

COMMUNITY MORTGAGE BANKING PROJECT

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Study of 33 Million Home Loans Shows that Quality Underwriting Standards Reduce Default More than Mandatory Down Payments

Regulators' Push for Down Payment Requirement Would Increase Costs for Responsible Borrowers and Reliance on Government Guarantees, CMBP Says

Alexandria, Va. – March 7 2011 -- Mandatory down payments like those being contemplated by U.S. banking regulators are not a significant factor in preventing mortgage default compared with a comprehensive set of quality underwriting standards, according to a new analysis of 33 million home loans originated between 2002 and 2008, the Community Mortgage Banking Project (CMBP) said today.

The study examined loans that met each of eight key underwriting and product features that are outlined in the statutory framework for Qualified Residential Mortgages (QRM) in the Dodd Frank legislation.¹ As reported previously by CMBP, these “qualified” mortgages performed dramatically better than loans that did not meet all eight standards, which defaulted at 3 times the rate of qualified mortgages.²

A further analysis of this data shows that boosting down payments in 5% 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 (see attached Chart). For example, moving from a 5% to a 10% down payment on loans that already meet all of the other QRM standards reduces the default experience by an average of only two- or three-tenths of one percent. However, the increase in the minimum down payment from 5% to 10% would eliminate anywhere from seven to 15% of borrowers from qualifying for a lower rate QRM loan (see Table below). Increasing the minimum down payment even further to 20%, as some of the QRM regulators are proposing, would amplify this disparity, knocking 20 to 25% of borrowers out of QRM eligibility, with only small improvement in default performance of about eight-tenths of one percent.

QRM: Impact of Raising Down Payments on Default Rates and Borrower Eligibility							
Year	2002	2003	2004	2005	2006	2007	2008
Reduction in default rate* by increasing downpayment 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 downpayment 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 days delinquent, plus in default, plus foreclosed.

¹ Fully documented income and assets; fixed-rate or 7-year or greater ARMs; no negative amortization; no interest only loans; no balloon payments; conservative total debt-to-income ratio; mortgage insurance on loans with 80% or greater loan-to-value ratios; and maturities no greater than 30 years.

² Study conducted by Vertical Capital Solutions for Genworth Financial, February 2010.

“Mandating a minimum down payment of 20% will not improve loan performance in a meaningful way. But it will most certainly make loans more expensive, and perhaps out of reach, for responsible home buyers,” said Glen Corso, managing director of the CMBP. “The explicit mandate of Congress was to reduce default rates. This new analysis of the data shows that regulators can comply with that mandate by fashioning a QRM with a suite of sound underwriting standards without resorting to imposing a high down payment requirement. These loans will be more effective at reducing default rates while encouraging more private lending to responsible borrowers and supporting a housing market recovery.

The release of the study, the largest and most detailed of its kind, comes as banking regulators rewrite the nation’s rules for mortgage lending with requirements that will have long-lasting implications for American homebuyers. The regulations are being written to comply with the Dodd-Frank financial overhaul law, which called for a new Qualified Residential Mortgage that would be exempt from risk retention requirements. In that behind-the-scenes debate, some regulators support including a 20% down payment requirement as part of the QRM – an approach Congress explicitly rejected.

In addition to raising mortgage costs and undermining the housing recovery, a QRM with a mandatory 20% down payment requirement will force taxpayers to shoulder even more of the risk in the housing market and will further increase consolidation in the mortgage market. “Risk retention is not cost free,” said Corso. “Non-QRMs will have significantly higher interest rates. As a result, a tightly drawn QRM will drive lower down payment borrowers straight into the FHA and other government backed mortgages that are exempt from risk retention.”

An unduly narrow QRM also creates a huge advantage for the largest banks that currently dominate the mortgage market. These are the only institutions that have the capacity to make a significant volume of non-QRM loans and hold the 5% credit risk required by rule. “Today, the three largest banks account for more than 50% of the mortgage lending in the country,” Corso noted. “If the regulators move forward and define only a small segment of the market as QRM-eligible, this will drive community banks and locally owned mortgage bankers out business, further consolidating mortgage lending into a handful of too-big-to-fail mega banks.”

Key players on Capitol Hill echo these concerns. In an op-ed last month, Sen. Isakson (R-GA), who co-sponsored the QRM amendment, wrote: “I am concerned, however, that regulators may propose an entirely unnecessary large down payment for borrowers to meet the definition of a Qualified Residential Mortgage. This is not what we intended. We sought to curtail lax underwriting standards and risky products by lenders, not to penalize credit-worthy borrowers seeking homeownership. In fact, we debated and specifically rejected a minimum down-payment standard for the Qualified Residential Mortgage ... Arbitrarily tossing in a new requirement for a large down payment will hinder, rather than help, that effort.”

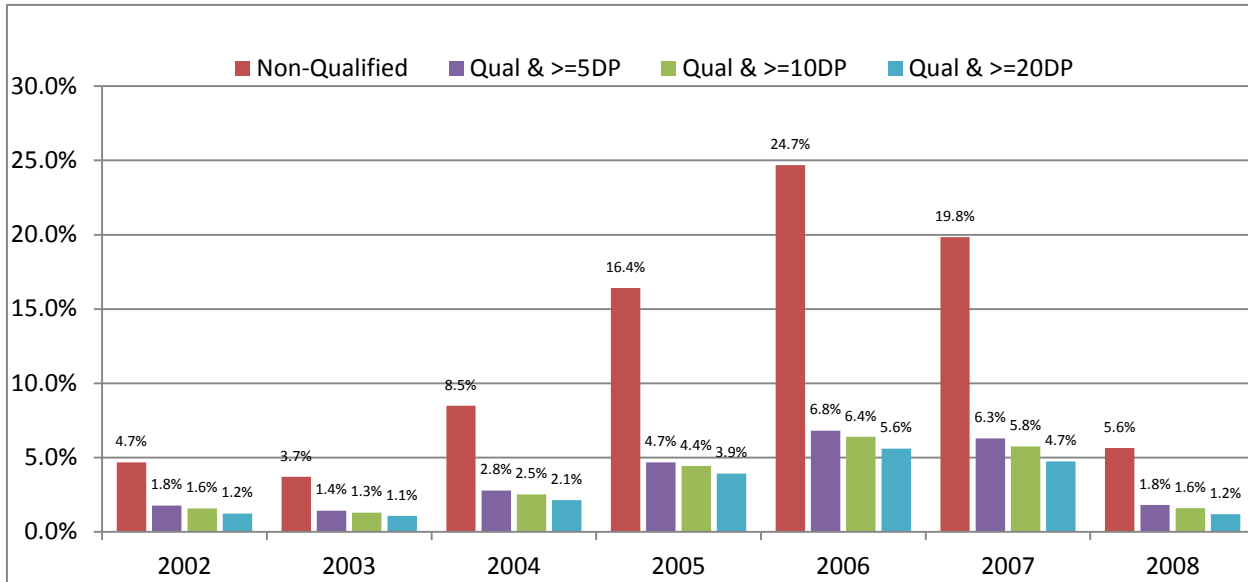
“The Congressional record makes clear that the purpose of the QRM was to drive down defaults while encouraging more private lending to responsible borrowers,” Corso said. “A 20 percent down payment requirement would do just the opposite. It would carve out the QRM for the wealthiest borrowers, regardless of credit risk; increase costs for responsible borrowers; expand the role of government in the housing market, and drive out community based lenders. This is no way to encourage a housing market recovery.”

Community Mortgage Banking Project is a public policy organization representing the interests of independent mortgage bankers. For decades, the community-based mortgage banker has delivered value and choice to consumers by leveraging local market expertise, quality service, and lower costs for borrowers. The CMBP supports financial market reforms that promote consumer access, borrower and investor transparency, local competition and choice, and a value added mortgage chain. For more information visit www.communitymortgagebankingproject.com.

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CHART 1

IMPACT OF INCREASING MINIMUM DOWNPAYMENT ON QRM's Low Down Payments not a Major Driver of Default when Underwritten Properly



Default = 90 or days delinquent, plus in default, plus foreclosed.

Source: Data from CoreLogic, Inc. Analysis by Genworth Financial and the Community Mortgage Banking Project