LENDERS UPDATE™

ALT & ASSOCIATES NEWSLETTER

A COMPLIMENTARY SERVICE TO THE MORTGAGE LENDING INDUSTRY

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JANUARY 17, 2013

HIGH-COST VERSUS HIGHER-PRICED MORTGAGE LOANS

Last Thursday, the Consumer Financial Protection Bureau ("CFPB") issued its final rule to implement additional portions of the Dodd–Frank Wall Street Reform and Consumer Protection Act. The final rule amends Regulation Z by revising and expanding the test for coverage under HOEPA. The new rule also bans potentially "risky" features for High-Cost mortgages and limits certain fees and practices. It also requires that consumers receive information about pre-loan housing counseling for High-Cost mortgages.

As we know, regulation Z has two categories for loans with higher rates. The first is *Higher-Priced* mortgage loans. The second is *High-Cost* mortgage loans. We thought it would be helpful to summarize applicable Regulation Z requirements for these two categories. Hopefully this will provide clarification of this distinction and also show how the new changes referenced above fit into Regulation Z as it will be effective January 10, 2014. While our summaries will be somewhat detailed, they do not represent the entire regulations as they apply. They are provided for general information, *not legal advice*.

Higher-Priced Mortgage Loans
(effective as of this date)

A Higher-Priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling with an APR that exceeds the "average prime offer rate" for comparable transactions as of the date the interest rate is set by 1 ½ % for first liens or 3 ½ % for subordinate liens.

"Average prime offer rate" means an APR derived from average prices offered by a representative sample of creditors which have low-risk pricing characteristics. The CFPB publishes these rates regularly.

Not included within the category are initial construction loans, temporary or bridge loans of 12 months or less, reverse mortgage transactions and HELOCs.

If a loan fits within this category it is subject to the following restrictions:

- **Ability to repay must be demonstrated.**
- **Prepayment penalties are restricted unless the penalty is otherwise permitted by law and the penalty 1) will not apply after two years, 2) upon consummation, the penalty will not apply if the source of prepayment funds is a refinance by the creditor or an affiliate, and 3) the amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation.**
- **As to escrow accounts, a creditor may not make a loan secured by a first lien unless an escrow account is established before consummation for payment of taxes and required insurance. This requirement does not apply to cooperatives and/or to condominium units where the homeowners association has an obligation to maintain a master policy.**

High-Cost Mortgage Loans
(incorporating the new changes effective January 10, 2014)

A High-Cost mortgage is any consumer credit transaction secured by consumer's residence where the APR exceeds the applicable "average prime offer rate" by more than 6.5% for first lien transactions and 8.5% for subordinate lien transactions.

Alternatively, a loan is also a High-Cost mortgage if the total points and fees exceed 5% of the total loan amount if in excess of $20,000 (adjusted annually) or 8% for loans under $20,000.

Reverse mortgages, initial construction, transactions originated by housing finance agencies in which the agency is the creditor, and transactions originated by the United States Department of Agriculture's Housing Sevice Direct Loan Program, are exempt.

The APR is based on the fixed rate of interest for the term of the loan or upon the interest rate set at the maximum margin permitted during the term of the loan for variable rates.

In addition to standard disclosures, a creditor of a High-Cost loan must provide an additional early disclosure.

A High-Cost Mortgage shall:

- <u>not</u> allow, with some limited and specific exceptions, a payment schedule with a payment that is more than two times the regular periodic payment (obviously, this includes balloon payments),
- <u>not</u> allow negative amortization,
- <u>not</u> allow a payment schedule that consolidates more than two periodic payments which are paid in advance from the proceeds,
- <u>not</u> allow a prepayment penalty,
- <u>not</u> provide for financing of points and fees,
- <u>must</u>, verify the borrower's ability to repay for all loans, now including HELOCs, and
- may <u>not</u> provide a demand feature that permits the creditor to accelerate the indebtedness in advance of the original maturity date unless there is fraud, or material misrepresentation, or the consumer fails to meet the payment terms, or there is action or inaction which adversely affects the creditor's security.

Please remember that the above is a summary for general information purposes. Individual questions should be addressed by reference to the regulation or regulations in full or to appropriate counsel. With that said, we do hope that this provides an understanding of the distinction between the two categories.

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ALT & ASSOCIATES provides regulatory, compliance, operational advice and transactional assistance, as well as litigation representation, to the financial services industry. Over the past three decades, members of the firm have represented Institutional Lenders and Mortgage Bankers and Brokers in all aspects of their operations.

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