

What to Know About High-Cost Laws

In addition to potential state laws, brokers should understand federal Section 32 statutes

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THE HIGH-COST MORTGAGE, AS defined by the Home Ownership and Equity Protection Act of 1994 (HOEPA), is an elusive concept for brokers to understand. One big reason is that the definition of these mortgages — i.e., those with interest rates or costs that exceed a certain level — comes through an amalgamation of laws.

Brokers must understand which laws affect them — and how. After all, violations come with harsh penalties, including refunding all closing costs and interest to the borrower. Lenders also will hold brokers accountable for brokering them a loan that goes against Section 32 of Regulation Z of the federal Truth in Lending Act, which implemented the federal high-cost laws. When this happens, brokers often must repurchase the loan from the lender, costing several thousands of dollars.

Where to start

The first step is understanding the difference between the federal high-cost-mortgage law and those of various states. Federal laws do not preempt state rules, to the extent that state laws offer borrowers protection that federal statutes do not.

At press time, 29 states and the District of Columbia have laws about high-cost mortgages. In the other states and territories, borrowers rely solely on the federal laws.

Federal high-cost laws came into play with HOEPA. The Federal Reserve Board, which interprets the Truth in Lending Act and HOEPA, promulgated 12 CFR Section No. 226.32, commonly known as Section 32.

Section 32 covers only closed-end consumer loans made on a borrower's primary residence. There are a few ways loans will

trigger Section 32 provisions:

1. **If points and fees of a mortgage loan exceed 8 percent of the loan amount;**
2. **If the annual percentage rate is more than 8 percent higher than the comparable Treasury bill for a first lien; or**
3. **If the annual percentage rate is more than 10 percent higher than the comparable Treasury bill for a junior lien.**

Knowing federal restrictions

Although high-cost loans carry some restrictions and additional disclosure requirements, they are basically the same as normal loans. High-cost loans cannot have:

- **A balloon payment and termination in less than five years, except in cases of bridge loans;**
- **A prepayment penalty without considering the borrower's ability to repay and unless the borrower's back-end debt ratio is 50 percent or less;**
- **Negative amortization;**
- **Due-on-demand provisions; or**
- **More than two months of required advance payments to the lender from the borrower.**

In addition to these restrictions, the lender — or the broker in charge of giving disclosures — must provide disclosures of the following at least three business days before the loan closes:

- **Actual annual percentage rate;**
- **Borrower's regular periodic payment and balloon amount, if any;**
- **A statement that monthly payments may**

increase, in the case of a variable interest rate, and maximum monthly payment in these cases; and

- **The total that the borrower will borrow, if it is a refinance.**

During this time period, the following notice also must be disclosed to borrowers verbatim: "You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application. If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan."

"The penalty for violating Section 32 is stiff. The borrower essentially gets a free loan, and the lender must credit the borrower all closing costs and all interest paid to date. In addition, violating Section 32 may be a basis for lending regulators to pull your broker's or lender's license."

The Truth in Lending Act states that home-equity lines of credit (HELOCs) are exempt from Section 32 but only if they do not attempt to evade it. There has not been significant case law to define exactly what evades Section 32 and what does not.

Of greater concern are the so-called interest-only HELOCs. These HELOCs typically allow for interest-only payments during its term and for a balloon payment at the end of the loan. A court could determine that these loans are not true, open-end lines of credit because they do not contemplate an ability to pay down the credit line.

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High-Cost Laws

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They merely are interest-only. Be wary of these types of HELOCs, especially in the lawsuit-heavy market we have entered.



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Ultimately, knowing how high-cost mortgage laws apply can be vital to brokers' business. **!**

Note: This article was written for educational and informational purposes only and should not be construed as legal advice. Consult an attorney to determine what is legal and appropriate for your specific situation.

Who Has High-Cost Laws?

States and territories with laws that cover high-cost mortgages include:

- Arkansas
- California
- Colorado
- Connecticut
- Dist. of Columbia
- Florida
- Georgia
- Illinois
- Indiana
- Kansas
- Kentucky
- Maine
- Maryland
- Massachusetts
- Minnesota
- Nevada
- New Jersey
- New Mexico
- New York
- North Carolina
- Ohio
- Oklahoma
- Pennsylvania
- Rhode Island
- South Carolina
- Tennessee
- Texas
- Utah
- Vermont
- Wisconsin