Ability To Repay And Qualified Mortgage Standards

For mortgage professionals only.

(REV040815BB)

InterFirst
MORTGAGE COMPANY

Agenda

- **ATR/QM**
  - ATR/QM Rule
  - ATR Standards
  - How to Determine Ability to Repay
  - QM Standards, Loan Characteristics, and Eligibility
- **Points and Fees**
  - Affiliates
  - LLPAs
  - Examples
- **ATR/QM Implications**
  - Broker Compensation Plans

The ATR/QM Rule

- The Consumer Financial Protection Bureau recently amended Regulation Z. Regulation Z implements the Ability to Repay (ATR) and Qualified Mortgage (QM) rule under the Truth in Lending Act .

- The ATR rule requires lenders to make a reasonable determination that the borrower has the ability to repay the loan.

- To be considered a QM, the loan cannot have risky features, it must conform to underwriting guidelines, and points and fees must be within limit.

- The lender must retain evidence that it complied with the ATR/QM rule for three years after the loan is consummated.

- Effective Date: Applications received “in the door” by 1/10/2014

InterFirst
MORTGAGE COMPANY

Ability to Repay Standards

- Lenders must make a reasonable determination that the borrower has the ability to repay the loan according to its terms
- Applies to all closed-end residential mortgage loans
  - Except: HELOCs, temporary or “bridge” loans of 12 months or less, and construction-to-permanent loans with a phase of 12 months or less
- In order to be a Qualified Mortgage, the ATR requirement must be satisfied

InterFirst MORTGAGE COMPANY

How to Determine Ability to Repay

The lender must consider eight underwriting factors to make a reasonable determination of the borrower's ability to repay.

They include the borrower's:

1. Current or expected income and/or assets
2. Current employment status (if employment income is used to qualify)
3. Monthly payment on the proposed mortgage loan
4. Monthly payment on any coexisting loan
5. Monthly payment for mortgage-related obligations
6. Current debt obligations
7. Monthly debt-to-income ratio (DTI) or residual income
8. Credit history

InterFirst MORTGAGE COMPANY

Qualified Mortgage Standards

- The QM rule was designed to create safer loans by prohibiting or limiting certain high-risk products and features.
- To be considered a QM, the loan must meet the ATR rule.
- QMs have three types of characteristics: restrictions on loan features, underwriting, and points and fees.
- In exchange for meeting QM standards, lenders receive a degree of legal protection from borrower lawsuits.

Qualified Mortgage Characteristics

QMs must meet the requirements below.

Loan Features

- Regular periodic payments
- Terms of 30 years or less
- Cannot include risky features (e.g. negative amortization, interest-only, pre-payment penalties, balloon payments)

Underwriting Requirements

- 43% DTI limit (or higher GSE/FHA/VA/RHS limit)
- Monthly payment using the maximum interest rate that applies in the first five years and periodic P&I based on that rate
- Borrower's income, assets, and all current debts must be verified

InterFirst MORTGAGE COMPANY

QM Characteristics (Cont.)

Points and Fees

- Total Points and Fees Cannot Exceed 3% of the total loan amount for total loan amounts of $100,000 or more
- Higher thresholds are provided for loan amounts below $100,000
  - $3,000 for loan amounts $60,000 - $99,999
  - 5% for loan amounts $20,000 - $59,999
  - $1,000 for loan amounts $12,500 - $19,999
  - 8% for loan amounts < $12,500
- Note: The caps above must include the broker compensation fee and IMC's administrative fee. To comply with QM standards, the broker compensation fee should not exceed 2.5%.

InterFirst MORTGAGE COMPANY

QM Loan Eligibility

Loans that are eligible for sale to a GSE (the actual sale to the GSE does not need to occur) or eligible for insurance / guarantee by the FHA/VA/RHS are considered QM loans provided:

- ✓ The loan characteristics do not include prohibited terms
- ✓ Agency guidelines are met (e.g. DTI ratio)
- ✓ Points and fees limits are not exceeded

Examples of Points and Fees Always Included

- Broker compensation (should not exceed 2.5%)
- Lender admin. fees and origination charges
- Commitment/Rate lock fees
- LLPA's that are not included in the interest rate of the loan
- Discount points that do not lower the interest rate commensurate with industry standards
- Non-refundable PMI above the FHA MIP level in a comparable transaction
- Finance charges (other than interest) paid to the lender, broker, or an affiliate such as a service provider (e.g. credit reports, appraisals)
- All prepayment penalties paid to the lender (for refinance only)
- Credit insurance premiums and impounds

InterFirst MORTGAGE COMPANY

Examples of Points and Fees Never Included

- Interest
- Government mortgage insurance (MIP) or VA funding fees
- Up-front PMI if the premium is less than or equal to the FHA UFMIP amount (currently 1.75%) and the borrower receives a pro-rated refund upon early payoff
- Bona fide 3rd party charges provided no portion is retained by the lender, broker, or affiliate (e.g. title exam, title insurance, escrow, survey, credit report, and appraisal)
- Bona fide discount points:
  - Up to two discount points if the interest rate without the discount does not exceed the APOR by more than 1%
  - One discount point if the interest rate exceeds the APOR by more than 1% but less than 2%

InterFirst MORTGAGE COMPANY

What is an Affiliate?

- 12 CFR §1026.32(b)(5) defines an affiliate as “any company that controls, is controlled by, or is under common control with another company, as set forth in the Bank Holding Company Act of 1956”.
- According to The Bank Holding Company Act, any company has control over another if:
  - The company directly or indirectly, controls, or has power to vote 25% or more of any class of voting securities of the other company,
  - The company controls in any manner the election of a majority of the directors or trustees of the other company, or
  - The Board determines that the company directly or indirectly exercises a controlling influence over the management or policies of the other company.
- Legal interpretations of affiliation and control vary. In general, if any of the following situations exist, businesses are considered affiliates:
  - A business has 25% or more common ownership of another
  - A business has a subsidiary relationship with another
  - An entity or person exercises a controlling influence on the management or policies of another entity

InterFirst MORTGAGE COMPANY

Impact of Affiliate Relationships on QM Points and Fees

- All lender affiliate fees are included in the total allowable points and fees for each loan.
- Not all broker affiliate fees are included. Examples are as follows.

Included	Excluded
Title	Appraisal companies or AMCs
Escrow	Credit report fees
Closing	Inspection companies
Processing	Hazard insurance

InterFirst MORTGAGE COMPANY

LLPA's

- Points charged to offset LLPA's and similar risk adjustment fees may not be excluded from points and fees as bona fide third-party charges.
    - Unless a specific inclusion applies, "points and fees" includes all non-interest components of the finance charge.
    - They are excludable (as any points charged to consumers may be) as long as they satisfy the criteria of the "bona fide discount points" exclusion.

InterFirst MORTGAGE COMPANY

LLPA's (Cont.)

- The rule excludes varying amounts of "bona fide discount points" depending on how close the undiscounted rate is on the date the rate is set to a comparable transaction's "APOR". This exclusion allows lenders to exclude:

  - Up to two bona fide discount points if the pre-discounted interest rate does not exceed the APOR by more than one percentage point, and
  - Up to one bona fide discount point if the pre-discounted interest rate does not exceed the APOR by more than two percentage points

InterFirst MORTGAGE COMPANY

LLPA Example

- For a primary residence purchase transaction at 95% LTV, FICO 720, APR 3.75%,
  - The FNMA LLPA would be 0.75%
- If the lender charged the borrower 0.75% (as an up-front fee), the full amount would count towards points and fees. However, if the lender were to offer this loan at 4.00%, no points, there would be no impact to the total points and fees.
- If the lender then offered the borrower 3.75% subject to a 0.75% discount fee, the discount fee would be considered a bona fide discount and excluded from the points and fees
- **Two Assumptions:**
  - The rate of 4% with no points does not exceed the APOR on a comparable transaction by more than 2 percentage points.
  - The .25% basis point reduction in the interest rate (4% to 3.75%) resulting from charging a 0.75% discount fee is “consistent with industry practices”.

InterFirst MORTGAGE COMPANY

Points and Fees Example
$200,000 Principal Loan Amount

Fee	Amount	Include	Reason
Admin Fee	$799	Yes	Paid to the lender and is not excludable.
Lender Paid Broker Comp.	$4,000	Yes	Paid to the broker by the lender (2.0% broker comp.)
Upfront PMI	$2,400	No	Can be excluded if the premium amount is refundable and does not exceed the maximum allowed by the FHA.
Appraisal Fee	$450	No	Included only if it is paid to an affiliate or to the extent the fee is retained by the lender
Credit Report	$20	No	Included only if it is paid to an affiliate or to the extent the fee is retained by the lender
Other closing fees (e.g. title, tax stamps, recording , document preparation)	$2,500	No	Excludable as bona-fide 3rd party charges not payable to the creditor, originator, or affiliate.

Broker Comp. fee on a 2.0% comp. plan: **$4,000** ($200,000 * 2.0%)

Total QM points and fees : **$4,799** ($799 lender admin fee + $4,000 broker comp. fee)

Points and Fees Example (Cont.)
$200,000 Principal Loan Amount

Points and fees on qualified mortgages cannot exceed 3% of the **Total Loan Amount** or $3,000 for loan amounts less than $100,000.

For this example, on a $200,000 principal loan amount, the QM points and fees limit cannot exceed 3% of the Total Loan Amount of $194,581.14.

<u>Maximum allowable QM points and fees:</u>

$5,837.43 ($194,581.14 * 3%)Since the total points and fees for this loan are $4,799, below the maximum allowed, this loan is within Qualified Mortgage guidelines.

<u>To calculate the Total Loan Amount:</u>

Instructions	Calculation
1. Add all prepaid finance charges (APR fees), regardless of whether they are financed into the loan. This amount is the TIL “amount financed”. It includes the broker’s comp., admin. fee, settlement fee, and interest.	Broker’s comp. $4,000 Admin. fee $799 Settlement fee $250 Interest @4.5% <u>$369.86</u> Total $5,418.86
2. Add all lender affiliate fees that are financed into the loan.	N/A
3. Subtract the total prepaid finance charges and affiliate fees calculated above from the principal loan balance.	$200,000 - $5,418.86 = **$194,581.14**

InterFirst
MORTGAGE COMPANY

Broker Compensation Plans

Effective December 17th, 2013, brokers may update their compensation plans for the first quarter of 2014.

Due to the recent regulatory amendments, IMC has implemented the following important policy changes:

- Broker compensation is limited to a maximum of 2.5%
- IMC no longer allows a floor or a flat fee.

If the comp. level is not updated by 12/31/13, IMC will suspend the broker until the plan has been changed. As a reminder, comp. plan changes will be in effect with applications received “file in the door” as of 1/1/14.

The IMC administrative fee will be increasing to $799, effective 1/1/14. At a minimum, the admin. fee must be included in the points and fees calculation to comply with QM regulations.

Brokers are encouraged to evaluate their loan scenarios to ensure their comp. levels allow them to include the admin. fee.

InterFirst
MORTGAGE COMPANY

Other Implications of the ATR/QM Rule

- The QM points and fees limitation will not be an issue for most. The majority of brokers are already under the 3% maximum.
- Brokers may be able to restructure service provider relationships to minimize the impact of the use of affiliate service providers.
- Despite concerns about the impact of MI premiums, up front, non-refundable PMI is unusual. The vast majority of loans with PMI have monthly PMI premiums.

InterFirst MORTGAGE COMPANY

333 Knightsbridge Parkway, Suite 210
Lincolnshire, IL 60069
Direct: (847) 239-7272