DETROIT HOME MORTGAGE

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Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
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**RE: Risk Management Guidance for Higher Loan-to-Value Lending in Communities Targeted for Revitalization**

Dear Mr. Feldstein:

On behalf of many of the participants in the Detroit Home Mortgage (DHM) program, we appreciate the opportunity to share our views on the proposed guidance regarding higher loan-to-value mortgage lending in communities targeted for revitalization with the revision published in the *Federal Register* on June 20, 2016. The participants represented in this letter include the following:

- Community Reinvestment Fund, USA
- The Huntington National Bank
- Flagstar Bank
- FirstMerit Bank, National Association
- Talmer Bank and Trust
- The Kresge Foundation

The DHM participants wish to thank the Comptroller of the Currency and

Agency staff for their efforts to foster responsible, prudent lending by national banks that can restore market forces in communities struggling with blight and high vacancies. This new guidance enables national banks to address the serious mismatch in some economically distressed communities and some of our largest cities between the cost of acquiring and / or rehabilitating a home and the appraised value of that home based on existing and comparable sales. This impacts the price at which that home can be sold in the marketplace, and is able to be addressed with innovative but appropriate mortgage products specifically designed for new (and existing) homeowners in neighborhoods hard hit by the financial crisis. We commend the Comptroller for this new guidance as it creates a path for depository institutions to finance the type of homeownership that will ultimately stabilize and revitalize places suffering from significant disinvestment.

**BACKGROUND**

In collaboration with Community Reinvestment Fund, a national Community Development Financial Institution (CDFI) and a leader in channeling resources from the capital markets to support community economic development and helping mission-driven organizations improve efficiency and build capacity, the Kresge Foundation, the Michigan State Housing Development Authority (MSHDA), and five Detroit banks together have launched an effort in February 2016 to offer a standard mortgage product, the "Detroit Home Mortgage" that is offered exclusively within the city of Detroit.

As indicated in our prior comments (dated February 22nd, 2016), Detroit's housing market is challenged in a variety of ways. Disinvestment in the Detroit residential market has resulted in a massive number of vacant homes, many with substantial rehabilitation required before they can be occupied. The decrease in Detroit's population, which has fallen twice as much as the number of housing units in the city, has led to an abundance of available housing. Home prices are at historically low levels in many neighborhoods;

however, many of these homes require extensive rehabilitation, yet property values are suppressed not allowing borrowers to obtain the financing they need in order to purchase the home and make the necessary improvements.

Related to Detroit's housing stock challenges, potential homeowners face the daunting challenge of qualifying for appropriate financing. Currently, the biggest contributor to Detroit's blight is the inability for qualified borrowers to get mortgages, as appraised values cannot support purchase plus rehabilitation in the normal course of residential mortgage finance. As noted[1] by Mayor Duggan, "The single biggest problem to restoring blight is that we can't get mortgages." According to recent reports including the data reported in 2013 and 2014 by institutions under the Home Mortgage Disclosure Act (HMDA), borrowers in Detroit requesting mortgages are twice as likely to be denied due to a collateral shortfall as they are for poor credit. This is due to the high loan-to-value ratios caused by homes with low appraised values and high rehabilitation costs. In these reports and data, denial rates for home improvement loans in Detroit were noted to be very high, with nearly 80 percent of applications for FHA-backed home improvement loans denied in 2013. In 2014, 88 percent of the homes purchased in Detroit were acquired for cash and a mere 12 percent were financed with a mortgage. These statistics demonstrate that the Detroit housing market is currently dominated by those who have the liquidity to purchase a home with cash, denying a large segment of the population homeownership opportunities, further exacerbating Detroit's housing challenges.

The Detroit Home Mortgage (DHM) program looks to address this. It is a three-year program to provide $40 million in second mortgages to fund necessary repair and rehabilitation activities for 1,000 homebuyers in Detroit. To operate at this scale, nearly twenty local, regional and national partners are

[1] http://www.crainsdetroit.com/article/20140918/NEWS/140919680/we-cant-get-mortgages-duggan-asks-expats-to-help-solve-detroit

involved. Of these partners, the banks include: Flagstar Bank, Talmer Bank and Trust, Huntington National Bank, FirstMerit Bank, and Liberty Bank and Trust, all of which will originate conventional first mortgages up to 96.5% loan-to-value consistent with FHA guidelines, and originate second mortgages for the difference between the appraised value and the costs of rehabilitating homes to livable standards.

To provide additional information from what was provided in our prior comments, under the DHM program and related agreements, the participating banks simultaneously originate the first and second mortgages, with the first mortgage generally being "held for investment" as part of the bank's portfolio, and the second mortgage is being "held for sale" on an interim basis. Although the DHM program is based largely on FHA guidelines, neither the first or second mortgages are eligible for FHA insurance (due primarily to the same combined LTV issue this guidance seeks to address). After the participating bank originates the first and second mortgage, it conveys the second mortgage to the DHM loan fund under the standing loan purchase and sale agreement, typically either (a) with the next periodic (monthly) cycle if the home has already been rehabilitated and is therefore "move-in ready", or (b) if rehabilitation is necessary, upon the completion of construction and meeting of all legal requirements for occupancy. This standing loan purchase and sales agreement allows for the unconditional sale of these second mortgages from the participating bank to the DHM loan fund, and is on a non-recourse basis (recourse is limited to if the loan does not in fact conform to the DHM program terms, and for which there are a variety of remedies available). This construction period, similar to FHA guidelines, may be up to six months (shorter in some instances depending on level of rehabilitation necessary, or longer on an exceptions basis). During this interim period, additional credit enhancements are agreed to be provided to the bank by the Kresge Foundation (consistent with the protections provided to the borrower) should an eligible hardship / life event be experienced by a homeowner (e.g. death, job loss, etc.) during the construction process after the loan has been closed, but before the completion of the property and conveyance of the second to the DHM loan fund. This credit enhancement covers the second lien, and specifically any difference between the amount lent (excluding any undrawn amounts, up to the DHM maximum of $75,000 per property) and the net proceeds from the disposition of the property, and is part of Kresge's overall support afforded to the DHM loan fund. For operational reasons, it is necessary to have the banks hold both the first and second mortgages on an interim basis, as the use of proceeds for construction may be spread across both liens. For example, a property acquired for $10,000 with $60,000 of construction (therefore total development cost of $70,000), and an as-completed appraised value of $50,000 would have $20,000 in the second and $48,250 on the first mortgage (96.5% of appraised value, with the remaining 3.5% provided by the borrower as down payment, in addition to any third-party fees and closing costs). Similar to the FHA 203(k) product, the DHM program requires a rehabilitation scope of work to be completed in advance of the appraisal, and upon which the as-completed appraised value is based, and includes the equivalent of a "HUD Consultant" with additional responsibilities to ensure the timely progress of the construction, and validation of progress against construction draws. Standalone second mortgages (i.e. those without a simultaneously originated first mortgage) are not allowed under the DHM program.

In order to ensure that homebuyers understand the potential complexities of a higher loan-to-value mortgage as well as the process of renovating a home, a borrower education component has been created for the program and that is provided in addition to standard HUD approved homebuyer education and related counseling programs. The educational programming has been further tailored, with each homebuyer receiving mandatory education for the higher loan-to-value aspect of DHM. Currently, ten non-profit counseling agencies have committed to providing borrower education services for DHM. We appreciate that the revised guidance includes reference to homebuyer education as being an important part of a program.

**COMMENTS AND RECOMMENDATIONS**

Our commitment to addressing the financing needs of low-income or underserved people and communities informs our interest in this new guidance proposed by the Office of the Comptroller of the Currency (the OCC or Agency). The preamble accurately describes the challenges facing distressed communities and reflects the situation in many cities around the country such as Detroit. At the same time, the Agency understands the constraints banks face when trying to extend credit in markets where the appraised values of homes remain far below the cost of purchasing and / or rehabilitating a new or existing home.

The DHM participants strongly support the OCC's efforts to address the challenges of mortgage lending in these distressed communities significantly affected by the financial crisis and the decline in housing values. Home values in these communities continue to lag making it nearly impossible to finance home purchase and / or repairs and upgrades to residential properties with conventional mortgage products. The guidance proposed by the OCC will enable banks to offer innovative mortgage financing for purchasing and /or rehabilitating, one- to four-unit residential properties where the loan amount may exceed supervisory loan-to-value (SLTV) limits. It is in the context of our strong support for this proposal that we wish to offer specific comments and seek clarification on several aspects of the new guidance.

1. **Oversight and Monitoring.** Consistent with our prior comment letter, the DHM participants support the Agency's approach to oversight and monitoring of the policies and procedures banks must adopt and implement in order to offer mortgage products for purchase and / or

rehabilitation that exceed supervisory loan-to-value limits. It is important that these credit products be both responsible and appropriate for the borrowers or customers who receive them. For these products to be effective in revitalizing targeted communities they must be safe and produce the intended outcomes. Assessing whether these programs are in fact contributing to revitalization efforts while simultaneously ensuring that banks are effectively managing their risks are the two key elements required for success. We commend the OCC for recognizing both elements are essential and must be carefully balanced.

2. **Confirmation of Second Liens on an Interim Basis When Originated with a First Lien Simultaneously.** One area where clarification would be helpful relates to the role of second lien loans. We would strongly encourage the Agency to include clarification in *Section A. Eligible Loan* indicating that second liens when originated simultaneously and combined with first liens would be acceptable or covered as a part of this guidance if originated as part of a program. As the revised guidance is written, this section now specifically indicates all second liens as ineligible under the proposed guidance for higher loan-to-value lending in targeted communities, limiting creative mortgage products that make use of a first and second lien loan structure. We encourage the Agency to consider simply adding language clarifying that second lien loans designed to help close the "appraisal gap" between the cost of acquiring and / or rehabilitating a home resulting from depressed home values and the appraised value are eligible under this new guidance, when originated simultaneously with a first lien. As noted with the Detroit Home Mortgage program, the second mortgage is being "held for sale" on an interim basis (as allowed for with the standing loan purchase and sale agreement). We also understand that there are exemptions in place under *12 CFR 34 Appendix A to Subpart D – Interagency Guidelines for Real Estate Lending* to exempt "Loans that are to be sold promptly after origination,

DETROIT HOME MORTGAGE

without recourse, to a financially responsible third party". The guidance as currently written allows for a bank to originate and hold a higher LTV first lien under certain circumstances. We believe the guidelines should apply, and same allowances should be provided for, when a combined first and second lien structure are originated simultaneously.

3. **Confirmation of Eligible Maximum Loan Amount.** Consistent with our prior comment letter, with respect to the stipulation that an eligible loan must have an original loan balance of $200,000 or less in *Section A. Eligible Loan* (and elsewhere), we urge the Agency to consider increasing the amount of an "*eligible loan*" to be consistent with FHA guidelines on maximum loan amounts (which are calculated at the county level nationwide) to accommodate homeowners who choose to make substantial renovations to a home or make larger investments in already renovated homes located in eligible communities. Moreover, in the case where a mortgage product consists of a combined first / second lien loan and a borrower is seeking to acquire an historic property, it may be difficult for the loan balance to remain at or below the $200,000 limit. Therefore, we suggest that the guidance clarify that eligible loans include the combined first and second line loan with a total principal balance equal to or less than the FHA maximum loan amount. We would like to ensure alignment of the guidance with efforts such as the Detroit Home Mortgage program which is focused on more systemic issues in the housing market, and inclusive of mixed incomes which is important to the community at large and which allows for a range of price points and need for "gap" financing. The FHA loan size limits are well-known in the banking industry and are adjusted for local economic conditions. For these reasons, we believe that the FHA limits are well-suited to the purpose of the guidance rather than a nationally uniform and unchanging cut-off level.

4. **Compatibility with Distressed Property Purchases, and Support for Existing Homeowners.** Consistent with our prior comment letter, we respectfully request a clarification in *Section A. Eligible Loan* that mortgage products should include not only those used to purchase, or purchase and rehabilitate a new home as described, but also include mortgages used for rehabilitating properties currently owned by a homeowner (and which may involve refinancing). In our experience, we find that including existing homeowners is necessary to ensure compatibility with other programs in the local housing market. For example, a homeowner might purchase a property from a land bank or at auction, often for a *de minimis* amount, with the intent to rehabilitate it using financing available through another program (such as the DHM program) for which they may already be prequalified. We appreciate that the revised guidance allows for the amount of a purchase to be included if no more than six months before the date of the bank's loan commitment which will provide support for some of these homeowners. However, we note that in Detroit, that many homeowners have purchased their homes from the land bank outside of this allowed window. As such, we would request that this period be extended (e.g. up to two years) if it is clear that the intent of the homeowners was to rehabilitate the properties, but were unable to do so in a timely manner due to lack of financing. In addition, we believe it would be beneficial to support existing homeowners who have been unable to finance deferred maintenance of their property necessary for safety and livability (e.g. roof repairs, etc.), due to depressed real estate values. In some cases, an eligible loan may be used to refinance an existing loan and, in addition, the new loan may finance rehabilitation costs. However, we do not believe refinancing should be permitted without a rehabilitation component. Further, this is not to suggest that we would be supportive of providing financing to individual homeowners who had the means to properly maintain their properties but elected not to do so, but rather recognize that with many homeowners in Detroit, although they had

maintained the properties to the best of their abilities, were unable to obtain financing for major deferred maintenance items that would otherwise be afforded to them in a functioning market.

5. **OCC Supervisory Considerations.** *Section B Overall Evaluation of Program* requires the Agency to evaluate overall impact of banks' programs in communities targeted for revitalization. We appreciate the need for and value of evaluating the overall impact of these lending programs on an annual basis, we would encourage the OCC to clarify what examiners will be looking for in terms of "*the effect such lending has had on the housing market and other economic indicators in….*" these communities. As organizations engaged in community revitalization and economic development, the DHM participants know that making demonstrable progress in communities suffering severe dislocation requires time. We appreciate the Agency's acknowledgement in the revised guidance that measurable change may take several years, and encourage Agency examiners to set realistic and appropriate expectations for progress when evaluating the performance and/or the benefits of innovative residential mortgage and rehabilitation financing products, especially in the early years of these programs.

**CONCLUSION**

In closing, we wish to thank the OCC for their effort to provide banks with supervisory guidance that allows them to develop creative financing solutions to normalize distressed housing markets in communities battered by foreclosures and the fallout from the financial crisis. Implementation of this proposed guidance is a critical first step in enabling banks and community-based organizations to work together to restore market forces in struggling neighborhoods across the country. It is our hope that your colleagues at the Federal Reserve and the Federal Deposit Insurance Corporation will adopt similar guidance for the depository institutions they supervise.

We are grateful for the opportunity to share our views and recommendations as to how this guidance may be strengthened. Please do not hesitate to contact any of the respondents with any questions regarding comments included in this letter.

Sincerely,

Frank Altman
President and CEO
Community Reinvestment Fund, USA

on behalf of the Detroit Mortgage Fund, and the following participants:

The Huntington National Bank
Flagstar Bank, FSB
FirstMerit Bank, National Association
Talmer Bank and Trust
The Kresge Foundation

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