Pennsylvania Housing Finance Agency
211 North Front Street
Harrisburg, PA 17101

July 22, 2011

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Comments on Ability to Repay Standards
Docket No. R-1417
RIN No. AD 7100 AD75

(submitted via email- regs.comments@federalreserve.gov)

To the Board of Governors of the Federal Reserve System:

Following are comments on the proposed Ability to Repay rule.

By way of background, the Pennsylvania Housing Finance Agency ("PHFA") is a state agency, created and existing pursuant to state law in the Commonwealth of Pennsylvania. Like other state housing finance agencies, we are mission-driven, state chartered entity whose purpose is to provide affordable housing. We are a frequent issuer of tax exempt and taxable bonds to finance residential mortgage loans. Our program has been in existence since 1982 and we have funded more than 145,000 affordable fixed rate mortgage loans for low and moderate income Pennsylvania households. The consumer mortgages financed by PHFA are originated by private banks and mortgage lenders and then acquired by PHFA with the proceeds of the financing. PHFA does dictate the underwriting guidelines for the loans it funds, and we have always required full documentation. We also perform our own independent review of the originating lender's loan file both before closing and also prior to our funding of the closed loan.

PHFA also offers closing cost and down-payment assistance in the form of no-interest subordinate loans, assistance for making homes accessible for persons with disabilities, and homebuyer education at no cost to the consumer. We also service these loans in-house and boast a default rate that is consistently lower than both state and federal numbers.

We are presenting comments with regard to the general "Ability to Repay" standard, as well as the "Qualified Mortgage" definition set forth in the proposed Rule. We are not providing comments on the refinance provisions or the balloon-payment qualified mortgage, as we do not offer any mortgage products that would fall into either of those categories.

General Ability to Repay Standard:

We applaud the general Ability to Repay standard as presented in the proposed rule. We have found in our experience that the eight underwriting components identified are integral to a sound assessment of mortgage default risk. While we only provide mortgages with fixed interest rates, we also concur with the additional criteria of basing the mortgage payment on the fully indexed rate in the case of adjustable-rate mortgages. We concur generally with both the standards and documentation requirements being proposed, with specific feedback in response to the Board's requests as follows:

43(c)(2)(v) Mortgage-Related Obligations. It has been our experience that the items proposed to be included in "Mortgage-Related Obligations"—property taxes; mortgage-related insurance premiums required by the creditor; homeowner association, condominium and cooperative fees; ground rent or leasehold payments; and special assessments—are items that are easily verified by third party sources, with the exception of special assessments, which may not be known at the time of closing. Also, one-time special assessments and upfront mortgage insurance premiums should be included as a closing cost that is paid for at or prior to closing. Non-recurring, one-time fees should not be included as a "Mortgage-Related Obligation". It may be helpful to have additional clarification on what special assessments would be included. Additionally, the HUD-1 would not serve as prudent verification for these mortgage-related obligations because it is common for the HUD-1 to only be prepared a few days prior to closing, and this information would be needed much earlier during the underwriting process. Also, the example given regarding title insurance is unclear because that is not an item that would be included in "Mortgage-Related Obligations."

43(c)(2)(vi) Current debt obligations should not include installment loans with less than 10 payments remaining. Revolving accounts, on the other hand, should be included even if closed by the consumer after making application for the mortgage loan. Additionally, loans in deferment for at least 12 months from the date of mortgage application should not be included. The most common example of this type is deferred student loans. We have followed these three principles since the inception of our mortgage lending programs almost 30 years ago. We feel they are consistent with prudent underwriting standards. Regarding whether debts listed by the applicant but not appearing on the credit, we feel they should be included as debt and also verified to ensure the debt to income ratio is accurate. Lastly, under this topic, in our experience in handling applications from joint applicants, we have always included the debt obligations of all persons who will appear on the Note, regardless of whether they will reside in the property.

43(c)(2)(viii) Credit history verification should include the acceptance of non-traditional credit. Just because an applicant does not have a sufficient traditional credit history as reported on a credit report, it is not necessarily an indicator of increased default risk. Some borrowers have no or little established credit due to their young age, or because they have chosen to limit their use of credit, or due to religious and cultural background. These things, in fact, can all be positive factors in determining their willingness to repay the loan. In these cases, nontraditional credit sources such as car insurance, rent, utilities, etc., can establish the borrower's willingness to repay. FHA guidelines contain thorough and sensible criteria for how to establish a nontraditional credit history.

43(c)(3) Verification Using Third-Party Records is required by PHFA for all income and assets that are used to qualify the applicant for the mortgage. These records include paystubs, W2's, 1099's, federal income tax returns, bank statements, Verifications of Employment and Deposit completed by the lender, award letters for social security or other public assistance income, etc. We also require profit and loss statements for self-employed borrowers to be prepared by a disinterested third party, and this income is only used to qualify if it is consistent with the prior two years of income as documented by federal tax returns.

43(c)(7)-3 Compensating factors are permitted by PHFA to offset a high housing to income or debt to income ratio, as well as other negative factors. Although this is not an exhaustive list, the compensating factors we would routinely accept as mitigating increased risk in one or more categories are: two months PITI in reserves; two full years of stable income; payment shock less than 50 percent; 12 months timely rental payments verified by a non-relative; and underwriting ratios at or below 33/38.

Automated Underwriting Systems. If the Board is going to allow use of these systems as a safe harbor, clarification must be provided on what exactly would be included as meeting the safe harbor. In other words, if the system generates a positive finding (e.g., 'Approve' or 'Accept'), would it meet the safe harbor for the Ability to Repay standard in general? (We would suggest this not be allowed). Our suggestion would be to allow use of the systems as a safe harbor for the mathematical calculation of the debt to income ratios, loan to value ratio, mortgage related obligations, current debt obligations, and other fields that can be mathematically computed by information entered by the lender. The lender must still be responsible, however, for demonstrating that it has verified and documented the data as required by the Rule. It is permissible for lenders to generate other data fields by using computer-generated systems; for example, the amounts required to be listed on the Truth in Lending disclosure are routinely generated by loan origination computer systems.

As a general comment regarding the Ability to Repay Standards, we caution the Board in allowing creditors to "look to widely accepted governmental and non-governmental underwriting standards". This phrase is used repeated throughout the proposed Rule. We would remove the word 'non-governmental'. Part of the cause of the mortgage meltdown was that once-obscure underwriting standards, such as stated income loans, became widely accepted. We suggest the following phrase instead: "look to widely accepted governmental underwriting standards such as those of the FHA, VA, RD, and state housing finance agencies".

Qualified Mortgage Definition

While we understand the Board's reasons for providing two alternative definitions of 'Qualified Mortgage', we feel that adopting both options will be confusing and illogical. A safe harbor generally offers the regulated entity the most assurance for complying with the applicable regulation. It therefore is generally the most comprehensive set of criteria on the continuum of compliance. However, in this case, the definition presented as a rebuttable presumption of compliance (and hence, less assurance to the lender) contains more requirements. So, while the safe harbor standard would be more attractive to the lender, the presumption of compliance would perhaps be of better service to the borrower. For this reason, we recommend that the Board adopt the definition as presented under the presumption of compliance alternative, but make it a safe harbor. This will provide more clarity for the lender and the highest level of protection for the consumer.

Better yet, we feel the best approach would be to simply adopt the 'General Ability to Repay Standard' as both the Safe Harbor and as the 'Qualified Mortgage' definition. This would provide an approach that is logical, clear and simplistic. The various nuances, thresholds and complicated calculations involved with both alternative proposed Qualified Mortgage definitions will make it more complex and time consuming for the lender and less easily understood by consumers. This may very well result in higher fees to the consumer, a more bureaucratic process, and a restriction of mortgage credit in the marketplace. It may also present more challenges to smaller, community-based lenders, many of whom have always followed the logical and prudent approach as identified in the general standard.

Despite our position, we would still like to offer our comments as they relate to the proposed Qualified Mortgage definitions, in the event that the Board feels compelled to adopt one or both.

32(a)(1) Calculation of the "Total Loan Amount". Regarding the calculation of the "Total loan amount" to determine if the fees and points are within the acceptable threshold, we feel the amount listed on the Note should be used. This will allow for a simplistic and transparent calculation which is also easily understood by consumers.

32(b)(1)(i)(B) Mortgage Insurance. We feel that the Board is justified in its proposal to exclude from the "points and fees" calculation the mortgage insurance/guaranty charges on government insured/guaranteed loans or privately insured loans with the limitations specified in the proposal. This is logical because the monthly mortgage insurance premium has never been considered in previous calculations of points and fee thresholds as required under TILA, so it would make sense to exclude upfront premiums, as well. For example, a very common payment plan for mortgage insurance provided by private carriers requires no upfront premium, but instead a monthly premium. It is logical to adopt a points and fees calculation that is fairly and uniformly applied, and in the case of the charge for mortgage insurance/guaranty, due to the various payment schedules, it is reasonable to simply exclude it.

43(e)(2)(v)(E) Debt to Income Ratio. In response to the Board's solicitation for comments on whether this should be included in the Qualified Mortgage definition, it is our position that it should be included by requiring the lender to consider it. If the Board chooses to set thresholds, however, there must be allowable exceptions. For example, FHA allows for ratios of 31 and 43, but these may be exceeded with sufficient compensating factors. As the Board has identified, this is a difficult area for risk evaluation, and it is difficult to draw a bright line for the very reasons identified by the Board. However, it is still a very important component of the overall risk evaluation. As with the other underwriting components, there must be enough flexibility to allow for a common sense underwriting review. A prudent process is one where the totality of the circumstances and interaction of the various risk factors is evaluated as a whole. This, along with verified and documented data, leads to a sound underwriting decision. However, the mere difficulty in quantifying any particular risk category with specificity, such is the case with debt to income ratios, does not justify excluding it from the definition. It must be included, but with a sufficient degree of flexibility left intact.

43(e)(3) Limits on Points and Fees for Qualified Mortgages. We support Alternative 2, as we agree with the Board that this will produce a more equitable outcome for lower loan amounts. Although it is more complicated, computer systems vendors will likely incorporate this into the loan origination systems utilized by lenders. However, as stated above under our response to 32(a)(1), we feel the total loan amount should simply be the amount per the Note. Lastly, the loan size ranges should be indexed to account for inflation.

43(e)(3)(ii)(B) and (e)(3)(ii)(C) Exclusion of Discount Points. We feel that discount points should be excluded from the points and fees calculation altogether. These are points paid voluntarily by the borrower in exchange for a lower interest rate. The industry standard is that for each point paid, the borrower receives a quarter of one percent lower interest rate. If the Board feels they must be included, we suggest excluding three points, period, without any complicated calculations. While it is currently not very likely for borrowers to pay more than two, it was common to pay as many as three points during times of very high interest rates, for example, during the early 1980's.

High Priced Mortgage Loans/High Priced Covered Transactions:

Although PHFA does make loans with balloon payments or prepayment penalties and thus the application of the High Priced Mortgage Loan as it presented in the proposed Rule will not impact us, we are in favor generally of the Board exercising its authority under TILA Section 105(a) and 129B(e) to replace "annual percentage rate" with "transaction coverage rate" as defined in the Board's 2011 Escrow Proposal at 76 FR 11598, 11609, Mar 2, 2011, as the loan pricing benchmark for higher-priced covered transactions. This will help ensure that restrictions on loans meeting this definition are limited to the subprime market which, as recognized by the Board, is consistent with the intent of Dodd-Frank.

It has been our experience that many lenders have chosen not to originate a loan that falls into the "HPML" category, even if the reason it is exceeding the APR threshold is due to the current inclusion in the APR of the upfront mortgage insurance premium on FHA loans (or the guaranty fee on RD and VA loans), or due to the interest rate being higher to account for closing cost assistance being provided to the borrower by our lending program in the form of a zero interest soft second loan. Even though PHFA's loans have always and will always comply with the criteria as currently specified under section 226.35 and we therefore have not had an issue with purchasing these loans from our approved network of lenders, we have found that some of them have made corporate decisions not to make any High Priced Mortgage Loans simply because of the nefarious connotation imposed by such a label. And the result is that a credit worthy consumer is denied an affordable mortgage loan. The lender may be able to provide an alternative mortgage product with a slightly lower interest rate, but it will not have closing cost assistance, and the consumer will likely pay significantly higher fees. It could also have a higher monthly payment due to more costly mortgage insurance. Plus, in the case of our product, the consumer would not have the benefit of a state housing finance agency servicing their loan. Surely, this has been an unintended- but very real life- consequence of the "HPML" label. Words do matter, as the label itself implies that the product is automatically suspect and not in the consumer's interest. We support any action this rulemaking can take to clarify and clear up the unfortunate, surely unintended consequence of "HPML" designations.

Impact on Qualified Residential Mortgage Definition:

PHFA provided comments to the proposed risk retention rules as issued by, among various other federal entities, the Board of Governors of the Federal Reserve System. While we feel that the criteria presented under these proposed Ability to Repay standards is generally flexible, practical and reasonable, we feel the definition of a "Qualified Residential Mortgage" as presented under the proposed Risk Retention rules would create an industry benchmark that would both severely limit and increase the cost of mortgage loans available to low and moderate income home buyers, especially those purchasing their first home. As directed by the Dodd-Frank Act, the definition of a "Qualified Residential Mortgage" can be no broader than the Qualified Mortgage definition. Yet, as the two proposed rules are written, the Qualified Residential Mortgage is most definitely broader than the Qualified Mortgage definition. Bringing the Qualified Residential Mortgage definition into compliance with this directive by making it no broader than the Qualified Mortgage definition proposed herein will have a positive impact on the availability and pricing of mortgages to borrowers purchasing their first home and those borrowers with modest incomes and assets. It is the mission of housing finance agencies across the nation to provide affordable, sustainable financing to this population, which also happens to be a vital component of a robust housing market and healthy economy.

As we noted above, please consider that unintended consequences may arise in the implementation of some of these standards and recognize this fragile time in the housing market as you develop criteria. We encourage you to allow for flexibility in the application of these standards to the extent necessary to support a robust recovery of affordable housing market and responsible lending. To this end, we suggest that you appreciate the unique role of state housing finance agencies in filling gaps in the housing delivery system for people of modest means and with special needs. Our second mortgage loan and grant programs, employer-assisted housing programs, and initiatives to address special issues in our markets allow us to achieve our mission. To the extent it is possible for you to provide a direct and specific exemption for housing finance agency programs from the various specific criteria, we urge you to consider doing so.

Thank you very much for affording us an opportunity to provide our comments on the Proposed Rule. Please feel free to contact either of us (as set forth below) if you have any questions regarding any aspect of our suggestions or discussion.

Very truly yours;

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