Wednesday, October 2, 2013

HUD’s Safe and Rebuttable Qualified Mortgages

The anxiously awaited Proposed Rule (“Rule”) outlining the Qualified Mortgage for FHA loans was published in the Federal Register on September 30, 2013. Given the bland, bureaucratic title **Qualified Mortgage Definition for HUD Insured and Guaranteed Single Family Mortgages (“Issuance”)**, HUD is submitting for public comment its definition of a “qualified mortgage” for the types of loans that HUD insures, guarantees, or administers that align with the statutory ability-to-repay (“ATR”) criteria of the Truth-in-Lending Act (“TILA”) and the regulatory criteria of the definition given by the Consumer Financial Protection Bureau (“CFPB”), without departing from HUD’s statutory requirements. The expiration of the comment period is October 30, 2013.

A copy of the Proposed Rule is available in our Library.

In this article, I will provide an overview of the Rule with respect to Title II mortgages of the National Housing Act. I shall offer some practical insights relating to the potential consequences and implementation of the Rule for residential mortgage lenders and originators.*

Birthing HUD’s Proposed Rule

The Rule has its genesis in a foundational document, the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (“Dodd-Frank”), which created the new section 129C in TILA, establishing minimum standards for considering a consumer’s repayment ability for creditors originating certain closed-end, dwelling-secured mortgages, and generally prohibiting a creditor from originating a residential mortgage loan unless the creditor makes a reasonable and good faith determination of a consumer’s ability to repay the loan according to its terms.

Briefly, Section 129C is meant to provide lenders a specific format to meet the ATR requirements when lenders make “qualified mortgages” (“QMs”). A new section 129C(b), added by section 1412 of Dodd-Frank, establishes the presumption that the ATR requirements of section 129C(a) are satisfied if a mortgage is a “qualified mortgage,'' and authorizes the CFPB, to prescribe regulations that revise, add to, or subtract from the criteria in TILA that define a “qualified mortgage.'' (Section 129C also provides for a reverse mortgage to be a qualified mortgage if the mortgage meets the CFPB’s standards for a qualified mortgage, except to the extent that reverse mortgages are statutorily exempted altogether from the ATR requirements. The CFPB’s regulations provide that the ATR requirements of section 129C(a) do not apply to reverse mortgages. Section 129C(a)(8) excludes reverse mortgages from the repayment ability requirements.)

As you may know, I have published and presented extensively on QMs and have dubbed the non-qualified mortgage with the acronym “NQM.” For some of my work on this subject, please visit HERE, and HERE, and HERE.

Section 129C authorizes the agency with responsibility for compliance with TILA, that is, the CFPB, to issue a rule implementing these requirements. The CFPB already set forth its Final Rule on ATR, QMs, and NQMs, as issued in the Federal Register on January 30, 2013. Along with certain other agencies, HUD was also later on charged by the CFPB, pursuant to Dodd-Frank, with prescribing regulations defining the types of loans that it would insure, guarantee, or administer, as applicable, that are qualified mortgages. In the Rule, HUD now proposes that any forward single family mortgage insured or guaranteed by HUD must meet the criteria of a qualified mortgage, as defined in the Rule.

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HUD reviewed its mortgage insurance and loan guarantee programs and, in the Issuance, stated that all of the single family residential mortgage and loan products offered under HUD programs are qualified mortgages; that is, they "exclude risky features and are designed so that the borrower can repay the loan." However, for certain of its mortgage products, HUD proposes its Rule for qualified mortgage standards similar to those established by the CFPB in its definition of "qualified mortgage."

Safe Harbor and Rebuttable Presumption of Compliance

Through its "qualified mortgage" rulemaking, the CFPB established both a "safe harbor" and a "rebuttable presumption of compliance" for transactions that are qualified mortgages. CFPB's label of *safe harbor* is applied to those mortgages that are not higher-priced covered transactions (i.e., the annual percentage rate ("APR") does not exceed the average prime offer rate ("APOR") by 1.5 percent). These are considered to be the least risky loans and presumed to have conclusively met the ATR requirements of TILA. The label of *rebuttable presumption of compliance* is applied to those mortgages that are higher-priced transactions.

TILA Section 129C(b)(2)(ix) provides that the term "qualified mortgage" may include a "residential mortgage loan" that is "a reverse mortgage which meets the standards for a qualified mortgage, as set by the Bureau in rules that are consistent with the purposes of this subsection." But the Federal Reserve Board's proposal, adopted by the CFPB, does not include reverse mortgages in the definition of a "qualified mortgage." Indeed, the CFPB's Final Rule does not define a "qualified" reverse mortgage.

HUD proposes to designate Title I (home improvement loans), Section 184 (Indian housing loans), and Section 184A (Native Hawaiian housing loans) insured mortgages and guaranteed loans covered by the Rule to be safe harbor qualified mortgages and HUD proposes no changes to the underwriting requirements of these mortgage and loan products.

The largest volume of HUD mortgage products - those insured under Title II of the National Housing Act – would be bifurcated into qualified mortgages similar to the two categories created in the CFPB final rule: a safe harbor qualified mortgage and a rebuttable presumption qualified mortgage.

Specifically, the Rule would define the safe harbor qualified mortgage as a mortgage insured under Title II of the National Housing Act (excepting reverse mortgages insured under section 255 of this act) that meets the points and fees limit adopted by the CFPB in its regulation at 12 CFR 1026.43(e)(3), and that has an APR for a first-lien mortgage relative to the APOR that is less than the sum of the annual mortgage insurance premium ("MIP") and 1.15 percentage points. HUD would define a rebuttable presumption qualified mortgage as a single family mortgage insured under Title II of the National Housing Act (excepting reverse mortgages insured under section 255 of this act) that meets the points and fees limit adopted by the CFPB in its regulation at 12 CFR 1026.43(e)(3), but has an APR that exceeds the APOR for a comparable mortgage, as of the date the interest rate is set, by more than the sum of the annual MIP and 1.15 percentage points for a first-lien mortgage.

Therefore, under the Rule, HUD would require that all loans insured under Title II of the National Housing Act to be either a rebuttable presumption or safe harbor qualified mortgage, and, importantly, that they meet the CFPB's points and fees limit at 12 CFR 1026.43(e)(3). The CFPB set a three (3%) percentage points and fees limit for its definition of qualified mortgage and allowed for adjustments of this limit to facilitate the presumption of compliance for smaller loans.

Qualified Mortgage

There are eight criteria applied toward defining a QM. Section 129C(b)(2)(A) defines a "qualified mortgage" as a mortgage that meets the following requirements:

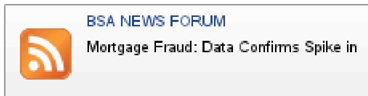
1. The transaction must have regular periodic payments;

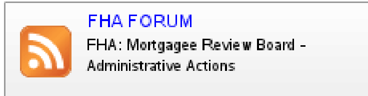
2. The terms of the mortgage must not result in a balloon payment;

3. The income and financial resources of the mortgagor are verified and documented;

4. For a fixed rate loan, the underwriting process fully amortizes the loan over the loan term;

5. For an adjustable rate loan, the underwriting is based on the maximum rate permitted





under the loan during the first 5 years and includes a payment schedule that fully amortizes the loan over the loan term;

6. The transaction must comply with any regulations established by the CFPB relating to ratios of total monthly debt to total monthly income;

7. The total points and fees payable in connection with the loan must not exceed 3 percent of the total loan amount; and

8. The mortgage must not exceed 30 years, except in specific areas.

The CFPB's regulations at 12 CFR 1026.43(e)(2) adopt, in part, the statutory qualified mortgage definition, and require that a mortgage meet 6 general requirements:

1. The transaction must have regular periodic payments;

2. The mortgage must not exceed 30 years;

3. The points and fees paid in connection with a loan greater than or equal to $100,000 does not exceed 3 percent of the total loan amount, with a higher amount allowed for loans under $100,000;

4. The creditor must underwrite the loan taking into account the monthly payment for mortgage-related obligations;

5. The creditor must consider and verify income and debt; and,

6. The ratio of the consumer's monthly debt to total monthly income must not exceed 43 percent.

The total amount of points and fees are 'capped" as follows:

· For loans greater than or equal to $100,000 (indexed for inflation), points and fees must not exceed 3 percent of the total loan amount.

· For a loan amount greater than or equal to $60,000 but less than $100,000, the points and fees must not exceed $3,000.

· For a loan amount greater than or equal to $20,000 but less than $60,000, the points and fees must not exceed 5 percent of the total loan amount.

· For a loan amount greater than or equal to $12,500 but less than $20,000, the points and fees must not exceed $1,000.

· For a loan amount less than $12,500, the points and fees must not exceed 8 percent of the total loan amount.

A QM falls into the safe harbor category and is conclusively presumed to have met the ATR requirements if it is not a "higher-priced covered transaction." The safe harbor presumption was established to limit ATR challenges on mortgages that are considered to be the least risky. Consumers can only challenge loans in this category by showing that the loans do not meet the definition of a "qualified mortgage."

A "qualified mortgage" that is a higher-priced covered transaction has only a rebuttable presumption of compliance with the ATR requirement, even though each element of the "qualified mortgage" definition is met. [12 CFR 1026.43(e)(1)(ii)(B)] A "higher-priced covered transaction" is a transaction that has an APR that exceeds the APOR for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for a first-lien covered transaction or by 3.5 or more percentage points for a subordinate-lien covered transaction.

Under the Rule, HUD proposes to define all FHA-insured single family mortgages to be qualified mortgages, except for reverse mortgages insured under HUD's Home Equity Conversion Mortgage (HECM) program (section 255 of the National Housing Act (12 U.S.C. 1715z–20)), which are exempt from the ATR criteria.

Finally, the CFPB's Final Rule temporarily grants "qualified mortgage" status to loans that satisfy certain underwriting standards. [12 CFR 1026.43(e)(4)] Loans in this category must satisfy the underwriting requirements of, and are therefore eligible to be purchased, guaranteed or insured by, one of the following:

· The government-sponsored enterprises (GSEs) (i.e., Fannie Mae and Freddie Mac) while they operate under Federal conservatorship or receivership; and,

· HUD (but only loans eligible to be insured under the National Housing Act), VA, USDA,

and RHS.

This temporary definition requires a qualified mortgage to satisfy only the first 3 requirements of the general definition of a qualified mortgage (i.e., regular periodic payments, term not to exceed 30 years, points and fees not exceeding those specified in 1026.43(e)(3)), and excludes the underwriting, credit and income verification, and 43 percent total monthly debt-to-income ratio requirements for a “qualified mortgage.”

These applicable provisions of the temporary definition have sunset provisions, such as:

· When each of the four Federal agencies issue their own “qualified mortgage” rule;

· When conservatorship ends for the GSEs; or

· For all four of the Federal agencies and the GSEs, no later than January 10, 2021, which is 7 years after the effective date of the CFPB final rule.

Streamline Refinances

The Rule would require FHA streamlined refinances to comply with HUD’s qualified mortgage rule. Section 129C(a)(5) of TILA grants HUD the authority to exempt streamlined refinancing from the income verification requirements of section 129C(a)(4) as long as such refinances meet certain requirements, including that the consumer is not 30 days or more past due on the prior existing residential mortgage loan, the loan does not increase the principal balance, the points and fees do not exceed 3 percent, and the new interest rate on the refinanced loan is lower than the current rate.

Specifically, HUD’s qualified mortgage rule would require streamlined refinances to meet the points and fees requirements and the HUD guidelines for FHA-streamlined refinances. HUD requirements only exempt lenders from verifying income if the loan is originated consistent with the FHA-streamlined refinancing requirements (i.e., the mortgage must be current, the loan is designed to lower the monthly principal and interest payment, and the loan involves no cash back to the borrower except for minor adjustments).

Requiring streamlined refinances to be “qualified mortgages” will also subject them to the APR threshold requirement for being either a rebuttable presumption or safe harbor qualified mortgage.

Given the unique nature of streamlined refinances, this proposed rule would modify the CFPB’s rebuttable presumption standard to clarify that a presumption is rebutted if the lender does not meet the underwriting requirements applicable to the transaction. Therefore, if a streamlined refinance was a “rebuttable presumption qualified mortgage” the presumption could only be rebutted by showing that the lender did not meet the applicable HUD requirements for originating streamlined refinances, including the points and fees limit.

Safe Harbor Qualified Mortgage

The terminology “Safe Harbor Qualified Mortgage” – which I shall call the “Safe QM” – is really an FHA semantic convention. The Safe QM would be defined as one that:

1. Either is a mortgage insured under the National Housing Act (excepting a mortgage insured under Title I or a HECM) that

    a. Meets the requirements of the National Housing Act, including the cap on points and fees,

    b. And has an APR for a first-lien mortgage relative to the APOR that is less than the combined annual mortgage insurance premium and 1.15 percentage points;

2. Or is a mortgage insured under Title I.

A mortgagee that meets the requirements for a SAFE QM is deemed to meet the ATR guidelines.

Rebuttable Presumption Qualified Mortgage

The terminology “Rebuttable Presumption Qualified Mortgage” – which I shall call the “Rebuttable QM” – is really yet another FHA semantic convention. The Rebuttable QM would be defined as a single family mortgage that is insured under the National Housing Act(excepting a mortgage insured under Title I or a HECM) that

1. Includes the requirement that it does not exceed the CFPB’s cap on points and fees, and

2. Has an APR that exceeds the APOR for a comparable mortgage, as of the date the

interest rate is set, by

a. More than the combined APR,

b. And 1.15 percentage points for a first-lien mortgage.

The Rule provides that a mortgage which meets the requirements for a Rebuttable QM would be presumed to comply with the ability to repay requirements.

It should be noted that any rebuttal of such presumption of compliance must show that, despite meeting the "rebuttable presumption qualified mortgage" requirements, the mortgagee did not make a reasonable and good faith determination of the mortgagor's repayment ability at the time of consummation, as applicable to the type of mortgage, when underwriting the mortgage in accordance with HUD requirements, or that the cap on points and fees was exceeded.

Comparing the HUD QM to the CFPB QM

HUD's safe harbor and rebuttable presumption definitions are similar, but not identical to, those of the CFPB. For instance, the CFPB does not establish a "safe harbor qualified mortgage" or a "rebuttable presumption qualified mortgage." Rather, the CFPB provides separate definitions of "higher-priced covered transaction" and "qualified mortgage" and then states that (1) a qualified mortgage which is not a higher-priced transaction complies with the ability-to-repay requirements; and (2) a qualified mortgage that is a higher-priced transaction is presumed to comply with the ability-to-repay requirements.

Even though the CFPB's Final Rule is structured in this way to provide only a single definition of a "qualified mortgage," CFPB's Final Rule acknowledges that "the final rule distinguishes between two types of qualified mortgages based on the mortgage's APR relative to the APOR." The CFPB's Final Rule also acknowledges that the definition of "qualified mortgage" may be structured in different ways, and the two alternative definitions of a qualified mortgage were proposed, one that would have operated as a legal safe harbor, and one that would have provided a rebuttable presumption of compliance. [78 FR 6417, 6508.]

Furthermore, the APR relative to APOR for the HUD QM is similar to the CFPB QM in its Final Rule, in that HUD's Rule would distinguish between the two types of qualified mortgages based on the mortgage's APR relative to the APOR for the great majority of FHA-insured single family mortgages. Using the APR relative to APOR to distinguish between safe harbor and rebuttable presumption for most loans provides consistency with a significant feature of the CFPB's Final Rule. The APOR does not include private mortgage insurance (PMI).

Thus, HUD's purpose in establishing two categories of qualified mortgages for the bulk of loans it insures is to "maintain consistency with the TILA statutory criteria defining qualified mortgage, as well as the CFPB's definition, to the extent consistent with the National Housing Act." The difference in structure from the CFPB's Final Rule is that HUD proposes to incorporate the APR as an internal element of HUD's definition of qualified mortgages that would distinguish the Safe QM from the Rebuttable QM. The CFPB's "higher-priced covered transaction" is an external element that is applied to a single definition of "qualified mortgage."

HUD's Safe QM would provide a different APR relative to APOR threshold than the CFPB's requirement that a first-lien covered transaction have an APR of less than 1.5 percentage points above the APOR. Under HUD's Rule, for a non-Title I single family mortgage to meet the "safe harbor qualified mortgage" definition, the mortgage would be required to have an APR that does not exceed the APOR for a comparable mortgage by more than the combined annual mortgage insurance premium (MIP) and 1.15 percentage points. Because all FHA-insured mortgages include a MIP that may vary from time to time, including the MIP as an element of the threshold that distinguishes safe harbor from rebuttable presumption, this calculation methodology presumably allows the threshold to "float" in a manner that permits HUD to adjust the MIP if HUD adopted a threshold based only on the amount that APR exceeds APOR. If a straight APR over APOR threshold were adopted by HUD, every time HUD would change the MIP, HUD would also have to consider changing the threshold APR limit.

Liability Protection

FHA-approved lenders that originate a safe harbor mortgage operate with greater legal protections than those that issue rebuttable presumption mortgages, but the latter group is not without legal protections.

For an FHA-approved lender that originates a Safe QM, the mortgage is conclusively presumed to comply with the ATR requirements. According to HUD, meeting the qualified mortgage criteria and underwriting requirements and pricing of the loan at a prime rate are sufficient to ensure that the lender made a reasonable and good faith determination

that the borrower will be able to repay the loan. If a borrower brings a claim that the FHA-approved lender did not make a reasonable and good faith determination of the borrower's ATR in the FHA-insured mortgage, and the court finds that the originated mortgage was a Safe QM, as defined by HUD, then that finding by the court conclusively establishes that the lender complied with the ATR requirements and the consumer's claim is denied.

For an FHA-approved lender that originates a Rebuttable QM, the mortgage is presumed to comply with the ATR criteria. If a borrower brings a claim that the FHA-approved lender did not make a reasonable and good faith determination of the borrower's ATR in the FHA-insured mortgage, and the court finds that the originated mortgage was a Rebuttable QM, as defined by HUD, then the borrower may rebut the presumption. Therefore, according to HUD, "the lender should exert greater care in underwriting the loan than would be true in the absence of any liability for extending a loan which the borrower cannot afford to repay." For the borrower to prevail on its claim against a lender that originates a Rebuttable QM, the borrower must prove that the lender did not make a reasonable and good faith effort in evaluating the borrower's ability to repay the FHA-insured mortgage in accordance with HUD requirements.

For either type of mortgage, however, documentation of the borrower's ATR will be important in demonstrating compliance with the ATR criteria. Referencing the CFPBs Final Rule, HUD states: "As enacted by the Dodd-Frank Act, TILA section 129C(a)(1) provides that no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good-faith determination, based on verified and documented information, that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan according to its terms and all applicable taxes, insurance, and assessments." [See 78 FR 6460]

Ratios: HUD and the CFPB

There are also provisions among HUD's requirements that already apply to mortgages insured under the National Housing Act and are consistent with section 129C(b)(2)(B) of TILA and the CFPB's own requirements, including that a mortgage must have regular periodic payments, that the mortgage does not exceed 30 years, and that lenders apply specific underwriting requirements. HUD's Rule continues to use its existing underwriting and income verification requirements, which means that HUD is not adopting CFPB's 43 percent total monthly debt-to-income ratio requirement.

Higher-Priced Covered Transactions

The fact that the CFPB's Final Rule provides a separate definition of "higher-priced covered transaction" may potentially create issues in that some of HUD's Safe QMs would also be higher-priced covered transactions, as defined by the CFPB. To the extent that there are requirements not related to qualified mortgages that apply to higher-priced covered transactions, according to HUD, such requirements would apply to mortgages that meet the higher-priced covered transaction definition regardless of whether they are safe harbor or rebuttable presumption. As an example, HUD states that the calculation of certain maximum payments with respect to loans with balloon payments [under 12 CFR 1026.43(c)(5)(ii)(A)] is not expected to have any impact on mortgages insured under the National Housing Act. Apart from this requirement, HUD has stated that it is "currently not aware of other possible overlaps of CFPB requirements."

Effective Date

HUD's Rule is expected to be finalized and effective by January 10, 2014. If the Rule is not effective by this date, its mortgages will be subject to the CFPB's definition of qualified mortgage, which, for instance, would result in a lower share of Safe QMs for FHA and would negatively affect borrowers with greater than 43 percent total monthly debt-to-income ratios.

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