concluded that the property was a commercial activity based on an internet search which identified a "business" operated at our address. Not the above hobby; the connection was to our dog club's non-profit, volunteer-operated rescue program for which I am the treasurer. This required yet another full-page letter of explanation.

From my perspective the qualification process is "guilty until proven innocent." It is a mortgage application, not a Background Investigation. The first step taken by some underwriters seems to be a record search to determine what information the applicant has withheld, and then present that information in a near-accusatory manner under an implied threat of disapproval. These searches can yield outdated or erroneous information, which is still passed on as a requirement, for example: "We also need clarification of what the following list of address (sic) pertain to:" On this particular list, three items were simple variants of our current address; the underwriters could not even be bothered to read what they had collected before sending it on for "clarification."

Underwriting personnel are not reachable by the applicant, nor, apparently, can they be held accountable for inappropriate findings and decisions. They are insulated by service representatives who may or may not have the background in policy and regulation to negotiate with the underwriters on behalf of the customer. This leads to an excessive degree of written, email and telephone interaction as questions go back and forth. To resolve one "showstopper" issue completely unrelated to our actual income, I was forced to appeal directly to the Vice President for Underwriting at one of the nation's largest financial institutions.

What may have been the ultimate excess was described in a media article: a woman was declined because the new property, in the *opinion* of the underwriters, was "too far" from her place of employment, and the increased commuting costs would be too great. I was not aware that FNMA had empowered the industry to make those value judgments.

I fully appreciate that there were legitimate problems in mortgage origination - we can all agree that only a totally broken process allowed a "...strawberry picker with an income of $14,000" to obtain a $724,000 loan (Michael Lewis, *The Big Short*, p. 97). But to have this much trouble *lowering* a payment is inexcusable, and is also irresponsible if we are to work together to fix the nation's housing problems. We have not been late in over twelve years of payments on this property; I have had mortgages for 35 years on four different properties and have never been late. Our credit scores averaged 760 and the LTV was 60 per cent. As an aside, although this was not a Veteran's Administration (V.A.) loan, I was interested to read that veterans have "...a lower default rate than prime borrowers over all...according to the Mortgage Bankers Association..." ("V.A. Loans Harder to Get," by Bob Tedeschi, *The New York Times*, June 23, 2010). I will assume that this fact is not reflected in credit scoring models or in your guidance to lenders regarding military and veteran applicants.

Individuals with solid track records and the intent, experience and means to ensure priorities are maintained and mortgages kept current should have the option to choose ARMs and other specialized mortgage products to maximize cash flow or meet other objectives. Qualification must be based upon the actual ability to pay, not an abstract formula that loses relevance in many situations, and lenders must be granted the flexibility to recognize and address these situations. In the mortgage qualification process, though you cannot tailor for each individual situation, it is equally obvious that one size can not and *must not* fit all.

It appears FNMA has two options. The mortgage industry can continue to impose, in your name, qualification requirements which disenfranchise legitimate, capable and responsible borrowers, and thus continue to exacerbate this housing crisis for many otherwise qualified individuals. Or, you can revisit these standards, perhaps, for example, by expressing the question of "how much is left after housing costs are met?" in *dollar* terms, and not as a percentage of the mortgage payment. I would like to offer some specific recommendations:

First, that you proceed as rapidly as possible to provide clear and specific guidance to lenders allowing them to value an income stream that includes the withdrawal of principal from *non-employment-related* liquid assets. The implications for many retired applicants are profound. Some may actually be using their accumulated assets to met expenses in retirement; others, like us, may only need the implied value of that income stream as qualifying tool. But either way, those funds should be available for qualification, and to deny their use for this purpose is potentially discriminatory.

Second, and closely related to the first, modify the DTI criteria to recognize that beyond a certain level of residual income after housing costs are met, the ratio simply breaks down.

Third, examine the voluminous disclosure requirements and shift the emphasis from shielding lenders and loan processors from liability to true consumer education and most importantly, full disclosure of the actual qualification requirements and process. <u>An applicant should not be required to play guessing games with the lender, nor learn from a newspaper article what he or she must do to qualify for a mortgage</u>.

Fourth, relax or modify the criteria for comparable sales, if in fact these are FNMA guidelines. In a slow market, or in our case a rural area, comparables may not be straightforward. Appraisals continue to be a major part of the problem: "Have down payment, but stuck in appraisal hell"

(Linda Stern, *Reuters*, December 14, 2010), and "House Appraisals Under Fire" (M.P. McQueen, the *Wall Street Journal*, December 30, 2010).

Finally, take steps to ensure that irrelevant items which have no legitimate bearing on an applicant's *real* ability to pay are not employed as excuses to decline an application or to overly complicate the qualification process.

It is my sincere hope that our unpleasant and entirely unnecessary experience might catalyze a reevaluation of your qualification guidelines for lenders. It may be that our case is so isolated as to be inconsequential, but the extensive media coverage suggests otherwise - that we may be only the tip of an iceberg of a group of retirees and others in comparable situations. I will again apologize for the length of this letter and the number of different issues I have raised, but I can only speculate what impact this is having on the overall housing market and the nation's ability to recover from recession. I would be most happy and frankly, quite relieved, to learn of any errors of fact contained in this letter.

Is what we have gone through really the FNMA concept of responsible lending?

Sincerely,

James C. Moses
Commander, US Navy (Retired)

Copy to:

Mr. Gene B. Sperling, Assistant to the President for Economic Policy
Senator Barbara A. Mikulski
Senator Benjamin L. Cardin
Board of Governors of the Federal Reserve
Ms. Phyllis Caldwell, Chief, Office of Homeownership Preservation,
U.S. Department of the Treasury
The Honorable Raphael W. Bostic, Assistant Secretary, Policy Development and Research
U.S. Department of Housing and Urban Development
Director, Federal Housing Finance Agency
U.S. Equal Employment Opportunity Commission
Panelists attending the White House Conference on the Future of Housing Finance
ABA Commission on Law and Aging
American Association of Retired Persons (Attn: Legal)
Military Officers Association of America (Attn: Legal)
National Consumer Law Center
National Women's Law Center
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