Comment on Proposed Changes to FHA Guidelines

FR-5404-N-01 - Federal Housing Administration Risk Management Initiatives: Reduction of Seller Concessions and New Loan-to-Value and Credit Score Requirements

August 2, 2010

CMPS Institute[1] appreciates the opportunity to comment on HUD's proposal to reduce seller concessions while strengthening LTV and credit score requirements.

New LTV and Credit Score Requirements
We applaud HUD's proposal to establish a 500 minimum credit score requirement across the board for borrowers utilizing FHA-insured home loans. We also applaud HUD's proposal to reduce the allowable LTV on purchase loans to 90% from 96.5% for borrowers with credit scores between 500 and 579. The analysis clearly shows that default rates and the resulting negative impact to the Mutual Mortgage Insurance Fund (MMIF) can be greatly reduced if this measure is taken. While less than 2% of potential FHA buyers may be locked out of getting a home loan until they improve their credit score, this will help the housing market in the long run by reducing future foreclosures and preserving the availability of FHA-insured financing for the vast majority of homebuyers who utilize FHA-insured home loans[2].

Reduction of Seller Concessions
We completely disagree with HUD's proposal to effectively double the buyer's down payment requirements by reducing seller concessions to 3% from 6%. This will hurt the housing market by making it more difficult for qualified buyers with high credit scores to buy a home. Specifically, there are two reasons why we believe the proposal to reduce seller concessions should be abandoned.

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[1] The CMPS Institute administers the Certified Mortgage Planning Specialist (CMPS®) designation through an extensive curriculum that focuses on suitability of various mortgage options, a comprehensive examination process, an enforceable code of ethics, and annual continuing education requirements. Recognized for its preeminence within the industry, the CMPS curriculum goes above and beyond the minimal licensing requirements, and represents the core knowledge expected of residential mortgage professionals. Over 5,500 mortgage professionals have gone through the program since its establishment in 2005. CMPS Institute is an NMLS-approved course provider under the SAFE Act (NMLS Provider ID # 1400384).

[2] See Table A in HUD's notice that illustrates how approx. 1.92% of all FHA borrowers had no credit score or credit scores below 580, while 98.08% of all FHA borrowers had credit scores above 580. Also see Table B that illustrates how borrowers with credit scores below 580 had a whopping 27.62% average default rate while borrowers with credit scores above 580 had an 8.97% average default rate.

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Reason #1 - Lack of a Clear "Cause and Effect" Link Between Seller Concessions and Significantly Higher Default Rates

In Table C of HUD's notice it is estimated that loans with 6% seller concessions had an average default rate of 8.27% vs. an average 5.85% default rate for loans with 3% seller concessions[3]. However, it is not clear whether this 28.47% increase in average default rates was caused by the difference in seller concessions or by some other factor[4]. For example, what if borrowers with low credit scores had a tendency to utilize 6% seller concessions in the years 2003-2008, while borrowers with higher credit scores had a tendency to utilize 3% seller concessions? In this case, why would HUD attribute the default rates to higher seller concessions vs. attributing the default rates to lower borrower credit scores?

Further, HUD failed to specify the overall percentage of loans that utilize 6% seller concessions vs. the percentage of loans that utilize 3% seller concessions. This is a significant omission in the data required to make such a universal decision impacting all FHA borrowers. For example, assume that loans with 6% seller concessions represent the majority of FHA purchase loans (say, 80%), and loans with less than 6% seller concessions represent a very small percentage of FHA purchase loans (say 20%). This minority percentage of loans with less than 6% seller concessions are also likely to exhibit other characteristics such as lower LTV ratios and significantly higher credit quality than the broader pool of loans. In this sense, it would make more sense for FHA to increase credit quality (as called for in HUD's proposal), than for HUD to also mandate that seller concessions be reduced without a clear "cause and effect" link.

Reason #2 – Recent Increase in FHA's Upfront Mortgage Insurance Premium (UFMIP) Skews the Data and Greatly Amplifies the Adverse Impact of Reduced Seller Concessions

The data used to illustrate the difference between 3% seller concessions and 6% seller concessions is taken from years in which the FHA UFMIP was much lower than it is today. Furthermore, the difference in default rates was most pronounced in the years 2003-2006 – the years of rampant origination fraud in the mortgage industry. In this sense, borrowers who utilized higher seller concessions may not have been doing so simply to pay the UFMIP and reasonable closing costs. They could have been using 6% seller concessions to pay for higher than reasonable points and fees associated with loans originated during those time periods.

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[3] Average default rates calculated based on data in Table C of HUD's notice illustrating default rates for the endorsement years 2003-2008.

[4] The lack of "cause and effect" between seller concessions and default rates is proven quite clearly by looking at the aberration in default rates for the year 2003. In that year, loans with zero seller concessions were in fact MORE likely to default than loans with 3% seller concessions. Using the logic in HUD's notice (default rates are impacted by seller concessions), it may seem prudent to prohibit loans with zero seller concessions and require at least 3% seller concessions on all loans. On the other hand, using our logic, it seems quite clear that default rates have much more to do with credit quality and other factors than seller concessions.

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Today's 2.25% UFMIP, higher appraisal and other standard closing costs, and a typical 1% loan origination fee, result in bona fide closing costs to the borrower that is well above the proposed 3% threshold for seller contributions. Reducing the allowable seller concessions to 3% will very likely have the impact of nearly doubling the required borrower contribution at closing from 3.5% to 6.5%.

In rationalizing the reduction of seller concessions from 6% to 3%, HUD cites conventional lending programs that cap seller concessions at 3% for similar LTV products, and the VA program which caps seller concessions at 4%. However, HUD fails to mention that conventional loan programs do not carry a 2.25% upfront mortgage insurance premium in addition to standard monthly mortgage insurance. A standard conventional loan at 95% LTV with 3% seller concessions would only result in a 5% borrower contribution at closing vs. a likely 6.5% borrower contribution at closing on a 96.5% LTV FHA loan under HUD's proposal.

The VA funding fees range from 1.25% to 3.3%, but the VA allows 100% financing. Therefore, even if VA borrowers have to pay 1%-3% in closing costs out of their own pocket, the effective borrower contribution at closing is less than the effective borrower contribution for 96.5% LTV FHA loans with 6% seller concessions.

In conclusion, CMPS Institute strongly urges HUD to reconsider the proposal to reduce seller contributions from 6% to 3%. HUD's proposal would:

- Be especially burdensome to borrowers and the housing market in light of the increased 2.25% UFMIP that is now required on FHA loans
- Adversely impact housing affordability by nearly doubling the required borrower contribution at closing from 3.5% to 6.5%
- Adversely impact borrowers with high credit quality who are unlikely to default on their loans without any clearly illustrated benefit (cause and effect) in terms of reduced default rates on FHA loans

For further information on these and other mortgage, financial industry and regulatory reforms, please contact:

Gibran Nicholas, Chairman
CMPS Institute
3017 Walnut Ridge Dr.
Ann Arbor, MI 48103
888.608.9800
Gibran@CMPSInstitute.org

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