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Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 Seventh Street SW, Room 10276
Washington, DC 20410-0500

RE: Qualified Mortgage Definition for HUD Insured and Guaranteed Single Family Mortgages
[Docket No. FR 5707-P-01]

The Department of Housing and Urban Development (HUD) has solicited comments in response to its proposed qualified mortgage (QM) definition for loans that are insured, guaranteed, or administered by HUD. The National Housing Resource Center (NHRC) is a national advocacy organization serving the interests of the non-profit housing counseling community and, by extension, housing consumers, especially those from communities that have historically underserved in the primary housing market, such as borrowers of color, low- and moderate-income borrowers, and borrowers from rural communities. NHRC appreciates the opportunity to share our concerns with this proposed definition and to offer suggestions for ways in which the proposal can be improved.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) generally requires mortgage lenders to make a good faith determination that the borrower to whom the mortgage is being made is reasonably able to repay the loan. If the lender does not make a reasonable and good faith determination that the borrower is able to repay the loan, the borrower is given a defense to judicial or non-judicial foreclosure. As an alternative to making an ability-to-repay determination, Dodd-Frank provides lenders with a presumption of compliance with the ability-to-repay determination if the loan is a qualified mortgage (QM), as defined by the Bureau of Consumer Financial Protection (CFPB) or, when applicable, the federal agency that insures, guarantees, or administers the loan. Here, HUD proposes a QM definition for the loans it insures, guarantees, or administers that would generally align the HUD QM definition with the CFPB QM definition, but would significantly expand the scope of loans for which lenders are given increased legal protection.

CFPB's QM definition requires QM loans to have certain product features and meet certain underwriting standards intended to ensure the borrower will have a reasonable ability to repay the loan. For example, the CFPB QM definition generally excludes risky loan products such as negative amortization loans, interest-only loans, and balloon-payment loans, sets a cap on the maximum amount of points and fees that can be charged, and requires that the borrower's

monthly debt-to-income ratio (DTI) not exceed 43 percent. Within QM, however, the CFPB QM definition provides different levels of legal protection based on the cost of the loan, as measured by the loan's annual percentage rate (APR) relative to the average prime offer rate (APOR). Specifically, under the CFPB QM definition, a loan that otherwise meets the QM requirements but for which the APR is more than 1.5 percentage points higher than the APOR is considered a higher-priced covered transaction and is given a rebuttable presumption of compliance with the requirement that the lender make a reasonable and good faith determination of the borrower's ability to repay the loan. A loan that meets the QM requirements and for which the APR exceeds the APOR by 1.5 percentage points or less, on the other hand, is given "safe harbor." The "safe harbor" designation means that a borrower's only way to rebut the presumption that the lender made a reasonable and good faith determination that the borrower is able to repay the loan is to show that the lender did not actually meet the QM requirements, for example, by proving the lender did not properly verify the borrower's income or debt obligations.

Under HUD's proposed QM definition, all National Housing Act single family mortgages, except for HECMs, are defined as QMs. All loans that are insured by FHA under Title II of the National Housing Act (with the exception of reverse mortgages), would be required to meet the points and fees caps adopted for QMs by CFPB (3 percent for loans of \$100,000 or more with a higher cap for smaller loans) and, as with the CFPB definition, would distinguish between safe harbor and rebuttable presumption QMs by reference to the loan's APR relative to the APOR. Whereas the CFPB QM definition draws the line between safe harbor and rebuttable presumption QMs at APR greater than 1.5 percentage points above the APOR, the HUD QM definition, draws the line between safe harbor and rebuttable presumption QMs at the sum of the annual mortgage insurance premium (MIP) and 1.15 percentage points. MIP is currently 0.55 percentage points, so a larger number of mortgages would be given safe harbor under the HUD proposal. A loan would be treated as a rebuttable presumption QM if its APR exceeds the APOR by more than the sum of the MIP and 1.15 percentage points.

With respect to underwriting and income verification requirements, the HUD proposal would continue to use HUD's existing requirements, rather than adopting the underwriting and income verification requirements in CFPB's QM definition. As a result, under HUD's proposed QM definition, borrowers would be permitted to have a DTI in excess of 43 percent (in which case the loan would need to be manually underwritten), whereas the CFPB definition sets a hard cap at 43 percent DTI.

Also under the HUD proposal, all loans that are insured under the National Housing Act Title I program (home improvement loans) would be treated as safe harbor QMs, with no APR limit or cap on points and fees. The HUD proposal would also treat all Section 184 (Indian housing loans) and Section 184A (Native Hawaiian housing loans) guaranteed loans as safe harbor QMs, also without a limit on APR or cap on points and fees, until appropriate parameters are proposed to distinguish between which of these loans are treated as safe harbor QMs and which are treated as rebuttable presumption QMs.

NHRC is concerned that HUD's proposed definition of QM not only includes a safe harbor provision, but also expands the scope of the safe harbor provided for under the CFPB definition. While the underwriting standards for FHA-insured loans are generally effective at ensuring borrowers will have a reasonable ability to repay their loan, this is not universally true, meaning borrowers may be sold unaffordable FHA-insured loans. Accordingly, HUD should not provide a safe harbor from the ability-to-repay defense for any FHA-insured loans. Instead, all loans meeting the other QM eligibility requirements should be given a rebuttable presumption of compliance with the ability-to-repay determination requirements. At a minimum, HUD should not *expand* the scope of the safe harbor provision, as its proposed QM definition would do.

Additionally, regardless of where the line is drawn between safe harbor and rebuttable presumption QM loans, HUD should adopt strong compliance and enforcement provisions to ensure that the required minimum standards are being met in practice and to ensure borrowers have appropriate recourse when these standards are not actually complied with.

1. FHA's Underwriting Standards Allow for Unaffordable Loans and Therefore Create a Greater Need for Borrower's to Have Strong Legal Protections

A. No FHA-Insured Loans Should be Treated as Safe Harbor QMs

The underwriting and income-verification requirements for FHA-insured loans generally do a good job of ensuring that borrowers will be able to afford their mortgage. This not always the case, however. Borrowers of FHA-insured loans are in need of greater protection under the ability-to-repay and QM rules, not less, as the current proposal would provide. Furthermore, an FHA-insured loan may be unaffordable for the borrower even if the APR is not excessively high relative to the APOR. The current proposal, which would use the loan's APR relative to the APOR as the sole determinant of the legal recourse that is available to the borrower, misses this important point.

Accordingly, HUD should adopt a QM definition that does not provide the enhanced safe harbor legal protection for any FHA-insured loans. Rather, all FHA-insured loans should be treated as rebuttable presumption QMs. Such a rule would strike the appropriate balance between protecting lenders that make loans the borrower has a reasonable ability to repay and providing borrowers appropriate legal recourse when lenders do not do so.

B. Alternatively, HUD Should Not Expand the Scope of FHA-Insured Loans that Are Treated as Safe Harbor QMs

Should HUD choose not to adopt a QM definition that would treat all loans insured by FHA pursuant to Title II of the National Housing Act (except HECMs) as rebuttable presumption QMs, HUD should adopt, at a minimum, a standard that does not significantly expand the scope of FHA-insured loans that are treated as safe harbor QMs beyond those that would qualify as safe harbor QMs under the CFPB definition, as the current proposal would do. Applying the

CFPB QM definition, only about 74 percent loans insured under Title II would qualify as safe harbor QMs, while about 19 percent would be treated as rebuttable presumption QMs. Under the HUD proposal, however, about 93 percent of these loans would be treated as safe harbor QMs. (Under either proposal, about 7 percent of these loans would not qualify as QMs based on cap on the points and fees, although the HUD proposal would require all Title II loans to comply with the points and fees requirements).

The large increase in the percentage of Title II loans qualifying for safe harbor QM status under the HUD proposal results from the different formulas used to draw the line between safe harbor and rebuttable presumption QMs. Whereas the CFPB QM definition treats as safe harbor QMs all QMs for which the APR is not more than 1.5 percentage points above the APOR, the HUD proposed definition would treat as safe harbor QMs all QMs for which the APR is not more than the MIP plus 1.15 percentage points. Using the current MIP rate of 0.55 percentage points, under the HUD proposal a QM loan could have an APR up to 1.7 percentage points greater than the APOR and still qualify as a safe harbor QM.

While the proposal offers little explicit justification for doing so, the proposal appears to be the result of two concerns. First, HUD points to the lower costs for lenders to comply with its proposed definition, as compared to the CFPB QM definition, which, HUD argues, will incentivize lenders to continue making these loans without passing on the additional costs to borrowers. Somewhat perversely, HUD also points to the reduction in litigation that will follow from providing borrowers less legal recourse under its proposed QM definition as an additional savings for lenders that it expects will be passed on to borrowers in the form of lower interest rates. While impact on loan cost is an important consideration that should be taken into account in HUD's QM definition, and safe harbor loans may be less expensive, this is not the only relevant concern. The purpose of overall Dodd-Frank ability-to-repay rule of which the CFPB and HUD QM rules are subsets, is to strike a balance between providing lenders legal protection when making relatively safe loans that the borrower reasonably can be expected to repay, and providing borrowers with appropriate legal recourse when lenders do not do so. While HUD's mission to facilitate lending to traditionally underserved borrowers is relevant here, so too must be preserving the legal rights of borrowers where lenders fail to meet their obligations to ensure the borrower's reasonable ability to repay the loan. For the same reasons outlined in section A above, the flexible underwriting standards permitted under Title II, including compensating factors, create the need for greater legal protections for borrowers. If HUD chooses not to adopt a QM definition that will treat all Title II loans as rebuttable presumption QMs, it should at least not significantly expand the scope of loans that are treated as safe harbor QMs, as the current proposal would do.

The second factor HUD points to in order to justify its different formula for distinguishing safe harbor QMs from rebuttable presumption QMs is the perceived need to allow its APR to APOR spread rate to float with the MIP rate. Otherwise, HUD argues, it would potentially have to change the APR to APOR spread rate every time it changed the MIP rate in order to ensure the

financial soundness of its insurance fund. Even assuming this is a legitimate concern that should be accounted for in the HUD QM definition, however, it would be very simple to do so without unnecessarily expanding the scope of QM loans that are treated as safe harbor QMs. The most obvious way to do this would be to set the permissible APR to APOR spread for safe harbor QMs to be no greater than the difference between 1.5 percentage points and MIP. Applying this formula, the sum of APR and MIP could not exceed 1.5 percentage points.

2. HUD Should Adopt Strong Compliance and Enforcement Provisions to Ensure Compliance with Its Requirements

Regardless of where HUD chooses to draw the line between safe harbor and reasonable presumption QMs, the history of lenders failing to comply with FHA's minimum requirements makes it essential that HUD also adopt strong compliance and enforcement provisions to ensure that lenders comply with its requirements. Accordingly, HUD should also adopt strong compliance and enforcement provisions to ensure that, however it defines QM in its final rule, lenders rigorously adhere to its requirements. Specific examples of what is needed include compliance and enforcement provisions that will:

- Clearly establish how borrowers can rebut the presumption of compliance;
- Make explicit that the HUD QM definition does not preempt borrowers from bringing state claims;
- Provide for the effective oversight of FHA lending by HUD;
- Preserve homeownership for borrowers when lenders do not follow the QM lending requirements; and
- Ensure servicer compliance with rigorous loss mitigation requirements.

Such provisions are necessary regardless of the specifics of HUD's QM definition, including where the line, if any, is drawn between safe harbor and rebuttable presumption QMs. In order for any of these to provide meaningful borrower protections, it is necessary that HUD adopt a compliance and enforcement regime that will ensure lenders are adhering to the minimum standards that are established.