Chapter 8
Federal Housing Policies: Part One

Learning Objectives
- Understand how federal legislation has affected the mortgage and housing markets
- Understand how legislation has been passed to increase affordability of housing
- Understand how the federal government has sought to foster efficiency in the housing and mortgage market, and the various laws that have been enacted to promote competition

Housing Affordability
- Federal programs make housing more affordable
- Three categories
  - Economic support of financial institutions
  - Mortgage insurance, grants, and subsidies
  - Income tax provisions

Economic Support of Financial Institutions
- Loans to institutions at below-market rates from Federal Home Loan Bank
- Deposit insurance
  - National Housing Act of 1934 created the Federal Savings and Loan Insurance Corporation
  - Allows lender to take on greater risk than otherwise

Mortgage Insurance and Grants
- Federal Housing Administration (FHA) provides default insurance protecting lenders against loss in foreclosure
- HUD administers direct grant programs such as the Community Development Block Grants for acquisition or rehab of property, construction of neighborhood centers, etc.

Subsidies
- HUD provides subsidy programs for low-income households where a portion of housing costs are paid
- HOME Program set up a trust fund to increase the supply of low-income housing
- HOPE Program issues grants to rehab public housing
INCOME TAX PROVISIONS

- Interest and property taxes on owner-occupied residence are deductible on individual’s federal income tax return
- Owner-occupied residence receives favorable capital gains tax treatment
- Points at purchase are considered prepaid interest and can generally be deducted that year (owner occupied)
- Points on refinance can be deducted over the life of the loan, and if the loan is paid off early, the unpaid portions can be recovered.


- You can deduct the points in full in the year they are paid, if all the following requirements are met:
- Your loan is secured by your main home (your main home is the one you live in most of the time).
- Paying points is an established business practice in your area.
- You use the cash method of accounting.
- The points were not paid for items that usually are separately stated on the settlement sheet such as appraisal fees, inspection fees, title fees, attorney fees, or property taxes.
- The funds you provided at or before closing, plus any points the seller paid, were at least as much as the points charged. You cannot have borrowed the funds from your lender or mortgage broker in order to pay the points.
- You use your loan to buy or build your main home.
- The points were computed as a percentage of the principal amount of the mortgage, and
- The amount is clearly shown on your settlement statement.

More IRS pointers on Points

- Points that do not meet these requirements may be deductible over the life of the loan. Points paid for refinancing generally can only be deducted over the life of the new mortgage. However, if you use part of the refinanced mortgage proceeds to improve your main home and you meet the first six requirements stated previously, you can fully deduct the part of the points related to the improvement in the year you paid them with your own funds. Points charged for specific services, such as preparation costs for a mortgage note, appraisal fees or notary fees are not interest and cannot be deducted. Points paid by the seller of a home cannot be deducted as interest on the seller’s return, but they are a selling expense which will reduce the amount of gain realized. Points paid by the seller may be deducted by the buyer provided the buyer provides the seller with the amount of points paid and the buyer subtracts the amount from the basis, or cost, of the residence. Points you pay on loans secured by your second home can be deducted only over the life of the loan.

EFFICIENCY AND STABILITY

- Fostered in two ways:
  - creating liquid and efficient markets primarily through securitization (Fannie Mae, Freddie Mac, Ginnie Mae)
  - Deregulation such as the Depository Institutions Deregulation and Monetary Control Act of 1980 that eliminated ceilings on deposit rates and mortgage rates and eliminated usury ceilings

MAKING REAL ESTATE FINANCE COMPETITIVE

- Interstate Land Sales Full Disclosure Act
  - Requires disclosure of information in interstate land sales
- Consumer Credit Protection Act (Truth-In-Lending, or Regulation Z, 1968)
  - Applies to consumer loans and residential mortgages
  - Finance charges must be disclosed including APR

REGULATION Z AND ALTERNATIVE MORTGAGES

- Any negative amortization on graduated payment loans is a finance charge
- ARM terms must be disclosed, e.g., index, margin, caps, etc.
- Disclosures on SAMs must be based on the original interest rate
- APR on buydowns must account for the lower initial rate
HOME EQUITY LOANS

- Are “open ended” in that the borrower can draw amounts as needed
- Best described as open-ended, non-amortizing adjustable-rate loans
- Payment terms and periodic rate must be disclosed

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

- Passed in 1974 and requires reasonable estimates of all settlement costs to be disclosed before closing
- Charges include appraisal fee, credit report fee, inspection, mortgage insurance, title insurance, document preparation, prepaid interest, recording fee, attorney fees, etc.

RESPA (cont.)

- Borrower must be given a copy of a booklet detailing RESPA
- Good faith estimate prior to closing
- Uniform Settlement Statement lists all charges and disbursements at closing
- Prohibits abusive practices such as kickbacks, excessive escrow, etc.

"The proposed final rules are intended to protect consumers from unfair or deceptive acts and practices in mortgage lending, while keeping credit available to qualified borrowers and supporting sustainable homeownership," said Federal Reserve Chairman Ben S. Bernanke. "Importantly, the new rules will apply to all mortgage lenders, not just those supervised and examined by the Federal Reserve. Besides offering broader protection for consumers, a uniform set of rules will level the playing field for lenders and increase competition in the mortgage market, to the ultimate benefit of borrowers," the Chairman said.


- Press Release  Release Date: July 14, 2008
- For immediate release
- The Federal Reserve Board on Monday approved a final rule for home mortgage loans to better protect consumers and facilitate responsible lending. The rule prohibits unfair, abusive or deceptive home mortgage lending practices and restricts certain other mortgage practices. The final rule also establishes advertising standards and requires certain mortgage disclosures to be given to consumers earlier in the transaction.
- The final rule, which amends Regulation Z (Truth in Lending) and was adopted under the Home Ownership and Equity Protection Act (HOEPA), largely follows a proposal released by the Board in December 2007, with enhancements that address ensuing public comments, consumer testing, and further analysis.

The final rule adds four key protections for a newly defined category of "higher-priced mortgage loans" secured by a consumer's principal dwelling. For loans in this category, these protections will:

- Prohibit a lender from making a loan without regard to borrowers' ability to repay the loan from income and assets other than the home's value. A lender complies, in part, by assessing repayment ability based on the highest scheduled payment in the first seven years of the loan. To show that a lender violated this prohibition, a borrower does not need to demonstrate that it is part of a "pattern or practice."
- Require creditors to verify the income and assets they rely upon to determine repayment ability.
- Ban any prepayment penalty if the payment can change in the initial four years. For other higher-priced loans, a prepayment penalty period cannot last for more than two years. This rule is substantially more restrictive than originally proposed.
- Require creditors to establish escrow accounts for property taxes and homeowner's insurance for all first-tier mortgage loans.
In addition to the rules governing higher-priced loans, the rules adopt the following protections for loans secured by a consumer’s principal dwelling, regardless of whether the loan is higher-priced:

- Creditors and mortgage brokers are prohibited from coercing a real estate appraiser to misstate a home’s value.
- Companies that service mortgage loans are prohibited from engaging in certain practices, such as pyramiding late fees. In addition, servicers are required to credit consumers’ loan payments as of the date of receipt and provide a payoff statement within a reasonable time of request.
- Creditors must provide a good faith estimate of the loan costs, including a schedule of payments, within three days after a consumer applies for any mortgage loan secured by a consumer’s principal dwelling, such as a home improvement loan or a loan to refinance an existing loan. Currently, early cost estimates are only required for home-purchase loans. Consumers cannot be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining the consumer’s credit history.

One element of the original proposal has been withdrawn. The Federal Reserve Board had proposed for public comment certain requirements pertaining to so-called “yield-spread premiums.” During the intervening period, the Board engaged in consumer testing that cast significant doubt on the effectiveness of the proposed rule. As part of its ongoing review of closed-end loan rules under Regulation Z, however, the Board will consider alternative approaches.

The new rules take effect on October 1, 2009. The single exception is the escrow requirement, which will be phased in during 2010 to allow lenders to establish new systems as needed.

Example: Truth In Lending Disclosure

- A customer is offered a 6.75%, 30 yr FRM loan for $160000 (80% LTV) with 3 points and no other financing fees. This loan will close on the first of the month.
  - What is the FTLAPR?
  - What is the Finance Charge?
  - What is the Amount Financed?
  - What is the Total of Payments?

Example: When will PMI be cancelled?

- PMI will automatically be cancelled when the loan is 78% of the original purchase price
- For a 30 year 7.75% loan with $10,000 down for a $200,000 house, in what month will the PMI be cancelled?

HOMEOWNERS PROTECTION ACT (1998)

- Requires lenders to inform borrowers of right to cancel mortgage insurance when the loan-to-value ratio reaches 80%
- Insurance must be cancelled when loan-to-value reaches 78%
- House price appreciation is not considered
- If the lender buys insurance for you, and increases your rate to reflect this, or is you are using a government program such as FHA, the insurance remains for the life of the loan.