

“High Cost” home loans

A. The Federal anti-predatory loan law, HOEPA (Home Ownership and Equity Protection Act) applies only to certain defined loans, and requires enhanced disclosures, restrictions on certain loan terms, and private remedies for violations of the act. HOEPA covers loans where (i) the annual percentage rate is 10 points above Treasury securities, or (ii) the points and fees exceed either 8% of the loan or \$451. But only a very small percentage of loans meet the threshold. The report recommends that Congress should lower the threshold interest rate to 6% above Treasury securities for first liens, and 8% above Treasury securities for second liens. The fee threshold should be lowered to 7% or \$1,000. (*Curbing Predatory Home Mortgage Lending*, p. 53 and pp. 85-87.)

B. The report recommends Congress expand the definition of high-cost loans to include purchase money mortgages, reverse mortgages, and home equity lines of credit. (*Curbing Predatory Home Mortgage Lending*, p. 86.)

C. “Instead of setting ceilings on fees and interest rates, the [AARP] Model Act prohibits certain loan terms and lending practices for high-cost loans. This approach follows the structure used in the federal Home Ownership and Equity Protection Act (HOEPA). HOEPA similarly creates special requirements applicable to high-cost loans. However, the HOEPA thresholds for high-cost loans are too high to reach the bulk of high-cost loans. According to data cited by the Federal Reserve Board, only 1% of such loans are currently covered. (*Home Loan Protection Act: A Model State Statute*, p. 7.)

D. Threshold is a key provision of the [AARP] Model Act because it determines which loans are subject to the restrictions on high-cost loans. Like HOEPA, the Model Act uses the alternative tests for either points and fees or interest rate [or prepayment penalty, if included as a threshold]. The Model Act’s thresholds are lower than those in HOEPA, thus many more high-cost loans will be covered. The use of a ‘threshold’ to define high-cost loans recognizes the same basic theory that underlies HOEPA: that additional regulation is warranted when the cost of a loan is substantially more than is charged in a typical market rate transaction. Exceeding any one of the two [or three] separate thresholds will cause a home loan to be treated as a high-cost loan, with the additional high-cost loan restrictions. The rate threshold is a bifurcated threshold:

- For a first lien mortgage loan, the threshold is met if the loan rate equals or exceeds by 6 percentage points the yield on five-year U.S. Treasury securities as of the 15th date of the month immediately preceding the loan closing.
- For a subordinate mortgage lien or a mortgage secured by a lien on a manufactured home, the rate threshold is met if the loan rate equals or exceeds by eight percentage points the yield on five-year U.S. Treasury securities as of the 15th date of the month immediately preceding the loan closing.

The purpose of using a bifurcated trigger – one for first liens and a higher trigger for second mortgage liens, is to encourage lenders to make second mortgages rather than

refinancing a first mortgage with a small additional extension of credit to the consumer. This dual trigger system is also used in Illinois, Massachusetts, and New York. The higher trigger for second mortgages provides some incentive for lenders to make more second mortgages. When a homeowner needs to borrow only a small amount of the available home equity, current law encourages lenders to refinance existing (generally affordable priced) purchase money loans to provide a relatively small amount of additional credit. (*Home Loan Protection Act: A Model State Statute*, pp.12-13.)

E. The [AARP] Model Act uses five-year [emphasis added] U.S. Treasury securities as a benchmark. In contrast, HOEPA and new regulations in Illinois, Massachusetts, and New York use U.S. Treasury securities with terms comparable to the length of the loan as benchmarks. Such provisions complicate establishing rate thresholds and make lender compliance difficult. Using five-year U.S. Treasury securities more closely matches the actual expected life of mortgage loans, and particularly subprime loans. Due to prepayments, the average life of these loans is five years, even though the stated term may be 15, 20 or 30 years. Thus, using longer comparable term securities also overstates the actual U.S. Treasury securities rate because rates generally are higher on longer-term securities. (*Home Loan Protection Act: A Model State Statute*, p.13.)

F. Salvador Gil, Spanish-speaker, received a high-cost home loan from a predatory lender in October 1999. He consolidated his two mortgages into one loan. At the time he owed less than \$184,000. He was charged more than \$15,000 in fees that was added to the principal. There was also \$1,300 in third party fees charged, which went to the brokers. This raised the principal from \$184,000 to \$200,000. The loan is for 30 years, longer than the original mortgages, and requires a monthly payment of \$2,000, which is difficult for him to make. (H&CD Hearing, 4/17/02, p. 41, lines 13-19, and lines 20-26, p. 42, lines 1-9.)