

What The New Mortgage Lending Rules Really Mean

By Amy Fontinelle

Since the housing crisis began, mortgage lending guidelines and regulations have been continually changing in an attempt to eliminate the problems that caused the crisis. Each step in the process has had consequences for borrowers, lenders, the housing market and the broader economy. (For more, check out *Are You Ready To Buy A House?*)

Recently Enacted Changes

The Dodd-Frank Wall Street Reform and Consumer Protection Act passed in July 2010 is the source of the latest changes as it became effective in April. The act addresses numerous components of the financial services industry. One provision, the Mortgage Reform and Anti-Predatory Lending Act, contains several new laws specifically related to housing finance.

Compensation of Mortgage Originators and Anti-Steering Provisions

Under the act, mortgage brokers can no longer earn higher commissions for closing loans with higher fees and/or higher interest rates. Commissions must be based on the mortgage principal amount. This rule is intended to prevent unethical behavior and predatory lending, but it also means that brokers now have reduced incentives to work with imperfect borrowers that are more difficult to qualify for a loan because brokers will not be compensated for the additional work of closing such a loan.

Jared Martin, CEO of East Coast residential mortgage lender Keystone Funding, says that another problem with the new laws is that "the rules are out of sync with how the mortgage industry operates." Now, under certain situations, mortgage originators must be paid a salary or hourly wage instead of a commission only.

This change "puts an enormous burden on small, regional lenders who cannot handle the extraordinary overhead of a salary/wage structure for all their employees in an industry that is setup for commission-based compensation," says Martin.

The new rule also says that mortgage originators cannot steer potential borrowers to the loan that will result in the highest payment for the mortgage originator. Rather, they must present borrowers with options containing different fee and interest rate structures so borrowers can choose the option that is in their best interests. The rule prohibits originators "from steering any consumer to a residential mortgage loan that the consumer lacks a reasonable ability to repay" or that has "predatory characteristics or effects." (For more information on this career, read *Career Comparison: Real Estate Agent Or Mortgage Broker.*)

FHA Mortgage Insurance Premiums Change Again

FHA mortgages are considered a higher-risk product since they require a down payment of only 3.5% and have flexible lending guidelines for imperfect borrowers. FHA mortgage borrowers must pay two risk premiums on their loans. The first risk premium borrowers pay is the up-front mortgage insurance premium (UFMIP), a fee that can be paid as a closing cost or, more

commonly, is rolled into the loan. The second is a monthly mortgage insurance premium. Both premiums are calculated as a percentage of the mortgage amount. These percentages have been bouncing around for months; the most recent change, effective April 18, does not affect the UFMIP (which remains at 1%), but it increases the PMI from 0.90% to 1.15% per year.

These new rules are officially in effect, but several aspects of mortgage lending are currently up in the air because of recent proposals that are still being reviewed. (To learn more about mortgage insurance, see *6 Reasons To Avoid Private Mortgage Insurance*.)

Proposed Changes: QRMs

Regulators want to establish a standard minimum down payment of 20% for qualified residential mortgages (QRMs). QRMs are supposed to decrease borrower default risk by establishing high lending standards for down payments, borrower debt-to-income ratios and borrower income documentation.

The Center for Responsible Lending is critical of the proposed rule, stating that the 20% down payment standard would make it more difficult for the average person to buy a home by requiring them to save longer for a down payment or to seek a higher-interest non-QRM loan. The organization also believes the rule would push more borrowers into government-subsidized mortgages like the FHA loan. Additionally, the Center states that higher down payments create a minimal decrease in default rates.

The Center's April 14, 2011, paper titled "Proposed QRM Harms Creditworthy Borrowers and Housing Recovery" calculates that with a savings rate of \$3,000 per year, it could take families 14 years to save up for a 20% down payment and 5% closing costs on a home with a median sales price of \$172,100.

If it becomes more difficult to borrow, then it also becomes more difficult for existing homeowners to sell or to move. Thus, such changes would affect everyone in the housing market, not just potential new borrowers.

Refinancing

The proposed QRM rule would also increase home equity requirements for refinancing. Homeowners would need 25% or 30% equity to refinance. Furthermore, the rule would require borrowers to have a lower percentage of debt (including the proposed mortgage debt) relative to their incomes. Borrowers would thus qualify for smaller mortgages than they do today, and borrowers at the margin would not be able to qualify for enough of a loan to purchase a home.

The QRM proposal only applies to private mortgages that are not government-subsidized or guaranteed by Fannie Mae or Freddie Mac. Private mortgages currently represent a very small share of the market (approximately 10%). However, Fannie and Freddie have been under government conservatorship since 2008, and their future role in housing finance is uncertain.

The QRM proposal is open to public comment until June 10. (To help you understand your mortgage better, check out *Understanding the Mortgage Payment Structure*.)

The Bottom Line

In theory, the new rules mean greater protection for consumers in the form of mortgages that they can afford to repay. In reality, new regulations always have unintended consequences that lead to even more regulations. Consumers may see higher fees and decreased loan availability.

We can also expect some lenders to find creative ways to circumvent the new rules, which may or may not benefit consumers.

With so much uncertainty and historically low interest rates, now may be a good time to buy if you can afford it - and if you will be able to stay in a home long-term to ride out the continuing changes in the market.(For more on mortgages, see *5 Steps To Scoring A Mortgage*.)

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