New Mortgage Lending Regulations Effective January 2014

By: Susan Brown (MLO-471817), Umpqua Bank
Michael Neef (MLO-227081), American Pacific Mortgage
Eric Wiley (MLO-17831), Pacific Residential Mortgage

In response to the financial crisis of 2007, The Dodd Frank Act of 2010, also known as The Wall Street Reform and Consumer Protection Act, was passed. In 2014 the next series of rules within this law will be implemented that bring about a new era in mortgage lending oversight across the nation. Dodd Frank requires a new, single regulator to oversee all consumer finance activity. Mortgage finance is covered within these new regulations and by the new regulator, the Bureau of Consumer Financial Protection (better known as the CFPB).

As a requirement of the Dodd Frank Act, the next phase of mortgage lending rules is being implemented in January, 2014. These rules include the newly defined Qualified Mortgage (QM) and Ability to Repay (ATR) standards. While the burden to adhere to these new rules is placed upon the mortgage industry specifically, there are some practical points that real estate professionals should be aware of.

Lenders will generally want the loans that they write to be QMs. If the loan is originated and closed as a QM (that is not considered a Higher Priced Mortgage Loan, or HPML) there is a legal Safe Harbor achieved for lenders that protects them from a future claim by the homeowner that the loan offered was unaffordable. If a loan is not closed as a non-HPML QM, there is only a Rebuttable Presumption established which means there is a risk of litigation by the consumer who could claim that the loan they purchased was not appropriate for their ability to repay. This future claim represents an unknown liability for the lender. Consequently, non QM loans may be hard to find and more expensive and HPML QM loans will be more scrutinized in underwriting.

The Bottom Line

Most loans offered today will still be able to be offered within the QM and ATR standards. Many of the newly mandated QM requirements just add concrete to the standard guidelines that banks have already been underwriting against. This means that moving forward lenders will not bend on guidelines with the same flexibility as in the past. Whereas before some banks could make executive decisions in “Grey” area’s based on their opinion of the borrower or loan file’s strengths without inheriting large amounts of risk. The risk of making a loan outside the QM and ATR standards is defined by the consumer’s right to legal action.

There are a few aspects of this regulation which will be impossible to measure until we have had experience underwriting to the new standards. However, for the most part, we would like to believe that for the MAJORITY of our clients, this will have little negative impact.

A New 43% Debt-to-Income Standard

Before you get too excited, this only applies to a small portion of loans in today’s marketplace. Namely the larger, or Jumbo loans and some other niche, portfolio loans. Loans slated for Fannie Mae, Freddie Mac, FHA, VA and USDA do not currently have the 43% debt-to-income (DTI) maximum cap. These lending institutions, collectively labeled as “Agencies”, have up to 7 years to comply with this new requirement, or as late as 2021.

Risqué Features No More

QM loans will be required to have a lack of risky features. Risky is defined as loans with:

- Terms over 30 years
- Pre-payment penalties (some exceptions apply)
- Interest-only payments
- Negatively amortizing balances
- Balloon payments
- Deferred principal reduction
- An introductory interest rate fixed for less than 5 years

Things You Should Know as a REALTOR®

Buyers will have more up-front requirements in applying for a home loan and they will be offered more information throughout the process. We expect this to bring about some questions during a home purchase transaction. Some helpful hints:

- **Full doc means full doc** – Simply expect homebuyers to give ALL paperwork asked of them up front. (BEST PRACTICE)

- **Lending Guidelines** – They will generally feel more rigid though the actual guidelines won't change much. Expect a bit less flexibility across the board. Lenders simply have less wiggle room.

- **Home Valuations** – Get ready to have conversations about the fact that some "lesser quality" valuations will be in the hands of the homebuyer. For example, lenders may look at and review different forms of automated valuations, such as Zestimates, and if they do, these will now have to be provided to your buyers in a timely fashion.

- **Homeownership Counseling** – While there are no new requirements for a homebuyer to attend a homeownership counseling class, they will be provided with a list of the closest 10 homeownership counseling centers. Lenders have to produce this list. Again, there is no new mandate for counseling but this might generate questions directed your way.

- **Private Mortgage Insurance** - Some mortgage insurance products that exist today will be altered after these rules are implemented.

- **Loan Originators Will Be Tracked** - Mortgage Loan Originators will have their national license or registration number placed on mortgage notes and the collateral.

- **Caps on Points and Fees** – New restrictions towards the total points and fees charged by lenders apply. This is a detailed point for lending institutions but won't have much anticipated impact on consumers and Realtors. More seller concessions may be required in some instances.

- **New Disclosures and Settlement Statements –** August 2015, yes, August 2015 – we have time….. There are definite improvements to the manner in which numbers will be described. There are also some new requirements. More details to follow as the rule is 1,888 pages long.

The Sky Is Not Falling!

Most loan products and features offered prior to the new rules will be offered after the new rules take effect. There is no immediate 43% DTI requirement across the board – it will take years to implement such a change across all of the government agency products. Regulators also know to move cautiously given the state of the housing recovery and the need to re-introduce private sector housing finance alternatives to Fannie Mae and Freddie Mac.

Create a Winning Team!

Your transactions really are only as good as the weakest link (team member). Don't leave your success to chance. Lenders have more hoops to jump through so make sure you surround yourself with professionals who have the experience to navigate these new waters. The true professionals will ask more questions in order to eliminate red flags early. Prepare your homebuyers of the fact that they need to be ready to provide all of their information and documentation early in the process to ensure smooth closings at the finish line.