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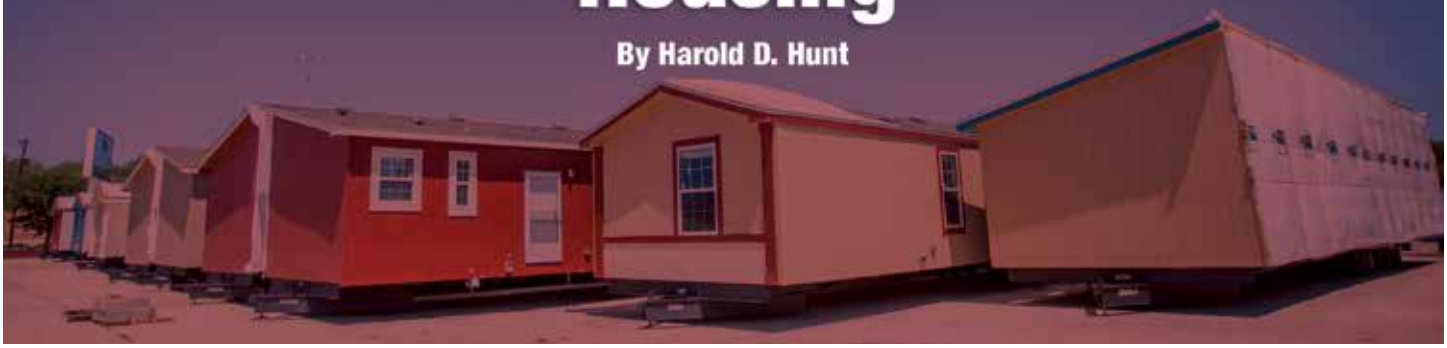
Dodd-Frank's Impact on Manufactured Housing

By Harold D. Hunt



New rules mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) took effect on January 14th and are expected to have a significant impact on residential mortgage markets. One of the areas that could be hardest hit is the financing of manufactured housing, a critical segment of affordable housing in Texas.

D.J. Pendleton, executive director of the Texas Manufactured Housing Association (TMHA), offers an overview of the major consequences for his industry in this interview. Pendleton served on the industry's Dodd-Frank task force, which evaluated proposed mortgage regulations and advocated on behalf of the manufactured housing industry.

Which Dodd-Frank rules will have the biggest impact on manufactured housing (MH) lending?

Three rules should be the most challenging for our industry, and I think all three are primarily meant to protect the buyer.

First is the ability to repay (ATR) rule, which requires lenders to verify that borrowers can actually make the mortgage payments. This rule defines a "qualified mortgage" (QM) and explains how that designation relates to the lender's level of liability stemming from the origination process.

Then there's the high-cost mortgage loan/home ownership and equity protections act (HOEPA) rule. A non-QM loan will be classified as "high-cost" or "predatory" based on tripping one of two triggers, either an annual percentage rate (APR) cap or a points and fees cap.

Finally, the loan originator compensation (LO Comp) rule mandates who can be classified as a loan originator based on their activities or actions. Any compensation paid to any individual defined as a loan originator must be included in the calculation of points and fees. That means this rule can potentially influence every other rule, limit and increased liability that comes with exceeding points and fees thresholds.

What are the important elements of the ATR Rule?

The rule establishes two types of QMs. First is the "safe harbor" QM, basically a plain vanilla, fully amortizing loan with a low fixed interest rate or an adjustable rate that falls within specific parameters and has low points and fees. Safe harbor QMs will be issued to borrowers with a relatively small debt load compared with loans made before the recent financial crisis.

Sandwiched between a safe harbor QM and non-QM loans is the "rebuttable presumption" QM. Unlike the safe harbor provision, which protects lenders from borrower lawsuits, this loan can be challenged in court. However, borrowers must prove that the lender didn't make a reasonable and good faith determination of their ability to repay the loan at the time it was originated.

Borrowers will have a maximum of three years after loan origination to bring such claims against their creditors. This time limit doesn't apply if the lender or any assignee ever attempts to bring a foreclosure action against the borrower.

Lenders who fail to comply with the ATR Rule are subject to a broad array of civil penalties and cease-and-desist orders from the Consumer Financial Protection Bureau (CFPB). These penalties are far from toothless. The civil penalties alone can be up to $5,000 per day for any violation and up to $25,000 per day for a reckless violation. The "nuclear option" penalty is up to $1 million per day for a knowing violation.

How does the ATR Rule affect manufactured housing lending?

The rule determines whether a loan is a QM or not based on a comparison of the spread between a potential loan's APR and the average prime offer rate (APOR) published weekly by the Federal Reserve Board.

The problem is the APOR is based on the pricing terms for comparable loan transactions pulled from a Freddie Mac survey of prime mortgage lenders. The

few MH lenders there are can't access funds at the APOR. As a result, it will be extremely difficult for MH loans to qualify for QM status.

Calculation of loan points and fees will vary. The rule states that loans above $100,000 cannot have points and fees exceeding 3 percent of the loan amount. For smaller loans, the rule created four tiers for determining total points and fees depending on loan amount.

While the tiers exceed 3 percent, the dollar amounts are relatively small when compared with what can be collected on larger loans. So I don't think the rule went far enough to pay for the cost of originating loans for the five or six national MH lending portfolios.

I say portfolios because there really is no secondary mortgage market for MH loans. The ATR rule creates "temporary QM status" for loans originated until 2021 as long as any of the federal agencies such as Fannie, Freddie or HUD insure, purchase or provide a guaranty for them.

Temporary QMs will play a significant role in traditional lending for site-built homes. But their impact on MH lending will be miniscule. Government-sponsored entities do not participate in MH lending at any significant level, especially personal property loans. So the MH lenders' cost of funds and liquidity have always been and will continue to be a problem for our industry.

You mentioned the APR and points and fees triggers related to the high-cost/HOEPA rule. Could you explain them in a little more detail?

Under the rule, a loan will be classified as high-cost if its APR is 6.5 percent or more above the APOR. However, if it's a personal property or "chattel" loan less than $50,000, the cap is raised to 8.5 percent above APOR. There are approximately ten MH chattel loans for every one MH real property loan. Between January and July 2013, 7,815 chattel loans and 746 real property loans originated in Texas.

The points and fees cap is split. For loans of $20,000 or more, total points and fees cannot exceed five percent of the total loan amount. The cap is 8 percent or $1,000, whichever is smallest, for transactions less than $20,000.

What's the significance of a loan being classified as high-cost?

I think the big impact will come from the extremely high liabilities and penalties related to originating and investing in high-cost loans.

Borrowers may get their loan rescinded if certain prohibited terms are included. Lenders will now be subject to much higher damages than are allowed for other types of Truth in Lending violations. Mandatory credit counseling before entering into such a loan also adds expense. Finally, any investor in or purchaser of a high-cost mortgage will also be subject to any claims and defenses against the original lender.

It's difficult to obtain industry-wide lending data on MH loans. However, we spoke to several of the largest lenders in Texas about the possible impact on their originations. These select lenders originated approximately 47 percent of all the MH loans in 2012. They estimate that 40 to 45 percent of all MH loans originated in Texas during 2012 would have failed either the APR or points and fee caps, putting them in the high-cost category. That represented about 2,500 loans that year. So I think the rule may create a real dampening effect on the origination of and investment in any MH loans that get classified as high-cost.

The lenders calculated that just raising the APR cap from 8.5 to 10 percent over APOR for chattel loans less than $50,000 would have caught about 91 percent of those 2012 loans here in Texas and kept them out of the high-cost category. Despite countless efforts, comment letters and meetings with the CFPB over the last 18 months, they are unwilling to raise the rates for manufactured home loans.

I see three possibilities for the way this rule will play out. One is that the caps are too low for lenders, so high-cost loans don't get originated and potential borrowers get turned away. Another possibility is that retailers and factories cut their profit margins just to keep the lights on and try to survive until the rule can be changed. That's a pretty risky strategy.

A third possibility is an interest rate "buy-down" to induce lenders to make the loan. In many cases, the MH retailer will be the source of the buy-down through seller points. If this occurs, the entire MH market will adjust by increasing the cost of manufactured homes.

I believe this will adversely impact both buyers and sellers as some consumers will be priced out of homes. That will negatively impact retailers and manufacturers. For those consumers who can still afford the home, they will be paying more for less simply because of the limits placed on lenders through this "consumer protection" rule.

Let's say this third option is pervasive, and a year from now the MH industry has sold about the same number of homes. CFPB announces that the sky didn't fall and claims victory, but the manufactured housing industry is stuck with this model and consumers still foot the bill.

What should readers know about the LO Comp Rule?

The rule defines a loan originator as a person who, in expectation of direct or indirect compensation or other monetary gain, performs any of the following activities:

- takes a loan application,
- offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person or
- represents to the public through advertising or other means of communication that he or she can or will perform any of these activities.

The rule exempts individuals performing purely administrative or clerical tasks on behalf of a loan originator under certain conditions. Clerical and administrative exceptions are the most critical in the final rule. Exceptions apply only if there is a direct employee-employer relationship. The final rule specifically eliminates the clerical and administrative exception for other agents or contractors.

In our retail sales setting, where there are only a handful of lenders and no mortgage brokers in the chattel space, the act of "referring" takes on a special challenge. The final rule went to

extensive lengths to justify how the CFPB interpreted a "referral" as a trigger for classification as a loan originator.

Referring includes any oral or written action directed to consumers that can influence them to select a particular loan originator or creditor. So I believe the rule makes it fairly easy to inadvertently become classified as a loan originator.

How will manufactured housing be affected by the LO Comp Rule?

The list of administrative penalties and liabilities for violations of this rule is lengthy. For the MH industry in particular, in which retailers are not direct employees of lenders and therefore not exempt from the referral activity to a lender, another dilemma arises. If salespersons cannot steer customers to one of the five or six lenders available and navigate the buyer through viable lending programs offered by lenders, the borrower may not be able to find financing.

The CFPB did provide additional guidance in the final rule. They allow a salesperson to provide general information about creditors and loan originators that may offer financing for manufactured homes in a general area when doing so does not cross the delicate line of "referring." These types of general acts do allow for a salesperson to, in a neutral manner, provide general brochures and information about creditors.

I don't think the rule provided the "bright line" the MH industry had continuously requested, so we are left to navigate under these general activity-based allowable examples. Without a rule change, it will take years of regulation and litigation to identify with certainty which specific acts cross the line and make a salesperson an accidental loan originator.

Another issue is prequalification. Again, this is where the MH industry deviates from the traditional home buying and selling process, in which buyers routinely know before shopping for a home how much of a loan they can qualify for. Our retail sales setting is more akin to buying a car or boat off a retail lot. Many customers want to look without knowing anything about their potential borrowing capacity. Salespeople must be able to focus in and show potential buyers homes they can afford.

The cost to obtain a mortgage broker license is somewhere between $500 and $2,000 and 20 hours of class time. The bigger issue is whether MH salespeople will be able to pass the broker exam, which is based on traditional lending terminology. Individuals who have worked only with chattel loans are generally unfamiliar with that terminology.

Some salespeople may still choose to obtain a mortgage broker's license just to be able to talk about lending terms without fear of reprisal. That should be a competitive advantage because they will be able to talk credit, send potential buyers to a specific lender and help them fill out a credit application.

However, one more uncertainty arises when the salesperson in the transaction is also a licensed loan officer. The rule states that, once a salesperson is engaged in loan origination activities, all compensation must go toward points and fees. Some concerned lenders are looking at this as a possible liability to becoming licensed if it means that both origination charges and the salesperson's commission are included in points and fees.

Any final thoughts?

The most frustrating part of this entire effort is the fact that our niche industry is a square peg that doesn't fit into CFPB's round hole. This is not to say there haven't been gains made and modifications obtained on our behalf, without which our industry would have been eliminated completely. However, at a fundamental level I think politicians and regulators still have great difficulty understanding our industry.

We also have been neglected by the government-sponsored entities, which significantly support the site-built industry. This has severely limited the MH industry's liquidity, increased our cost of funds and drastically restricted our loan originating and lending environment.

Finally, I'm convinced that federal regulators lack knowledge of how we differ from the traditional site-built home industry. At the sales level, we have retail lots with retailers. We do not have Realtors and mortgage brokers. We primarily serve consumers seeking affordable homes in rural areas. We are the only form of unsubsidized, affordable family housing that exists through a small number of fixed rate, fully amortizing portfolio lenders.

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Our industry did not contribute to the subprime-lending situation that led to the housing crisis. Yet the collateral damage inflicted on us will dramatically affect the way we do business and the consumers we serve. Looking ahead, we believe these regulatory changes will have a negative impact on all involved. I'm sure the CFPB would see things differently. Only time will tell who is right.

Editor's note: For a more in-depth discussion of Dodd-Frank's effect on manufactured housing, see Pendleton's article "The Road Ahead" at http://www.texasmha.com/news/featured/mhtq-cover-story-the-path-ahead.

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THE TAKEAWAY

The Dodd-Frank Wall Street Reform and Consumer Protection Act was intended to protect low-income homebuyers but may instead wind up limiting their housing choices. Expectations are that the bill will seriously damage the manufactured home industry by making it more difficult for buyers to obtain financing.

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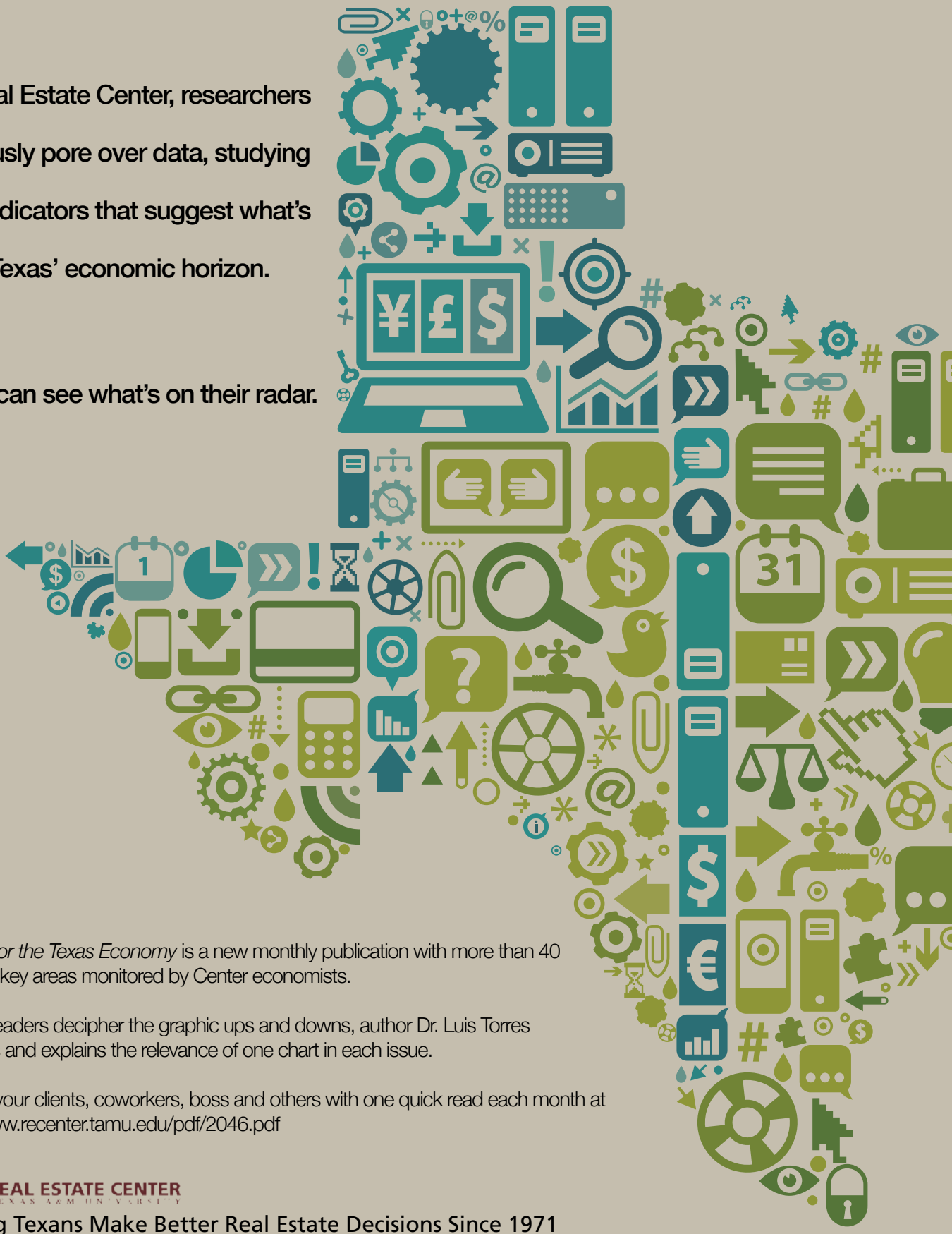

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