NLC NON-PRIME LENDING COUNCIL

The Lender

SPRING 2020

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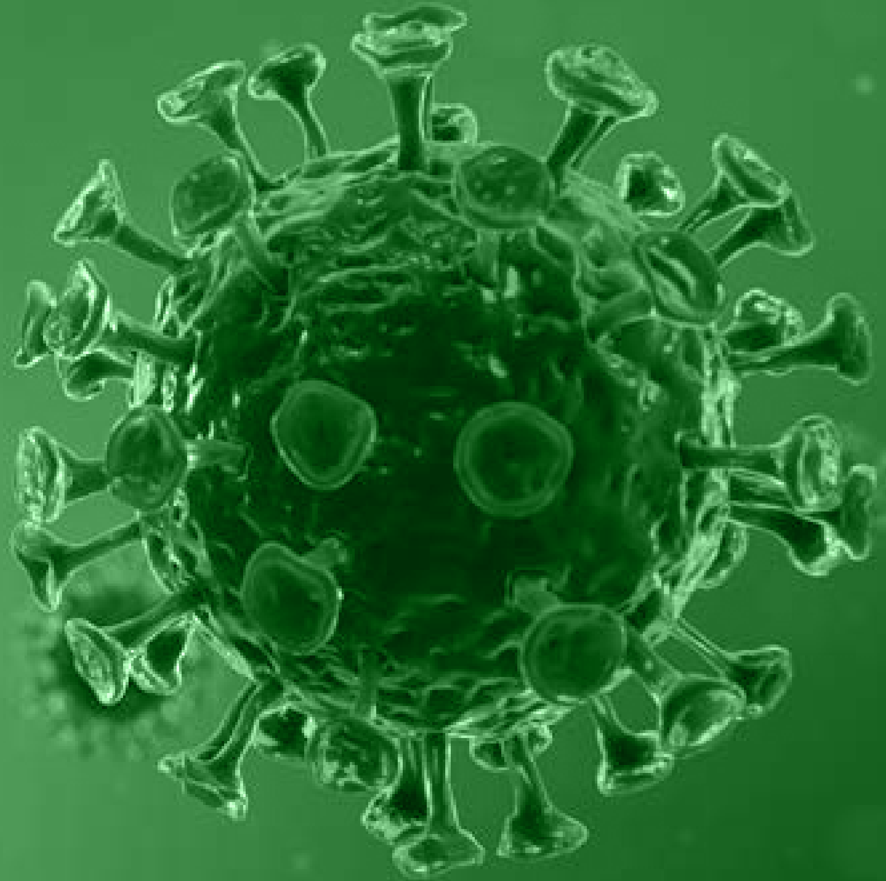

COVID-19's Impact on Non-QM

Forbearance plans could impact homeowners' ability to tap credit during these trying times.

Aaron Samples has been with First Guaranty Mortgage for more than three years and has been its CEO for over a year.

He has a track record of developing and implementing sales strategies, distribution initiatives, marketing, advertising, and sales plans, and other items.

Samples is a strategic leader with a keen ability to motivate and lead employees at all levels in the fulfillment of corporate vision and

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mission. He has a proven track record of developing and implementing sales strategies, distribution initiatives, marketing, advertising, sales plans, establishing goals, and determining forecasts while motivating the team to achieve corporate goals, budgeting, and overall business planning.

Samples appeared on a recent episode of ***DS5: Inside the Industry*** to discuss the challenges facing the non-QM market brought on by COVID-19 and what the return of the industry may look like.

What is the Current State of the Non-QM Market?

I think the best term to use in the non-QM market is paused. I think across the market, we've seen most lenders kind of drawback, hit the pause button. There's not a lot of non-QM lending occurring across the marketspace.

I think it's important to know, though, this is not due to credit, or risk, or asset performance. This is 100% a liquidity issue. The asset, quality, and performance of these loans have been very good for the last several years. It's unfortunate that the market's on pause. I think a lot of people need the credit, need the availability to tap that credit and that product.

We do feel like—the market feels like—that there will be a return to the product. I don't want to speculate when that'll be and I think anybody that does is wrong.

A lot of that depends on the duration of the shelter-place-orders, and things of that nature. We do think it will return. It may look differently when it returns. It may go back to its roots, maybe like it looked like in 2015—lower LTV, higher FICOS.

I would expect it to evolve from there just like it did and we're optimistic we see a healthy return to that market.

How could mortgage forbearance programs impact the housing market moving forward?

This is a million-dollar question. It's my view that the forbearance programs have already affected the mortgage markets and the housing markets immensely.

And I think how it affects the markets moving forward, in large part we'll have to wait and see. But to some degree, the federal government and agencies came out and told homeowners that they didn't have to make their mortgage payments.

There wasn't a lot of guidance around that. So what we've seen is our servicers just get inundated with people calling in. Many of which need help very badly. Many of which may not need help.

This has created a frenzy and panic in the industry. We don't know the percentage of folks who will go into forbearance. We don't understand the delinquency rates on a go-forward basis. Servicers are on the hook for making advances. This is principal and interest, taxes, and insurance for folks who are delinquent or in forbearance, and this could be up to a year.

What that all has created is people pulling back. We've seen credit standards tighten immensely. We've seen people kind of step back and slow down production because of the uncertainty around these items. And the effect of this is that consumers have lost their ability to tap credit.

And this is a time where consumers need to be able to refinance to put themselves in better positions through this process, and they certainly need access to their equity to help pay bills and get themselves through this difficult time.

It's already had a dramatic effect on the mortgage and housing markets and time will tell how the effects end on a long-term basis.

See more exclusive interviews on ***DS5: Inside the Industry*** *by visiting theMReport.com.*

From the Chair

Welcome,

It is my pleasure to welcome you to the first quarterly newsletter for the Non-Prime Lending Council (NLC).

I am proud to join fellow industry leaders as we work to drive innovation and education in the non-QM sector of the housing market.

The current landscape of the market is changing due to the spread of COVID-19, and the non-QM industry is not immune to its effects. What does this mean and how will we work to help our customers?

We, as an industry, can come together to better serve a population of the housing market that has yet to be addressed.

Welcome to the Q1 2020 NLC newsletter.

Sincerely,

Aaron Samples, CEO, First Guaranty Mortgage Corp.

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Removing DTI Ratio From QM 'Appropriate Step' for CFPB

Meg Burns, SVP, Mortgage Policy for the Housing Policy Center, discusses the law surrounding the GSE Patch, its expiration, and what it all means for homeowners.

By Five Star

Meg Burns is the Housing Policy Council's (HPC) SVP of Mortgage Policy. She supports HPC's engagement with policymakers on various housing finance issues, including housing finance and regulatory reform.

Before joining HPC, Burns was a partner at the Collingwood Group, a Washington, D.C.-based housing finance advisory firm. Before Collingwood, Burns served as the Senior Associate Director of the Office of Housing and Regulatory Policy at the Federal Housing Finance Agency (FHFA), overseeing the policy activities of the GSEs in conservatorship, including several high-impact projects such as the Servicing Alignment Initiative, redesign of the HARP program, and development of the new representation and warranty model.

Burns spoke about the much-debated issue of the debt-to-income (DTI) ratio, what the removal of it could mean for homeowners, and what's next for the CFPB and the QM Rule.

Could you please explain the law surrounding the debt-to-income ratio and the QM Rule?

A lot of people, as a result of the GSE Patch, have forgotten how the law is actually structured and what it really means. So, let's go back to the Dodd-Frank Act, the actual foundation for the ability to repay qualified mortgage regulation; the law stipulates that for every mortgage made in America, the lender must evaluate the consumer's ability to repay, and the law specifies how the lender must do that.

The law stipulates a list of the underwriting variables that include current income, expected income, obligations, debt-to-income, and credit history. These are common underwriting variables that you would see in most standards, such as the GSE or FHA underwriting guidelines, or, frankly, in private proprietary underwriting standards.

The ATR mandate is the foundation of the law. Every mortgage in America requires that the lender ascertain the customer's ability to repay the mortgage on the basis of that information—income, obligations, DTI, credit history, and more.

On top of that, the law actually says there is a segment of mortgages, all of which must meet ATR, that are designated qualified mortgages and those qualified mortgages are presumed to fulfill the ability to repay standard. They are presumed to fulfill the ability to repay standard, based on a set of safe products and safe practice requirements, also stipulated by law.

The ATR mandate is the foundation of the law. Every mortgage in America requires that the lender ascertain the customer's ability to repay the mortgage on the basis of that information—income, obligations, DTI, credit history, and more.

This QM section of the law is the place where Congress was addressing the predatory practices that were of concern leading up to the mortgage crisis. This is a place where they essentially said, we are going to prohibit the kind of lending products and practices that we think

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contributed to this crisis.

So, this section of the law specifies that a qualified mortgage cannot have risky features, such as negative amortization, interest-only payments, extended terms, stated-income, high rates, and fees.

To give some color, negative amortization means that the loan balance is growing over time because the principal balance is not being paid down and the loan could ultimately exceed the value of the property. That is prohibited. Similarly, interest-only mortgages are prohibited from QM because a consumer is paying only the interest on the loan and therefore the principal balance isn't being paid down, so they're not gaining any equity.

One concern with this approach is the same—that the loan balance exceeds the value of the property at some point in the future. That is prohibited. For example, the lender must collect and validate income for all consumers. Stated income and liar loans are not permissible.

To push this point even further, extended-term mortgages, where the borrower would carry the indebtedness over a very extended period of time—any terms greater than 30 years—are prohibited under the QM section of the law. Mortgages with points and fees greater than 3% are prohibited from QM.

High-cost mortgages are prohibited because these practices were used in a predatory manner to compensate lenders for excessive risk in lieu of rejecting consumers who lacked the capacity to repay.

These two sections of the law—ATR and QM—go hand in hand. Every mortgage in America must fulfill the ability to repay with underwriting standards that meet the factors built into the law. Some segments of these loans are QM, and QM loans are presumed to fulfill ATR because they are safe products, originated in accordance with the mandated practices and features of the QM provisions of Dodd-Frank.

The intent with the interplay between ATR and QM is that the products and practices that the law is prohibiting for QM loans were the kinds of things that enabled a lender to circumvent the fundamental ATR requirements leading up to the crisis. By prohibiting these in QM, the law makes clear, "If the lender is meeting these QM requirements, we can presume that this loan fulfills the ATR mandate of this law." This is the fundamental structure of the law—ATR as the foundation and QMs are a segment of ATR mortgages.

On top of this structure, the CFPB added something authorized but not defined by law, a legal liability pricing lever which many refer to as Safe Harbor. For QM loans only, if the annual percentage rate on the loan is at no more than 150 basis points over the average prime offer rate (APOR), the presumption of compliance with ATR is conclusive.

These loans are essentially considered prime rate loans and the pricing reflects the lower-risk nature of these loans. For these loans, the consumer may not challenge whether the lender fulfilled the ability to repay requirement. If the annual percentage rate on the loan is greater than 150 over APOR, then the presumption that the loan fulfills ATR is rebuttable and the consumer has the right to say, "I just went delinquent and now I'm questioning whether you ever really assessed my capacity to repay on this loan at the outset."

What are your thoughts on the possible elimination of the debt-to-income ratio?

The CFPB layered into the regulation of the DTI requirement for a qualified mortgage. The law mandates safe product features, but not the DTI. The law simply provided the Bureau the authority to either add to the statutory elements for qualified mortgages or subtract from them.

The Bureau added the 43 DTI element to the QM definition in the 2014 rule. They then actually worried that the 43 DTI was at a level that might constrain the market and they added the GSE Patch as a mechanism to ensure that those borrowers who couldn't meet the 43 DTI requirement had another option. So, the GSE Patch served as an exception to the 43 DTI.

Those elements of QM, the DTI and GSE Patch, were not required. They were add-ons that the Bureau, in its evaluation of the regulation, performed in 2018, actually identified as the most problematic features of the regulation. If you read the CFPB "look back" report, they say the GSE Patch distorted the marketplace, and they say that the reason that people turn to the GSE Patch is because of the DTI requirement.

The DTI was stringent, set at 43%, but also troublesome because the associated instructions provided to the lending community regarding how to fulfill the 43 DTI were insufficient. We often refer to these instructions as Appendix Q, because they are included in Appendix Q of the regulation. These instructions, as recognized by CFPB itself, are problematic.

In the assessment report, the Bureau presented these two aspects of the regulation to be a challenge and as elements that constrained and/or distorted the market in ways that were negative for the industry and consumers. The look-back evaluation is mandated by the Dodd-Frank law and the conclusions affirm and support the proposal that the Bureau is putting forward now—to allow expiration of the GSE Patch in January 2021 and simultaneous removal of the DTI from QM with the related Appendix Q.

We at the Housing Policy Council agree with their direction; given that these elements, the GSE Patch and DTI, generated negative impacts for the industry and consumers and that these elements are not required by law. We think that their removal makes a lot of sense. We led a policy discussion on the

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future of QM with a diverse coalition of 23 organizations—both industry associations and consumer advocacy and civil rights organizations—and we all agree that removal of the DTI makes a lot of sense.

It's consistent with the law in the purest form. We appreciate that the CFPB identified these two problematic features and is now signaling that the Bureau plans to eliminate them. Elimination of the DTI preserves access to credit in the future. It's not disruptive to the functioning of the market. It does not introduce new credit risk to the equation because every mortgage in America must fulfill the fundamental obligation of the law, the ability to repay standards.

How could millennials, minorities, or low-income buyers be impacted by the elimination of the DTI ratio?

The 23 organizations that got together discussed this issue and we tried to highlight that point in our letter. We speak very directly to our concern that the marketplace continues to serve a population that is changing as a result of shifts in demographics. We cite some statistics to help frame the issues; we fundamentally believe that by removing the DTI at the time of the expiration of the GSE patch, we will be able to continue to serve this new millennial and more diverse population.

One of the things that we point out in the letter—and this is true of all new homeowners—the future population of new homebuyers will generally have lower incomes. They generally have thinner credit histories. They generally have a profile that is not the same as second-time buyers whose income increases as they advance in their careers and who have accumulated more wealth.

The letter states:

> *"The Bureau has a unique opportunity to modify the ATR QM rule to meet the needs of changing housing market. Elimination of the DTI requirement for prime and near-prime loans would preserve access to sustainable credit for the new generation of first-time homebuyers in a safe and sustainable way and accordance with the fundamental ATR requirements. This change is especially important for reaching historically underserved borrowers, including low- to moderate-income households and communities of color. Household formation growth is being largely driven by communities of color throughout the nation."*

According to projections by the Urban Institute, by 2030, 10.4 million new households will be made up by people of color. Of these total new households, 46% are projected to be Hispanic, 18% are African-American, 24% are other races, and only 12% are projected to be non-Hispanic white. If we look at just homeowners, Hispanics, for example, are projected to account for 56% of all new homeowners between 2020 and 2030. Communities of color are more likely to have lower-incomes, live in multi-generational households, have thin to no traditional credit history, be self-employed, and participate in the gig economy.

If the mortgage market fails to support these potential new homeowners along with their homebuying journey, the nation will share the economic consequences. But, the bottom line is the changes that we are proposing and that we understand the CFPB may pursue to remove the DTI and the Appendix Q instructions at the time that they remove the GSE patch, will certainly enable the lending community to serve these customers.

Fulfilling the fundamental ATR underwriting requirements that include evaluation of current income, expected income, obligations, debt-to-income, credit history, etc., but also offering them safe product features that under QM are required, they would end up getting safe, affordable, well-priced loans, and that's our goal.

What are the next steps in this process?

We know that the next formal public part of the process will be the release of the actual proposed regulation by the Bureau, and we expect that to be this spring. I think they indicated in the letter that they were shooting for May. At that juncture, all of the organizations that were part of this QM Coalition will likely coalesce again and we hope to support the proposal for removal of the DTI that we believe may be forthcoming and make the case for it.

Between now and then, there probably will continue to be some industry-wide, consumer advocacy conversations. One of the things that we as an industry are most concerned about is the number of articles that have suggested that by removing the DTI from QM, mortgage loans will no longer be underwritten in accordance with traditional standards that include DTI. That is incorrect.

We want to make it clear in the public domain, in the press, however we can, that this notion that removal of the DTI from QM is the same as removal of the DTI from ATR is not true. As I've tried to describe, the way the law reads, all mortgages must be underwritten in accordance with the ability to repay and the additional requirements that apply to the QM segment of those ATR-compliant loans reinforce that mandate.

And so, this potential change by the CFPB, to remove the DTI from QM only, cannot and will not contradict or change those ATR standards. It can't. The law stipulates that ATR must include DTI as an underwriting factor. This is a fact and, absent Congressional action, cannot be changed. Removal of the DTI from QM does not result in any change to the ATR mandate to underwrite the loan using DTI and those who continue to say as much are just dead wrong. | **NLC**

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Mortgage Lender Launches New Technology

This loan product tool and broker/client dashboard automates the prequalification process, calculates loan eligibility decisions instantly, and allows registered brokers access to their loan pipeline with Cherrywood.

Cherrywood Mortgage, a national small-balance commercial mortgage lender and affiliate of Angel Oak Companies, announced the launch of Cherrywood—Portal Real-Time Online (C-PRO). This commercial loan product tool and broker/client dashboard automates the prequalification process, calculates loan eligibility decisions instantly, and allows registered brokers access to their loan pipeline with Cherrywood.

This technology upends the small-balance commercial real estate industry by accelerating a formerly time-consuming process. Now brokers can get the answers and insights they need to grow their businesses autonomously.

"When we set out to create this tool, our focus was on optimizing brokers' time by giving them the power to potentially close loans faster and coordinate the customer relationship even better," said Ed Resendez, President, and COO at Cherrywood Mortgage. "The qualification process can be daunting for many individuals, so we see this technology improving efficiency and opening more doors for brokers who are looking to grow their businesses."

Utilizing proprietary technology, C-PRO enables brokers and prospects to input data online to determine if a property qualifies for a loan, and at what rate, within seconds. If the system indicates that the loan qualifies based on your input, a letter of interest (LOI) can be provided directly to registered brokers, who also gain access to a dashboard that offers unmatched transparency by tracking loan requests in real-time. Additionally, brokers can communicate directly with Cherrywood personnel through the dashboard, advancing the industry's standard of service.

"C-PRO's ability to qualify and offer financing options at the click of a button will revolutionize the industry," explained Christopher Lappi, EVP, CIO, and CTO at Cherrywood Mortgage. "By making manual tasks obsolete, such as sizing loans and issuing letters of interest, we help our clients get more deals done. C-PRO allows brokers registered with Cherrywood to upload loan condition documents and monitor their loans throughout processing and underwriting. Automating the financing process shows our dedication to 100% client satisfaction."

The launch of C-PRO comes on the heels of other innovative tech-led initiatives from Angel Oak aimed at improving the experience for borrowers and brokers alike. In 2018, Angel Oak Home Loans announced the MyHomeLoan Mortgage App, which gives prospective borrowers easy access to their entire home loan process via their smartphone. Last year, Angel Oak Mortgage Solutions implemented the QuickQual tool, which enhanced efficiency for brokers in the non-QM space by greatly improving the prequalification process.

"Cherrywood's successful integration of C-PRO is a foreshadowing of where the small-balance commercial lending industry is heading," said Mike Fierman, managing partner, and co-CEO at Angel Oak Companies. "Angel Oak and our affiliated companies aim to be leaders in the lending space, and it starts with our ability to leverage technology. Our dedication to technology and Cherrywood's innovation serve as testaments to that goal." | **NLC**

Citadel Servicing Corporation Purchased by HPS Investments

Citadel Servicing Corporation has been purchased by HPS Investments

Amidst the COVID-19 pandemic, Non-QM industry pioneer Citadel Servicing Corporation (CSC) was purchased by HPS Investments, a global investment firm that specializes in creative capital solutions and manages strategies across capital structures

"We are excited that HPS has purchased CSC," said new CSC CEO Kyle Gunderlock. "HPS have shown through past acquisitions the value they can bring. HPS's financial and operational resources, as well as their confidence in what the CSC team has achieved, enhances our ability to continue to lead in the non-QM market."

In addition to the resources available to CSC through this purchase, HPS brings a wealth of experience in growing businesses, allowing CSC to cement its position as the leader in the non-QM space. | **NLC**

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