LENDERS UPDATE™

A MONTHLY SERVICE TO THE MORTGAGE LENDING INDUSTRY

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Volume XIV **November 2007** **Issue XI**

The purpose of the Lenders Update is to provide a "heads-up" of new legislation and regulations affecting the mortgage lending industry. We try to provide brief summaries of new matters so our readers can judge whether the subject impacts their operations. We recommend that our readers review the entire new material in detail where relevant. For your convenience, the applicable statute, regulation, cases or website can be easily identified in the summary. Our Update includes information available to Alt & Associates by November 19, 2007

FEDERAL ISSUES

FHA POLICY REGARDING NON FHA-APPROVED MORTGAGE BROKERS

At the end of October the FHA issued a Policy Alert reconfirming their long existing policy that FHA loan origination services must be performed by an FHA approved lender or an FHA approved mortgage loan correspondent. A correspondent, of course, can be compensated for origination services it performs, either directly by the consumer, or indirectly by the FHA approved lender, without being in violation of the FHA.

Mortgage brokers that are not FHA approved brokers cannot perform loan origination services in any transactions. As well as being a violation of FHA regulations, it is the FHA's position, that this conduct would also violate RESPA, as an unearned fee in violation of Section 8 of RESPA. The Alert states that a broker, who is not FHA approved, may assist a borrower in obtaining an FHA loan. However, that broker cannot perform FHA loan origination services or be compensated for them. Any compensation to be paid to the non-approved broker must be paid from the mortgagor's own available assets. This fee must be disclosed on the HUD-1 at closing and a copy of the broker contract included in the loan file submitted for insurance endorsement. Please bear in mind that a borrower can only pay a fee that is commensurate with the amount normally charged for similar services. If the payment, or portion thereof, bears no reasonable relationship to the market value of the goods, the excess, over the market rate, may be used a evidence of a violation of Section 8 of RESPA.

HUD's Alert can be found at http://www.hud.gov/offices/hsg/sfh/lender/notaprbr.pdf

STATE ISSUES

ILLINOIS

Amendment to the Predatory Lending Database Program and New Restrictions for Mortgage Lenders and Brokers.

Senate Bill 1167, which has been pending since February 2007, was finally signed into law by the Governor on November 2, 2007. This new law makes significant changes to Illinois law beyond just the reestablishment of the Cook County Predatory Lending Database Program. We would recommend that those of you who are licensed as Residential Mortgage Lenders in Illinois study this statute carefully.

A copy of the Governor's Release can be found at:
http://www.ihda.org/admin/Upload/Files//5f95c2fa-5427-423d-9361-1cc77ba7e831.pdf

Most provisions of the law become effective **June 1, 2008**. However, the sections related to the database are not effective until **July 1, 2008**.

The new statute touches on many issues, among them are the following:

- A licensee must verify the borrower's reasonable ability to pay the principal and interest and other related charges of the loan. The determination of "reasonable ability to pay" is based on a fully indexed rate, in the case of a variable loan, and in the case of a negative amortization loan, the principal amount of the loan calculating the maximum amount of principal increases due to negative amortization.
- The borrower's income and financial resources must be verified by tax returns, payroll receipts, bank records, or other reasonably reliable methods. A mere statement by the borrower to the licensee of the borrower's income and resources is not sufficient to establish adequate verification.
- The new statute clarifies the relationship of a broker to a borrower. Now, the broker has an agency relationship with the borrower and must comply with certain stated duties including among others:
  - Acting in the borrower's best interest and in good faith.
  - Carrying out all lawful instructions of the borrower.
  - Disclosing to the borrower all material facts of which the broker has knowledge which might reasonably affect the borrower's rights, interest, or ability to receive the borrower's intended benefit.
  - The use of reasonable care in performing duties on behalf of the borrower.

The statute also provides for new regulations concerning prepayment penalties. From the effective date;

- no licensee may make, provide, or arrange a mortgage loan with a prepayment penalty unless the licensee offers the borrowers a loan without a prepayment penalty, which offer is in writing and is initialed by the borrower.
- The licensee also must indicate the amount of the discounted rate received in consideration for a mortgage loan with a prepayment.

- In the event that a prepayment penalty is permissible, it is limited to three years from the date of inception or to the first change date or rate adjustment of a variable rate loan whichever comes first. Prepayment penalties are limited to 3% in the first 12 months, 2% in the second 12 months and 1% in the third.

The next major change provided by the new law, requires a Notice of Change in Terms be provided to the borrower. A licensee must provide timely notice to the borrower of any material change in the terms of the loan which means:

- A change in the type of loan.
- A change in the term of the loan.
- An increase in the interest rate of more than 0.15% or an equivalent increase in the amount of discount points charged.
- An increase in the regular monthly payment of more than 5%.
- A change regarding escrow of taxes or insurance.
- A change regarding the payment requirement or payment of both the private mortgage insurance.
- The fees payable by the borrower to the licensee increase by more than 10% or $100 whichever is greater.

These disclosures must be provided no more than three days after learning of the change or 24 hours before the loan is closed whichever is earlier.

Finally, the law reinstitutes the predatory lending database. Again this is effective on **July 1, 2008**. The pilot program area is now defined as all areas within Cook County designated as such by the Department due to high rate of foreclosure on residential home mortgages resulting from predatory lending practices. With minor changes, the pilot program is the same as that instituted in the past. It essentially provides that:

- Within 10 days of taking a mortgage application, the broker or originator for the loan, within the pilot program area, must submit to the predatory lending database, all required information.
- Within 7 days after receipt of this information, the Department will compare the information to counseling standards and issue to the borrower and the broker or originator a determination of whether counseling is recommended. This counseling requirement may not be waived by the borrower.
- If the terms of the loan are changed, or a new commitment is issued, then the broker or originator must resubmit all of the information and start all over again.
- Title companies are now required, within 10 days after closing, to submit to the predatory lending database, all the information required relative to the closed loan.
- Counseling must be recommended if, after review, it is found that the borrower or borrowers are first-time homebuyers or refinancing a primary residence and the loan is a mortgage that includes one or more of the following:
    - Interest only payments.
    - Negative amortization.
    - Total points and fees in excess of 5%
    - Prepayment penalties.
    - The loan is an ARM.

Reverse mortgages are exempt from these requirements.

MASSACHUSETTS:

Massachusetts Delays Implementation of its New Mortgage Lending Regulations.

As we know, Massachusetts recently implemented new amendments to regulations governing mortgage broker and lender practices. A significant portion of these amendments were to take effect on November 15, 2007. However, in a press release issued by the Office of the Attorney General of Massachusetts on November 13, 2007, the implementation date was advanced to **January 2, 2008**.

According to the Attorney General's release, this was done because lenders were not prepared to meet their responsibilities under the amendments and perhaps more importantly, because some lenders stated they intended to withdraw from doing business in Massachusetts or withdrawing certain products.

It is the Attorney General's opinion, that lenders may withdraw based on an inaccurate view of one of the new regulations. Section 8.06(17) prohibits a conflict of interest between a mortgage broker's compensation and their client's interests. Some lenders believe this is a blanket prohibition on paying broker costs or points and fees. The Attorney General's opinion is that this is an inaccurate interpretation. In their words, "not all such compensation poses a conflict between the broker's financial interest and the interests of the client".

It is anticipated that the Attorney General will issue more guidance on this issue in the immediate future. However, as of the date of this publication, those guidelines have not been issued.

The Attorney General's Release can be found at the following:
http://www.mass.gov/?pageID=pressreleases&agId=Cago&prModName=cagopressrelease&prFile=2007_11_13_mortgage_reg_date.xml

Also of interest, is the Attorney General's report concerning "The American Dream Shattered; The Dream of Homeownership and the Reality of Predatory Lending", which can be found at:
http://www.mass.gov/Cago/docs/Consumer/mortgagereport1107.pdf

TEXAS

Home Equity Constitutional Amendment.

At the elections on November 6, 2007, voters in Texas had a group of constitutional amendments to consider. It turns out, all were passed, including one referenced as Proposition 8. The purpose of this amendment was to clarify certain provisions concerning home equity loans in Texas. The provisions of this amendment will become effective within 30 days after the official state canvas of the returns. This means that they could be effective at any time. Again, as of the date of writing this article, they were not in effect. However, for those of you doing these types of loans in Texas, please be aware.

The substance of the amendment is that:

- Ø Lenders must provide a twelve day disclosure containing new information described by the amendment.
- Ø Any loans in process which have not closed as of the effective date should be stopped and a new disclosure provided with a new 12 day waiting period.
- Ø The basic law, the substance of which is uniquely found in the Texas constitution, is that a home equity loan must provide a 12-day waiting period after an application is submitted to the lender, before it closes, or alternatively, 12 days from the date that this 12 day disclosure is provided. In the case of a mailing, three days must be added. Sundays and federal legal holidays are excluded from the calculation.

A copy of the proposition can be located at the site for the Texas Constitution at:
http://tlo2.tlc.state.tx.us/txconst/sections/cn001600-005000.html