

State High-Cost Laws: 3 Case Studies

Laws in California, Florida and Texas may be indicative of where other states are heading

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MORTGAGE BROKERS AND LENDERS not only must be aware of federal high-cost mortgage laws, but they also should know their states' high-cost mortgage laws.

As defined by the Home Ownership and Equity Protection Act of 1994 (HOEPA), high-cost mortgages have interest rates or costs that exceed a certain level and carry rules and restrictions that other loans might not. They're often called Section 32 mortgages, seeing as how Section 32 of Regulation Z of the Truth in Lending Act implemented federal high-cost laws.

At press time, 29 states and one territory had some sort of high-cost mortgage law on the books. All states' laws generally exempt home-equity lines of credit and other open-end plans, including credit cards and reverse mortgages. Although most of these laws apply to lenders, brokers must know these laws for two reasons:

1. **Brokering certain loans to private-money lenders requires knowledge** of these laws to place the loan properly; and
2. **Some states' high-cost laws require disclosures** that brokers sometimes must provide within three days of the borrowers' application.

High-cost-mortgage laws in three states — California, Florida and Texas — are largely representative of rules in all states and territories with these provisions. By understanding the rationale behind them, brokers can have a better idea for how these laws apply in other states in which they do business.

California

California enacted its high-cost mortgage law in 2001. It offers California borrowers more protection than does Section 32.

California's high-cost law covers mortgages where the loan amount exceeds the single-family Fannie Mae conforming-loan limit and fits within one of the following scenarios:

- **The loan's points and fees are more than 6 percent of the loan amount.**
- **The annual percentage rate (APR) exceeds 8 percent more than the comparable U.S. Treasury bill.**

For these loans in California, lenders or brokers must give the borrower a "Consumer Caution and Home Ownership Counseling Notice" at least three days before signing loan documents.

In addition, the following loan terms are prohibited:

- **No note can have a balloon payment** and terminate in less than five years; bridge loans excluded.
- **No note can have a prepayment penalty** without considering the borrowers' ability to repay and unless the borrowers' back-end-debt ratio is 50 percent or less.
- **No note can negatively amortize.**
- **No note can have due-on-demand provisions.**
- **A lender cannot require more than two months of advance payments from the borrower.**

If a lender or broker violates California's high-cost law, borrowers can rescind the loan transaction, which means the lender must refund all points, fees and interest to the borrower. The law also allows the borrower to obtain punitive damages if the lender willfully violated the law.

Furthermore, California law imposes criminal liability and possible disciplinary action against the lender's license for high-cost violations.

Mortgage brokers should read their lender contracts to see what happens if the loan violates California's high-cost law. Find out if the lender

indemnifies itself or requires the broker to repurchase the loan. Most agreements will include this language, especially in today's market.

Florida

The Florida Fair Lending Act, which took effect in 2002, offers borrowers more protections than does Section 32 — though its high-cost-loan triggers are the same. Section 32's triggers for high-cost laws are:

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

When these conditions exist, lenders or brokers must give borrowers a high-cost-loan notice no later than three business days before consummation of the loan. Florida law also prohibits:

- **Charging prepayment penalties for longer than three years;**
- **Charging any default interest on the loan;**
- **Balloon loans with a maturity of less than 10 years;**
- **Extending credit to the borrower without considering the ability to repay;**
- **Making payments directly to home-improvement contractors;**
- **Refinancing a high-cost loan during the first 18 months unless a "reasonable benefit" exists for the borrower;**
- **Charging any fees to modify, renew or amend a high-cost loan;**
- **Originating a loan directly as a result of a sales call at the borrowers' residence, unless there is a prearranged appointment with or an invitation from the borrowers;**
- **Provisions in the loan that allow the lender to call the loan in at its sole discretion;**
- **Negative amortization; and**

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State High-Cost Laws

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- **Contract for a late charge that's more than 5 percent of payment.**

If lenders or brokers are found in "material violation" of the Florida Fair Lending Act, borrowers can rescind the loan transaction, with the lender refunding all points, fees and interest. Florida law imposes criminal liability of as much as \$5,000 per violation and possible disciplinary action against the lender's license.

Again, brokers should read their lender contracts for indemnification and repurchasing clauses.

Texas

Texas enacted its high-cost mortgage law in 2001. Like California and Florida, it also offers borrowers more protection than does Section 32 — in addition to requiring more disclosures.

Texas' law covers loans that meet Section 32's triggers and are at or below half of Fannie Mae's single-family conforming-loan limit. Disclosures come into play when a loan's interest rate is greater than 12 percent. The disclosure must provide each borrower a statement regarding mortgage counseling, a list of the nearest available housing-counseling agencies, a list of other resources and more. The model form can be found at www.occ.state.tx.us/pages/Legal/Laws/reg/rules.pdf, on the document's final page.

Applicants must be delivered this high-cost notice on the good faith estimate delivery date, if the Real Estate Settlement Procedures Act (RESPA) applies. If RESPA does not apply, the notice must be delivered within three business days.

Texas prohibits the following loan terms for high-cost mortgages:

- **Balloons of less than five years**, unless the loan is adjusted because of the borrowers' seasonal or irregular income; bridge loans excluded.
- **Negative amortization**
- **Government or nonprofit-lender low-rate home loan being replaced for seven years** from the date the loan was made, unless the new loan is a restructuring to avoid foreclosure.

Brokers must consider the borrowers' ability to repay the loan. Texas law also allows borrowers to obtain actual damages against the lender, as much as \$10,000 in punitive damages and court costs for a violation of the disclosure portion of the high-cost law. Again, in all cases, mortgage brokers should read their lender con-

tracts for indemnification and repurchasing requirements in case of violation.

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When mortgage brokers and loan officers work with borrowers that need a high-cost loan, be sure to keep in mind the lender's programs and inquire as to whether the loan will be high-cost. Knowing what is allowed and prohibited will ensure a smoother, quicker and fully disclosed transaction. **■**

Disclaimer: Nothing in this article should be construed as legal advice. This article was written for educational and informational purposes only. Consult an attorney to determine what would be legal and appropriate for your situation.

Who Has High-Cost Laws?

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

- Arkansas
- California
- Colorado
- Connecticut
- District 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