

July 19, 2013

Interagency Supplemental Proposal: Appraisals for "Higher-Priced Mortgage Loans"

SUMMARY OF PROPOSAL

- The CFPB, NCUA, and other federal financial regulators (Agencies), recently issued a proposal to amend Regulation Z, which implements the Truth in Lending Act (TILA). This proposal relates to the final rule on appraisals that was issued by the Agencies in January of this year, which goes into effect on January 18, 2014.
- The Final Rule implements a provision added to TILA by the Dodd-Frank Act that requires appraisals for "Higher-Priced Mortgage Loans." For certain mortgages with an annual percentage rate that exceeds the average prime offer rate by a specified percentage, the Final Rule requires creditors to obtain an appraisal meeting certain specified standards, provide applicants with a notification regarding the use of the appraisals, and give applicants a copy of the appraisals used.
- The Agencies are proposing to amend the Final Rule to allow exemptions for: (1) transactions secured by existing manufactured homes and not land; (2) certain "streamlined" refinancings; and (3) transactions of \$25,000 or less.
- In regard to certain "streamlined" refinancings, the proposal would exempt an extension of credit where the following conditions are satisfied:
 - o The refinance loan's owner/guarantor is the current owner/guarantor of the existing obligation;
 - The periodic payments under the refinance loan must not result in negative amortization, cover only interest on the loan, or result in a balloon payment; and
 - o The proceeds from the refinance loan may only be used to pay off the outstanding principal balance on the existing obligation and to pay closing or settlement charges.
- The Agencies are accepting comments until September 9; send comments to CUNA by August 13.

BACKGROUND OF PROPOSAL

The Consumer Financial Protection Bureau (CFPB), National Credit Union Administration (NCUA), and other federal financial regulators ("the Agencies") jointly issued a rule to amend Regulation Z, which implements the Truth in Lending Act (TILA). The final rule implements appraisal requirements for extensions of credit for "higher-priced mortgage loans" (HPMLs) required by the Dodd-Frank Act.

Under the final rule, HPML is defined as a closed-end consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate (APR) that exceeds by a specified percentage the average prime offer rate (APOR) for a comparable transaction as of the date the interest rate is set. Specifically, a HPML would exist where the APR exceeds the APOR by:

- 1.5 percentage points for a first-lien non-jumbo loan;
- 2.5 percentage points for a first-lien jumbo loan; or
- 3.5 percentage points for a junior-lien loan.

The rule explicitly exempts the following types of transactions from the appraisal requirements for HPMLs:

- A loan that is a "qualified mortgage" under the CFPB's ability to repay rule;
- A reverse mortgage transaction;
- · A loan for initial construction of a dwelling;
- A temporary bridge loan (for 12 months or less);

- A loan secured by a new manufactured home; and
- A transaction secured by a mobile home, boat, or trailer.

In general, the final rule prohibits a creditor from making a HPML unless prior to consummation, the consumer obtains a written appraisal performed by a "certified or licensed appraiser" who conducts a physical visit of the interior of the property.

The Agencies are proposing to amend the Final Rule to allow exemptions for: (1) transactions secured by existing manufactured homes and not land; (2) certain "streamlined" refinancings; and (3) transactions of \$25,000 or less.

DESCRIPTION OF PROPOSAL

1) Definition of "Business Day" (§1026.2(a)(6))

The term "business day" is used with respect to two requirements in the Final Rule. First, the Final Rule requires the creditor to provide the consumer with a disclosure that "shall be delivered or placed in the mail not later than the third business day after the creditor receives the consumer's application for a HPML." Second, the Final Rule requires the creditor to provide to the consumer a copy of each written appraisal obtained under the Final Rule "[n]o later than three business days prior to consummation of the loan."

The Agencies propose to define "business day" in the Final Rule to mean "all calendar days except Sundays and the legal public holidays specified in 5 U.S.C. 6103(a), such as New Year's Day, Martin Luther King Day, Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving, and Christmas Day." § 1026.2(a)(6). The Agencies propose this definition for consistency with disclosure timing requirements under both the existing Reg Z mortgage disclosure timing requirements and the CFPB's proposed rules for combined mortgages disclosures under TILA and the Real Estate Settlement Procedures Act (RESPA).

CUNA Question 1: Do you support the proposed changes to the definition of "business day"? Why or why not?

2) Exemptions from Appraisal Requirements for Higher-Priced Mortgage Loans (§ 1026.35(c)(2)

2a) Loans Secured Solely by Existing Manufactured Home and Not Land (§ 1026.35(c)(2)(ii)(B))

In the Final Rule, the Agencies exempted several classes of loans from the HPML appraisal rules, including transactions secured by a "new manufactured home." However, the Final Rule does not exempt transactions secured solely by an existing (used) manufactured home and not land from the HPML appraisal requirements. In new § 1026.35(c)(2)(ii)(B), the Agencies propose to exempt transactions secured solely by an existing (used) manufactured home and not land from the HPML appraisal requirements. Proposed comment 35(c)(2)(ii)(B)-1 would clarify that an HPML secured by a manufactured home and not land would not be subject to the appraisal requirements of § 1026.35(c), regardless of whether the home is titled as realty by operation of state law. The Agencies recognize that in certain states residential structures such as manufactured homes may be deemed real property, even though they are not titled together with the land. The Agencies believe that the barriers discussed in more detail below to producing USPAP-compliant real property appraisals with interior property inspections for manufactured homes in home-only transactions are the same regardless of whether a jurisdiction categorizes the manufactured home as personal property (chattel) or real property.

CUNA Question 2: Do you support the proposed exemption for loans secured solely by existing manufactured homes and not land? Why or why not?

2b) Certain Refinancings (§ 1026.35(c)(2)(vii))

The proposal would also exempt from the HPML appraisal rules certain types of refinancings with characteristics common to refinance products often referred to as "streamlined" refinances. Specifically, the proposal would exempt an extension of credit that is a refinancing where the owner or guarantor of the refinance loan is the current owner or guarantor of the existing obligation. In addition, the regular periodic payments under the refinance loan must not result in negative amortization, cover only interest on the loan, or result in a balloon payment. Finally, the proceeds from the refinance loan may be used solely to pay off the outstanding principal balance and to pay closing or settlement charges.

Federal government agencies—HUD, VA, and USDA—as well as the GSEs have developed "streamlined" refinance programs to address consumer, creditor and investor risks.¹ These programs enable many consumers to refinance the balance of those mortgages through an abbreviated application and underwriting process. Under these programs, consumers with little or no equity in their homes, as well as consumers with significant equity in their homes, can restructure their mortgage debt, often at lower interest rates or payment amounts than under their existing loans.

CUNA Question 3: Do you support the proposed exemptions for certain "streamlined" refinancings? Why or why not? Are there other refinancings you believe should be exempt from the HPML appraisal requirements?

Valuation requirements of "streamlined" refinance programs.

The "streamlined" underwriting for certain refinancings often, but not always, does not include a USPAP-compliant appraisal with an interior-inspection appraisal. One reason for this is that, in currently prevailing "streamlined" refinance programs, the value of the property securing the existing and refinance obligations is not considered to determine borrower eligibility for the refinance. The owner or guarantor of the existing loan retains the credit risk, and the "streamlined" refinance does not change the collateral component of that risk.

HUD/FHA: The HUD "Streamline" Refinance program administered by the Federal Housing Administration (FHA) permits but generally does not require a creditor to obtain an appraisal. The Agencies understand that almost all FHA "streamlined" refinances are done without requiring an appraisal. The FHA program does not require an alternative valuation type for transactions that do not have appraisals.

VA & USDA: VA & USDA programs do not require appraisals. FHA, VA, and USDA streamline refinance programs also do not require an alternative valuation type for transactions that do not have appraisals.

Private "streamlined" refinance programs: The Agencies also believe that private creditors may offer "streamlined" refinance programs for borrowers meeting certain eligibility requirements.

The Agencies decline to propose an exemption for all refinance loans, as they believe such an exemption would be overbroad. For example, in refinances involving additional cash out to the consumer, consumer equity in the home can decrease significantly, increasing risks, so the Agencies do not believe an exemption from this rule would be appropriate.

The Agencies do, however, believe that a narrower exemption for certain types of HPML refinance loans, generally consistent with the program criteria for "streamlined" refinances under GSE and federal government agency programs, would be in the public interest and promote the safety and soundness of creditors. The Agencies recognize that, by reducing the risk of foreclosures and helping borrowers better afford their mortgages, "streamlined" refinancing programs can contribute to stabilizing communities and the economy, both now and in the future. "Streamlined" HPML refinances can help borrowers who are at

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¹ Under existing GSE "streamlined" refinance programs, Freddie Mac and Fannie Mae purchase and guarantee "streamlined" refinance loans for consumers under HARP (whose existing loans have loan-to-value ratios (LTVs) over 80%) as well as for consumers whose existing loans have LTVs at or below 80%.

risk of default in the near future, as well as those who might not default in the near term, but could significantly benefit by refinancing into a lower rate mortgage for considerable cost savings over time.

The Agencies believe that an exemption for not only GSE and government agency "streamlined" refinances, but also those under proprietary "streamlined" refinance programs, may be warranted.

CUNA Question 4: Do you support the proposed exemption for refinance loans under proprietary "streamlined" refinance programs? Why or why not?

Same owner or guarantor.

Consistent with "streamlined" refinance programs discussed previously, proposed § 1026.35(c)(2)(vii)(A) requires that, for the exemption for certain refinancings to apply, the owner or guarantor of the refinance loan must be the current owner or guarantor of the existing obligation. The Agencies propose to include this requirement as a condition of obtaining the refinance loan exemption from the HPML appraisal rules because the Agencies believe that this restriction is important to promote the safety and soundness of financial institutions and in turn benefits the public.

The proposed rule uses the terms "owner or guarantor" rather than the term "holder" to clarify that the proposed regulation refers to the entity that either owns the credit risk because the loan is held in its portfolio or that guarantees the credit risk on a loan held in an asset-backed securitization. For example, assume Fannie Mae holds an existing obligation in its portfolio, which is then refinanced under one of Fannie Mae's "streamlined" refinance programs into a loan with a better rate and lower payments for the consumer. Fannie Mae might then decide to place the new refinance loan into a pool of loans guaranteed by Fannie Mae; in this case, Fannie Mae would technically be the guarantor, not the "owner." However, under the proposal, the refinance would meet the condition of proposed § 1026.35(c)(2)(vii)(A)(1) because the owner or guarantor remains the same on the refinance loan as on the existing obligation. Proposed comment 35(c)(2)(vii)(A)-1 clarifies that the term "owner" in § 1026.35(c)(2)(vii)(A) refers to an entity that owns and holds a loan in its portfolio.

The Agencies generally believe that the "same owner or guarantor" criterion for the proposed exemption makes it unnecessary to require that the creditor (which is not necessarily the owner of the loan) also be the same for both the existing obligation and the refinance loan. If consumers can shop for a "streamlined" refinancing among multiple creditors without having to obtain an appraisal, they may be able to obtain better rates and terms.

CUNA Question 5: Do you support the proposed requirement that the owner or guarantor of the refinance loan be the current owner or guarantor of the existing obligation? Why or why not?

Prohibition on certain risky features.

Proposed § 1026.35(c)(2)(vii)(B) would require that a refinancing eligible for an exemption from the HPML appraisal rules not allow for negative amortization ("cause the principal balance to increase"), interest-only payments ("allow the consumer to defer repayment of principal"), or a balloon payment, as defined in § 1026.18(s)(5)(i). The proposed commentary would clarify that the terms of the legal obligation must require the consumer to make payments of principal and interest on a monthly or other periodic basis that will repay the loan amount over the loan term.

CUNA Question 6: Do you agree with the proposed prohibition on the certain risky features described above? Why or why not?

No cash out.

Proposed § 1026.35(c)(2)(vii)(C) would require that the proceeds from a refinancing eligible for an exemption from the HPML appraisal rules be used for only two purposes: (1) to pay off the outstanding

principal balance on the existing first-lien mortgage obligation; and (2) to pay closing or settlement charges required to be disclosed under RESPA.

CUNA Question 7: Do you agree with the proposed "no cash out" prohibition in regard to use of the proceeds from a refinancing? Why or why not?

CUNA Question 8: Additional condition — Obtaining an alternative valuation and providing a copy to the consumer: The Agencies seek comment on whether the exemption for refinance loans should be conditioned on the creditor obtaining an alternative valuation (i.e., a valuation other than a FIRREA- and USPAP-compliant real property appraisal) and providing a copy to the consumer three days before consummation. The Agencies note that the purpose of TILA section 129H is, in part, to protect consumers by ensuring that they receive a copy of an appraisal with an interior property inspection of the home before entering into a HPML that is not a qualified mortgage. Specifically, TILA section 129H mandates providing a copy of an appraisal with an interior property inspection for HPMLs that are not exempt from the appraisal requirements, three days before closing, with no option to waive this right. The Agencies' Final Rule implements these requirements.

Do you support conditioning the exemption for refinance loans on the creditor obtaining an alternative valuation and providing a copy to the consumer three days before consummation? Why or why not?

2c) Extensions of Credit for \$25,000 or Less (§ 1026.35(c)(2)(viii))

The Agencies are also proposing an exemption from the HPML appraisal rules for extensions of credit of \$25,000 or less, indexed every year for inflation. In the 2012 Proposed Rule, the Agencies requested comment on exemptions from the final rule that would be appropriate. In response, several commenters recommended an exemption for smaller dollar loans. These commenters generally believed that interior inspection appraisals on these loans would significantly raise total costs as a proportion of the loan and thus potentially be detrimental to consumers.

CUNA Question 9: Do you support the proposed exemption for extensions of credit of \$25,000 or less? Would a different threshold be more appropriate? If so, how much and why?

3) Proposed Effective Date

The Agencies intend that exemptions adopted as a result of this supplemental proposal will be effective on January 18, 2014, the same date on which the Final Rule will become effective. In the section-by-section analysis below, the Agencies request comment on a number of conditions that might be appropriate to require creditors to meet to qualify for the proposed exemptions. If the Agencies adopt any conditions on an exemption, the Agencies will consider establishing a later effective date for those conditions, to allow creditors sufficient time to adjust their compliance systems, if necessary.

CUNA Question 10: Do you support the proposed effective date of January 18, 2014?

CUNA Question 11: Any other comments or questions.

Please send comments to Senior Assistant General Counsel <u>Luke Martone</u>.

Click <u>here</u> for the proposed rule in the *Federal Register*.