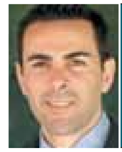

By Yanni Raz
CEO
HML

The Intersection of Hard Money and Section 32

Know how regulations surrounding high-cost mortgages affect your deals

Hard-money lending has become a staple of the mortgage industry, as residential and commercial investors seek new ways to access liquid capital when an opportunity arises. With interest-rate increases impending, many real estate investors are learning that the hard-money marketplace can help them close deals fast — an imperative in today's market where purchasing decisions (and the subsequent acquisition of funds) must be made quickly. When they aren't, another investor may secure a deal and snap the property off the market.

In investor-heavy markets like California and Arizona, mortgage brokers and originators should take advantage of the opportunities that hard-money lending offers. To do so, they must be aware of all the rules and regulations that govern high-cost lending — particularly the provisions of Section 32 of Regulation Z of the Truth in Lending Act.

Section 32

The Home Ownership and Equity Protection Act (HOEPA) of 1994 defined "high-cost mortgages" and placed restrictions on this type of home-equity lending. These loans often are referred to as Section 32 mortgages because Section 32 of Regulation Z of the Truth in Lending Act implements the law. This section of the law outlines the regulations in place when a mortgage transaction involves an owner's primary residence. Omitted, however, are any transactions involving commercial or investment real estate.

Initially, these rules did not cover home-equity lines of credit (HELOCs), purchase or construction loans, and reverse loans. Recent changes have been made to several provisions of the rule by the Consumer Financial Protection Bureau (CFPB), however, and these will be implemented beginning in January 2014. These changes expand HOEPA protection to purchase loans and HELOCs, but construction loans, reverse mortgages and certain U.S. Department of Agriculture loans remain exempt.

> **"Several factors can impact whether or not a loan will be defined as a Section 32 loan. When a loan falls within the definition of a high-cost mortgage, specific disclosures must be made to consumers and certain loan features are limited or banned outright."**

Several factors can impact whether or not a loan will be defined as a Section 32 loan. When a loan falls within the definition of a high-cost mortgage, specific disclosures must be made to consumers and certain loan features are limited or banned outright. Mortgage professionals must be aware of what these trigger factors are to remain compliant and avoid penalties.

Interest rates

The first factor to consider is interest rates. Although the interest rate listed on the home-owner's promissory note may not fall into Section 32 territory, it's the annual percentage rate (APR) listed on the Truth-in-Lending statement that determines the loan's qualification as a Section 32 protected mortgage.

The CFPB's recent changes have altered Section 32 thresholds. As of January 2014, the loan is considered a high-cost mortgage if:

- **The APR is more than 6.5 percentage points higher than the average prime offer rate** for a first mortgage on the owner's principal residence.
- **The APR is more than 8.5 percentage points higher than the average prime offer rate** for a first mortgage of less than $50,000 for a personal property dwelling (such as a manufactured home).
- **The APR is more than 8.5 percentage points higher than the average prime offer rate** for a second or junior mortgage.

When a potential homeowner applies for financing, the interest rate on Treasury securities have a significant impact. The loan application's submission date, and included loan rate, must be compared to the Treasury securities interest rate on the 15th of the previous month. If the loan rate is 6.5 percentage points higher than the applicable Treasury rate, Section 32 terms are enacted.

By subtracting the Treasury yield amount from the mortgage's interest rate, you can determine whether or not the loan qualifies.

continued ››

Yanni Raz is CEO of HML and has been a hard-money lender for more than 10 years. Raz was a real estate broker for five years before he partnered with a group of investors from California and began assisting real estate investors in financing commercial and residential projects. He writes about real estate financing for magazines, blogs and other online news outlets. Reach Raz at info@hardmoneyloans.org or (818) 308-4443. Visit hardmoneyloans.org, equitytrustmortgage.com and facebook.com/Hard.money.lenders.CA.

Scotsman Guide

Reprinted from *Scotsman Guide* Residential Edition and scotsmanguide.com, November 2013

‹‹ continued

If you end up with a number that is higher than 6.5, the mortgage in question is a Section 32 loan. Before the CFPB's recent changes, the threshold was 8 percentage points.

Fees

The fees associated with a mortgage also can qualify the loan as a Section 32 transaction.

As of January 2014, the loan will be considered a high-cost mortgage if:

- **The points and fees exceed 5 percent of the loan** for a loan that is for $20,000 or more
- **The points and fees exceed the lesser of 8 percent of the loan or $1,000,** for a loan that is less than $20,000

Before the CFPB's changes and applicable to the remainder of 2013, the loan is a Section 32 mortgage if the total fees and points payable by the borrower at or before closing exceeded the larger of $625 or 8 percent of the total loan amount.

Remember, HOEPA includes in its calculations any fees that could be considered prepaid finance charges. This typically includes any fees borrowers pay to the mortgage originator or lender, such as the mortgage-broker fee, applicationfee, processing fee, origination fee, etc.

Requirements of Section 32

If the loan does fall into the definition of a high-cost mortgage under Section 32, the lender and mortgage originator are obligated to make certain disclosures to the borrower, and some loan features are limited or banned.

If the loan falls under Section 32, as of January 2014, the lender must:

- **Provide the borrower with information in advance that explains the high-cost mortgage** and states the terms, costs and fees associated with the loan.
- **Certify that the borrower has received homeownership counseling** about the particular high-cost mortgage being offered.

In addition, the CFPB has added bans to loan features like prepayment penalties, balloon payments, fees for loan modifications and more.

• • •

Staying informed regarding Section 32 loans is critical when working in the hard-money marketplace. Both sides of the transaction must understand the disclosure requirements that are in place for any mortgage that qualifies as a Section 32 loan.

By paying close attention to the changes in Section 32 loans, lenders and investors can protect themselves properly, and stay within the guidelines articulated in the 2013 amendments. Full disclosure of credit counseling, among other things, is required, and a failure to adhere to these guidelines can lead to complications in the loan's repayment.

Hard-money lending continues to drive the real estate marketplace. Although investors often leverage these loans to make quick purchases, those interested in lending for personal, primary-residence mortgages must consider how Section 32 regulations will impact their transactions.