National Community
Stabilization Trust

September 8, 2020

Comment Intake
Bureau of Consumer Financial Protection
1700 G Street, NW
Washington, DC 20552

RE: RIN 3170-AA98 / Docket No. CFPB-2020-0020

To Whom it May Concern:

Thank you so much for the opportunity to comment on the Qualified Mortgage Definition under the Truth-in-Lending Act (Regulation Z): General QM Loan Definition.

Established in 2008, the National Community Stabilization Trust (NCST) has worked with hundreds of local partners across the nation to renovate more than 27,000 foreclosed homes, more than three quarters of which have ended up with families becoming homeowners and helping to anchor and revitalize their communities.

Additionally, we manage a portfolio of severely delinquent mortgage loans and sponsor two coalitions – the Homeownership Alliance and the Middle Neighborhoods Initiative – that focus on the importance of homeownership to BIPOC and LMI communities and work to expand access to responsible, sustainable mortgages.

Our work focuses exclusively on single-family, residential properties in distressed neighborhoods, often neighborhoods of color. Whenever possible, we try to support efforts to resell these homes to owner-occupants, both because homeownership is important for supporting family prosperity and quality of life and also because increasing homeownership rates can have positive effects on neighborhood stabilization generally.

Because of our commitment to homeownership in underserved communities, we have a keen interest in issues related to access to credit and responsible lending. We deeply and genuinely support lending and pricing policies that provide fair treatment to lower-income buyers, buyers of color, buyers of lower-priced homes, and buyers in historically redlined communities.

At the same time, we are wary of mortgage or other home loan products that financially burden homeowners or produce homeownership that is not sustainable across economic cycles. **There is nothing worse for a neighborhood than the multiple foreclosures or vacant homes that result from unsustainable lending**.

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Not only does it harm individual families, but it blights the neighborhood, negatively affects nearby home values, reduces tax collections, and increases police and fire protection costs.

We are commenting today because the definition of the Qualified Mortgage plays a highly significant role in ensuring both that borrowers have ample access to credit and that they obtain affordable, sustainable mortgages, including a defense to foreclosure in the event that their mortgage was not properly underwritten.

N.B.: this public comment period comes at a time when our small, nonprofit organization is suffering from the impact of COVID-19 and when many other emergency policy decisions are occurring. We wish the Bureau of Consumer Financial Protection had delayed this important and complex - but not urgent - rulemaking and instead extended the QM Patch until the pandemic had subsided.

I. Substituting pricing for an income assessment in the QM definition undermines the congressional intent of the Ability to Repay Law

When the Dodd-Frank Act of 2010 established an Ability to Repay requirement for residential mortgages, it was simultaneously banal and groundbreaking. It was banal because the average layperson assumes that no lender would ever make a loan to a person who it did not think could afford to pay the loan back in its entirety. Yet it was groundbreaking because at the time it was passed, our nation was reeling from a crisis created when large swaths of the mortgage industry abandoned this seemingly basic principle.

While a full discussion of the factors that led to the 2008 financial crisis is beyond the scope of this comment, a core problem was that interests of consumers and lenders were no longer aligned as they were in the days when lenders held mortgages on their books until maturity. Under new origination and securitization models, key parties in each stage of the transaction - mortgage brokers, lenders, securitizers and even ratings agencies – got paid regardless of mortgage performance, and they made it early in the mortgage term. The sustainability of those mortgage payments over time mattered only to homeowners themselves and the ultimate investors in mortgage-backed securities, and both of those stakeholders found themselves holding the bag when the system collapsed.

Given that the so-called originate-to-distribute model will continue to undergird our housing finance system, Congress sought to restore the alignment of interests between lenders and borrowers by imposing a requirement that lenders make sustainable mortgages or face legal consequences. The Dodd-Frank Act of 2010 required that "no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan…."[1] This is what people call the Ability to Repay rule (ATR).

To make compliance simpler for mortgage lenders, the legislation created a category of loans that could be presumed to meet the ATR requirement if it met the criteria outlined. This special category is known as the Qualified Mortgage (QM), and based on the Bureau's rules implementing QM, lenders who make loans meeting the QM definition either receive full immunity from liability or a rebuttable presumption that there is no liability.

Because of this liability shield, the QM criteria include a specific requirement that lenders consider the affordability of the loan for the borrower. Essentially, this income assessment requirement imports the Ability to Repay concept inside the safe harbor. Under this clause, the Consumer Financial Protection Bureau would establish rules "relating to ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the Bureau may determine… ."[2]

By removing the debt-to-income (DTI) requirement and replacing it with a rate-spread assessment, the Bureau has essentially eliminated the ATR proxy inside QM. The QM definition then relies solely on product feature restrictions – which are extremely useful and important in and of themselves, but which do not constitute an individualized assessment of affordability – and on pricing. Pricing may be highly correlated to ability to repay, but it varies based on factors extrinsic to the borrower (such as target profitability levels) or extrinsic to the borrower's capacity (such as prepayment risk). In short, it is not the same thing as an assessment of the borrower's capacity to make payments, which is what the statute requires.

Eliminating this ATR proxy is especially problematic for loans that meet the QM rate-spread "safe harbor" threshold. For those loans, the statute's overarching ATR requirement may still exist in theory, but it will no longer exist in practice, because the borrower will no longer have an individualized basis to challenge the QM safe harbor designation. This could lead to a situation where a loan made at 100+ percent DTI could still be a QM-safe-harbor loan if it was priced low enough. While it's easy to say that would never happen because the prudent lender would not price that way, that's exactly what we saw happen in the run-up to the financial crisis.

[1] 15 U.S.C § 1639c (Minimum standards for residential mortgage loans).

[2] Id.

In the housing market we've been in since Dodd-Frank passed, lenders have lent cautiously, home values have reliably increased year after year, and (until now) unemployment has been at record lows. But as we emerge from the COVID-19 crisis, we will have a long period of instability in the labor market with concomitant financial pressure on consumers. Additionally, while the housing market is one of the few bright stops in today's recession, some submarkets are quite weak, and there could be more widespread home price declines when the bulk of any COVID foreclosures hit the market in two or three years. These conditions could foster irresponsible lending.

While we do not favor the rate-spread approach, we also do not support retaining the current QM provision that imposes a flat 43 percent DTI cut-off for QM loans. This requirement unnecessarily restricts access to credit and falls especially hard on lower-income consumers. There has long been a consensus in the mortgage industry that any flat DTI cut-off is an imperfect measure, and as many other commenters note, rate spread is a better predictor of default right now than a borrower's DTI, as are FICO scores.

However, rather than using a rate-spread, FICO or other non-income-related measure in place of assessing affordability, the Bureau should look to the other option that Congress explicitly and intentionally included in the Dodd-Frank QM definition: that the Bureau to look to **alternative affordability measures**.

For years, the Bureau has indicated an interest in exploring these alternative measures, and with the significant advances in technology since 2010, it seems like now would be the right time to crack the code of residual-income or cash-flow underwriting. Rather than adopting the rate-spread approach, the Bureau should extend the QM Patch while it undertakes a serious effort to find an appropriate, alternative measure to evaluate whether individual borrowers can afford their mortgages for the long term.

For a more in-depth discussion of why substituting pricing for an individualized affordability assessment is a flawed approach, we recommend the comment letter submitted today by the Consumer Federation of America, the National Consumer Law Center, and Prosperity Now. We also think that comment's other proposals on potential alternatives using a higher DTI with compensating factors deserve serious consideration.

II. If the Bureau chooses the rate-spread approach, it must include strong rules for “consider” and “verify”; incorporate strong fair lending principles; and reinforce Dodd-Frank’s prohibitions on asset-based lending.

NCST has joined with several other organizations to submit a comment letter submitted today under separate cover that provides a term sheet for “consider” and “verify,” fair lending, and asset-based lending. That term sheet is titled the “Joint Civil Rights-Consumer Groups Term Sheet on Fair Lending and Consider and Verify Requirements for QM.”

III. The Bureau should not allow creditors to “mix and match” consider and verify requirements

You have asked if the rule should allow creditors to “mix and match” consider and verify requirements. Given the limited information provided, NCST cannot say for sure, but we would be concerned that approach may not work as intended. Several of us at NCST have worked at regulatory agencies, and our experience is that each regulator attempts to craft an internally consistent and comprehensive approach for its own stakeholders. Mixing and matching from different systems could have unintended consequences or could result in lenders exploiting differences in approach.

IV. If the Bureau chooses the rate-spread approach, it must develop an alternative to protect borrowers receiving adjustable rate mortgages.

While adjustable rate mortgages (ARMs) are included within Dodd-Frank’s QM definition, ARMs pose more risk than fixed-rate mortgages. This is partly because whenever the rate on a consumer loan adjusts upward, it creates some level of payment shock, and also because ARMs are simply more difficult to understand. Short-term (less than five year) ARMs are even riskier because the homeowner has had little time to build equity. If the Bureau takes a rate-spread approach to QM, the QM requirement to “underwrite at the maximum rate” is no longer as meaningful when an income assessment is no longer occurring.

NCST’s preferred approach would be that if the Bureau proceeds with the rate-spread approach, ARMs should no longer be eligible for the QM safe harbor at all. They should instead be designated as rebuttable presumption loans if they are eligible, or non-QM loans if not.

In the alternative, NCST endorses the proposal made in the comment letter from the Center for Responsible Lending to address these risks. This proposal would compare the maximum interest rate on the ARM in the first five years with the Average Initial Interest Rate (AIIR) for a comparable ARM product plus 250 basis

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points (the 250- basis point limit would not be adjusted for loan size, because borrowers who are only able to afford a small house are likely to be particularly vulnerable to short-reset ARM payment shock).

Again, NCST appreciates the opportunity to comment on the QM proposal. If you have any questions, please do not hesitate to contact us.

Sincerely,

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