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June 18, 2010

The Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Christopher J. Dodd
Chairman
Committee on Banking, Housing & Urban
Affairs
U.S. Senate
Washington, DC 20515

Dear Chairmen Frank and Dodd:

On behalf of the nearly 5,000 members of the Independent Community Bankers of America, I write to express our concern regarding two mortgage-related provisions of the conference base text of H.R. 4173 that will make it harder for community banks to meet the mortgage needs of their customers, particularly in rural areas.

Rural customers have unique credit needs, collateralized by rural properties, which do not lend themselves to securitization. As a result, community banks that serve rural customers tend to hold loans in portfolio, where the lender is exposed to the entire credit risk of the borrower for the full term of the loan. They not only have "skin in game," to evoke a common theme of the legislation, but bear the full risk of default. For this reason, portfolio lenders exercise special diligence in underwriting, and we believe that this special diligence should exempt portfolio loans from several restrictions of the legislation targeted at loan features thought to increase risk of default or foreclosure: the exclusion of balloon payment loans from the definition of "qualified loans," and the requirement that mortgage lenders escrow taxes and insurance for all loans.

Balloon loans

Under Section 1413, balloon payments, among other loan features, exclude a loan from the definition of "qualified mortgage," which means that the lender has to determine that the borrower has a "reasonable ability to repay" and that refinanced loans provide a "net tangible benefit" to the borrower. This provision will make balloon loans impractical for many community banks because of the legal liability associated with making non-qualified loans. For the reasons described below, we recommend that the legislation incorporate an exception for loans held by the originator in portfolio so that

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the balloon feature does not exclude these loans from being considered qualified mortgages.

Balloon loans are a traditional community bank loan product, often made in small amounts – typically \$40,000 to \$60,000 – to finance homes, particularly in rural areas, and manufactured housing, an important affordable housing source in many parts of the country. According to a recent survey, 80 percent of ICBA members offer short term balloon loans, and, for these lenders balloon loans make up 75 to 100 percent of their mortgage loan portfolio. A typical balloon loan has a 15 to 30 year amortization, and a three to five year balloon. They are generally renewed at maturity, though they do not renew automatically so that the lender has the opportunity to review the underwriting before each extension.

Community bank balloon loans, which typically require a 20 percent down payment, are no more risky than conventional loans. In our survey, 31.3 percent of respondents stated that they had less incidence of foreclosure/default with balloon loans than with conventional long-term fixed rate mortgages or ARMs. 63.8 percent of respondents said that the default rate was about the same.

Because many rural loans have unique characteristics and are collateralized by properties that are difficult to appraise, they are difficult to securitize and have to be funded through the lender's deposit base, not through the proceeds of securitization. This explains the prevalence of balloon loans among rural lenders: The loan maturity has to match the maturity of their deposit base for asset-liability management purposes.

We understand legislators' desire to restrict or ban abusive loan features that contributed to the bubble in real estate prices and the current financial crisis. Community bank balloon loans held in portfolio played no role in the financial crisis. Excluding these loans from "qualified loans" will reduce funding for affordable housing in rural areas without serving any public policy purpose.

Escrow

Section 1461 requires first lien mortgage lenders to establish escrow accounts for the payment of taxes and insurance. There is a significant cost involved with establishing escrow accounts, particularly for community banks that have small lending volumes, must outsource their escrow services, and are not eligible for volume discounts.

Seventy-three percent of banks responded to our survey that their bank does not currently escrow for taxes and insurance on mortgages. Of these banks, 92 percent claimed that one reason for not escrowing was the lack of available staff resources. Seventy-six percent of these banks also listed "Cost" as a reason for not providing escrow accounts. In order to provide

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escrow account services, a bank needs to make an initial investment in systems and software, employee training and legal fees. For banks that do not currently provide escrow accounts, 39 percent estimated the initial cost to provide escrow accounts would be over \$25,000. In addition, banks would have ongoing costs of monthly servicing fees, in-house staff costs and software and systems maintenance fees. Forty-one percent of banks stated the annual cost per loan would be \$100-249, and 35 percent of banks stated the loan cost would be over \$250 per loan. Fifty-six percent of banks estimated they would need to hire at least 1 full-time employee to maintain these escrow accounts, which included 19 percent of banks that responded they would need at least 1.5 full-time employees to maintain these accounts.

If community banks were to establish escrow account, borrowers would face higher interest rates. Among all of the bank respondents, twenty-eight percent stated that interest rates on their loans would increase by 26-50 basis points due to these escrow requirements. Thirteen percent of banks estimated an increase of 51-75 basis points per loan and 13 percent of banks estimated an increase of 76 - over 100 basis points per loan.

The costs are such that an escrow requirement could lead many community banks to sharply reduce or eliminate their mortgage businesses, particularly those in smaller communities with limited residential mortgage lending opportunities. Thirty-three percent of all banks responded that these escrow requirements would make them stop making the types of mortgages that would trigger the requirements. Sixty-two percent of banks stated if they stopped making mortgages due to these requirements, borrowers in rural areas would be the most impacted.

As described above, loans held in portfolio are underwritten with much greater diligence than securitized loans. The lender has every incentive to ensure that taxes and insurance, as well as principle and interest, are paid on a timely basis. For loans held in portfolio, the escrow requirement is redundant and a needless expense that will lead many community banks to stop providing mortgages, which will do further harm to the housing market.

We hope that you will consider making these changes to the legislation.

Sincerely,

/s/

Camden R. Fine
President and CEO