

## Section 35 Higher Priced Mortgage Loan (HPML) 1026.35

<b>Background</b>	<p>In response to the real estate market troubles of 2008, legislative attitudes shifted sharply toward pro-consumer lending protections. In 2009, a new era of regulatory requirements began, starting with MDIA’s mandatory delayed closing period and continuing with the creation of a new category of mortgages: “Higher Priced Mortgage Loans”. HPMLs are deemed to be more expensive than a mortgage with average terms, so a lender must “facilitate responsible lending” by not only ensuring the consumer has the ability to repay the loan, but must also:</p> <ul style="list-style-type: none"> <li>• Obtain a full interior appraisal from a licensed or certified appraiser;</li> <li>• Provide a second appraisal for free, if it is a “<u>flipped</u>” home; and</li> <li>• In many instances, maintain an <u>escrow</u> account for at least five years.</li> </ul>
<b>Definition 1026.35(a)</b>	<p>HPMLs are consumer loans that possess <b><i>all</i></b> these characteristics:</p> <ul style="list-style-type: none"> <li>• Secured by the borrower’s <b>PRINCIPAL Dwelling</b> (any 1-4 unit structure used as a residence)</li> <li>• Closed-end (any type: including purchase, refi, or closed end home equity)</li> <li>• APR exceeds the Average Prime Offer Rate (APOR) + margin, for a comparable transaction (as of the last date the rate is set / locked), by: <ul style="list-style-type: none"> <li>○ 1.50% for a 1<sup>st</sup> lien</li> <li>○ 2.5% for a jumbo loan</li> <li>○ 3.5% for subordinate liens</li> </ul> </li> </ul> <p>Rate spread calculator: <a href="https://ffiec.cfpb.gov/tools/rate-spread">https://ffiec.cfpb.gov/tools/rate-spread</a></p> <p>Note: Small Creditors do NOT have a rate spread of their own. Under the ATR / QM rules of 1026.43(b)(4), there is a 3.5% threshold for Small Creditor Portfolio QMs, used in determining coverage for Higher Priced Covered Transactions (HPCTs). This is unrelated to HPMLs.</p>
<b>Evasion Prohibition 1026.35(d)</b>	<p>A creditor may not purposefully structure a loan as an open-end credit (as defined in 1026.2(a)(20)) to evade HPML requirements.</p>
<b>Relationship to Section 43 ATR / QM underwriting</b>	<p>When the Section 35 HPML category was initially created, ATR / QM rules did not yet exist. The requirement to determine a borrower’s “ability to repay” was first introduced for HPMLs, but with the adoption of broader Section 43 ATR / QM rules in 2014, specific underwriting requirements for HPMLs became part of the overall ATR / QM rules for all consumer real estate loans.</p> <p>However, other relationships between HPMLs and ATR/QM exist. In brief:</p> <ul style="list-style-type: none"> <li>• Escrow exemption: ATR/QM “covered transactions” are used in part to determine escrow exemption qualifications for small creditors;</li> <li>• Appraisal exemption: If an HPML is a QM (of any variety), it will enjoy an exemption from the HPML appraisal rules.</li> </ul>

<b>Requirements</b>	<p>There are no special disclosure requirements for HPMLs (other than a Right to Copy of Appraisal Notice, already required by Reg B and included on the LE). The only two requirements that must be considered for every HPML are:</p> <ol style="list-style-type: none"> <li>1. Escrow Requirements</li> <li>2. Appraisal Requirements</li> </ol> <p>Each has its own criteria and exemptions, detailed below.</p>
<b>1. Escrow Requirement 1026.35(b)(1)</b>	<p>Unless exempted, a <b>1<sup>st</sup> lien, principal dwelling</b> HPML must have an escrow account established <b>prior to loan consummation</b> for <b>5 years</b> for the payment of property taxes and mortgage-related insurance premiums required by the creditor (ex: hazard insurance, default insurance, and/or flood insurance). Any insurance obtained voluntarily by the borrower, such as earthquake insurance or credit life insurance, is not included in this requirement.</p> <p>Note: “Principal dwelling” includes structures classified as personal property under State law. For example, this includes a mobile / manufactured home, boat, or trailer used as the principal dwelling and taken as collateral. It also includes condominiums.</p>
<b>Escrow Exemptions 1026.35(b)(2)</b>	<p>There are three kinds of HPML escrow exemptions:</p> <ol style="list-style-type: none"> <li>a. Transaction type;</li> <li>b. Limited exemption for condo property insurance; or</li> <li>c. Small Creditor Exemption for institutions without an escrow system</li> </ol>
<b>Escrow Exemptions - a. Transaction Type 1026.35(b)(2)(i)</b>	<p>No escrow account is required if the HPML is:</p> <ul style="list-style-type: none"> <li>• Secured by shares in a cooperative;</li> <li>• To finance the initial construction of a dwelling;</li> <li>• A temporary / “bridge” loan with a term of 12 months or less; or</li> <li>• A reverse mortgage</li> </ul> <p>Note concerning construction/perm one-time HPMLs: A construction period of 12 months or less is exempt from the escrow requirement. However, the permanent financing of the loan WILL require an escrow account. The APR on a one-time construction/perm transaction is calculated in accordance with 1026.22(a)(1) and Appendix D and is then compared to the APOR for a transaction comparable to the permanent financing to determine if it is an HPML.</p>
<b>Escrow Exemptions - b. Limited Exemption for Certain Property Insurance 1026.35(b)(2)(ii)</b>	<p>Limited exemption for certain types of property insurance: No escrow account is required for insurance premiums on condos, planned unit developments, or other common interest communities which require participation in a governing association that maintains a master policy for all dwellings.</p> <p>This exemption only applies to property insurance. Property taxes on such units must still be escrowed.</p>

<p><b>Escrow Exemptions - c. Small Creditor Without Ability to Escrow</b> 1026.35(b)(2)(iii) – (v)</p>	<p>This class of exemptions pertains to the creditor, and thereby exempts ALL HPML escrowing (rather than for any single transaction). This exemption has a four-part test, and the creditor must meet ALL criteria:</p> <ul style="list-style-type: none"> <li>i. <u>The creditor must be a rural / underserved lender.</u> During the preceding calendar (or if the application was received before 4/1, during either of the two preceding calendar years), the creditor extended a <i>first lien</i> ATR/QM “covered transaction” on property located in either a “rural” or “underserved” county. <a href="https://www.consumerfinance.gov/policy-compliance/guidance/rural-and-underserved-counties-list/">https://www.consumerfinance.gov/policy-compliance/guidance/rural-and-underserved-counties-list/</a> <b>AND</b></li> <li>ii. <u>The creditor must be a Small Creditor, by volume.</u> During the preceding calendar year (or if the application was received before 4/1, during either of the two preceding calendar years), the creditor and its affiliated together extended no more than 2,000 <i>first lien</i> ATR / QM “covered transactions”. * <b>AND</b></li> <li>iii. <u>The creditor must be a Small Creditor, by asset size.</u> As of the preceding 12/31 (or if the application was received before 4/1, either of the two preceding 12/31 dates), the creditor and its affiliates that regularly extended <i>first lien</i> ATR / QM “covered transactions” together, had total assets of less than \$2B (adjusted annually).* <b>AND</b></li> <li>iv. <u>Does not maintain escrow accounts.</u> Neither the creditor nor an affiliate may maintain an escrow account unless it is for HPMLs dated 4/1/10 – 5/1/16, or post-consummation escrowing for a distressed consumer to prevent default or foreclosure. If the institution escrows in any other way (even as an occasional accommodation or at borrower request), then it cannot claim this exemption, and must escrow current HPMLs. In writing this, the CFPB wanted to make sure the exemption was for those small creditors that do not have a system to administer escrowing as a regular business practice.</li> </ul> <p>* Once the CFPB issues regulations to implement a portion of S2155, the volume threshold will be reduced to 1,000 loans and the asset threshold will be increased to \$10B in assets.</p>
<p><b>Escrow Cancellation Requirements</b> 1026.35(b)(3)</p>	<p>A required HPML escrow account may NOT be cancelled until either:</p> <ul style="list-style-type: none"> <li>• The debt obligation is terminated (ex: repaid, refinanced, rescinded or foreclosed); or</li> <li>• Upon borrower request at least 5 years after loan consummation. Then, both of these criteria must be satisfied: <ul style="list-style-type: none"> <li>1. The unpaid principal balance must be less than 80% of the original property value securing the loan; and</li> <li>2. The consumer cannot be delinquent or in default</li> </ul> </li> </ul>

<p><b>2. Appraisal Requirements 1026.35(c)(1)</b></p>	<p>If a loan is an HPML, unless it is exempted, it is subject to three different appraisal requirements:</p> <ul style="list-style-type: none"> <li>a. Disclose the applicant’s Right to Receive a Copy of the Appraisal; and</li> <li>b. Obtain a full appraisal conducted by a certified or licensed appraiser who conducts a physical visit of the interior of the collateral property; and</li> <li>c. Obtain an additional appraisal at no-charge for “flipped” properties</li> </ul>
<p><b>Exemptions to Appraisal Requirements 1026.35(c)(2)</b></p>	<p>If the loan is any one of the following loan transactions, it is exempt from the HPML Appraisal Requirements:</p> <ul style="list-style-type: none"> <li>• A Qualified Mortgage (QM) of any type;</li> <li>• A loan amount equal to or less than \$26,700 (2019 figure);</li> <li>• A loan to finance the initial construction of a dwelling;</li> <li>• A bridge loan with a maturity of 12 months or less, made in connection with the acquisition of a dwelling to be the consumer’s principal dwelling;</li> <li>• A reverse mortgage;</li> <li>• Certain “streamlined” refinances;</li> <li>• A loan secured by a mobile home (under 320 sq ft), boat or trailer;</li> <li>• A loan secured by a manufactured home <i>without land</i>, <u>so long as</u> the creditor obtains and provides another prescribed valuation (see the Reg);</li> <li>• A loan secured by a NEW manufactured home <i>with land</i> – but only the interior physical inspection is waived. An appraisal is still required. (Note: An HPML secured by a USED manufactured home <i>with land</i> is not exempted at all and is subject to the full appraisal requirement.)</li> </ul>
<p><b>a. Appraisal Disclosure Requirement 1026.35(c)(5)</b></p>	<p>Unless exempted, the creditor shall disclose to the consumer in writing:</p> <p><i>“We may order an appraisal to determine the property’s value and charge you for this appraisal. We will give you a copy of any appraisal, even if your loan does not close. You can pay for an additional appraisal for your own use and at your own cost.”</i></p> <p>Compliance with this requirement is easy, as it is already required by Reg B, and is included on all consumer real estate Loan Estimates. The timing requirement for this disclosure (and for the delivery of the appraisal itself) also follows the Reg B requirement and is not detailed here.</p>
<p><b>b. Full Appraisal with Interior Inspection 1026.35(c)(3)</b></p>	<p>Unless exempted, a creditor must obtain, prior to closing, a written appraisal of the property being mortgaged, performed by a certified or licensed appraiser who conducts a physical visit of the interior of the property that will secure the transaction.</p>

<p><b>c. “Flipped” Appraisal Requirement 1026.35(c)(4)</b></p>	<p>Unless exempted, a creditor must ALSO obtain an additional appraisal <i>at no cost to the consumer</i>, if the property is being flipped, as determined by:</p> <ul style="list-style-type: none"> <li>• The seller obtained the collateral property 90 days or less prior to the date of the purchase agreement, and the sales price exceeds the seller’s acquisition cost by 10%; or</li> <li>• The seller obtained the collateral property 90 – 180 days to the date of the purchase agreement, and the sales price exceeds the seller’s acquisition cost by 20%</li> </ul> <p>If a flip has occurred, the creditor must obtain the second appraisal by a different certified or licensed appraiser, and it must be a full appraisal with an interior physical inspection. There are also additional analytical requirements that either of the two appraisals must meet, see 1026.35(c)(4)(iv) for details.</p>
<p><b>Additional Exemptions from “Flipped” Appraisal Requirement 1026.35(c)(4) (vii)</b></p>	<p>Even if a HPML is not otherwise exempted from the overall appraisal requirements, it would be exempted from the second appraisal requirement for purchasing flipped property if the property is:</p> <ul style="list-style-type: none"> <li>• From a local, State, or Federal government agency;</li> <li>• From a person who acquired title through foreclosure, deed-in-lieu, or similar procedure</li> <li>• From a 501(c)(3) non-profit entity as part of a local, State, or Federal government program that is permitted to acquire title to single-family properties for resale;</li> <li>• From a person who acquired title by inheritance or other court order to which the seller was a party;</li> <li>• From an employer / relocation agency in connection with the relocation of an employee;</li> <li>• From a servicemember who received deployment / permanent change of station order after purchasing the property;</li> <li>• Located in a federal disaster area as designated by the President; or</li> <li>• Located in a rural county. <a href="https://www.consumerfinance.gov/policy-compliance/guidance/rural-and-underserved-counties-list/">https://www.consumerfinance.gov/policy-compliance/guidance/rural-and-underserved-counties-list/</a></li> </ul>

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