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# H.R. 3915 Would Impose New Burdens and Limits on Moderate Income Borrowers

*Ronald D. Utt, Ph.D.*

The Manager's Amendment to the Mortgage Reform and Anti-Predatory Lending Act of 2007 (H.R. 3915) was reported out of the House Financial Services Committee earlier this month and is now before the full House for consideration. Originally crafted for the purpose of addressing the many flaws in the mortgage market that led to the subprime mortgage turmoil, the current bill would encourage lenders to limit their lending to only the very best credit risks. This would put individuals of moderate incomes, imperfect credit histories, and limited wealth at an even greater disadvantage, leading to a decline in the homeownership rate, now at record levels. Among the victims of this mandatory credit quality cleansing would be members of some ethnic minority groups whose current homeownership rates are today only slightly better than the homeownership rate for the nation as a whole in 1890.

Although the causes of the subprime mortgage collapse were as numerous as the questionable practices devised and allowed by devious and inattentive borrowers, brokers, lenders, and investors, the chief cause of the collapse was a significant decline on the part of many mortgage market participants in the application of traditional underwriting practices designed to assure that borrowers had a reasonable prospect of servicing their debt. How this deterioration in underwriting quality occurred and spread so far and so fast will be left to the economic historians of the future, but in many respects, the mortgage market of the past few years had all the characteristics of the typical speculative bubble that Charles Mackay so perceptively uncovered in his classic *Extraordinary Popular Delusions and the Madness of Crowds*. And as with the bubbles of the past, the market has reacted to the current turmoil by tightening up credit standards and eliminating many of the abuses that became all too prevalent in recent years.

Among the many problems with H.R. 3915 are what some critics have described as the vague and subjective standards and requirements in several sections, notably Sections 122, 201, and 202. Section 122, for example, would amend the Truth and Lending Act by adding a new section 129A, which (among other changes) would require that mortgage loan originators

> with respect to each consumer seeking or inquiring about a residential mortgage loan, diligently work to present the consumer with a range of residential mortgage loan products for which the consumer likely qualifies and which are appropriate to the consumer's existing circumstances, based on information known by, or obtained in good faith by, the originator.

The phrase "appropriate to the consumer's existing circumstances" is problematic. Existing circumstances that may impact a borrower's repayment

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prospects include health, marital stability, and employment prospects, so fulfilling this requirement could require a massive invasion of a borrower's privacy. Since the bill relies upon the threat of subsequent litigation to settle the extent to which lenders fulfilled this requirement, lenders that fail to require applicants to submit to a complete physical, a session with a marriage counselor, and an employer interview could face uncertain risks in the courts. Inasmuch as these three issues are often factors contributing to loan defaults, they would certainly be valid "existing circumstances" that the law would expect lenders to uncover.

Section 201 amends the Truth in Lending Act by adding a new Section 129B that imposes a "reasonable ability to repay" duty on lenders by requiring the following:

> (1) IN GENERAL- In accordance with regulations prescribed jointly by the Federal banking agencies, in consultation with the Commission, 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, according to its terms, and all applicable taxes, insurance, and assessments.

and

> (3) BASIS FOR DETERMINATION- A determination under this subsection of a consumer's ability to repay a residential mortgage loan shall be based on consideration of the consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio, employment status, and other financial resources other than the consumer's equity in the dwelling or real property that secures repayment of the loan.

This section would likely have a direct impact on homeownership levels. Section 201(3), for example, specifies lenders must consider "other financial resources" before making a loan, but does that mean lenders should consider such assets a mandatory requirement for loan qualification? Inasmuch as many borrowers struggle to meet the downpayment requirement, this additional burden would serve to limit mortgage credit and homeownership to a wealthier class of borrower than has heretofore been the practice in the United States. It would also, presumably, undermine all of the federal programs designed to encourage homeownership among moderate income households since few, if any, of the program participants have a net worth of any consequence—as required for program eligibility.

Section 202 of the bill would amend the Truth in Lending Act by adding to the new Section 129B (discussed above) additional language to ensure that there is a "Net Tangible Benefit for Refinancing of Residential Mortgage Loans." Specifically, the new provision states:

> (1) IN GENERAL- In accordance with regulations prescribed under paragraph (3), no creditor may extend credit in connection with any residential mortgage loan that involves a refinancing of a prior existing residential mortgage loan unless the creditor reasonably and in good faith determines, at the time the loan is consummated and on the basis of information known by or obtained in good faith by the creditor, that the refinanced loan will provide a net tangible benefit to the consumer.

This provision effectively deputizes the mortgage industry as a quality of life police force by requiring them to pass judgment upon what exactly it is that a borrower intends to do with any additional monies acquired by way of a loan refinancing. If the borrower intends to buy a new car, would the lender need to know how many cars the household already owns, predicted major uses of the new car, the availability of bus and trolley service in the neighborhood, and whether the hoped-for vehicle is an extravagant sport utility vehicle or a sturdy little pre-owned sedan? What if the loan is to pay prospective medical bills? Would the lender then have to judge whether the procedure is justified at this time or whether it could be safely delayed until the cost could be met through accumulated savings rather than debt? Again, since the penalty to the lender of making the wrong decision is to become chum for trial lawyers, there is every expectation


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that refinancing would become unavailable for many prospective borrowers.

As currently written, H.R. 3915 would force an unprecedented measure of caution on mortgage lenders by forcing them to acquire much more information than has been typical in the past and thereby intrude upon borrowers' privacy. It also would establish an explicit series of credit standards for lenders, which could have the effect of excluding many moderate income borrowers from the ownership market. In sum, the enactment of H.R.3915 would delay the housing market recovery that is now struggling to get underway.

—*Ronald D. Utt, Ph.D., is Herbert and Joyce Morgan Senior Research Fellow in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.*