

# LEVY & WATKINSON, P.C.

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November 13, 2007

**VIA TELEFAX (202) 226-0792  
AND FEDERAL EXPRESS**

Congressman Albio Sires  
1024 Longworth  
Washington, D.C. 20515

Re: HR 3915

Dear Congressman Sires:

As a firm which represents mortgage lenders and brokers, I would like to share with you one of the concerns our clients have regarding the provisions in HR 3915.

One of our reservations involves the standards in the bill which requires creditors to make a determination at the time that the mortgage is consummated that the consumer has a "reasonable ability to repay the loan" or that a refinancing has a "net tangible benefit" to the borrower. Our reservations stem from our history in New Jersey where the Legislature, in the New Jersey Home Ownership Security Act of 2002, N.J.S.A. 46:10B-22 et seq. ("NJHOSA") required that all "covered loans" have a "reasonable tangible net benefit."

This standard, similar to the standards proposed in HR 3915, was subjective. What constitutes a tangible net benefit to one party may not constitute a net benefit to another. A cash-out refinance, for example, could be obtained by a borrower for any number of purposes: vacation, health care, education costs, restructuring of high-cost unsecured personal debt, home improvements and rate reduction, among others. Should a borrower be denied a loan because the borrower wants to use the proceeds for travel, a reason many might not consider "frivolous" and not of "benefit" to the borrower's finances?

The inability to determine with any certainty whether a loan had a "reasonable tangible net benefit" led bond rating agencies such as Standard & Poor's and Fitch to not rate loans subject to the standard. The Department of Banking and Insurance attempted to

draft a guideline as to what constituted a “tangible net benefit” but soon realized the difficulty of the task. Although the economic benefits of a loan may be defined, the non-economic benefits such as travel or education are impossible to be calibrated.

As a result, the passage of NJHOSA caused a severe interruption in the mortgage industry and interfered with the availability of credit. As discussed in the enclosed study by Richard F. DeMong from the University of Virginia McIntire School of Commerce, the “vagueness of the Law and the inherent risk of the potential penalties” caused lenders to reconsider making subprime loans after NJHOSA became effective in November 2003. This led, for example, to a reduction in cash-out refinances of about 57% in the two months following passage of NJHOSA. Due to ambiguities in the law, lenders feared at the time that loans made would not satisfy the “reasonable tangible net benefit” standard.

The problems were finally cured only upon amendments to the legislation removing the “reasonable tangible net benefit” standard. As indicated in the enclosed release by Fitch:

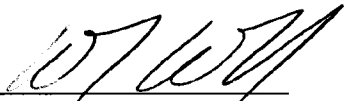
...According to the Act, covered home loans and flipping are conjoined concepts that effectively prevent mortgage lenders from refinancing an existing home loan made within the prior 60 months, if the new loan does not provide a “reasonable tangible net benefit” to the borrower. However, the act does not define reasonable, tangible net benefit. This lack of definition is largely seen as one of the primary reasons that lenders pulled back from the New Jersey mortgage market. Elimination of covered home loans and flipping should benefit the New Jersey mortgage market, since it can be expected that more lenders will now begin, or resume, making mortgage loans in New Jersey.

As indicated, efforts were made in New Jersey to define “reasonable tangible net benefit.” However, the term by its nature is subjective to the borrower. What may be a sufficient benefit to one borrower may not be to another. And should not a borrower who meets underwriting criteria have the ability to refinance and obtain cash out for personal reasons sufficiently significant to the borrower?

We note that the Legislation contains many provisions, such as licensing of all loan officers, including those working with depositories, which we support. However, based on our experience in New Jersey and the substantial disruption we experienced in the mortgage market, we hope that Congress will amend HR3915 to remove the subjective requirements regarding “net tangible benefit” and “reasonable ability to repay.” Thank you for permitting us to comment on the proposed legislation.

Very truly yours

Levy & Watkinson, P.C.

By   
Wayne A. Watkinson

## **Fitch Comments on NJ's Amendment to the 2002 NJ Homeownership Security Act**

NEW YORK--(BUSINESS WIRE)--Aug. 25, 2004--On July 6, 2004, Gov. James E. McGreevey of New Jersey, signed Senate Bill 279 (the amendment) that amends the New Jersey Homeownership Security Act of 2002 (the act). The amendment, which is effective immediately, addresses many concerns that have been expressed, particularly by mortgage originators, since passage of the act that became effective on Nov. 28, 2003. In particular, the amendment removes any reference to 'covered home loans' and 'flipping.' The 'total points and fees threshold' for high cost home loans is changed from 5% to 4.5%; and importantly, the Department of Banking and Insurance (DOBI) is now given more regulatory authority. However, the amendment does not change, or further clarify, the assignee liability or safe harbor issues. Thus, Fitch's policies and procedures in regard to 'high-cost home loans' in New Jersey, as detailed in our press release dated June 5, 2003, are not affected by passage of this Amendment.

The removal of covered home loans and flipping from the act, as per the amendment, should eliminate some impediments and uncertainties for existing and potential mortgage lenders in the State of New Jersey. According to the Act, covered home loans and flipping are conjoined concepts that effectively prevent mortgage lenders from refinancing an existing home loan made within the prior 60 months, if the new loan does not provide a 'reasonable, tangible net benefit' to the borrower. However, the act does not define reasonable, tangible net benefit. This lack of definition is largely seen as one of the primary reasons that lenders pulled back from the New Jersey mortgage market. Elimination of covered home loans and flipping should benefit the New Jersey mortgage market, since it can be expected that more lenders will now begin, or resume, making mortgage loans in New Jersey. However, as a reminder that some uncertainty still remains, the amendment also added a caveat that these deletions 'shall create no presumption that any home loan that is refinanced does not constitute an unlawful practice under P.L. 1960, c.39 (C.56:8-1 et seq.).'

The amendment expands the number of high cost home loans that potentially fall under the scope of the act by decreasing the total points and fees threshold from 5% to 4.5% for loans that are \$40,000 or more. Since the amendment is effective immediately (i.e., as of July 6, 2004), this has implications for a lender's existing pipeline of loans. Lenders should reexamine their pipeline of loans, as well as their current policies and procedures for identifying predatory loans to ensure that this threshold change is properly accounted for. In addition, Fitch will continue to incorporate an assessment of a lender's predatory controls for New Jersey high cost home loans as part of its ongoing originator review process.

A third key area of the amendment eliminates regulatory uncertainty from the act. The Commissioner of Banking and Insurance, within the Department of Banking and Insurance (DOBI) and in consultation with the Division of Consumer Affairs in the Department of Law and Public Safety is now empowered to promulgate and govern any provisions of the act and this amendment. Previously, their powers of interpretation and regulation were confined to certain, highly restrictive sections of the act. With this expanded authority, DOBI can be expected to issue interpretations of the act and amendment that creditors will be able to rely upon.

It should be noted that the amendment did not substantively change the assignee liability or safe harbor portions of the act. Therefore, to rate RMBS transactions, which contain any loans originated in New Jersey after the act's effective date of Nov. 28, 2003, Fitch will continue its policy of reviewing the results of an independent analysis of loans by an acceptable, unaffiliated third party that states that due diligence was conducted on the New Jersey loans. Please refer to Fitch's press release dated June 5, 2003 for further information.

Fitch will continue to monitor anti-predatory lending legislation and provide the market with

## The Impact of the New Jersey Home Ownership Security Act of 2002

Richard F. DeMong  
Virginia Bankers Professor of Bank Management  
McIntire School of Commerce  
University of Virginia  
March 26, 2004

The New Jersey Home Ownership Security Act of 2002 became effective on November 27, 2003. Prior to its effective date, Standard & Poor's announced that it would no longer rate structured transactions from New Jersey if they included high-cost home loans. Joanne W. Rose, executive managing director of global structured finance at Standard & Poor's, stated that "...Standard & Poor's assesses the impact the statute may have on our ability to rate the amount of credit risk in structured finance pools. If we can't quantify the risk, we can't rate the structure." (S&PCORRECT: S&P Report Addresses New Jersey State Predatory Lending Law) S&P reversed its position just before the implementation of the law. Many lenders expressed their concern about the liabilities and vagueness of the law.

The National Home Equity Mortgage Association (NHEMA) and the National Association of Mortgage Brokers (NAMB) asked me to assess the impact of the implementation of the NJ Home Ownership Security Act. To assess the impact of the Law, I sent a survey in February of 2004 to 24 lenders that specialize in subprime loans and to mortgage brokers in NJ. The response rate for the lenders survey was 58 percent (14 lenders out of the sample of 24—one additional survey came in too late to include in these results, but its data appeared to be very similar to the 13 timely responses). I received 84 timely responses from mortgage brokers in NJ. There were three responses from mortgage brokers that were received too late to be included in this study. I also sent the survey to Pennsylvania subprime lenders and mortgage brokers so that I could isolate other factors such as seasonal trends and economic conditions from the results. I received a total of 67 responses from lenders or mortgage brokers in PA (6 lenders responded and 61 mortgage brokers). The 14 lenders who responded to this survey have a significant majority of the subprime market in NJ. The mortgage brokers included in this survey also represented a significant part of the subprime market. I estimate that this survey represents at least fifty percent of the subprime market share in NJ and probably more.

The quantitative and qualitative results of the survey indicate that the NJ Home Ownership Security Act had a significant impact on lending to subprime borrowers in NJ. Eighty-four percent of the lenders and mortgage brokers indicated that they have reduced certain types of subprime lending in NJ because of the implementation of the Law. The results of their changes in lending practices are statistically significant and quite startling. In an earlier survey (DeMong, November 2003) lenders indicated that the vagueness of the Law and the inherent risk of the potential penalties of the Law caused them to reassess the wisdom of making certain subprime loans in NJ after November 2003. This

study illustrates the dramatic decrease in subprime lending in NJ since the implementation of the Law.

The dollars of credit lent for cash-out refinance loans in NJ dropped significantly in the two months after the implementation of the Law (December 2003 and January 2004) from the levels in the two full months before the implementation of the Law (September and October 2003). After factoring out the changes that occurred in Pennsylvania, I found that the change in dollars lent in subprime cash-refinance loans that was unique to NJ was a drop of 57.7 percent from the amounts lent before the implementation of the loan. (See Exhibit 1) I derived the 57.7 percent by comparing the drop of cash-out refinance credit in NJ to the drop in PA. For December 2003 and January 2004 the drop in credit in NJ was 67.2 percent but only 9.5 percent in PA. Thus the drop that was unique to NJ was the difference in those two percentage drops (67.2% in NJ – the 9.5% drop in PA which was a unique drop in NJ of 57.7%). Similarly the dollars of subprime home improvement loans dropped by 75.4 percent in NJ and only 2.2 percent in PA. Thus the decrease in subprime home improvement lending that was unique to NJ was 73.2%. All of these calculations were made by comparing the dollars lent in December 2003 and January 2004 to the dollars lent in September and October 2003.

**Exhibit 1**  
**Change in Lending From Oct/Nov 2003 to Dec 2003/Jan 2004**

	<b>% Change in \$ Lent in NJ*</b>	<b>% Change in \$ Lent in PA*</b>	<b>% Change in \$ Lent Unique to NJ</b>	<b>Significant at**</b>
Cash-out Refinance Loans	-67.2%	-9.5%	-57.7%	.000
Home-Improvement Loans	-75.4%	-2.2	-73.2%	.000

\*Total number of NJ responses was 91 and number of PA responses was 67.

\*\*Less than 1 chance out of a thousand that this was a random result.

The total dollar decrease in subprime lending in NJ in the two months after the implementation of the Law as compared to the two full months before the implementation of the Law is between \$800,000,000 and \$1,000,000,000 with just the lenders and mortgage brokers that responded to this survey. I had to use a range estimate to eliminate any possible double counting that could occur if the surveyed mortgage broker used one of the surveyed lenders in this study. If the number was generalized to all subprime lenders and mortgage brokers in NJ the initial dollar impact would obviously be much higher.

### **Qualitative Analysis**

I asked the lenders for their primary and secondary reasons for the drop in subprime lending in NJ. The primary reason stated by NJ lenders was the implementation of the Home Ownership Security Law for both cash-out refinance loans and home-improvement

loans. (See Exhibits 2 and 3) A majority also listed the Law as the secondary reason for the change in subprime lending in December 2003 and January 2004. The total is greater than 100% because I had one lender that reported that the Law was both the primary and secondary reason for its decrease in cash-out refinance loans in NJ. I am not reporting the reasons given by the lenders for the drop in subprime home improvement lending because I had only one lender respond to that question. Most of them indicated it was the same reasons for the drop in cash-out refinancing lending.

**Exhibit 2**  
**Lenders' Reasons for Drop in Subprime Cash-Out Refinance Lending in NJ**

	Primary Reason	Secondary Reason
NJ Home Ownership Security Act	55%	50%
Don't Know or No Change	45%	38%
Seasonal, economic and market conditions and interest rates	0%	12%

The response from the mortgage brokers in NJ was even stronger and more informative than the response from the lenders in NJ. Forty-five percent of the lenders responded that they didn't know the reason for the drop in lending. Only 6 percent of the mortgage brokers didn't know the reason for the drop in lending. (See Exhibit 3) Fifty-four percent of the mortgage brokers stated that the primary reason for the drop was the change in the law. In addition, 32 percent of the lenders attributed the primary reason for the drop in cash-out refinance lending was a drop of investors or lenders in NJ after the implementation of the law. It can reasonably be assumed that the drop in investors or lenders is primarily a result of the implementation of the Home Ownership Security Act.

Thirty percent of the mortgage brokers listed the Home Ownership Security Act as the secondary reason for the decrease in subprime cash-out refinance lending in NJ. And another 31 percent listed the loss of lenders or investors as the secondary reason for the drop in cash-out refinancing lending in NJ in December 2003 and January 2004 when compared to the two full months before the implementation. Only 15% listed economic or market conditions or the interest rate changes as the secondary reason for the drop in cash-out refinancing. Eighty-four percent of the mortgage brokers in NJ listed the Law as a primary or secondary reason for the drop in subprime cash-out refinance lending in NJ after November 2003.

**Exhibit 3**  
**Brokers' Reasons for Drop in Subprime Cash-Out Refinance Lending in NJ**

	Primary Reason	Secondary Reason
NJ Home Ownership Security Act	54%	30%
Loss of Investors or Lenders	32%	31%
Don't Know or No Change	6%	21%
Seasonal, economic and market conditions and interest rates	8%	15%
Other	0%	3%

The brokers gave similar reasons for the drop in subprime home improvement lending in NJ after the implementation of the law. (See Exhibit 4) Just as they did for cash-out refinancing, mortgage brokers in NJ found the primary reason for the drop in subprime home improvement lending, in the two months following the implementation of the Law as compared to the two full months before the Law, to be the Law itself. Again it is reasonable to assume that the reason that there was a loss of investors or lenders after the implementation was a direct result of the Law. Similar to the reasons for the drop in cash-out refinance lending, 99 percent of the mortgage brokers in NJ saw the implementation of the Law as the primary or secondary reason for the drop in home improvement lending. Similarly, 53 percent saw the loss of investors or lenders as the primary or secondary reason for the drop in lending.

**Exhibit 4**  
**Brokers' Reasons for Drop in Subprime Home Improvement Lending in NJ**

	Primary Reason	Secondary Reason
NJ Home Ownership Security Act	66%	33%
Loss of Investors or Lenders	14%	39%
Don't Know or No Change	17%	11%
Seasonal, economic and market conditions and interest rates	3%	11%
Other	0%	6%

In addition to a reduction in subprime cash-out refinance and home improvement loans, lenders and brokers report a reduction in owner-occupied loans to subprime borrowers and subprime loans under a certain dollar amount.

The dramatic drop in subprime lending in NJ is worrisome because this reduction, which was reported to be a reaction to the implementation of the NJ Home Ownership Security Act, limits the availability of credit to deserving potential borrowers who have a spotty credit record.

## **Employment in NJ**

Forty percent of the lenders and mortgage brokers in NJ have reduced the number of employees or offices in NJ since November 2003. This is in stark contrast to increase reported by both lenders and mortgage brokers in PA. The average PA lender and mortgage broker opened one office since November 2003.

The average lender in NJ closed 2 offices and reduced employment by a median of 4 employees. I am reporting the median statistic for the number of employees rather than the mean because one large lender and mortgage broker closed an office with a large number of employees, which skewed upward the average reduction in the number of employees since November 2003. The results are lower and more conservative using the median statistic, since they are not skewed upward by the actions of a few large lenders or brokers. The reduction of the number of employees includes those that the lender or mortgage broker expects to let go within the next sixty days. The average mortgage broker in NJ closed 2 offices and reduced employment by a median of 6 employees. The differences in the change of the number of offices and employees in NJ and PA were statistically significant at the .015 and .000, respectively.

## **Analysis**

The drop in subprime lending in New Jersey in the first two months after the implementation of the Law is similar and just as startling as the results of a telephone survey that I conducted just before the implementation of the Law. The study that I did late in November showed that the surveyed lenders planned to cut their subprime cash-out refinance and home improvement lending by 69 percent (DeMong, 2003). That survey was completed before S&P changed its position on rating debt that included structured transactions from NJ. Many expected that S&P's decision to rate NJ mortgage debt would soften the blow of the law. However, the results of the current study show that subprime lending significantly dropped almost by the same percentage as predicted before the implementation of the Law and before S&P reversed its position.

Why does the drop in subprime lending matter? It matters because there is obviously less credit available to potential, albeit higher risk, borrowers with less than perfect credit records. It appears that many of these potential NJ borrowers will now be unable to acquire credit even if they are willing to pay a higher interest rate than borrowers with a clean credit record. This is an unfortunate result since these individuals with either impaired credit, or lack of credit record, could have used the cash-refinance loans to payoff higher interest rate mortgage debt or credit card debt. A recent report from the Federal Reserve Bank of New York has found that, on average, consumers have used the funds from refinancing to restructure their personal balance sheets and reduce their debt-servicing burden. (McConnell, Peach, and Al-Haschimi, [http://www.ny.frb.org/research/current\\_issues/ci9-12/ci9-12.html](http://www.ny.frb.org/research/current_issues/ci9-12/ci9-12.html)) The reduction of subprime cash-out refinance loans will reduce the ability of nonprime borrowers to take

