Thursday, August 30, 2012

Appraisals and APR for Higher-Risk Mortgages

On August 15, 2012, six federal financial regulatory agencies issued a proposed rule to establish new appraisal requirements for "higher-risk mortgage loans." The proposed rule has been issued by the Board of Governors of the Federal Reserve System, the Consumer Financial Protection Bureau (Bureau), the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the National Credit Union Administration, and the Office of the Comptroller of the Currency.

The proposed rule would implement amendments to the Truth in Lending Act (TILA) enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank). Under the Dodd-Frank, mortgage loans are higher-risk if they are secured by a consumer's home and have interest rates above a certain threshold.

For higher-risk mortgage loans, the proposed rule would require creditors to use a licensed or certified appraiser who prepares a written report based on a physical inspection of the interior of the property. The proposed rule also would require creditors to disclose to applicants information about the purpose of the appraisal and provide consumers with a free copy of any appraisal report.

Creditors would have to obtain an additional appraisal at no cost to the consumer for a home-purchase higher-risk mortgage loan if the seller acquired the property for a lower price during the past six months. This requirement is meant to address fraudulent property flipping by seeking to ensure that the value of the property being used as collateral for the loan legitimately increased.

The aforementioned agencies are seeking comments from the public on all aspects of the proposal. The public will have 60 days, or until October 15, 2012, to review and comment on most of the proposal.

IN THIS ARTICLE

History

"Higher Risk" Mortgage Loans

Appraisal Requirements

Additional Written Appraisal

Calculating the Annual Percentage Rate

Replacing the Annual Percentage Rate

History

On July 21, 2010, Dodd-Frank was signed into law. Section 1471 of Dodd-Frank establishes a new TILA section 129H, which sets forth appraisal requirements applicable to "higher-risk mortgages."

Specifically, new TILA section 129H does not permit a creditor to extend credit in the form of a higher-risk mortgage loan to any consumer without first:

- Obtaining a written appraisal performed by a certified or licensed appraiser who conducts a physical property visit of the interior of the property.

- Obtaining an additional appraisal from a different certified or licensed appraiser if the purpose of the higher-risk mortgage loan is to finance the purchase or acquisition of a mortgaged property from a seller within 180 days of the purchase or acquisition of the

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- Property by that seller at a price that was lower than the current sale price of the property. (The additional appraisal must include an analysis of the difference in sale prices, changes in market conditions, and any improvements made to the property between the date of the previous sale and the current sale.)

- Providing the applicant, at the time of the initial mortgage application, with a statement that any appraisal prepared for the mortgage is for the sole use of the creditor, and that the applicant may choose to have a separate appraisal conducted at the applicant's expense.

- Providing the applicant with one copy of each appraisal conducted in accordance with TILA section 129H without charge, at least three (3) days prior to the transaction closing date.

"Higher Risk" Mortgage Loans

The new TILA section 129H(f) defines a "higher-risk mortgage" with reference to the annual percentage rate (APR) for the transaction. A higher-risk mortgage is a "residential mortgage loan" secured by a principal dwelling with an APR that exceeds the average prime offer rate (APOR) for a comparable transaction as of the date the interest rate is set, as follows:

- By 1.5 or more percentage points, for a first lien residential mortgage loan with an original principal obligation amount that does not exceed the amount for the maximum limitation on the original principal obligation of a mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the sixth sentence of section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454).

- By 2.5 or more percentage points, for a first lien residential mortgage loan having an original principal obligation amount that exceeds the amount for the maximum limitation on the original principal obligation of a mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the sixth sentence of section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454).

- By 3.5 or more percentage points for a subordinate lien residential mortgage loan.

The definition of "higher-risk mortgage" expressly excludes qualified mortgages, as defined in TILA section 129C, as well as reverse mortgage loans that are qualified mortgages as defined in TILA section 129C.

These rate thresholds are substantially similar to rate triggers currently in Regulation Z for "higher-priced mortgage loans," a category of loans to which special consumer protections apply. In general, loans are "higher-risk mortgage loans" under this proposed rule if the APR exceeds the APOR by 1.5 percent for first-lien loans, 2.5 percent for first-lien jumbo loans, and 3.5 percent for subordinate-lien loans.

Note: the "higher-priced mortgage loan" rules apply the 2.5 percent over APOR trigger for jumbo loans only with respect to a requirement to establish escrow accounts.

Appraisal Requirements

Consistent with the statute, the proposal would allow a creditor to make a higher-risk mortgage loan only if the following conditions are met:

- The creditor obtains a written appraisal.

- The appraisal is performed by a certified or licensed appraiser.

- The appraiser conducts a physical property visit of the interior of the property.

- At application, the applicant is provided with a statement regarding the purpose of the appraisal, that the creditor will provide the applicant a copy of any written appraisal, and that the applicant may choose to have a separate appraisal conducted at the expense of the applicant.

- The creditor provides the consumer with a free copy of any written appraisals obtained for the transaction at least three (3) business days before closing.

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Interview: Anti-Money Laundering Program for Nonba...
► July (4)
► June (2)
► May (2)
► April (3)
► March (5)
► February (2)
► January (6)
► 2011 (106)
► 2010 (86)
► 2009 (8)

Additional Written Appraisal

In addition, as required by the Act, the proposal would require a higher-risk mortgage loan creditor to obtain an additional written appraisal, at no cost to the borrower, under the following circumstances:

- The higher-risk mortgage loan will finance the acquisition of the consumer's principal dwelling.

- The seller is selling what will become the consumer's principal dwelling acquired the home within 180 days prior to the consumer's purchase agreement (measured from the date of the consumer's purchase agreement).

- The consumer is acquiring the home for a higher price than the seller paid, although comment is requested on whether a threshold price increase would be appropriate.

The additional written appraisal, from a different licensed or certified appraiser, generally must include the following information:

> An analysis of the difference in sale prices (i.e., the sale price paid by the seller and the acquisition price of the property as set forth in the consumer's purchase agreement), changes in market conditions, and any improvements made to the property between the date of the previous sale and the current sale.

Calculating the Annual Percentage Rate

The proposal also includes a request for comments to address a proposed amendment to the method of calculation of the APR that is being proposed as part of other mortgage-related proposals issued for comment by the Bureau.

In the Bureau's proposal to integrate mortgage disclosures (viz., 2012 TILA-RESPA Proposal), the Bureau is proposing to adopt a more simple and inclusive finance charge calculation for closed-end credit secured by real property or a dwelling.

As the finance charge is integral to the calculation of the APR, the Agencies believe it is possible that a more inclusive finance charge could increase the number of loans covered by this rule. The Agencies have noted that the Bureau currently is seeking data to assist in assessing potential impacts of a more inclusive finance charge in connection with the 2012 TILA-RESPA Proposal and its proposal to implement the Dodd-Frank provision related to "high-cost mortgages" (viz., 2012 HOEPA Proposal).

Replacing the Annual Percentage Rate

The Agencies have also noted that the Bureau is seeking comment on whether replacing APR with an alternative metric may be warranted to determine whether a loan is covered by the 2012 HOEPA Proposal, as well as by the proposal to implement the Dodd-Frank's escrow requirements in TILA section 129D (viz., 2011 Escrow Proposal).

In our view, the alternative metric (if adopted) would also have implications for the 2011 Ability-to-Repay proposal. One possible alternative metric discussed in those proposals is the "transaction coverage rate" (TCR), which would exclude all prepaid finance charges not retained by the creditor, a mortgage broker, or an affiliate of either.

As we've outlined above, the new rate triggers for both "high-cost mortgages" and "higher-risk mortgages" under Dodd-Frank are based on the percentage by which the APR exceeds APOR. Given this similarity, the Agencies are correct to seek comment as to whether a modification should be considered for this rule as well, and if so, what type of modification is going to be needed.

Accordingly, the higher-risk mortgage loan may be defined in the alternative as calculated by either the TCR or APR, with comment sought on both approaches. The Agencies are relying on their exemption authority under section 1471 of Dodd-Frank to propose an alternative definition of higher-risk mortgage.

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Appraisals for Higher-Risk Mortgage Loans

Interagency Issuance

August 15, 2012

Labels: Ability to Repay, APOR, Appraisal Compliance, APR, CFPB, Dodd-Frank Act, Higher-Risk Mortgages, TCR, TILA, Transaction Coverage Rate, Truth in Lending Act

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