My name is Adam Rust. I have been research director at the Community Reinvestment Association of North Carolina since January of 2005. In my position, I rely on Home Mortgage Disclosure Act (HMDA) data on a regular basis.

I don't think that I am making a claim that anyone would refute when I acknowledge that HMDA data manifests the ambition that prompted and helped to pass the Community Reinvestment Act. From that point, though, I would offer that there is a long way between providing data that merely observes the letter of the law, and developing a standard that honors the spirit of that legislation.

I would like to submit a paper that was published in connection with the conference "Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act," with my written comments.

I am a "user" of this data. My viewpoint is of that of a person who consumes this information, and not that of a bank that submits or of a regulator that oversees it. I use it for the basic day-to-day fulfillment of my job.

Why This is Important

Community groups are taken much more seriously when they can complement their direct dialogue with a financial institution with verifiable statistics. It is one thing to say "you don't make loans in our neighborhood," and quite another to say "you only made two prime rate loans in our census tract in the last three years, and both were for investors."

I use HMDA data in many ways. The traditional question, posed since the CRA was passed, is 'how are banks and thrifts meeting the credit needs of their local communities'? That is still a frequent impetus for the use of this data. I've answered that question not just for local community groups, but also for Mayors and County Commissioners. We routinely present our conclusions on the story told by HMDA data to the banks that have submitted the data. Still, the data has other uses. I have used the data to construct an index for socially responsible investors. A national church group has asked us to use HMDA data in a project that interacts with data from the FDIC, the National Information Center, and other government data sources.

Nonetheless, the old HMDA approach assumed that most mortgage loans were the same. More loans were good, and fewer loans were bad. That viewpoint, in the light of what we know now in 2010, is optimistic at best. More often than not, the new focus is qualitative. The traditional question was 'how much credit?' That has been replaced by a new concern, namely 'what type of credit?'

HMDA data is not designed to accommodate that change. I believe that the Federal Reserve should take the opportunity to create new metrics for evaluating how credit is extended across communities.

Defining the Problem:

The underlying problem is that a gap has developed between how loans are evaluated in the marketplace and how they are recorded in HMDA data.

Even as recently as 1991, when FIRREA gave more depth to HMDA data, there was far more homogeneity in home mortgage lending products.

a) Not all borrowers are taking out 30-year fixed-rate prime mortgage loans. Pricing is based upon risk. There are new, exotic loan products.
b) More people are able to get credit than before, but many are using poor quality credit.
c) There are new gatekeepers of mortgage credit. Branches are still the place where some consumers apply for a loan, but many consumers use a mortgage broker or access an online application.

What would be very helpful would be some means of linking subsidiaries to their corporate parent. Wells Fargo, for instance, issues mortgages through more than 60 channels. It can be very hard to be sure if you are including the right LARs for

The share of home mortgage loans made with an adjustable rate of interest has flucated from as high as almost 40 percent to as 2 percent.

Data Elements. *Should the Board add, modify, or delete any data elements? For example, lenders currently are not required to report key underwriting data, such as information about the borrower's creditworthiness and loan-to-value and debt-to-income ratios. Some HMDA data users and others believe that this information would improve the usefulness of HMDA data in identifying possible discriminatory lending patterns. On the other hand, collecting this additional data would increase HMDA reporters' compliance burdens and costs and could pose risks to consumers' privacy.*

Each year, when I request data from a certain lender, their CRA officer sends me a letter reminding me that HMDA data only tells some of the story. This is an excerpt from her 2006 letter, although every year offers a similar expression:

"As you analyze this data, please also consider that the HMDA results tell only part of the story since certain risk and other loan factors that affect pricing are not included. Because these factors tell only part of the story, since certain risk and other loan factors that affect pricing are not included…differences in pricing are based on differences in risk."

This letter underscores how the absence of important data elements undermines the utility of HMDA data. It also goes to show that this feeling is held not just by consumer advocates, but also by lenders.

Update HMDA to track with current practices in loan underwriting: Freddie Mac says that there are three important elements to loan underwriting: credit reputation, capacity, and collateral[i]. Credit score encapsulates the first factor. Capacity is harder. It includes not just debt ratios such as debt-to-income and loan-to-value, but also cash reserves and loan characteristics. Collateral is expressed by a down payment, by the property use, and by property type. Freddie Mac uses these data points to determine the suitability of a loan for GSE purchase.

Credit Reputation	Capacity	Collateral
Credit score	Debt-to-income	Loan-to-value
Foreclosures, delinquencies	Number of Borrowers	Down payment
Credit accounts: type, age, limits, usage	Income Type: Self-employed, salaried	Property type
New credit requests	Cash reserves	Owner type

HMDA data offers no insight into the first and second elements, and only some insight into collateralization.

The solution is to include variables that matter to bankers. Mortgage loans are underwritten and evaluated for loan-to-value.

Variables should accommodate safety and soundness concerns. For the last ten years, most advocates have focused on combating subprime lending.

Create a categorical credit score variable: The ideal data point here achieves a compromise between the needs of users to control for credit quality and the right of consumers to have some degree of privacy.

A credit score data point should be a categorical variable with perhaps four credit bands: two for different grades of subprime credit, one for median credit, and one for prime credit. This reduces the noise of identify a consumer by a falsely exact score, and it creates a relative “cloak” of privacy for consumers.

Expand indicators that reflect credit capacity: Banks and thrifts extend credit according to important “ability to pay” factors. New language in the CFPA will require lenders to honor that standard. The value of new HMDA data would be enhanced if it gave users the ability to examine the extent that these lenders are hewing to that expectation. We know from research that these variables are incredibly significant. Research indicates that payment to income, also expressed as the debt coverage ratio, is the most reliable indicator of mortgage default[ii] [iii] .

Important features of loans are currently not present in HMDA data: Most of the innovations in lending were applied most widely to "subprime loans." Prime loans were more likely to have fixed-rate interest rates and to fit within standards that conformed to the requirements of GSE delivery guidances. Subprime loans were much more likely to come with prepayment penalties and balloon payments, for instance. Discerning those features is an important ability for analysts of mortgage data, because those features are associated with higher rates of foreclosure.

There are many important "features" that would add a lot of value to HMDA data. The advantage would be in identifying the quality of lending. We know that there are wide variations in the combined sum of origination fees. Many subprime refinance loans required borrowers to submit to very high fees. In some instances, borrowers were shielded from those costs because they were able to fold them into the loan balance. Either way, it is an important thing to watch.

We know that many borrowers with good credit received "subprime" mortgages. Mortgage characteristics are also relevant, and would include an adjustable-rate mortgage type[iv], loan term[v] (longer mortgages are riskier), and the presence of a pre-payment penalty[vi].

Being "under water," a term that describes a mortgage where the loan amount exceeds the value of the home it is made against, is the leading factor for predicting a default. Loan-to-value, based upon either tax value or appraised value, would narrow the gap.

Amend loan purpose to highlight physical reinvestment in communities: The existing "loan purpose" category should be enhanced to tell us more about the reinvestment that it supports. The CRA was designed to encourage reinvestment in communities, and the HMDA is designed to monitor those efforts. Community interests would be served by making a distinction between loans that support additional construction, and those that do not. This is an important category of mortgage financing, particularly for older and more established areas. While the creation of new investment is implicit in loans currently characterized for home rehabilitation, and refinance lending is explicitly not included, there is no distinction between home purchase loans for new construction and for existing housing. This fix would make an important comment on the availability of capital.

Coverage. *Regulation C currently requires depository institutions and non-depository for profit mortgage lenders to report HMDA data if they exceed certain size and activity thresholds. Should the Board: Require reporting by additional types of institutions, such as mortgage brokers and non lender loan purchasers? Exempt any types of institutions from reporting? Make other changes to the rules regarding which types of institutions are required to report?*

- I would like it if they would identify the source of those loan channels.
- I would like to have the LAR identify the regulatory agency that has granted a charter or license to the lender.

Scope. *Should the Board require lenders to report on home-secured loans in addition to home purchase, home improvement, and refinancing loans, such as reverse mortgages or all home equity lines of credit (including those that are not used for home improvements)? Should any types of home secured loans be excluded from reporting?*

The intent of the CRA was to give clarity to the flow of capital into neighborhoods. Part of that flow is the amount of dollars entering neighborhoods to support new construction and rehabilitation.

I expect that there will be a wide variety of ideas in this category, which should reflect the importance of this question. I believe that existing loan type categories should be tweaked, and also that new categories should be added to the loan type indicator. Specifically, data should re

Reverse mortgages deserve an explicit designation in HMDA data. Rules at the Department of Housing and Urban Development impose extensive requirements for consumers that want to get a reverse mortgage, because there is a widespread snese that these loans should be used only when consumers are aware of their risks. A home is often the largest asset held by low-and-moderate income households. The designation should be included in the loan type field.

The Federal Reserve should also add clarity to the nature of mortgages and loans made on manufactured homes. Many manufactured homes are purchased as personal property, while others are purchased as real property. The distinction is significant. It influences the terms of the loan and it implies a different set of consumer protections. States have different definitions of how manufactured housing is classified. HMDA should make it clear if the home is real property or personal property.

Compliance and technical Issues. *What are the most common compliance issues institutions face under HMDA and Regulation C? Are there provisions of Regulation C where clarification would be useful to HMDA reporters? Are there technical issues that should be resolved?*

Not relevant to my experience.

Other issues. *What emerging issues in the mortgage market are likely to affect the usefulness and accuracy of HMDA data? What other changes to Regulation C should the Board consider?*

The CRA original intent focused on encouraging banks and thrifts to make loans in low-income neighborhoods. The GSEs and FHA have implemented new policies that could have the unintended consequence of adding to the disinvestment in low-income neighborhoods. The Loan Level Pricing Adjustment (LLPA) and the Adverse Markets Delivery Charge (ADMC) add costs for lenders seeking to resell loans. Inevitably, these costs will be passed on to consumers. The LLPA and the ADMC trigger additional origination fees for loans with low credit scores, high debt-to-incomes, and high loan-to-value measures. These are all factors that will impact the availabilyt of credit. This is a policy that could undermine opportunity for families in poor areas. In short, it is a classic CRA issue. HMDA data, as currently constructed, is almost useless for this task. Only three of the 13 factors in the LLPA are found within HMDA. The implicit assumption behind the LLPA is that these additional factors are likely to increase risk. These are safety and soundness factors. The policy governs loans delivered to the agencies. However, it is hard to imagine that the new policies will not carry over into origination fees paid by retail consumers. The consequence of this new dynamic will certainly fall heavily on low and moderate income constituencies.

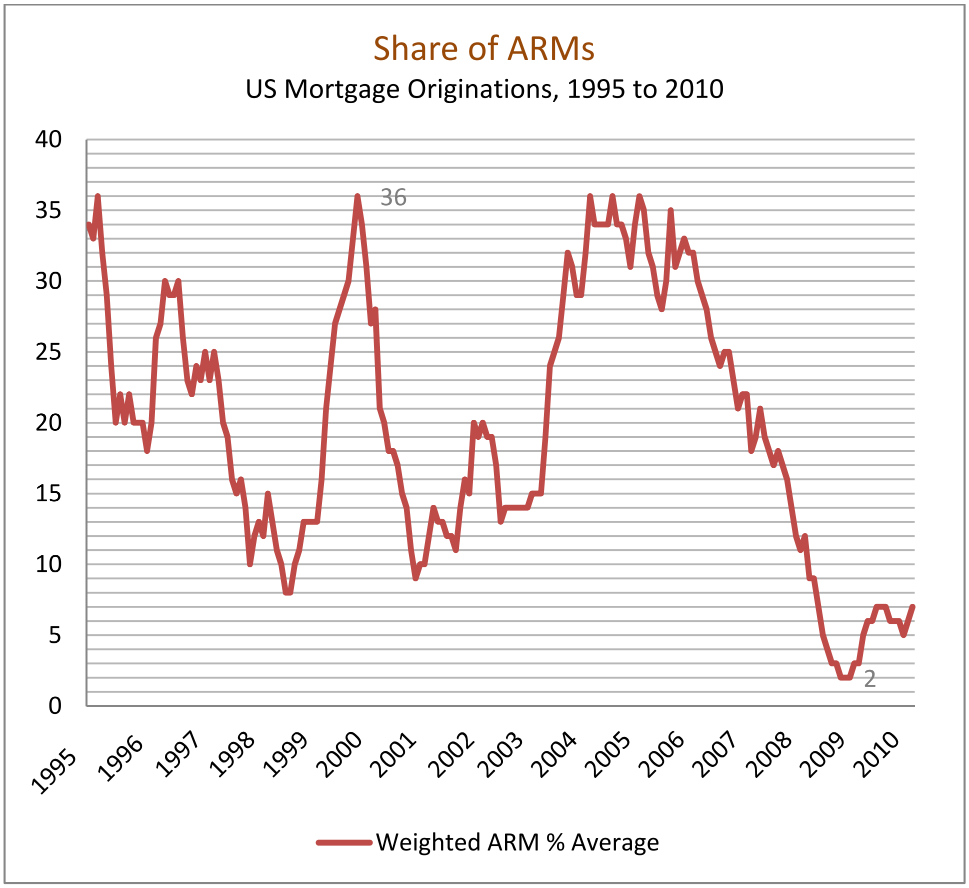
Indicator	*In HMDA?*	*In LLPA?*	*Basis Points*	*Factor*
ARM	No	Yes	Up to 25	LTV
Balloon Mortgage	No	Yes	12.5	LTV
Investment Property	Yes	Yes	175 to 375	LTV, Balloon
Multiple Unit Property	Yes	Yes	Up to 100	LTV
Manufactured Home	Yes	Yes	50	LTV
40 Year Term	No	Yes	125	LTV
Interest-Only	No	Yes	25 to 100	LTV, Balloon
Condominium or Co-Operative	No	Yes	Up to 75	LTV, Term, Balloon
Cash-Out Refinance	No	Yes	0 to 300	Credit Score
High Balance (LTV)	No	Yes	75	ARM, Cash-Out Refi
Credit Score	No	Yes	Up to 300	LTV
Subordinate Financing	Yes	Yes	25 to 75	Credit Score, I/O, LTV, CLTV
My Community Mortgage	No	Yes	75 to 125	Subordinate Financing, I/O,Term, ARM

In some cities, there is almost no lending for new construction or for home rehabilitation loans. More than 64 percent of home rehab loans were denied in Detroit in 2008, for instance.

The reforms that are needed for HMDA data would answer the concerns of someone trying to model the impact of the LLPA and the AMDC.

Solution: These factors could be expressed through discrete indicators. An alternative would be to report the summary of LLPA fees on all purchased loans delivered to the GSEs.

Table 1: Share of Adjustable-Rate Mortgages, 1995-2010



John Krainer (2010) Mortgage Choice and the Pricing of Fixed-Rate and Adjustable-Rate Mortgages." FRBSF Economic Letter.

Mismatch between who reports and who makes loans:

I have heard that there is some gap in reporting by institutions that make loans for manufactured housing. I cannot verify that, beyond the assurances given to me by Fed staff, that this is true. Point is, I t feels true and so it is.

Academics can construct very reliable logistic regression models for estimating the likelihood of loan default. Some of the most important variables are missing from HMDA data.

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[i] http://www.freddiemac.com/corporate/au-works/factors.html

[ii] Williams, A. O., W. Beranek, and J. Kenkel, 1974. Default Risk in Urban Mortgages: A Pittsburgh Prototype Analysis. *AREUEA Journal* 2 (2): 101-2.

[iii] Quercia, Roberto, McCarthy, George W. and Stegman, Michael A., Mortgage Default Among Rural, Low-Income Borrowers (1993). Levy Economics Institute Working Paper No. 96. Available at SSRN: http://ssrn.com/abstract=139564 or doi:10.2139/ssrn.139564

[iv] Posey, L. L., and A. Yavas, 2001. Adjustable and fixed rate mortgages as a screening mechanism for default risk. *Journal of Urban Economics* 49: 54-79.

[v] Von Furstenberg, G. M., 1969. Default Risk on FHA-Insured Home Mortgages as a Function of the Terms of Financing: A Quantitative Analysis. *Journal of Finance* 24: 459-77.

[vi] Quercia, Roberto, M. Stegman, and W. Davis. (2007) “The Impact of Predatory Loan Terms on Subprime Foreclosures: The Special Case of Prepayment Penalties and Balloon Payments.” Housing Policy Debate 18 (2) 311-346.