Inside Mortgage Finance Webinar

QUALIFIED MORTGAGES MATH: SECURING YOUR SAFE HARBOR

Background and APOR Considerations and Calculations

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Presented By
Donald C. Lampe
Partner
Morrison & Foerster LLP
2000 Pennsylvania Ave. NW
Suite 6000
Washington, DC 20006
dlampe@mofo.com
Phone: (202) 887-1524
Starting Points Under Reg Z §43

• Nomenclature
  – New rule is ATR (“ability to repay”) Rule
  – Legal risk protections for ATR determination: QM (“qualified mortgage”)
• Applies to dwelling-secured consumer credit transactions except:
  – HELOC’s
  – Reverse mortgages
  – Timeshares
  – Temp or “bridge” loans of ≤ 12 mos, including construction loans
Why QM Matters

• Revised & new TILA remedies severe, everlasting
  – Enhanced TILA remedies, including actual damages, atty fees, ↑statutory damages, finance charges
  – Defense to collection & foreclosure, life of loan (assignee liability), TILA damages that could have been recovered, as setoff or “recoupment” + atty fees
• ATR requirements in DFA §1411 narrow, strict & subjective – recognized need for “safe harbor”
• Creating “hierarchy of liability” v. creditors & assignees
Avenues to Compliance . . .

- What matters most: originating “qualified mortgages” (QM), especially for GSE delivery & Gov’t g’ty
- Getting there: no “toxic features” – and “points and fees” not > 3% (with sliding scale for smaller loans)
- AND to get to QM “safe harbor,” APOR test: APR not > APOR + 1.5%
- For most of market, “safe harbor” QM’s, especially “super-safe harbor” QM’s (GSE; gov’t guaranteed) will be the way to go
• For any QM loan, “points and fees” (per amended § 32) not > 3% (with some small loan size adjustments)
  • A HOEPA “points and fees” test for almost all covered loans
• For QM “safe harbor,” APR must not exceed HPM/Section 35 threshold of > 1.5% + APOR (firsts) or > 3.5% + APOR (subords)
• So, for all covered loans, MUST test for these “triggers” – now “all loans are HOEPA loans”
• Unlike HOEPA/Sec. 32, can’t “assume” QM triggers will not be exceeded
Getting to QM

• To end up w/ QM status, loan must not have any 1 of 4 “toxic features”:
  – Neg Am [must fully amortize w/ = monthly payments], Interest Only, Balloon Payments & Loan Term > 30 years (+ limits on prepayment penalties)
• Also, “points & fees” (based on “total loan amount”) must not exceed*:
  – 3% if loan amt ≥ $100,000
  – $3000 (inflation indexed) if < $100,000 but ≥ $60,000
  – 5% if < $60,000 but ≥ $20,000
  – $1,000 (inflation indexed) if < $20,000 but ≥ $12,500
*Gradations related to total loan amount not same as HOEPA/ §32
Two Categories of QM

- Depending on APR APOR “trigger,” TWO CATEGORIES of QM’s
  - If APR ≤ 1.5% + APOR (firsts) or ≤ 3.5% + APOR (subords) as of LOCK DATE (“date interest rate is set”), then so-called QM “safe harbor”
  - Otherwise, if APR determined this way in excess of APOR thresholds, QM “rebuttable presumption”

- “Safe harbor”: not a “presumption,” §43(e)(1) simply says, if QM, creditor or assignee complies w/ ATR requirements in §43(c)
APOR Testing Under §43(e)(1)

- If not “higher priced covered transaction,” safe harbor of compliance with ATR
- If so, then “rebuttable presumption” of compliance
- What is a “higher priced covered transaction”?
- §43(b)(4): APR test based on APOR
- So, determining APOR is key
• “Average prime offer rate” familiar concept from Reg Z higher priced mortgage (HPM) rule & HMDA reporting

• Defined in Reg Z §35(a)(2): annual percentage rate derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics

• Used not just for HPM transactions, but HMDA reporting of “rate spread” loans
Reg Z Commentary to §35(a)(2)-1

- APOR: “annual percentage rates derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. To obtain average prime offer rates, the Fed uses a survey of creditors that both meets the criteria of § 226.35(a)(2) and provides pricing terms for at least two types of variable-rate transactions and at least two types of non-variable-rate transactions. An example of such a survey is the Freddie Mac Primary Mortgage Market Survey.”
APOR Methodology Today

• Board uses Freddie Mac Primary Mortgage Market Survey (PMMS)

• Survey collects data for hypothetical, “best quality,” 80% loan-to-value, first-lien loan for four mortgage products: (1) 30-year fixed-rate; (2) 15-year fixed-rate; (3) one-year variable-rate; and (4) five-year variable-rate; each of the variable-rate products adjusts to index based on one-year Treasury rate plus a margin and adjusts annually after initial, fixed-rate period

• Full explanation: http://www.ffiec.gov/ratespread/newcalchelp.aspx#4
Finding and Calculating APOR

• Determinations depicted on FFIEC website, including tables and loan-level calculator and batch-level calculator
• Instructions on how to use the tables and the calculators
• Rate spread calculator: www.ffiec.gov/ratespread
• Rate spread calculator data requirements: lock date, APR, ammo type, fixed or variable, lien status
• Up to originator how to use these tools, within its business process flows – but for most originators seeking QM, tools in effect will be mandatory
Limits on APOR?

- Freddie Mac PMMS based on low-risk, “prime” loans and biased toward purchase money
- Not that difficult, if offering covered loans like those making up PMMS
- However, if offering other types of loans, APOR may be too low, comparatively
- Not safe to ASSUME covered loans will be “safe harbor” - every loan should be tested
Final Calculation

- Determination of “safe harbor” or “rebuttable presumption” based on APR not exceeding APOR + 1.5% or APOR + 3.5%
- Importance of accurate APR – if APR not accurate, “safe harbor” or “rebuttable presumption” may not be achieved
- Note: APR within tolerance should be considered accurate for QM purposes
- Low APR = false positives; high APR = false negatives
- Important note: a second threshold, §32 trigger at 5%, so even if not concerned with QM, still should be aware of “high cost” mortgage threshold