NEIGHBORHOOD FINANCE CORPORATION
NeighborWorks CHARTERED MEMBER

July 27, 2011

Honorable Ben S. Bernanke
Chairman
Board of Governors of the
Federal Reserve System
Washington, DC 20551

Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance
Corporation
Washington, DC 20429

Mr. Edward J. DeMarco
Acting Director
Federal Housing Finance Agency
Washington, DC 20552

Honorable Mary L. Shapiro
Chairman
Securities and Exchange Commission
Washington, DC 20549

Honorable Shaun Donovan
Secretary
Department of Housing & Urban
Development
Washington, DC 20410

Mr. John G. Walsh
Acting Comptroller
Office of the Comptroller of the Currency
Washington, DC 20219

Re: Interagency Proposed Rule on Credit Risk Retention

OCC: Docket No. OCC-2011-0002 regs.comments@occ.treas.gov
Federal Reserve: Docket No. R-1411 regs.comments@federalreserve.gov
FDIC: RIN 3064-AD74 comments@FDIC.gov
SEC: File Number S7-14-11 Rule-comments@sec.gov
FHFA: RIN 2590-AA43 RegComments@FHFA.gov
HUD: RIN 2501-AD53 via www.regulations.gov

Ladies and Gentlemen:

Thank you for the opportunity to comment on the "Credit Risk Retention" proposed rule as required by Section 941 of the Dodd Frank Act (P.L. 111-203). Neighborhood Finance Corporation (NFC) respectfully puts forth our recommendations and concerns regarding this proposed rule, <u>specifically the definition of a Qualified Residential Mortgage (QRM) and what would be a permitted Credit Risk Retention (CRR)</u>.

NFC is seeking an exemption from the CRR requirements of Section 941 of the Dodd Frank Act, as it would be appropriate in the public interest to do so, for reasons noted on page 7 of this letter. NFC is a not-for-profit mortgage bank, licensed in the State of Iowa. Our loan transactions fill a need that is unmet by traditional lenders. We suspect that holding an organization like NFC to the CRR requirements is an unintended consequence of Section 941 of Dodd Frank. To the extent exempting an

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organization such as NFC from the CRR requirements is not possible, we are proposing modifications to the QRM definition, as noted below.

NFC is a not-for-profit mortgage bank that was founded in 1990. Its mission is to revitalize neighborhoods in portions of Des Moines, Iowa. It accomplishes this by extending loans to persons buying homes or desiring to improve the properties they already own and occupy. A forgivable loan, used for property rehabilitation, accompanies each fully amortizing loan. The property rehabilitation is performed on each home after the loan closes with NFC. Each amortizing loan is either sold to Fannie Mae or to groups of local investors, in the form pool participations. These participations are Schedule D Private Placement Offerings that are filed with the Securities Exchange Commission.

Since its origin, NFC has originated more than $215 million in loans and grants. Historically, more than 50% of NFC's borrowers are low income, and 12%--14% are minorities. NFC's lending area is comprised of all the low income census tracts of the City of Des Moines, plus other neighborhoods that are targeted for revitalization. Approximately 85% of NFC's lending activity is eligible for Community Reinvestment Act credit for its investors.

In addition to lending, NFC provides quality pre-purchase homeownership counseling, financial fitness training and work with borrowers to improve their credit rating; improve their budgeting; and commit to a savings plan. NFC prepares borrowers to qualify for reasonably priced traditional mortgage loans so that they may achieve sustainable homeownership. It is this experience and expertise context that we provide the following comments on the following areas relevant to the proposed QRM definition:

1. Eligible loans
2. Borrower credit history
3. Down-payment requirement
4. Homeownership education and counseling
5. Default mitigation

Eligible Loans

NFC recognizes the deleterious effects of so-called "piggyback" loans that played such a large role in creating the housing and economic crises. Many of those that caused problems had less favorable terms than the 80% 1st mortgages. Not all secondary or subordinate loans are created equal or that by virtue of being secondary alone predict a level of default. NFC has been using private and public sector fully-amortizing secondary loans since 2004. These loans are either on the same terms as the 80% 1st mortgage or are 2% 10-year loans. At least half of our customers, depending on their counseling needs, have had an appropriate level of homebuyer education and counseling to ensure sustainable homeownership. Therefore, we recommend that these public-sector type subordinate loans not be prohibited as part of the QRM eligible loan definition.

Borrower Credit History

NFC agrees with the proposed rule in that a credit score threshold should not be part of the QRM definition. A credit history demonstrating borrower behavior around debt is of significant importance, but a hard-lined credit score threshold is not. Furthermore, three different credit bureaus will typically report a different score, despite that same set of facts being reported to all three. As noted in the discussion of QRM Eligibility Criteria the payment history is a much better indicator of ability to manage credit.

Down-Payment Requirement

NFC has serious concerns with the proposed down payment requirement offered in the rule. Requiring down payments of 10 or 20 percent is deemed by some as "getting back to basics." Well-underwritten low down payment home loans have been a significant and safe part of the mortgage finance system for decades. The proposed QRM exemption imposes minimum down payments of 10 or 20 percent, and equity requirements for refinancing borrowers of 25 percent or 30 percent. NFC disagrees with these down payment requirements and offers an alternative (see below).

A 10 or 20 percent down payment requirement for the QRM means that even the most creditworthy and diligent first-time homebuyer cannot qualify for the lowest rates and safest products in the market. Even 10 percent down payments create significant barriers for borrowers, especially in higher cost markets (see Attachment 1). This will significantly delay or deter aspirations for home ownership, or require first-time buyers to seek government-guaranteed loan programs or enter the non-QRM market, with higher interest rates and potentially riskier product features without adding a commensurately greater degree of sustainability overall.

NFC feels that as a result of the proposed requirements, responsible consumers who maintain good credit and seek safe loan products will be forced into more expensive mortgages under the terms of the proposed rule simply because they do not have 10 or 20 percent in down payment or even more equity for refinancing. These mortgages will be more expensive for consumers because the capital and other costs of retaining risk will be passed onto them, if the private market chooses to offer loans outside of the QRM standard at all and credit risk retention measures become onerous for the lender. In other words, the proposal unfortunately penalizes qualified, low-risk borrowers. The QRM should be redesigned to align with Congressional intent: encourage sound lending behaviors that reduce future defaults without harming responsible borrowers and lenders.

In addition, an analysis of loan performance data from CoreLogic's servicing databases on loans originated between 2002 and 2008 shows that boosting down payments in 5 percent increments has only a negligible impact on default rates, but it significantly reduces the pool of borrowers that would be eligible for the QRM standard. Table 1 and Attachment 2 show the default performance of a sample QRM definition based on the following attributes of loans: Fully documented income and assets; fixed-rate loans, or 7-year or greater initial period ARMs; no negative amortization; no interest only loans; no balloon payments; 41 percent total debt-to-income ratio; mortgage insurance on loans with 80 percent or greater loan-to-value ratios; and maturities no greater than 30 years.

These sample QRM criteria were applied to more than 20 million loans originated between 2002 and 2008, and default performance is measured by origination year through the end of 2010. While loans with 5 percent down payments (or 5 percent equity) are certainly riskier than loans with 20% down/equity, the data in Table 1 and the chart in Attachment 2 show that low down payment loans that follow the strong underwriting and product standards outlined above can be exempted from risk retention without exposing investors or the broader housing market to undue risk. In other words, once you apply the strong underwriting standards in the sample QRM definition, moving from a 5 percent to a 10 percent down payment requirement reduces the overall default experience by an average of only two- to three-tenths of one percent for each cohort year – negligible at best. However, the increase in the minimum down payment from 5 percent to 10 percent would eliminate from 7 to 15 percent of borrowers from qualifying for a lower rate QRM loan – statistically significant. Similarly, increasing the minimum down payment even further to 20 percent, as proposed in the QRM rule, would amplify this disparity by knocking 17 to 28 percent of borrowers out of QRM eligibility, with only small improvement in default performance of about eight-tenths of one percent on average. This lopsided result compromises the intent of the QRM provision in Dodd-Frank, which is to assure clear alignment of interests between consumers, creditors and investors without imposing unreasonable barriers to financing of sustainable mortgages. The analysis also demonstrates that although important to the home buying transaction, down payments are not the best indicator of default in the underwriting process.

Table 1
Sample QRM Analysis: Impact of Raising Down Payments Requirements on Default Rates and Borrower Eligibility

Origination Year	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Reduction in default rate* by increasing QRM down payment **from 5% to 10%**	0.2%	0.1%	0.3%	0.3%	0.2%	0.5%	0.2%
Proportion of borrowers **not eligible** for QRM at 10% Down	7.6%	6.6%	9.0%	8.4%	10.9%	14.7%	8.4%
Reduction in default rate* by increasing QRM down payment **from 5% to 20%**	0.6%	0.3%	0.7%	0.8%	0.8%	1.6%	0.6%
Proportion of borrowers **not eligible** for QRM at 20% Down	19.2%	16.7%	23.0%	22.9%	25.2%	28.2%	20.7%

* Default = 90 or more days delinquent, plus in process of foreclosure, plus loans foreclosed.
Source: Data from CoreLogic, Inc. Analysis by Vertical Capital Solutions for Genworth Financial and the Community Mortgage Banking Project.

The bottom line is that requiring a 10 or 20 percent down payment as an overlay to already-strong underwriting standards produces only minor improvement in market-wide default performance, but has a major adverse impact on access by creditworthy borrowers to the lower rates and safe product features of the QRM. NFC believes this is an unnecessary trade-off that would have a disproportionate impact on moderate income and minority families and would undermine efforts to create a sustainable housing recovery.

Given all this, NFC believes in the importance of a borrower's financial equity in the home buying transaction and subsequent responsibility. Although we consider a 20, 10 or even 5 percent down payment requirement to be too high and not play a role in the default potential of the home buyer, we do believe that a homeowner who has vested some financial commitment to the purchase of a home is important. We therefore offer that the QRM definition include a down payment requirement of 3 percent. Down payment would be cash only from the homebuyer; no gift, governmental assistance, or other. We believe that although small, the cash contribution is behaviorally material and demonstrates homebuyer commitment to the transaction. Furthermore, we feel strongly that homebuyer education and counseling plays a significant role in the home buying process and that we also offer that the QRM definition include only a 1 percent down payment requirement (again, down payment would be cash only from the homebuyer; no gift, governmental assistance, or other) for any loan where the homebuyer has successfully completed homebuyer education and counseling as outlined by the National Industry Standards for Homeownership Education and Counseling.[1]

Homeownership Education and Counseling

Homeownership is the single largest source of wealth for most Americans. Academics have shown that homeownership is associated with improved child education, higher neighborhood real estate values, increased savings and even reduced teen pregnancy rates.[2] Most benefits of homeownership derive from stability: people become homeowners when they have less need to move frequently, and when they have sufficient income and assets to invest in their home and ultimately in their community. It is important to note that NFC does not feel that homeownership education replaces sound underwriting; rather, they complement each other.

Homeownership education and counseling programs assist borrowers to make good choices in finding decent affordable homes. Qualified counseling programs cover topics ranging from understanding credit and savings; shopping for a mortgage; housing discrimination; home maintenance; and predatory lending. They alert home buyers to common scams in the market. They provide the homeowners with a thorough and unbiased review of their financial situation and the types of mortgage products that may best suit their needs. Quality counseling can provide tools to determine whether homeownership is an appropriate housing option in the first place.

Pre-purchase education and counseling has been proven to help reduce mortgage delinquencies among homebuyers. Several studies that examined the effect of homeownership education and counseling on default rates found lower delinquency and default rates. One study of Freddie Mac's affordable lending program provides direct empirical evidence of the service's value, concluding that some types of pre-purchase education and counseling have a significant impact on mortgage delinquency rates. Based on a group of 34,000 loans from Freddie Mac's portfolio that received this service, 90-day

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[1] National Industry Standards for Homeownership Education and Counseling, http://www.homeownershipstandards.org/standards

[2] Dietz, Robert D. "The Social Consequences of Homeownership" (Ohio State University: 2003).

delinquency rates were lowered by 19% for educated borrowers overall. Borrowers who received individual counseling experienced a 34% reduction in delinquency rates, while borrowers who received classroom and home-study education obtained 26% and 21% reductions in delinquency. [3]

NFC believes that homeownership education and counseling is an equally important factor in the underwriting process. NFC encourages you to consider incorporating homebuyer education and counseling into the (1) down payment requirement, as outlined above, and (2) as an additional requirement of the default mitigation eligibility criteria as outlined below.

Default Mitigation

Coordination between the borrower and the servicer in the case of delinquency is critically important to avoid future delinquencies and possible foreclosure. A homebuyer education and counseling agency is a trusted advisor that can help the homeowner get current, and help the servicer maintain a consistent cash flow. For example, we suggest that the final rule allow for a delinquent homeowner to receive post-purchase counseling: if a homeowner becomes 45 days delinquent (the delinquency term can be determined), then the servicer would refer that homeowner to a HUD-approved counseling agency (that also has adopted the National Industry Standards mentioned above) for post-purchase counseling. The servicer would absorb the cost of this counseling as we feel it is an appropriate and cost-savings service to the servicer.

An Urban Institute study on National Foreclosure Mitigation Counseling program's (NFMC) effectiveness concluded that the program was successful in both helping homeowners cure an existing foreclosure and reducing the likelihood that counseled homeowners would fall back into foreclosure:[4]

- During the first two years of the NFMC program, counseled homeowners were 70% more likely to get out of foreclosure and avoid a foreclosure sale than if they had not received NFMC counseling.
- On average, NFMC clients who received loan modifications in the first two program years reduced their monthly payments by $555; this is $267 more in reduction than if they had not received NFMC counseling.
- For clients counseled in 2008, NFMC counseling produced a 45% increase in the relative odds that a post-counseling modification would be sustained through 2009. The sustainability of modifications was greater than for homeowners without counseling because counseled homeowners received larger monthly payment reductions and counseling assistance with financial management.

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[3] Harad, Abdighani and Peter Zorn, "A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Counseling" (Harvard Joint Center for Housing Studies, 2003).

[4] Mayer, Neil, Peter A. Tatian, Kenneth Temkin, Charles A. Calhoun. 2010. *National Foreclosure Mitigation Counseling Evaluation: Preliminary Analysis of Program Effects September 2010 Update.* Washington, D.C.: The Urban Institute. Prepared for NeighborWorks® America.

- For clients counseled in 2008, the odds of making their loans current were 53% higher if they received counseling. Counseling produced payment reductions and financial planning assistance that helped move people from serious delinquency or foreclosure to a sustained cure of their mortgages.

Credit Risk Retention

After reading the proposed regulations, it is our understanding that mortgages meeting the QRM criteria as described above exempt the originating lending institution from Credit Risk Retention. For a not-for-profit organization, securing the five percent funding could be a significant challenge, resulting in less mission-based lending activity.

First, NFC is proposing that entities that meet all of the following criteria are exempt from retaining at least five percent of any mortgage loan sold to participants:

- The entity has been recognized as a tax exempt not-for-profit entity, as determined by Internal Revenue Code 501(c)3;
- The entity has demonstrated its program's ability to lessen the burden of government;
- The entity has been in existence for at least twenty years, demonstrating sustainability;
- The entity possesses a state issued mortgage banker/mortgage broker license, and its loan originators possess and maintain the required state and national mortgage licenses;
- The entity blends public and private funds to originate mortgage loans that promote housing rehabilitation and neighborhood revitalization, and leverages those funds through the sale of 100% of its originated mortgages to secondary market purchasers including local financial institutions that support the entity's mission for reasons including fulfilling their Community Reinvestment Act (CRA) goals and obligations;
- The entity's business model does not include the raising of capital that would be required for the entity to retain five percent of all of the neighborhood revitalization loans that it originates and sells;
- The entity has a board of directors that includes directors appointed by the entity's local city and/or county governmental bodies, i.e., the entity is not simply a not-for-profit arm of a for-profit lending institution; and
- The entity obtains an annual GAAP financial audit and is current with respect to the filing of its annual Internal Revenue Service Form 990 Information Return requirements.

If an exemption from Credit Risk Retention requirement is not possible for such organizations, under no circumstances should Vertical Risk Retention be required. For an organization such as ours, that would mean each year, a new financial source for the retained five percent would be needed. That would have a devastating effect on our ability to originate a sustainable amount of loans. With our mission being neighborhood revitalization, property improvement comes with each loan originated. Said differently, fewer loans translates to less property improvement and less fulfillment of NFC's mission. In other instances, lending institutions may impose fees wherever possible to fund the Vertical Risk Retention, thus passing the cost to the consumer, causing the transaction to be potentially prohibitive.

If Credit Risk Retention is imposed upon lenders, even not-for-profit licensed lenders, NFC recommends that the Horizontal Risk Retention option be adopted. The Horizontal Risk Retention, specifically in the form of guarantee first loss reserves, can be effective with attracting additional investor capital, which translates to more loans and more accomplishment of the organization's mission. Furthermore, the funding sources for loan loss reserves are more readily available, and interest earned adds to the reserve balance. The loan loss reserve balance should be retained by the organization until its balance is equal to 50 percent of the remaining unpaid principal balance of the asset backed securities or delivered loans. It is expected in today's origination environment, this would take at least 10 years. These loan loss reserve deposits would not provide cross-collateralization for other lending activities. The loan loss reserve should not remain until the last loan in the issuance is fully repaid, unless there are extraordinary delinquencies experienced with loans in the correlating issuance.

Conclusion

Strong and sustainable national economic growth will depend on creating the right conditions needed for a housing recovery. The prohibitively high minimum down payment/equity requirements and other narrow provisions of the proposed QRM will impair the ability of millions of households to qualify for low-cost financing, and could frustrate efforts to stabilize the housing market. We applaud your monumental efforts to date, and for the equally monumental effort before you to strike the appropriate balance in weighing all of these vastly important issues.

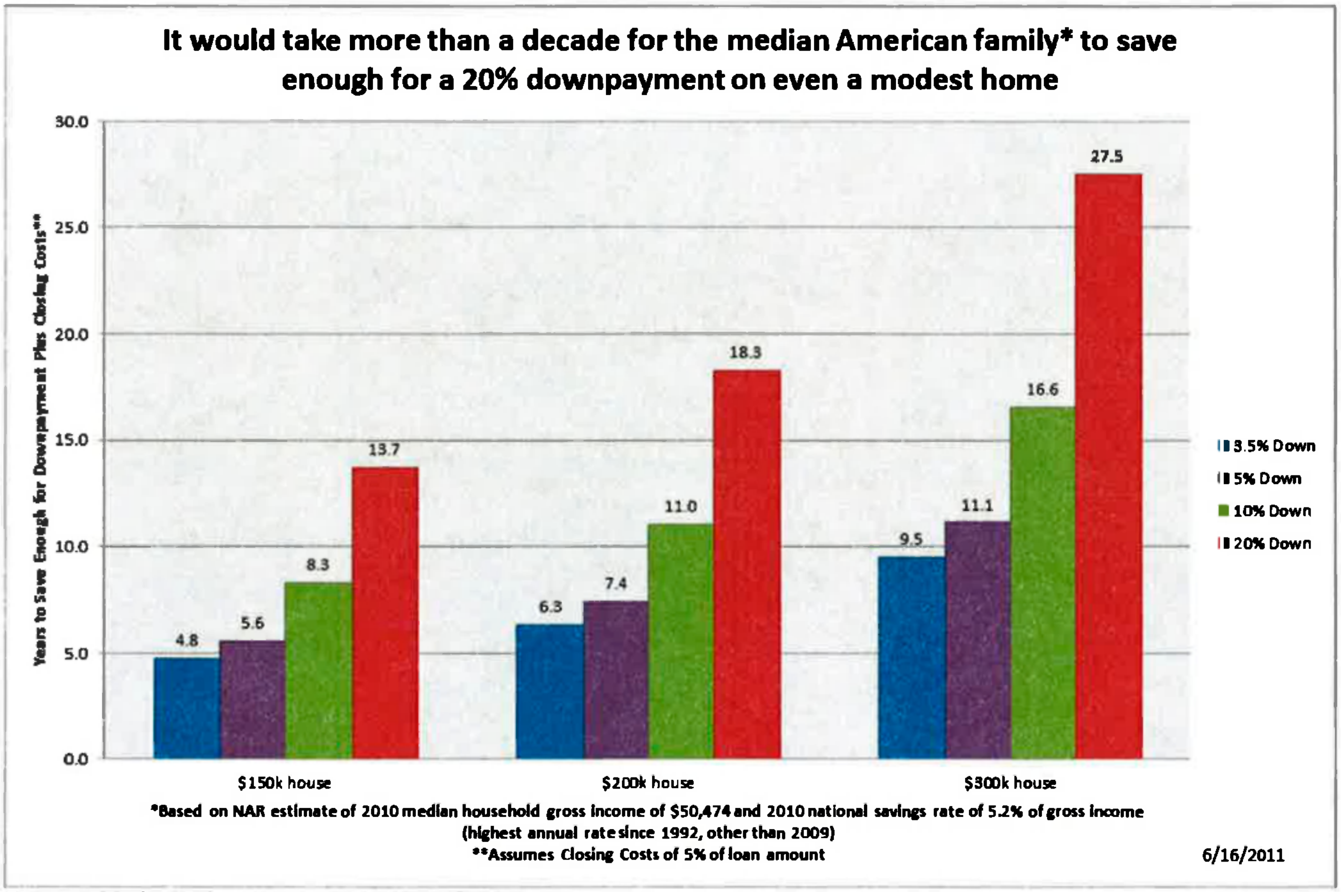
Thank you for your consideration of these comments and for your efforts on behalf of consumers and the mortgage markets. Please feel free to call or email me for any clarification of these comments.

Sincerely yours,

Holly A. Olson

Holly A. Olson
Executive Director

ATTACHMENT 1

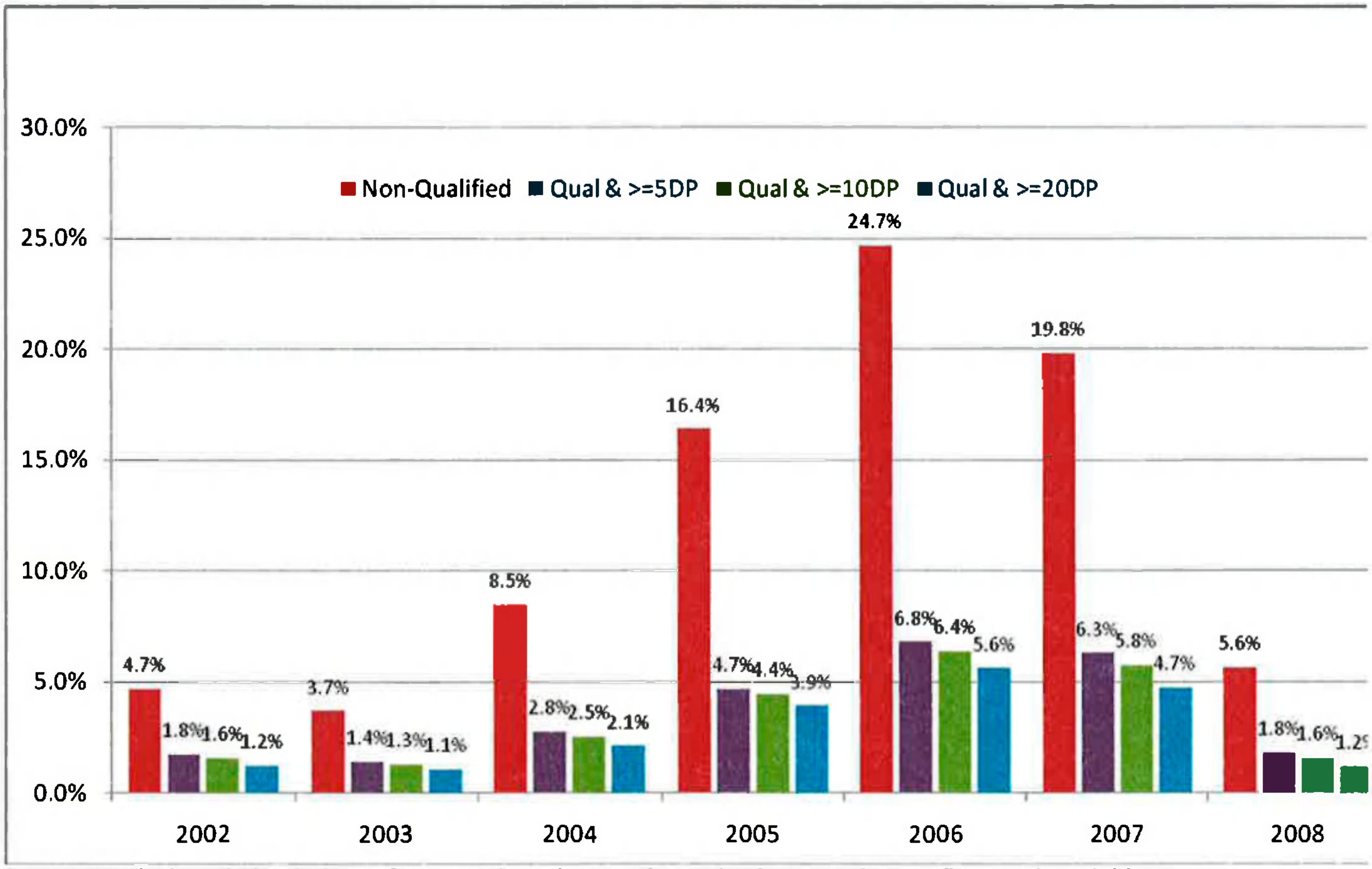


Source: National Association of REALTORS®

ATTACHMENT 2

Low Down Payments not a Major Driver of Default when Underwritten Properly
The red bar shows the performance of mortgages originated from 2002 – 2008 that do not meet all of the standards and features outlined below in the note. The other bars show the performance of mortgages that meet all of the sample QRM product and underwriting features. Within this second group of "QRM" bars, the blue bar shows how loans performed that met all these standards, plus had a 20 percent down payment or more; the green bar shows loans that the met all the standards plus had a down payment of at least a 10%; the purple bar shows these loans with at least 5% down. Naturally, loans with strong standards and at least 20% down performed best. However, the chart also shows clearly that lower down payment loans can be included in a strong QRM framework without exposing investors or the broader market to excessive risk.

IMPACT OF INCREASING MINUMUM DOWNPAYMENT ON DEFAULT RATES FOR LOANS THAT MEET SAMPLE QRM STANDARD



Source: Vertical Capital Solutions of New York, an independent valuation and advisory firm conducted this analysis using loan performance data maintained by First American CoreLogic, Inc. on over 30 million mortgages originated between 2002 and 2008. Note: Default rates are by origination year, through the end of 2010. The sample QRM in this analysis is based on fully documented income and assets; fixed-rate or 7-year or greater ARMs; no negative amortization; no interest only loans; no balloon payments; 41% total debt-to-income ratio; mortgage insurance on loans with 80% or greater loan-to-value ratios; and maturities no greater than 30 years.