

[Rules on Balloon Loans Change Next Month](#)

6-1-2011 by James H. Breay, Rodney D. Martin

Several years ago, the Michigan Legislature enacted the Consumer Mortgage Protection Act (Mortgage Act), which requires a mortgage lender to provide a number of "consumer protections" to a borrower in connection with a loan secured by residential real property. One of these protections requires certain types of mortgage loans with a term of less than five years to have a payment schedule that fully amortizes the outstanding principal balance. That is, certain balloon payment loans are prohibited.

This prohibition has had little impact until now, because it was generally considered to be preempted by a federal law called the Alternative Mortgage Transaction Parity Act of 1982. The Parity Act provided that, regardless of state law, a bank or other regulated lender could make a loan that is secured by an interest in residential real property and bears a fixed rate of interest, "but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule."

Unfortunately, the Dodd-Frank Act has amended the Parity Act in a manner that eliminates the preemption. The result is that on July 21, 2011, the Mortgage Act's prohibition of certain balloon loans will take effect because it will no longer be preempted by federal law.

However, the following types of balloon loans *are not* subject to the Mortgage Act:

- A loan in which the proceeds are used to acquire the dwelling
- A reverse-mortgage transaction
- An open-end credit plan – i.e. a loan in which the lender reasonably contemplates repeated advances

The prohibition of certain balloon loans also does not apply to a loan that has a maturity of less than one year, is a "bridge loan" and *is* "connected" with the acquisition or construction of a dwelling that is intended to become the borrower's principal dwelling.

The Mortgage Act is not limited to loans made for consumer purposes. It also applies to business loans. This will not affect most business loans because it applies only where the mortgaged property is the borrower's principal dwelling. In the vast majority of business loans, the borrower is a corporation, LLC or other type of entity.

Occasionally, however, the borrower is an individual. If the lender obtains a mortgage upon an individual borrower's principal dwelling, then the mortgage loan is subject to the prohibition of certain types of balloon loans and to the other consumer protections contained in the Mortgage Act.

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If you have any questions about whether a balloon loan is or is not permissible under the Mortgage Act, contact Jim Breay (616.752.2114 or jbrey@wnj.com), Rodney Martin (616.752.2138 or rmartin@wnj.com) or another member of the Financial Services or Commercial Finance practice groups.

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