# Dodd-Frank 2014 Part One: New Federal Rules Affecting Consumer Mortgage Loan Applications

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The Dodd-Frank Wall Street Reform and Consumer Protection Act became law in July of 2010. However, the process of changing the consumer mortgage loan process in America dictated by Dodd-Frank is not yet complete. Two new sets of regulations promulgated by the Consumer Financial Protection Bureau went into effect on January 10th of this year. The first, regulatory changes in the loan application process, affect all new consumer mortgage loan applications, including seller financing consumer mortgage loans. The second, regulatory changes in mortgage loan servicing and loss mitigation/loan modification processes, affect all outstanding consumer mortgage loans, regardless of when the loan was obtained. The second set of regulations will be the subject of the second part of this article. Note that both sets of regulations apply only to consumer credit mortgage loans secured by the borrower's family's dwelling. These rules do not apply to loans to investors for the purchase or refinance of non-owner occupied investment real estate.

The loan application changes, applicable to loans applied for on or after January 10, 2014, require banks and other mortgage lenders to make specific, detailed determinations of a borrower's "ability to repay" the loan, which I will refer to as "ATR". The ATR requirements do not apply to every consumer mortgage loan, however. Home equity lines of credit subject to 12 C.F.R. §1026.40, mortgages secured by a timeshare, reverse mortgages under 12 C.F.R. §1026.33, bridge loans and construction only loans with terms of a year or less, and the construction phase up to a year of construction to permanent loans are all exempt from ATR requirements.

There are also certain types of loans which are subject to ATR requirements generally, but not to the very specific bases for making the ATR determination. Those loans include non-standard adjustable rate, interest only and negative amortization loans being refinanced by the existing lender into standard mortgage loans, and certain mortgage loans which meet the definition of a "Qualified Mortgage" under the rules. "Qualified Mortgages must have regular periodic payments without negative amortization, deferment of repayment of principal or balloon payments. They must have terms of 30 years or under, and the lender must not charge more in total fees and points than three percent for loans of $100,000.00 or more, with slightly higher fees allowed for smaller loans.

Creditors on Qualified Mortgages still must calculate the maximum monthly payment possible under the loan terms in its first five years, must verify the consumer's income and assets other than the property, current debts, child support and alimony payments before closing. The loan payment added to the known debt payments must not exceed 43% of the borrower's monthly income.

Right now, many residential lenders are limiting their lending to only Qualified Mortgage Loans, because those loans are presumed to comply with the ATR requirements. It is anticipated that more lenders will loan outside the Qualified Mortgage safe harbor after more guidance is received from the Consumer Financial Protection Bureau on the specific bases for determination of ATR required for such loans.

The current regulations provide that a lender <u>must</u> consider the following <u>specific</u> items in determining the consumer's ability to repay a non- qualified loan:

a) The consumer's current or "reasonably expected" income, and assets not including the value of the land and home being mortgaged, and if income is from employment, the "status" of that employment. (Lenders are seeking further guidance now on what the quoted terms in this section really mean, since guessing at their meaning, and being wrong could be very expensive for the unlucky lender);

b) The monthly payment on the loan the lender plans to make, and the monthly payment on any simultaneous loan the lender knows or has reason to know will be made, together with the consumer's anticipated monthly payment for "mortgage related obligations" including property taxes, property insurance premiums, condominium, cooperative or homeowners' association fees, ground rents and leasehold payments;

c) The consumer’s current debt obligations, alimony and child support payment obligations, and the consumer’s credit history, score and report;
d) Based on the above, the lender must analyze the consumer’s debt to income ratio and residual income after payment of all debts.

The information obtained by the debtor to satisfy the above items must be from “reasonably reliable third party records”, which are defined to be documents prepared or reviewed by someone OTHER THAN the consumer, the creditor, the mortgage broker or any of their agents. Third party records also include copies of filed tax returns, creditors’ records of the consumer’s credit accounts, forms W-2, 1099, payroll or military earnings statements, financial institution records, government records and receipts from check cashing or funds transfer services.

Anecdotally, we have heard that these requirements have slowed the loan application process this year so far. It remains to be seen whether this slowdown in the process will remain a permanent result of the regulations, or is part of the learning curve for lenders in complying with the new regulations. For the time being, however, borrowers particularly on non-qualified consumer mortgage loans, should be prepared to wait longer for approval. The lender also needs the details of all property related expense to make a final decision on the loan, so the settlement company can’t wait for loan approval before ordering tax information, and consumers have to get their property insurance in place before final loan approval.

If you are a real estate investor who plans to sell homes to owner occupant buyers, taking back seller financing on those homes, note that the above rules for ability to repay apply to you, too. There are only two exemptions available under the rules to allow seller financing by someone who is not a licensed loan originator.

The first exemption is for an individual natural person, not an entity, the estate of an individual, or a regular trust, not a land trust or business trust. That exemption allows a qualified seller to sell only one property in a year to a consumer, with financing which does not include negative amortization, and has a fixed rate or five year adjustable rate. A balloon payment is not prohibited for these loans.

The second exemption allows an entity not a licensed loan originator to seller finance up to three properties per year, but the seller/lender must follow the specific bases for determining ATR, just like a lender, and the loan must be fully amortizing, with no balloon payments allowed. These rules apply equally to mortgage financing and to installment land contract

financing to consumers, but again do not apply to loans to other investors on their non-owner occupied investment properties. Lease-options do not require ATR as long as they are really leases, with only an option for the consumer to buy the property with financing for the purchase presumably to be obtained from a lender under ATR requirements. Don’t risk calling your seller financing a lease option to avoid the ATR requirements. If the CFPB determines it is really a finance plan and not an option, you will lose more than you can afford to in fines and penalties.
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