Ability to Repay (Mortgages)

# Section 1: Repayment Ability [12 CFR § 1026.43(a)]

## Introductory Commentary

### Regulatory Discussion

For reference: §1026.25(c)(3) states a creditor shall retain evidence of compliance with §1026.43 of this regulation for three years after consummation of a transaction covered by that section.

Comments 25(c)(3)-1 and -2 state:

Evidence of compliance with repayment ability provisions. A creditor must retain evidence of compliance with §1026.43 for three years after the date of consummation of a consumer credit transaction covered by that section. (See comment 25(c)(3)-2 for guidance on the retention of evidence of compliance with the requirement to offer a consumer a loan without a prepayment penalty under §1026.43(g)(3).) If a creditor must verify and document information used in underwriting a transaction subject to §1026.43, the creditor shall retain evidence sufficient to demonstrate compliance with the documentation requirements of the rule. Although a creditor need not retain actual paper copies of the documentation used in underwriting a transaction subject to §1026.43, to comply with §1026.25(c)(3), the creditor must be able to reproduce such records accurately. For example, if the creditor uses a consumer's Internal Revenue Service (IRS) Form W-2 to verify the consumer's income, the creditor must be able to reproduce the IRS Form W-2 itself, and not merely the income information that was contained in the form.

Dwelling-secured transactions and prepayment penalties. If a transaction covered by §1026.43 has a prepayment penalty, the creditor must maintain records that document that the creditor complied with requirements for offering the consumer an alternative transaction that does not include a prepayment penalty under §1026.43(g)(3), (4), or (5). However, the creditor need not maintain records that document compliance with those provisions if a transaction is consummated without a prepayment penalty or if the creditor and consumer do not consummate a covered transaction. If a creditor offers a transaction with a prepayment penalty to a consumer through a mortgage broker, to evidence compliance with §1026.43(g)(4) the creditor should retain evidence of the alternative covered transaction presented to the mortgage broker, such as a rate sheet, and the agreement with the mortgage broker required by §1026.43(g)(4)(ii).

### Regulatory Text

*None*

### Regulatory Commentary

***Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling***

*1.* ***Record retention.*** *See §1026.25(c)(3) and comments 25(c)(3)-1 and -2 for guidance on the required retention of records as evidence of compliance with §1026.43.*

## Scope – 12 CFR § 1026.43(a)

### Regulatory Discussion

This section applies to any consumer credit transaction that is secured by a dwelling, including any real property attached to a dwelling. Excluded from these requirements are:

* HELOCs
* Timeshares
* Reverse mortgages
* Temporary or “bridge” loans
* Construction loans (no longer than 12 months
* Other loan types, that most banks do not offer

### Regulatory Text

(a) **Scope.** This section applies to any consumer credit transaction that is secured by a dwelling, as defined in §1026.2(a)(19), including any real property attached to a dwelling, other than:

(1) A home equity line of credit subject to §1026.40;

(2) A mortgage transaction secured by a consumer's interest in a timeshare plan, as defined in 11 U.S.C. 101(53(D)); or

(3) For purposes of paragraphs (c) through (f) of this section:

(i) A reverse mortgage subject to §1026.33;

(ii) A temporary or “bridge” loan with a term of 12 months or less, such as a loan to finance the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months or a loan to finance the initial construction of a dwelling;

(iii) A construction phase of 12 months or less of a construction-to-permanent loan;

(iv) An extension of credit made pursuant to a program administered by a Housing Finance Agency, as defined under 24 CFR 266.5;

(v) An extension of credit made by:

[Paragraphs A through D Omitted, as these provisions do not impact banks.]

(vi) An extension of credit made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5211; 5219);

(vii) Consumer credit transactions that meet the following criteria…

[Paragraphs A through F Omitted, as these provisions do not impact banks.]

### Regulatory Commentary

***43(a) Scope.***

*1.* ***Consumer credit.*** *In general, §1026.43 applies to consumer credit transactions secured by a dwelling, but certain dwelling-secured consumer credit transactions are exempt or partially exempt from coverage under §1026.43(a)(1) through (3). (See §1026.2(a)(12) for the definition of “consumer credit.”) Section 1026.43 does not apply to an extension of credit primarily for a business, commercial, or agricultural purpose, even if it is secured by a dwelling. See §1026.3 and associated commentary for guidance in determining the primary purpose of an extension of credit. In addition, §1026.43 does not apply to any change to an existing loan that is not treated as a refinancing under §1026.20(a).*

*2.* ***Real property.*** *“Dwelling” means a residential structure that contains one to four units, whether or not the structure is attached to real property. See §1026.2(a)(19). For purposes of §1026.43, the term “dwelling” includes any real property to which the residential structure is attached that also secures the covered transaction. For example, for purposes of §1026.43(c)(2)(i), the value of the dwelling that secures the covered transaction includes the value of any real property to which the residential structure is attached that also secures the covered transaction.*

***Paragraph 43(a)(3).***

*1.* ***Renewable temporary or “bridge” loan.*** *Under §1026.43(a)(3)(ii), a temporary or “bridge” loan with a term of 12 months or less is exempt from §1026.43(c) through (f). Examples of such a loan are a loan to finance the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months and a loan to finance the initial construction of a dwelling. Where a temporary or “bridge loan” is renewable, the loan term does not include any additional period of time that could result from a renewal provision provided that any renewal possible under the loan contract is for one year or less. For example, if a construction loan has an initial loan term of 12 months but is renewable for another 12-month loan term, the loan is exempt from §1026.43(c) through (f) because the initial loan term is 12 months.*

*2.* ***Construction phase of a construction-to-permanent loan.*** *Under §1026.43(a)(3)(iii), a construction phase of 12 months or less of a construction-to-permanent loan is exempt from §1026.43(c) through (f). A construction-to-permanent loan is a potentially multiple-advance loan to finance the construction, rehabilitation, or improvement of a dwelling that may be permanently financed by the same creditor. For such a loan, the construction phase and the permanent phase may be treated as separate transactions for the purpose of compliance with §1026.43(c) through (f), and the construction phase of the loan is exempt from §1026.43(c) through (f), provided the initial term is 12 months or less. See §1026.17(c)(6)(ii), allowing similar treatment for disclosures. Where the construction phase of a construction-to-permanent loan is renewable for a period of one year or less, the term of that construction phase does not include any additional period of time that could result from a renewal provision. For example, if the construction phase of a construction-to-permanent loan has an initial term of 12 months but is renewable for another 12-month term before permanent financing begins, the construction phase is exempt from §1026.43(c) through (f) because the initial term is 12 months. Any renewal of one year or less also qualifies for the exemption. The permanent phase of the loan is treated as a separate transaction and is not exempt under §1026.43(a)(3)(iii). It may be a qualified mortgage if it satisfies the appropriate requirements.*

***Paragraph 43(a)(3)(iv) through (vii).***

*[Omitted, as these provisions do not impact banks.]*

# Section 2: Definitions

# 12 CFR § 1026.43(b)

## Introduction

All definitions below are specific to this section of the regulation. We have elected to offer no Regulatory Discussion for each of these definitions.

## Covered Transaction – 12 CFR § 1026.43(b)(1)

### Regulatory Text

(1) **Covered transaction** means a consumer credit transaction that is secured by a dwelling, as defined in §1026.2(a)(19), including any real property attached to a dwelling, other than a transaction exempt from coverage under paragraph (a) of this section.

**Regulatory Commentary**

*1. The definition of covered transaction restates the scope of the rule as described at §1026.43(a).*

## Fully Amortizing Payment - 12 CFR § 1026.43(b)(2)

### Regulatory Text

(2) **Fully amortizing payment** means a periodic payment of principal and interest that will fully repay the loan amount over the loan term.

**Regulatory Commentary**

*None.*

## Fully Indexed Rate - 12 CFR § 1026.43(b)(3)

### Regulatory Text

(3) **Fully indexed rate** means the interest rate calculated using the index or formula that will apply after recast, as determined at the time of consummation, and the maximum margin that can apply at any time during the loan term.

**Regulatory Commentary**

*1.* ***Discounted and premium adjustable-rate transactions.*** *In some adjustable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. In some cases, the initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula that will apply after recast, as determined at consummation (i.e., a “discounted rate”). In other cases, the initial rate may be higher (i.e., a “premium rate”). For purposes of determining the fully indexed rate where the initial interest rate is not determined using the index or formula for subsequent interest rate adjustments, the creditor must use the interest rate that would have applied had the creditor used such index or formula plus margin at the time of consummation. That is, in determining the fully indexed rate, the creditor must not take into account any discounted or premium rate. To illustrate, assume an adjustable-rate transaction where the initial interest rate is not based on an index or formula, or is based on an index or formula that will not apply after recast, and is set at 5 percent for the first five years. The loan agreement provides that future interest rate adjustments will be calculated based on a specific index plus a 3 percent margin. If the value of the index at consummation is 5 percent, the interest rate that would have been applied at consummation had the creditor based the initial rate on this index is 8 percent (5 percent plus 3 percent margin). For purposes of §1026.43(b)(3), the fully indexed rate is 8 percent. For discussion of payment calculations based on the greater of the fully indexed rate or premium rate for purposes of the repayment ability determination under §1026.43(c), see §1026.43(c)(5)(i) and comment 43(c)(5)(i)-2.*

*2.* ***Index or formula value at consummation.*** *The value at consummation of the index or formula need not be used if the contract provides for a delay in the implementation of changes in an index value or formula. For example, if the contract specifies that rate changes are based on the index value in effect 45 days before the change date, the creditor may use any index value in effect during the 45 days before consummation in calculating the fully indexed rate.*

*3.* ***Interest rate adjustment caps.*** *If the terms of the legal obligation contain a periodic interest rate adjustment cap that would prevent the initial rate, at the time of the first adjustment, from changing to the rate determined using the index or formula value at consummation (i.e., the fully indexed rate), the creditor must not give any effect to that rate cap when determining the fully indexed rate. That is, a creditor must determine the fully indexed rate without taking into account any periodic interest rate adjustment cap that may limit how quickly the fully indexed rate may be reached at any time during the loan term under the terms of the legal obligation. To illustrate, assume an adjustable-rate mortgage has an initial fixed rate of 5 percent for the first three years of the loan, after which the rate will adjust annually to a specified index plus a margin of 3 percent. The loan agreement provides for a 2 percent annual interest rate adjustment cap, and a lifetime maximum interest rate of 10 percent. The index value in effect at consummation is 4.5 percent; the fully indexed rate is 7.5 percent (4.5 percent plus 3 percent), regardless of the 2 percent annual interest rate adjustment cap that would limit when the fully indexed rate would take effect under the terms of the legal obligation.*

*4.* ***Lifetime maximum interest rate.*** *A creditor may choose, in its sole discretion, to take into account the lifetime maximum interest rate provided under the terms of the legal obligation when determining the fully indexed rate. To illustrate, assume an adjustable-rate mortgage has an initial fixed rate of 5 percent for the first three years of the loan, after which the rate will adjust annually to a specified index plus a margin of 3 percent. The loan agreement provides for a 2 percent annual interest rate adjustment cap and a lifetime maximum interest rate of 7 percent. The index value in effect at consummation is 4.5 percent; under the generally applicable rule, the fully indexed rate is 7.5 percent (4.5 percent plus 3 percent). Nevertheless, the creditor may choose to use the lifetime maximum interest rate of 7 percent as the fully indexed rate, rather than 7.5 percent, for purposes of §1026.43(b)(3). Furthermore, if the creditor chooses to use the lifetime maximum interest rate and the loan agreement provides a range for the maximum interest rate, then the creditor complies by using the highest rate in that range as the maximum interest rate for purposes of §1026.43(b)(3).*

*5.* ***Step-rate and fixed-rate mortgages.*** *Where the interest rate offered under the terms of the legal obligation is not based on, and does not vary with, an index or formula (i.e., there is no fully indexed rate), the creditor must use the maximum interest rate that may apply at any time during the loan term. To illustrate:*

*i. Assume a step-rate mortgage with an interest rate fixed at 6.5 percent for the first two years of the loan, 7 percent for the next three years, and 7.5 percent thereafter for the remainder of loan term. For purposes of this section, the creditor must use 7.5 percent, which is the maximum rate that may apply during the loan term. “Step-rate mortgage” is defined in §1026.18(s)(7)(ii).*

*ii. Assume a fixed-rate mortgage with an interest rate at consummation of 7 percent that is fixed for the 30-year loan term. For purposes of this section, the maximum interest rate that may apply during the loan term is 7 percent, which is the interest rate that is fixed at consummation. “Fixed-rate mortgage” is defined in §1026.18(s)(7)(iii).*

## Higher-Priced Covered Transaction - 12 CFR § 1026.43(b)(4)

### Regulatory Text

(4) **Higher-priced covered transaction** means a covered transaction with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for a first-lien covered transaction, other than a qualified mortgage under paragraph (e)(5), (e)(6), or (f) of this section; by 3.5 or more percentage points for a first-lien covered transaction that is a qualified mortgage under paragraph (e)(5), (e)(6), or (f) of this section; or by 3.5 or more percentage points for a subordinate-lien covered transaction.

**Regulatory Commentary**

*1.* ***Average prime offer rate.*** *The average prime offer rate is defined in §1026.35(a)(2). For further explanation of the meaning of “average prime offer rate,” and additional guidance on determining the average prime offer rate, see comments 35(a)(2)-1 through -4.*

*2.* ***Comparable transaction.*** *A higher-priced covered transaction is a consumer credit transaction that is secured by the consumer's dwelling with an annual percentage rate that exceeds by the specified amount the average prime offer rate for a comparable transaction as of the date the interest rate is set. The published tables of average prime offer rates indicate how to identify a comparable transaction. See comment 35(a)(2)-2.*

*3.* ***Rate set.*** *A transaction's annual percentage rate is compared to the average prime offer rate as of the date the transaction's interest rate is set (or “locked”) before consummation. Sometimes a creditor sets the interest rate initially and then re-sets it at a different level before consummation. The creditor should use the last date the interest rate is set before consummation.*

## Loan Amount - 12 CFR § 1026.43(b)(5)

### Regulatory Text

(5) **Loan amount** means the principal amount the consumer will borrow as reflected in the promissory note or loan contract.

**Regulatory Commentary**

*1.* ***Disbursement of the loan amount.*** *The definition of “loan amount” requires the creditor to use the entire loan amount as reflected in the loan contract or promissory note, even though the loan amount may not be fully disbursed at consummation. For example, assume the consumer enters into a loan agreement where the consumer is obligated to repay the creditor $200,000 over 15 years, but only $100,000 is disbursed at consummation and the remaining $100,000 will be disbursed during the year following consummation in a series of advances ($25,000 each quarter). For purposes of this section, the creditor must use the loan amount of $200,000, even though the loan agreement provides that only $100,000 will be disbursed to the consumer at consummation. Generally, creditors should rely on §1026.17(c)(6) and associated commentary regarding treatment of multiple-advance and construction-to-permanent loans as single or multiple transactions. See also comment 43(a)(3)-2.*

## Loan Term - 12 CFR § 1026.43(b)(6)

### Regulatory Text

(6) **Loan term** means the period of time to repay the obligation in full.

**Regulatory Commentary**

*1.* ***General.*** *The loan term is the period of time it takes to repay the loan amount in full. For example, a loan with an initial discounted rate that is fixed for the first two years, and that adjusts periodically for the next 28 years has a loan term of 30 years, which is the amortization period on which the periodic amortizing payments are based.*

## Maximum Loan Amount - 12 CFR § 1026.43(b)(7)

### Regulatory Text

(7) **Maximum loan amount** means the loan amount plus any increase in principal balance that results from negative amortization, as defined in §1026.18(s)(7)(v), based on the terms of the legal obligation assuming:

(i) The consumer makes only the minimum periodic payments for the maximum possible time, until the consumer must begin making fully amortizing payments; and

(ii) The maximum interest rate is reached at the earliest possible time.

**Regulatory Commentary**

*1.* ***Calculation of maximum loan amount.*** *For purposes of §1026.43(c)(2)(iii) and (c)(5)(ii)(C), a creditor must determine the maximum loan amount for a negative amortization loan by using the loan amount plus any increase in principal balance that can result from negative amortization based on the terms of the legal obligation. In determining the maximum loan amount, a creditor must assume that the consumer makes the minimum periodic payment permitted under the loan agreement for as long as possible, until the consumer must begin making fully amortizing payments; and that the interest rate rises as quickly as possible after consummation under the terms of the legal obligation. Thus, creditors must assume that the consumer makes the minimum periodic payment until any negative amortization cap is reached or until the period permitting minimum periodic payments expires, whichever occurs first. “Loan amount” is defined in §1026.43(b)(5); “negative amortization loan” is defined in §1026.18(s)(7)(v).*

*2.* ***Assumed interest rate.*** *In calculating the maximum loan amount for an adjustable-rate mortgage that is a negative amortization loan, the creditor must assume that the interest rate will increase as rapidly as possible after consummation, taking into account any periodic interest rate adjustment caps provided in the loan agreement. For an adjustable-rate mortgage with a lifetime maximum interest rate but no periodic interest rate adjustment cap, the creditor must assume that the interest rate increases to the maximum lifetime interest rate at the first adjustment.*

*3.* ***Examples.*** *The following are examples of how to determine the maximum loan amount for a negative amortization loan (all amounts shown are rounded, and all amounts are calculated using non-rounded values):*

*i.* ***Adjustable-rate mortgage with negative amortization.***

*A. Assume an adjustable-rate mortgage in the amount of $200,000 with a 30-year loan term. The loan agreement provides that the consumer can make minimum monthly payments that cover only part of the interest accrued each month until the principal balance reaches 115 percent of its original balance (i.e., a negative amortization cap of 115 percent) or for the first five years of the loan (60 monthly payments), whichever occurs first. The introductory interest rate at consummation is 1.5 percent. One month after the first day of the first full calendar month following consummation, the interest rate adjusts and will adjust monthly thereafter based on the specified index plus a margin of 3.5 percent. The maximum lifetime interest rate is 10.5 percent; there are no other periodic interest rate adjustment caps that limit how quickly the maximum lifetime rate may be reached. The minimum monthly payment for the first year is based on the initial interest rate of 1.5 percent. After that, the minimum monthly payment adjusts annually, but may increase by no more than 7.5 percent over the previous year's payment. The minimum monthly payment is $690 in the first year, $742 in the second year, and $797 in the first part of the third year.*

*B. To determine the maximum loan amount, assume that the initial interest rate increases to the maximum lifetime interest rate of 10.5 percent at the first adjustment (i.e., the due date of the first periodic monthly payment) and accrues at that rate until the loan is recast. Assume the consumer makes the minimum monthly payments as scheduled, which are capped at 7.5 percent from year-to-year. As a result, the consumer's minimum monthly payments are less than the interest accrued each month, resulting in negative amortization (i.e., the accrued but unpaid interest is added to the principal balance). Thus, assuming that the consumer makes the minimum monthly payments for as long as possible and that the maximum interest rate of 10.5 percent is reached at the first rate adjustment (i.e., the due date of the first periodic monthly payment), the negative amortization cap of 115 percent is reached on the due date of the 27th monthly payment and the loan is recast. The maximum loan amount as of the due date of the 27th monthly payment is $229,251.*

*ii.* ***Fixed-rate, graduated payment mortgage with negative amortization.*** *A loan in the amount of $200,000 has a 30-year loan term. The loan agreement provides for a fixed interest rate of 7.5 percent, and requires the consumer to make minimum monthly payments during the first year, with payments increasing 12.5 percent over the previous year every year for four years. The payment schedule provides for payments of $943 in the first year, $1,061 in the second year, $1,193 in the third year, $1,343 in the fourth year, and $1,511 for the remaining term of the loan. During the first three years of the loan, the payments are less than the interest accrued each month, resulting in negative amortization. Assuming that the consumer makes the minimum periodic payments for as long as possible, the maximum loan amount is $207,662, which is reached at the end of the third year of the loan (on the due date of the 36th monthly payment). See comment 43(c)(5)(ii)(C)-3 providing examples of how to determine the consumer's repayment ability for a negative amortization loan.*

## Mortgage-Related Obligations - 12 CFR § 1026.43(b)(8)

### Regulatory Text

(8) **Mortgage-related obligations** mean property taxes; premiums and similar charges identified in §1026.4(b)(5), (7), (8), and (10) that are required by the creditor; fees and special assessments imposed by a condominium, cooperative, or homeowners association; ground rent; and leasehold payments.

**Regulatory Commentary**

*1.* ***General.*** *Section 1026.43(b)(8) defines mortgage-related obligations, which must be considered in determining a consumer's ability to repay pursuant to §1026.43(c). Section 1026.43(b)(8) includes, in the evaluation of mortgage-related obligations, fees and special assessments owed to a condominium, cooperative, or homeowners association. Section 1026.43(b)(8) includes ground rent and leasehold payments in the definition of mortgage-related obligations. See commentary to §1026.43(c)(2)(v) regarding the requirement to take into account any mortgage-related obligations for purposes of determining a consumer's ability to repay.*

*2.* ***Property taxes.*** *Section 1026.43(b)(8) includes property taxes in the evaluation of mortgage-related obligations. Obligations that are related to the ownership or use of real property and paid to a taxing authority, whether on a monthly, quarterly, annual, or other basis, are property taxes for purposes of §1026.43(b)(8). Section 1026.43(b)(8) includes obligations that are equivalent to property taxes, even if such obligations are not denominated as “taxes.” For example, governments may establish or allow independent districts with the authority to impose levies on properties within the district to fund a special purpose, such as a local development bond district, water district, or other public purpose. These levies may be referred to as taxes, assessments, surcharges, or by some other name. For purposes of §1026.43(b)(8), these are property taxes and are included in the determination of mortgage-related obligations.*

*3.* ***Insurance premiums and similar charges.*** *Section 1026.43(b)(8) includes in the evaluation of mortgage-related obligations premiums and similar charges identified in §1026.4(b)(5), (7), (8), or (10) that are required by the creditor. This includes all premiums or charges related to coverage protecting the creditor against a consumer's default, credit loss, collateral loss, or similar loss, if the consumer is required to pay the premium or charge. For example, if Federal law requires flood insurance to be obtained in connection with the mortgage loan, the flood insurance premium is a mortgage-related obligation for purposes of §1026.43(b)(8). Section 1026.43(b)(8) does not include premiums or similar charges identified in §1026.4(b)(5), (7), (8), or (10) that are not required by the creditor and that the consumer purchases voluntarily. For example:*

*i. If a creditor does not require earthquake insurance to be obtained in connection with the mortgage loan, but the consumer voluntarily chooses to purchase such insurance, the earthquake insurance premium is not a mortgage-related obligation for purposes of §1026.43(b)(8).*

*ii. If a creditor requires a minimum amount of coverage for homeowners' insurance and the consumer voluntarily chooses to purchase a more comprehensive amount of coverage, the portion of the premium allocated to the required minimum coverage is a mortgage-related obligation for purposes of §1026.43(b)(8), while the portion of the premium allocated to the more comprehensive coverage voluntarily purchased by the consumer is not a mortgage-related obligation for purposes of §1026.43(b)(8).*

*iii. If the consumer purchases insurance or similar coverage not required by the creditor at consummation without having requested the specific non-required insurance or similar coverage and without having agreed to the premium or charge for the specific non-required insurance or similar coverage prior to consummation, the premium or charge is not voluntary for purposes of §1026.43(b)(8) and is a mortgage-related obligation.*

*4.* ***Mortgage insurance, guarantee, or similar charges.*** *Section 1026.43(b)(8) includes in the evaluation of mortgage-related obligations premiums or charges protecting the creditor against the consumer's default or other credit loss. This includes all premiums or similar charges, whether denominated as mortgage insurance, guarantee, or otherwise, as determined according to applicable State or Federal law. For example, monthly “private mortgage insurance” payments paid to a non-governmental entity, annual “guarantee fee” payments required by a Federal housing program, and a quarterly “mortgage insurance” payment paid to a State agency administering a housing program are all mortgage-related obligations for purposes of §1026.43(b)(8). Section 1026.43(b)(8) includes these charges in the definition of mortgage-related obligations if the creditor requires the consumer to pay them, even if the consumer is not legally obligated to pay the charges under the terms of the insurance program. For example, if a mortgage insurance program obligates the creditor to make recurring mortgage insurance payments, and the creditor requires the consumer to reimburse the creditor for such recurring payments, the consumer's payments are mortgage-related obligations for purposes of §1026.43(b)(8). However, if a mortgage insurance program obligates the creditor to make recurring mortgage insurance payments, and the creditor does not require the consumer to reimburse the creditor for the cost of the mortgage insurance payments, the recurring mortgage insurance payments are not mortgage-related obligations for purposes of §1026.43(b)(8).*

*5.* ***Relation to the finance charge.*** *Section 1026.43(b)(8) includes in the evaluation of mortgage-related obligations premiums and similar charges identified in §1026.4(b)(5), (7), (8), or (10) that are required by the creditor. These premiums and similar charges are mortgage-related obligations regardless of whether the premium or similar charge is excluded from the finance charge pursuant to §1026.4(d). For example, a premium for insurance against loss or damage to the property written in connection with the credit transaction is a premium identified in §1026.4(b)(8). If this premium is required by the creditor, the premium is a mortgage-related obligation pursuant to §1026.43(b)(8), regardless of whether the premium is excluded from the finance charge pursuant to §1026.4(d)(2).*

## Points and Fees - 12 CFR § 1026.43(b)(9)

### Regulatory Text

(9) **Points and fees** has the same meaning as in §1026.32(b)(1).

**Regulatory Commentary**

*None.*

## Prepayment Penalty - 12 CFR § 1026.43(b)(10)

### Regulatory Text

(10) **Prepayment penalty** has the same meaning as in §1026.32(b)(6).

**Regulatory Commentary**

*None.*

## Recast - 12 CFR § 1026.43(b)(11)

### Regulatory Text

(11) **Recast** means:

(i) For an adjustable-rate mortgage, as defined in §1026.18(s)(7)(i), the expiration of the period during which payments based on the introductory fixed interest rate are permitted under the terms of the legal obligation;

(ii) For an interest-only loan, as defined in §1026.18(s)(7)(iv), the expiration of the period during which interest-only payments are permitted under the terms of the legal obligation; and

(iii) For a negative amortization loan, as defined in §1026.18(s)(7)(v), the expiration of the period during which negatively amortizing payments are permitted under the terms of the legal obligation.

**Regulatory Commentary**

*1.* ***Date of the recast.*** *The term “recast” means, for an adjustable-rate mortgage, the expiration of the period during which payments based on the introductory fixed rate are permitted; for an interest-only loan, the expiration of the period during which the interest-only payments are permitted; and, for a negative amortization loan, the expiration of the period during which negatively amortizing payments are permitted. For adjustable-rate mortgages, interest-only loans, and negative amortization loans, the date on which the recast is considered to occur is the due date of the last monthly payment based on the introductory fixed rate, the interest-only payment, or the negatively amortizing payment, respectively. To illustrate: A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a fixed interest rate and permits interest-only payments for the first five years of the loan (60 months). The loan is recast on the due date of the 60th monthly payment. Thus, the term of the loan remaining as of the date the loan is recast is 25 years (300 months).*

## Simultaneous Loan - 12 CFR § 1026.43(b)(12)

### Regulatory Text

(12) **Simultaneous loan** means another covered transaction or home equity line of credit subject to §1026.40 that will be secured by the same dwelling and made to the same consumer at or before consummation of the covered transaction or, if to be made after consummation, will cover closing costs of the first covered transaction.

**Regulatory Commentary**

*1.* ***General.*** *Section 1026.43(b)(12) defines a simultaneous loan as another covered transaction or a home equity line of credit (HELOC) subject to §1026.40 that will be secured by the same dwelling and made to the same consumer at or before consummation of the covered transaction, whether it is made by the same creditor or a third-party creditor. (As with all of §1026.43, the term “dwelling” includes any real property attached to a dwelling.) For example, assume a consumer will enter into a legal obligation that is a covered transaction with Creditor A. Immediately prior to consummation of the covered transaction with Creditor A, the consumer opens a HELOC that is secured by the same dwelling with Creditor B. For purposes of this section, the loan extended by Creditor B is a simultaneous loan. See commentary to §1026.43(c)(2)(iv) and (c)(6), discussing the requirement to consider the consumer's payment obligation on any simultaneous loan for purposes of determining the consumer's ability to repay the covered transaction subject to this section.*

*2.* ***Same consumer.*** *For purposes of the definition of “simultaneous loan,” the term “same consumer” includes any consumer, as that term is defined in §1026.2(a)(11), that enters into a loan that is a covered transaction and also enters into another loan (e.g., second-lien covered transaction or HELOC) secured by the same dwelling. Where two or more consumers enter into a legal obligation that is a covered transaction, but only one of them enters into another loan secured by the same dwelling, the “same consumer” includes the person that has entered into both legal obligations. For example, assume Consumer A and Consumer B will both enter into a legal obligation that is a covered transaction with a creditor. Immediately prior to consummation of the covered transaction, Consumer B opens a HELOC that is secured by the same dwelling with the same creditor; Consumer A is not a signatory to the HELOC. For purposes of this definition, Consumer B is the same consumer and the creditor must include the HELOC as a simultaneous loan.*

## Third Party Record - 12 CFR § 1026.43(b)(13)

### Regulatory Text

(13) ***Third-party record*** means:

(i) A document or other record prepared or reviewed by an appropriate person other than the consumer, the creditor, or the mortgage broker, as defined in §1026.36(a)(2), or an agent of the creditor or mortgage broker;

(ii) A copy of a tax return filed with the Internal Revenue Service or a State taxing authority;

(iii) A record the creditor maintains for an account of the consumer held by the creditor; or

(iv) If the consumer is an employee of the creditor or the mortgage broker, a document or other record maintained by the creditor or mortgage broker regarding the consumer's employment status or employment income.

**Regulatory Commentary**

***43(b)(13) Third-Party Record.***

*1.* ***Electronic records.*** *Third-party records include records transmitted electronically. For example, to verify a consumer's credit history using third-party records as required by §1026.43(c)(2)(viii) and 1026.43(c)(3), a creditor may use a credit report prepared by a consumer reporting agency that is transmitted electronically.*

*2.* ***Forms.*** *A record prepared by a third party includes a form a creditor gives to a third party to provide information, even if the creditor completes parts of the form unrelated to the information sought. For example, if a creditor gives a consumer's employer a form for verifying the consumer's employment status and income, the creditor may fill in the creditor's name and other portions of the form unrelated to the consumer's employment status or income.*

***Paragraph 43(b)(13)(i).***

*1.* ***Reviewed record.*** *Under §1026.43(b)(13)(i), a third-party record includes a document or other record prepared by the consumer, the creditor, the mortgage broker, or the creditor's or mortgage broker's agent, if the record is reviewed by an appropriate third party. For example, a profit-and-loss statement prepared by a self-employed consumer and reviewed by a third-party accountant is a third-party record under §1026.43(b)(13)(i). In contrast, a profit-and-loss statement prepared by a self-employed consumer and reviewed by the consumer's non-accountant spouse is not a third-party record under §1026.43(b)(13)(i).*

***Paragraph 43(b)(13)(iii).***

*1.* ***Creditor's records.*** *Section 1026.43(b)(13)(iii) provides that a third-party record includes a record the creditor maintains for an account of the consumer held by the creditor. Examples of such accounts include checking accounts, savings accounts, and retirement accounts. Examples of such accounts also include accounts related to a consumer's outstanding obligations to a creditor. For example, a third-party record includes the creditor's records for a first-lien mortgage to a consumer who applies for a subordinate-lien home equity loan.*

# Section 3: Repayment Ability

# 12 CFR § 1026.43(c)

## General Requirement - 12 CFR § 1026.43(c)(1)

### Regulatory Discussion

In general, a creditor cannot extend *credit to a consumer that is secured by a dwelling* (a “covered transaction”) unless there is a *reasonable and good faith determination* that the consumer will have a *reasonable ability to repay* the loan.

There are numerous considerations discussed in the commentary.

### Regulatory Text

(1) **General requirement.** A creditor shall not make a loan that is a covered transaction unless the creditor makes a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability to repay the loan according to its terms.

### Regulatory Commentary

*1.* ***Reasonable and good faith determination.***

*i.* ***General.*** *Creditors generally are required by §1026.43(c)(1) to make reasonable and good faith determinations of consumers' ability to repay. Section 1026.43(c) and the accompanying commentary describe certain requirements for making this ability-to-repay determination, but do not provide comprehensive underwriting standards to which creditors must adhere. For example, the rule and commentary do not specify how much income is needed to support a particular level of debt or how credit history should be weighed against other factors. So long as creditors consider the factors set forth in §1026.43(c)(2) according to the requirements of §1026.43(c), creditors are permitted to develop their own underwriting standards and make changes to those standards over time in response to empirical information and changing economic and other conditions. Whether a particular ability-to-repay determination is reasonable and in good faith will depend not only on the underwriting standards adopted by the creditor, but on the facts and circumstances of an individual extension of credit and how a creditor's underwriting standards were applied to those facts and circumstances. A consumer's statement or attestation that the consumer has the ability to repay the loan is not indicative of whether the creditor's determination was reasonable and in good faith.*

*ii.* ***Considerations.***

*A. The following may be evidence that a creditor's ability-to-repay determination was reasonable and in good faith:*

*1. The consumer demonstrated actual ability to repay the loan by making timely payments, without modification or accommodation, for a significant period of time after consummation or, for an adjustable-rate, interest-only, or negative-amortization mortgage, for a significant period of time after recast;*

*2. The creditor used underwriting standards that have historically resulted in comparatively low rates of delinquency and default during adverse economic conditions; or*

*3. The creditor used underwriting standards based on empirically derived, demonstrably and statistically sound models.*

*B. In contrast, the following may be evidence that a creditor's ability-to-repay determination was not reasonable or in good faith:*

*1. The consumer defaulted on the loan a short time after consummation or, for an adjustable-rate, interest-only, or negative-amortization mortgage, a short time after recast;*

*2. The creditor used underwriting standards that have historically resulted in comparatively high levels of delinquency and default during adverse economic conditions;*

*3. The creditor applied underwriting standards inconsistently or used underwriting standards different from those used for similar loans without reasonable justification;*

*4. The creditor disregarded evidence that the underwriting standards it used are not effective at determining consumers' repayment ability;*

*5. The creditor disregarded evidence that the consumer may have insufficient residual income to cover other recurring obligations and expenses, taking into account the consumer's assets other than the property securing the loan, after paying his or her monthly payments for the covered transaction, any simultaneous loans, mortgage-related obligations, and any current debt obligations; or*

*6. The creditor disregarded evidence that the consumer would have the ability to repay only if the consumer subsequently refinanced the loan or sold the property securing the loan.*

*C. All of the considerations listed in paragraphs (A) and (B) above may be relevant to whether a creditor's ability-to-repay determination was reasonable and in good faith. However, these considerations are not requirements or prohibitions with which creditors must comply, nor are they elements of a claim that a consumer must prove to establish a violation of the ability-to-repay requirements. For example, creditors are not required to validate their underwriting criteria using mathematical models. These considerations also are not absolute in their application; instead they exist on a continuum and may apply to varying degrees. For example, the longer a consumer successfully makes timely payments after consummation or recast the less likely it is that the creditor's determination of ability to repay was unreasonable or not in good faith. Finally, each of these considerations must be viewed in the context of all facts and circumstances relevant to a particular extension of credit. For example, in some cases inconsistent application of underwriting standards may indicate that a creditor is manipulating those standards to approve a loan despite a consumer's inability to repay. The creditor's ability-to-repay determination therefore may be unreasonable or in bad faith. However, in other cases inconsistently applied underwriting standards may be the result of, for example, inadequate training and may nonetheless yield a reasonable and good faith ability-to-repay determination in a particular case. Similarly, although an early payment default on a mortgage will often be persuasive evidence that the creditor did not have a reasonable and good faith belief in the consumer's ability to repay (and such evidence may even be sufficient to establish a prima facie case of an ability-to-repay violation), a particular ability-to-repay determination may be reasonable and in good faith even though the consumer defaulted shortly after consummation if, for example, the consumer experienced a sudden and unexpected loss of income. In contrast, an ability-to-repay determination may be unreasonable or not in good faith even though the consumer made timely payments for a significant period of time if, for example, the consumer was able to make those payments only by foregoing necessities such as food and heat.*

*2.* ***Repayment ability at consummation.*** *Section 1026.43(c)(1) requires the creditor to determine, at or before the time the loan is consummated, that a consumer will have a reasonable ability to repay the loan. A change in the consumer's circumstances after consummation (for example, a significant reduction in income due to a job loss or a significant obligation arising from a major medical expense) that cannot be reasonably anticipated from the consumer's application or the records used to determine repayment ability is not relevant to determining a creditor's compliance with the rule. However, if the application or records considered at or before consummation indicate there will be a change in a consumer's repayment ability after consummation (for example, if a consumer's application states that the consumer plans to retire within 12 months without obtaining new employment or that the consumer will transition from full-time to part-time employment), the creditor must consider that information under the rule.*

*3.* ***Interaction with Regulation B.*** *Section 1026.43(c)(1) does not require or permit the creditor to make inquiries or verifications prohibited by Regulation B, 12 CFR part 1002.*

## Basis for Determination - 12 CFR § 1026.43(c)(2)

### Regulatory Discussion

### The repayment ability determination requires consideration of the following eight items:

* + Income or assets
  + Employment status
  + Monthly payment on the proposed loan
  + Monthly payment on any simultaneous loan
  + Monthly payment for mortgage-related obligations
  + Other debts and obligations (i.e., alimony and child support)
  + monthly debt-to-income ratio or residual income
  + Consumer's credit history

The commentary provides additional important information on each of the eight items.

### Regulatory Text

(2) **Basis for determination.** Except as provided otherwise in paragraphs (d), (e), and (f) of this section, in making the repayment ability determination required under paragraph (c)(1) of this section, a creditor must consider the following:

(i) The consumer's current or reasonably expected income or assets, other than the value of the dwelling, including any real property attached to the dwelling, that secures the loan;

(ii) If the creditor relies on income from the consumer's employment in determining repayment ability, the consumer's current employment status;

(iii) The consumer's monthly payment on the covered transaction, calculated in accordance with paragraph (c)(5) of this section;

(iv) The consumer's monthly payment on any simultaneous loan that the creditor knows or has reason to know will be made, calculated in accordance with paragraph (c)(6) of this section;

(v) The consumer's monthly payment for mortgage-related obligations;

(vi) The consumer's current debt obligations, alimony, and child support;

(vii) The consumer's monthly debt-to-income ratio or residual income in accordance with paragraph (c)(7) of this section; and

(viii) The consumer's credit history.

### Regulatory Commentary

***43(c)(2) Basis for Determination***

*1.* ***General.*** *Section 1026.43(c)(2) sets forth factors creditors must consider when making the ability-to-repay determination required under §1026.43(c)(1) and the accompanying commentary provides guidance regarding these factors. Creditors must conform to these requirements and may rely on guidance provided in the commentary. However, §1026.43(c) and the accompanying commentary do not provide comprehensive guidance on definitions and other technical underwriting criteria necessary for evaluating these factors in practice. So long as a creditor complies with the provisions of §1026.43(c), the creditor is permitted to use its own definitions and other technical underwriting criteria. A creditor may, but is not required to, look to guidance issued by entities such as the Federal Housing Administration, the U.S. Department of Veterans Affairs, the U.S. Department of Agriculture, or Fannie Mae or Freddie Mac while operating under the conservatorship of the Federal Housing Finance Agency. For example, a creditor may refer to such guidance to classify particular inflows, obligations, or property as “income,” “debt,” or “assets.” Similarly, a creditor may refer to such guidance to determine what information to use when evaluating the income of a self-employed or seasonally employed consumer or what information to use when evaluating the credit history of a consumer who has obtained few or no extensions of traditional “credit” as defined in §1026.2(a)(14). These examples are illustrative, and creditors are not required to conform to guidance issued by these or other such entities. However, as required by §1026.43(c)(1), a creditor must ensure that its underwriting criteria, as applied to the facts and circumstances of a particular extension of credit, result in a reasonable, good faith determination of a consumer's ability to repay. For example, a definition used in underwriting that is reasonable in isolation may lead to ability-to-repay determinations that are unreasonable or not in good faith when considered in the context of a creditor's underwriting standards or when adopted or applied in bad faith. Similarly, an ability-to-repay determination is not unreasonable or in bad faith merely because the underwriting criteria used included a definition that was by itself unreasonable.*

***Paragraph 43(c)(2)(i).***

*1.* ***Income or assets generally.*** *A creditor may base its determination of repayment ability on current or reasonably expected income from employment or other sources, assets other than the dwelling that secures the covered transaction, or both. The creditor may consider any type of current or reasonably expected income, including, for example, the following: salary; wages; self-employment income; military or reserve duty income; bonus pay; tips; commissions; interest payments; dividends; retirement benefits or entitlements; rental income; royalty payments; trust income; public assistance payments; and alimony, child support, and separate maintenance payments. The creditor may consider any of the consumer's assets, other than the value of the dwelling that secures the covered transaction, including, for example, the following: funds in a savings or checking account, amounts vested in a retirement account, stocks, bonds, certificates of deposit, and amounts available to the consumer from a trust fund. (As stated in §1026.43(a), the value of the dwelling includes the value of the real property to which the residential structure is attached, if the real property also secures the covered transaction.)*

*2.* ***Income or assets relied on.*** *A creditor need consider only the income or assets necessary to support a determination that the consumer can repay the covered transaction. For example, if a consumer's loan application states that the consumer earns an annual salary from both a full-time job and a part-time job and the creditor reasonably determines that the consumer's income from the full-time job is sufficient to repay the loan, the creditor need not consider the consumer's income from the part-time job. Further, a creditor need verify only the income (or assets) relied on to determine the consumer's repayment ability. See comment 43(c)(4)-1.*

*3.* ***Reasonably expected income.*** *If a creditor relies on expected income in excess of the consumer's income, either in addition to or instead of current income, the expectation that the income will be available for repayment must be reasonable and verified with third-party records that provide reasonably reliable evidence of the consumer's expected income. For example, if the creditor relies on an expectation that a consumer will receive an annual bonus, the creditor may verify the basis for that expectation with records that show the consumer's past annual bonuses, and the expected bonus must bear a reasonable relationship to the past bonuses. Similarly, if the creditor relies on a consumer's expected salary from a job the consumer has accepted and will begin after receiving an educational degree, the creditor may verify that expectation with a written statement from an employer indicating that the consumer will be employed upon graduation at a specified salary.*

*4.* ***Seasonal or irregular income.*** *A creditor reasonably may determine that a consumer can make periodic loan payments even if the consumer's income, such as self-employment income, is seasonal or irregular. For example, assume a consumer receives seasonal income from the sale of crops or from agricultural employment. Each year, the consumer's income arrives during only a few months. If the creditor determines that the consumer's annual income divided equally across 12 months is sufficient for the consumer to make monthly loan payments, the creditor reasonably may determine that the consumer can repay the loan, even though the consumer may not receive income during certain months.*

*5.* ***Multiple applicants.*** *When two or more consumers apply for an extension of credit as joint obligors with primary liability on an obligation, §1026.43(c)(2)(i) does not require the creditor to consider income or assets that are not needed to support the creditor's repayment ability determination. If the income or assets of one applicant are sufficient to support the creditor's repayment ability determination, the creditor is not required to consider the income or assets of the other applicant. For example, if a husband and wife jointly apply for a loan and the creditor reasonably determines that the wife's income is sufficient to repay the loan, the creditor is not required to consider the husband's income.*

***Paragraph 43(c)(2)(ii).***

*1.* ***Employment status and income.*** *Employment status need not be full-time, and employment need not occur at regular intervals. If, in determining the consumer's repayment ability, the creditor relies on income from the consumer's employment, then that employment may be, for example, full-time, part-time, seasonal, irregular, military, or self-employment, so long as the creditor considers those characteristics of the employment. Under §1026.43(c)(2)(ii), a creditor must verify a consumer's current employment status only if the creditor relies on the consumer's employment income in determining the consumer's repayment ability. For example, if a creditor relies wholly on a consumer's investment income to determine repayment ability, the creditor need not verify or document employment status. See comments 43(c)(2)(i)-5 and 43(c)(4)-2 for guidance on which income to consider when multiple consumers apply jointly for a loan.*

***Paragraph 43(c)(2)(iii).***

*1.* ***General.*** *For purposes of the repayment ability determination required under §1026.43(c)(2), a creditor must consider the consumer's monthly payment on a covered transaction that is calculated as required under §1026.43(c)(5).*

***Paragraph 43(c)(2)(iv).***

*1.* ***Home equity lines of credit.*** *For purposes of §1026.43(c)(2)(iv), a simultaneous loan includes any covered transaction or home equity line of credit (HELOC) subject to §1026.40 that will be made to the same consumer at or before consummation of the covered transaction and secured by the same dwelling that secures the covered transaction. A HELOC that is a simultaneous loan that the creditor knows or has reason to know about must be considered as a mortgage obligation in determining a consumer's ability to repay the covered transaction even though the HELOC is not a covered transaction subject to §1026.43. See §1026.43(a) discussing the scope of this section. “Simultaneous loan” is defined in §1026.43(b)(12). For further explanation of “same consumer,” see comment 43(b)(12)-2.*

*2.* ***Knows or has reason to know.*** *In determining a consumer's repayment ability for a covered transaction under §1026.43(c)(2), a creditor must consider the consumer's payment obligation on any simultaneous loan that the creditor knows or has reason to know will be or has been made at or before consummation of the covered transaction. For example, where a covered transaction is a home purchase loan, the creditor must consider the consumer's periodic payment obligation for any “piggyback” second-lien loan that the creditor knows or has reason to know will be used to finance part of the consumer's down payment. The creditor complies with this requirement where, for example, the creditor follows policies and procedures that are designed to determine whether at or before consummation the same consumer has applied for another credit transaction secured by the same dwelling. To illustrate, assume a creditor receives an application for a home purchase loan where the requested loan amount is less than the home purchase price. The creditor's policies and procedures must require the consumer to state the source of the down payment and provide verification. If the creditor determines the source of the down payment is another extension of credit that will be made to the same consumer at or before consummation and secured by the same dwelling, the creditor knows or has reason to know of the simultaneous loan and must consider the simultaneous loan. Alternatively, if the creditor has information that suggests the down payment source is the consumer's existing assets, the creditor would be under no further obligation to determine whether a simultaneous loan will be extended at or before consummation of the covered transaction. The creditor is not obligated to investigate beyond reasonable underwriting policies and procedures to determine whether a simultaneous loan will be extended at or before consummation of the covered transaction.*

*3.* ***Scope of timing.*** *For purposes of §1026.43(c)(2)(iv), a simultaneous loan includes a loan that comes into existence concurrently with the covered transaction subject to §1026.43(c). A simultaneous loan does not include a credit transaction that occurs after consummation of the covered transaction that is subject to this section. However, any simultaneous loan that specifically covers closing costs of the covered transaction, but is scheduled to be extended after consummation must be considered for the purposes of §1026.43(c)(2)(iv).*

***Paragraph 43(c)(2)(v).***

*1.* ***General.*** *A creditor must include in its repayment ability assessment the consumer's monthly payment for mortgage-related obligations, such as the expected property taxes and premiums or similar charges identified in §1026.4(b)(5), (7), (8), or (10) that are required by the creditor. See §1026.43(b)(8) defining the term “mortgage-related obligations.” Mortgage-related obligations must be included in the creditor's determination of repayment ability regardless of whether the amounts are included in the monthly payment or whether there is an escrow account established. Section 1026.43(c)(2)(v) includes only payments that occur on an ongoing or recurring basis in the evaluation of the consumer's monthly payment for mortgage-related obligations. One-time charges, or obligations satisfied at or before consummation, are not ongoing or recurring, and are therefore not part of the consumer's monthly payment for purposes of §1026.43(c)(2)(v). For example:*

*i. Assume that a consumer will be required to pay property taxes, as described in comment 43(b)(8)-2, on a quarterly, annual, or other basis after consummation. Section 1026.43(c)(2)(v) includes these recurring property taxes in the evaluation of the consumer's monthly payment for mortgage-related obligations. However, if the consumer will incur a one-time charge to satisfy property taxes that are past due, §1026.43(c)(2)(v) does not include this one-time charge in the evaluation of the consumer's monthly payment for mortgage-related obligations.*

*ii. Assume that a consumer will be required to pay mortgage insurance premiums, as described in comment 43(b)(8)-2, on a monthly, annual, or other basis after consummation. Section 1026.43(c)(2)(v) includes these recurring mortgage insurance payments in the evaluation of the consumer's monthly payment for mortgage-related obligations. However, if the consumer will incur a one-time fee or charge for mortgage insurance or similar purposes, such as an up-front mortgage insurance premium imposed at consummation, §1026.43(c)(2)(v) does not include this up-front mortgage insurance premium in the evaluation of the consumer's monthly payment for mortgage-related obligations.*

*2.* ***Obligations to an association, other than special assessments.*** *Section 1026.43(b)(8) defines mortgage-related obligations to include obligations owed to a condominium, cooperative, or homeowners association. However, §1026.43(c)(2)(v) does not require a creditor to include in the evaluation of the consumer's monthly payment for mortgage-related obligations payments to such associations imposed in connection with the extension of credit, or imposed as an incident to the transfer of ownership, if such obligations are fully satisfied at or before consummation. For example, if a homeowners association imposes a one-time transfer fee on the transaction, and the consumer will pay the fee at or before consummation, §1026.43(c)(2)(v) does not require the creditor to include this one-time transfer fee in the evaluation of the consumer's monthly payment for mortgage-related obligations. Section 1026.43(c)(2)(v) also does not require the creditor to include this fee in the evaluation of the consumer's monthly payment for mortgage-related obligations if the consumer finances the fee in the loan amount. However, if the consumer incurs the obligation and will satisfy the obligation with recurring payments after consummation, regardless of whether the obligation is escrowed, §1026.43(c)(2)(v) requires the creditor to include the transfer fee in the evaluation of the consumer's monthly payment for mortgage-related obligations.*

*3.* ***Special assessments imposed by an association.*** *Section 1026.43(b)(8) defines mortgage-related obligations to include special assessments imposed by a condominium, cooperative, or homeowners association. Section 1026.43(c)(2)(v) does not require a creditor to include special assessments in the evaluation of the consumer's monthly payment for mortgage-related obligations if the special assessments are fully satisfied at or before consummation. For example, if a homeowners association imposes a special assessment that the consumer will have to pay in full at or before consummation, §1026.43(c)(2)(v) does not include the special assessment in the evaluation of the consumer's monthly payment for mortgage-related obligations. Section 1026.43(c)(2)(v) does not require a creditor to include special assessments in the evaluation of the consumer's monthly payment for mortgage-related obligations if the special assessments are imposed as a one-time charge. For example, if a homeowners association imposes a special assessment that the consumer will have to satisfy in one payment, §1026.43(c)(2)(v) does not include this one-time special assessment in the evaluation of the consumer's monthly payment for mortgage-related obligations. However, if the consumer will pay the special assessment on a recurring basis after consummation, regardless of whether the consumer's payments for the special assessment are escrowed, §1026.43(c)(2)(v) requires the creditor to include this recurring special assessment in the evaluation of the consumer's monthly payment for mortgage-related obligations.*

*4.* ***Pro rata amount.*** *For purposes of §1026.43(c)(2)(v), the creditor may divide the recurring payments for mortgage-related obligations into monthly, pro rata amounts. In considering a mortgage-related obligation that is not paid monthly, if the mortgage loan is originated pursuant to a government program the creditor may determine the pro rata monthly amount of the mortgage-related obligation in accordance with the specific requirements of that program. If the mortgage loan is originated pursuant to a government program that does not contain specific standards for determining the pro rata monthly amount of the mortgage-related obligation, or if the mortgage loan is not originated pursuant to a government program, the creditor complies with §1026.43(c)(2)(v) by dividing the total amount of a particular non-monthly mortgage-related obligation by no more than the number of months from the month that the non-monthly mortgage-related obligation was due prior to consummation until the month that the non-monthly mortgage-related obligation will be due after consummation. When determining the pro rata monthly payment amount, the creditor may also consider comment 43(c)(2)(v)-5, which explains that the creditor need not project potential changes. The following examples further illustrate how a creditor may determine the pro rata monthly amount of mortgage-related obligations, pursuant to §1026.43(c)(2)(v):*

*i. Assume that a consumer applies for a mortgage loan on February 1st. Assume further that the subject property is located in a jurisdiction where property taxes are paid in arrears on the first day of October. The creditor complies with §1026.43(c)(2)(v) by determining the annual property tax amount owed in the prior October, dividing the amount by 12, and using the resulting amount as the pro rata monthly property tax payment amount for the determination of the consumer's monthly payment for mortgage-related obligations. The creditor complies even if the consumer will likely owe more in the next year than the amount owed the prior October because the jurisdiction normally increases the property tax rate annually, provided that the creditor does not have knowledge of an increase in the property tax rate at the time of underwriting. See also comment 43(c)(2)(v)-5 regarding estimates of mortgage-related obligations.*

*ii. Assume that a subject property is located in a special water district, the assessments for which are billed separately from local property taxes. The creditor complies with §1026.43(c)(2)(v) by dividing the full amount that will be owed by the number of months in the assessment period, and including the resulting amount in the calculation of monthly mortgage-related obligations. However, §1026.43(c)(2)(v) does not require a creditor to adjust the monthly amount to account for potential deviations from the average monthly amount. For example, assume in this example that the special water assessment is billed every eight months, that the consumer will have to pay the first water district bill four months after consummation, and that the seller will not provide the consumer with any funds to pay for the seller's obligation (i.e., the four months prior to consummation). Although the consumer will be required to budget twice the average monthly amount to pay the first water district bill, §1026.43(c)(2)(v) does not require the creditor to use the increased amount; the creditor complies with §1026.43(c)(2)(v) by using the average monthly amount.*

*iii. Assume that the subject property is located in an area where flood insurance is required by Federal law, and assume further that the flood insurance policy premium is paid every three years following consummation. The creditor complies with §1026.43(c)(2)(v) by dividing the three-year premium by 36 months and including the resulting amount in the determination of the consumer's monthly payment for mortgage-related obligations. The creditor complies even if the consumer will not establish a monthly escrow for flood insurance.*

*iv. Assume that the subject property is part of a homeowners association that has imposed upon the seller a special assessment of $1,200. Assume further that this special assessment will become the consumer's obligation upon consummation of the transaction, that the consumer is permitted to pay the special assessment in twelve $100 installments after consummation, and that the mortgage loan will not be originated pursuant to a government program that contains specific requirements for prorating special assessments. The creditor complies with §1026.43(c)(2)(v) by dividing the $1,200 special assessment by 12 months and including the resulting $100 monthly amount in the determination of the consumer's monthly payment for mortgage-related obligations. The creditor complies by using this calculation even if the consumer intends to pay the special assessment in a manner other than that used by the creditor in determining the monthly pro rata amount, such as where the consumer intends to pay six $200 installments.*

*5.* ***Estimates.*** *Estimates of mortgage-related obligations should be based upon information that is known to the creditor at the time the creditor underwrites the mortgage obligation. Information is known if it is reasonably available to the creditor at the time of underwriting the loan. Creditors may rely on guidance provided under comment 17(c)(2)(i)-1 in determining if information is reasonably available. For purposes of this section, the creditor need not project potential changes, such as by estimating possible increases in taxes and insurance. See comment 43(c)(2)(v)-4 for additional examples discussing the projection of potential changes. The following examples further illustrate the requirements of §1026.43(c)(2)(v):*

*i. Assume that the property is subject to a community governance association, such as a homeowners association. The creditor complies with §1026.43(c)(2)(v) by relying on an estimate of mortgage-related obligations prepared by the homeowners association. In accordance with the guidance provided under comment 17(c)(2)(i)-1, the creditor need only exercise due diligence in determining mortgage-related obligations, and complies with §1026.43(c)(2)(v) by relying on the representations of other reliable parties in preparing estimates.*

*ii. Assume that the homeowners association has imposed a special assessment on the seller, but the seller does not inform the creditor of the special assessment, the homeowners association does not include the special assessment in the estimate of expenses prepared for the creditor, and the creditor is unaware of the special assessment. The creditor complies with §1026.43(c)(2)(v) if it does not include the special assessment in the determination of mortgage-related obligations. The creditor may rely on the representations of other reliable parties, in accordance with the guidance provided under comment 17(c)(2)(i)-1.*

*iii. Assume that the homeowners association imposes a special assessment after the creditor has completed underwriting, but prior to consummation. The creditor does not violate §1026.43(c)(2)(v) if the creditor does not include the special assessment in the determination of the consumer's monthly payment for mortgage-related obligations, provided the homeowners association does not inform the creditor about the special assessment during underwriting. Section 1026.43(c)(2)(v) does not require the creditor to re-underwrite the loan. The creditor has complied with §1026.43(c)(2)(v) by including the obligations known to the creditor at the time the loan is underwritten, even if the creditor learns of new mortgage-related obligations before the transaction is consummated.*

***Paragraph 43(c)(2)(vi).***

*1.* ***Consideration of current debt obligations.*** *Section 1026.43(c)(2)(vi) requires creditors to consider a consumer's current debt obligations and any alimony or child support the consumer is required to pay. Examples of current debt obligations include student loans, automobile loans, revolving debt, and existing mortgages that will not be paid off at or before consummation. Creditors have significant flexibility to consider current debt obligations in light of attendant facts and circumstances, including that an obligation is likely to be paid off soon after consummation. For example, a creditor may take into account that an existing mortgage is likely to be paid off soon after consummation because there is an existing contract for sale of the property that secures that mortgage. Similarly, creditors should consider whether debt obligations in forbearance or deferral at the time of underwriting are likely to affect the consumer's ability to repay based on the payment for which the consumer will be liable upon expiration of the forbearance or deferral period and other relevant facts and circumstances, such as when the forbearance or deferral period will expire.*

*2.* ***Multiple applicants.*** *When two or more consumers apply for an extension of credit as joint obligors with primary liability on an obligation, §1026.43(c)(2)(vi) requires a creditor to consider the debt obligations of all such joint applicants. For example, if a co-applicant is repaying a student loan at the time of underwriting, the creditor complies with §1026.43(c)(2)(vi) by considering the co-applicant's student loan obligation. If one consumer is merely a surety or guarantor, §1026.43(c)(2)(vi) does not require a creditor to consider the debt obligations of such surety or guarantor. The requirements of §1026.43(c)(2)(vi) do not affect the disclosure requirements of this part, such as, for example, §§1026.17(d), 1026.23(b), 1026.31(e), 1026.39(b)(3), and 1026.46(f).*

***Paragraph 43(c)(2)(vii).***

*1.* ***Monthly debt-to-income ratio and residual income.*** *See §1026.43(c)(7) and its associated commentary regarding the definitions and calculations for the monthly debt-to-income ratio and residual income.*

***Paragraph 43(c)(2)(viii).***

*1.* ***Consideration of credit history. “****Credit history” may include factors such as the number and age of credit lines, payment history, and any judgments, collections, or bankruptcies. Section 1026.43(c)(2)(viii) does not require creditors to obtain or consider a consolidated credit score or prescribe a minimum credit score that creditors must apply. The rule also does not specify which aspects of credit history a creditor must consider or how various aspects of credit history should be weighed against each other or against other underwriting factors. Some aspects of a consumer's credit history, whether positive or negative, may not be directly indicative of the consumer's ability to repay. A creditor therefore may give various aspects of a consumer's credit history as much or as little weight as is appropriate to reach a reasonable, good faith determination of ability to repay. Where a consumer has obtained few or no extensions of traditional “credit,” as defined in §1026.2(a)(14), a creditor may, but is not required to, look to nontraditional credit references, such as rental payment history or utility payments.*

*2.* ***Multiple applicants.*** *When two or more consumers apply for an extension of credit as joint obligors with primary liability on an obligation, §1026.43(c)(2)(viii) requires a creditor to consider the credit history of all such joint applicants. If a consumer is merely a surety or guarantor, §1026.43(c)(2)(viii) does not require a creditor to consider the credit history of such surety or guarantor. The requirements of §1026.43(c)(2)(viii) do not affect the disclosure requirements of this part, such as, for example, §§1026.17(d), 1026.23(b), 1026.31(e), 1026.39(b)(3), and 1026.46(f).*

## Verification Using Third-Party Records - 12 CFR § 1026.43(c)(3)

### Regulatory Discussion

A creditor *must verify* a consumer's repayment ability using reasonably reliable third-party records.

A creditor *must verify* a consumer's income or assets using the techniques discussed in (c)(4).

If a creditor relies on income from a consumer’s employment in determining repayment ability, the creditor *may verify* a consumer's employment status orally if the creditor prepares a record of the information obtained orally.

If a creditor relies on a consumer's credit report to verify a consumer's current debt obligations and a consumer's application states a current debt obligation not shown in the consumer's credit report, the creditor *need not independently verify* such an obligation.

The commentary provides additional guidance on these verifications.

### Regulatory Text

(3) **Verification using third-party records.** A creditor must verify the information that the creditor relies on in determining a consumer's repayment ability under §1026.43(c)(2) using reasonably reliable third-party records, except that:

(i) For purposes of paragraph (c)(2)(i) of this section, a creditor must verify a consumer's income or assets that the creditor relies on in accordance with §1026.43(c)(4);

(ii) For purposes of paragraph (c)(2)(ii) of this section, a creditor may verify a consumer's employment status orally if the creditor prepares a record of the information obtained orally; and

(iii) For purposes of paragraph (c)(2)(vi) of this section, if a creditor relies on a consumer's credit report to verify a consumer's current debt obligations and a consumer's application states a current debt obligation not shown in the consumer's credit report, the creditor need not independently verify such an obligation.

### Regulatory Commentary

***43(c)(3) Verification Using Third-Party Records.***

*1.* ***Records specific to the individual consumer.*** *Records a creditor uses for verification under §1026.43(c)(3) and (4) must be specific to the individual consumer. Records regarding average incomes in the consumer's geographic location or average wages paid by the consumer's employer, for example, are not specific to the individual consumer and are not sufficient for verification.*

*2.* ***Obtaining records.*** *To conduct verification under §1026.43(c)(3) and (4), a creditor may obtain records from a third-party service provider, such as a party the consumer's employer uses to respond to income verification requests, as long as the records are reasonably reliable and specific to the individual consumer. A creditor also may obtain third-party records directly from the consumer, likewise as long as the records are reasonably reliable and specific to the individual consumer. For example, a creditor using payroll statements to verify the consumer's income, as allowed under §1026.43(c)(4)(iii), may obtain the payroll statements from the consumer.*

*3.* ***Credit report as a reasonably reliable third-party record.*** *A credit report generally is considered a reasonably reliable third-party record under §1026.43(c)(3) for purposes of verifying items customarily found on a credit report, such as the consumer's current debt obligations, monthly debts, and credit history. Section 1026.43(c)(3) generally does not require creditors to obtain additional reasonably reliable third-party records to verify information contained in a credit report. For example, if a credit report states the existence and amount of a consumer's debt obligation, the creditor is not required to obtain additional verification of the existence or amount of that obligation. In contrast, a credit report does not serve as a reasonably reliably third-party record for purposes of verifying items that do not appear on the credit report. For example, certain monthly debt obligations, such as legal obligations like alimony or child support, may not be reflected on a credit report. Thus, a credit report that does not list a consumer's monthly alimony obligation does not serve as a reasonably reliable third-party record for purposes of verifying that obligation. If a credit report reflects a current debt obligation that a consumer has not listed on the application, the creditor complies with §1026.43(c)(3) if the creditor considers the existence and amount of the debt obligation as it is reflected in the credit report. However, in some cases a creditor may know or have reason to know that a credit report may be inaccurate in whole or in part. For example, a creditor may have information indicating that a credit report is subject to a fraud alert, extended alert, active duty alert, or similar alert identified in 15 U.S.C. 1681c-1 or that a debt obligation listed on a credit report is subject to a statement of dispute pursuant to 15 U.S.C. 1681i(b). A creditor may also have other reasonably reliable third-party records or other information or evidence that the creditor reasonably finds to be reliable that contradict the credit report or otherwise indicate that the credit report is inaccurate. If a creditor knows or has reason to know that a credit report may be inaccurate in whole or in part, the creditor complies with §1026.43(c)(3) by disregarding an inaccurate or disputed item, items, or credit report, but does not have to obtain additional third-party records. The creditor may also, but is not required, to obtain other reasonably reliable third-party records to verify information with respect to which the credit report, or item therein, may be inaccurate. For example, the creditor might obtain statements or bank records regarding a particular debt obligation subject to a statement of dispute. See also comment 43(c)(3)-6, which describes a situation in which a consumer reports a debt obligation that is not listed on a credit report.*

*4.* ***Verification of simultaneous loans.*** *Although a credit report may be used to verify current obligations, it will not reflect a simultaneous loan that has not yet been consummated and may not reflect a loan that has just recently been consummated. If the creditor knows or has reason to know that there will be a simultaneous loan extended at or before consummation, the creditor may verify the simultaneous loan by obtaining third-party verification from the third-party creditor of the simultaneous loan. For example, the creditor may obtain a copy of the promissory note or other written verification from the third-party creditor. For further guidance, see comments 43(c)(3)-1 and -2 discussing verification using third-party records.*

*5.* ***Verification of mortgage-related obligations.*** *Creditors must make the repayment ability determination required under §1026.43(c)(2) based on information verified from reasonably reliable records. For general guidance regarding verification see comments 43(c)(3)-1 and -2, which discuss verification using third-party records. With respect to the verification of mortgage-related obligations that are property taxes required to be considered under §1026.43(c)(2)(v), a record is reasonably reliable if the information in the record was provided by a governmental organization, such as a taxing authority or local government. The creditor complies with §1026.43(c)(2)(v) by relying on property taxes referenced in the title report if the source of the property tax information was a local taxing authority. With respect to other information in a record provided by an entity assessing charges, such as a homeowners association, the creditor complies with §1026.43(c)(2)(v) if it relies on homeowners association billing statements provided by the seller. Records are also reasonably reliable if the information in the record was obtained from a valid and legally executed contract. For example, the creditor complies with §1026.43(c)(2)(v) by relying on the amount of monthly ground rent referenced in the ground rent agreement currently in effect and applicable to the subject property. Records, other than those discussed above, may be reasonably reliable for purposes of §1026.43(c)(2)(v) if the source provided the information objectively.*

*6.* ***Verification of current debt obligations.*** *Section 1026.43(c)(3) does not require creditors to obtain additional records to verify the existence or amount of obligations shown on a consumer's credit report or listed on the consumer's application, absent circumstances described in comment 43(c)(3)-3. Under §1026.43(c)(3)(iii), if a creditor relies on a consumer's credit report to verify a consumer's current debt obligations and the consumer's application lists a debt obligation not shown on the credit report, the creditor may consider the existence and amount of the obligation as it is stated on the consumer's application. The creditor is not required to further verify the existence or amount of the obligation, absent circumstances described in comment 43(c)(3)-3.*

*7.* ***Verification of credit history.*** *To verify credit history, a creditor may, for example, look to credit reports from credit bureaus or to reasonably reliable third-party records that evidence nontraditional credit references, such as evidence of rental payment history or public utility payments.*

*8.* ***Verification of military employment.*** *A creditor may verify the employment status of military personnel by using a military Leave and Earnings Statement or by using the electronic database maintained by the Department of Defense to facilitate identification of consumers covered by credit protections provided pursuant to 10 U.S.C. 987.*

## Verification of Income or Assets - 12 CFR § 1026.43(c)(4)

### Regulatory Discussion

A creditor *must verify* the amounts of income or assets that the creditor relies on to determine a consumer's ability to repay, using third-party records that provide reasonably reliable evidence of the consumer's income or assets.

A creditor *may verify* the consumer's income using a tax-return transcript issued by the Internal Revenue Service (IRS).

Other examples of items that may be used:

* Copies of tax returns
* IRS Form W-2s
* Payroll statements, including military Leave and Earnings Statements;
* Financial institution records (such as direct deposit information on statements
* Records from the consumer's employer
* Records from a Federal, State, or local government agency stating the consumer's income from benefits or entitlements;
* Receipts from the consumer's use of check cashing services
* Receipts from the consumer's use of a funds transfer service.

### Regulatory Text

(4) **Verification of income or assets.** A creditor must verify the amounts of income or assets that the creditor relies on under §1026.43(c)(2)(i) to determine a consumer's ability to repay a covered transaction using third-party records that provide reasonably reliable evidence of the consumer's income or assets. A creditor may verify the consumer's income using a tax-return transcript issued by the Internal Revenue Service (IRS). Examples of other records the creditor may use to verify the consumer's income or assets include:

(i) Copies of tax returns the consumer filed with the IRS or a State taxing authority;

(ii) IRS Form W-2s or similar IRS forms used for reporting wages or tax withholding;

(iii) Payroll statements, including military Leave and Earnings Statements;

(iv) Financial institution records;

(v) Records from the consumer's employer or a third party that obtained information from the employer;

(vi) Records from a Federal, State, or local government agency stating the consumer's income from benefits or entitlements;

(vii) Receipts from the consumer's use of check cashing services; and

(viii) Receipts from the consumer's use of a funds transfer service.

### Regulatory Commentary

***43(c)(4) Verification of Income or Assets.***

*1.* ***Income or assets relied on.*** *A creditor need consider, and therefore need verify, only the income or assets the creditor relies on to evaluate the consumer's repayment ability. See comment 43(c)(2)(i)-2. For example, if a consumer's application states that the consumer earns a salary and is paid an annual bonus and the creditor relies on only the consumer's salary to evaluate the consumer's repayment ability, the creditor need verify only the salary. See also comments 43(c)(3)-1 and -2.*

*2.* ***Multiple applicants.*** *If multiple consumers jointly apply for a loan and each lists income or assets on the application, the creditor need verify only the income or assets the creditor relies on in determining repayment ability. See comment 43(c)(2)(i)-5.*

*3.* ***Tax-return transcript.*** *Under §1026.43(c)(4), a creditor may verify a consumer's income using an Internal Revenue Service (IRS) tax-return transcript, which summarizes the information in a consumer's filed tax return, another record that provides reasonably reliable evidence of the consumer's income, or both. A creditor may obtain a copy of a tax-return transcript or a filed tax return directly from the consumer or from a service provider. A creditor need not obtain the copy directly from the IRS or other taxing authority. See comment 43(c)(3)-2.*

***Paragraph 43(c)(4)(vi).***

*1.* ***Government benefits.*** *In verifying a consumer's income, a creditor may use a written or electronic record from a government agency of the amount of any benefit payments or awards, such as a “proof of income letter” issued by the Social Security Administration (also known as a “budget letter,” “benefits letter,” or “proof of award letter”).*

## Payment Calculation - 12 CFR § 1026.43(c)(5)

### Regulatory Discussion

*In general*, whether the loan is a fixed-rate, adjustable-rate or step-rate mortgage, the consumer’s *monthly payment calculation must be made* using:

* the fully indexed rate or any introductory interest rate, whichever is greater; and
* monthly, fully amortizing payments that are substantially equal.

There are *special rules for*:

* Loans with a balloon payment, the monthly payment calculation *must be made* using:
* The maximum payment scheduled during the first five years for non-HPML
* The maximum payment in the payment schedule, including the balloon payment, for an HPML
* Interest-only loans, the monthly payment calculation *must be made* using:
* The fully indexed rate or any introductory interest rate, whichever is greater
* Substantially equal, monthly payments of principal and interest that will repay the loan amount over the term of the loan remaining as of the date the loan is switches to payments.

Negative amortization loans, the monthly payment calculation *must be made* using:

* The fully indexed rate or any introductory interest rate, whichever is greater
* Substantially equal, monthly payments of principal and interest that will repay the maximum loan amount over the term of the loan remaining as of the date the loan reaches the maximum loan amount.

The commentary provides additional important information on these rules.

### Regulatory Text

(5) **Payment calculation**

(i) **General rule.** Except as provided in paragraph (c)(5)(ii) of this section, a creditor must make the consideration required under paragraph (c)(2)(iii) of this section using:

(A) The fully indexed rate or any introductory interest rate, whichever is greater; and

(B) Monthly, fully amortizing payments that are substantially equal.

(ii) **Special rules for loans with a balloon payment, interest-only loans, and negative amortization loans.** A creditor must make the consideration required under paragraph (c)(2)(iii) of this section for:

(A) A loan with a balloon payment, as defined in §1026.18(s)(5)(i), using:

(1) The maximum payment scheduled during the first five years after the date on which the first regular periodic payment will be due for a loan that is not a higher-priced covered transaction; or

(2) The maximum payment in the payment schedule, including any balloon payment, for a higher-priced covered transaction;

(B) An interest-only loan, as defined in §1026.18(s)(7)(iv), using:

(1) The fully indexed rate or any introductory interest rate, whichever is greater; and

(2) Substantially equal, monthly payments of principal and interest that will repay the loan amount over the term of the loan remaining as of the date the loan is recast.

(C) A negative amortization loan, as defined in §1026.18(s)(7)(v), using:

(1) The fully indexed rate or any introductory interest rate, whichever is greater; and

(2) Substantially equal, monthly payments of principal and interest that will repay the maximum loan amount over the term of the loan remaining as of the date the loan is recast.

### Regulatory Commentary

***43(c)(5) Payment Calculation.***

***43(c)(5)(i) General rule.***

*1.* ***General.*** *For purposes of §1026.43(c)(2)(iii), a creditor must determine the consumer's ability to repay the covered transaction using the payment calculation methods set forth in §1026.43(c)(5). The payment calculation methods differ depending on the type of credit extended. The payment calculation method set forth in §1026.43(c)(5)(i) applies to any covered transaction that does not have a balloon payment, or that is not an interest-only or negative amortization loan, whether such covered transaction is a fixed-rate, adjustable-rate or step-rate mortgage. The terms “fixed-rate mortgage,” “adjustable-rate mortgage,” “step-rate mortgage,” “interest-only loan” and “negative amortization loan” are defined in §1026.18(s)(7)(iii), (i), (ii), (iv) and (v), respectively. For the meaning of the term “balloon payment,” see §1026.18(s)(5)(i). The payment calculation methods set forth in §1026.43(c)(5)(ii) apply to any covered transaction that is a loan with a balloon payment, interest-only loan, or negative amortization loan. See comment 43(c)(5)(i)-5 and the commentary to §1026.43(c)(5)(ii), which provide examples for calculating the monthly payment for purposes of the repayment ability determination required under §1026.43(c)(2)(iii).*

*2.* ***Greater of the fully indexed rate or introductory rate; premium adjustable-rate transactions.*** *A creditor must determine a consumer's repayment ability for the covered transaction using substantially equal, monthly, fully amortizing payments that are based on the greater of the fully indexed rate or any introductory interest rate. In some adjustable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Sometimes, this initial rate charged to consumers is lower than the rate would be if it were determined by using the index plus margin, or formula (i.e., fully indexed rate). However, an initial rate that is a premium rate is higher than the rate based on the index or formula. In such cases, creditors must calculate the fully amortizing payment based on the initial “premium” rate. “Fully indexed rate” is defined in §1026.43(b)(3).*

*3.* ***Monthly, fully amortizing payments.*** *Section 1026.43(c)(5)(i) does not prescribe the terms or loan features that a creditor may choose to offer or extend to a consumer, but establishes the calculation method a creditor must use to determine the consumer's repayment ability for a covered transaction. For example, the terms of the loan agreement may require that the consumer repay the loan in quarterly or bi-weekly scheduled payments, but for purposes of the repayment ability determination, the creditor must convert these scheduled payments to monthly payments in accordance with §1026.43(c)(5)(i)(B). Similarly, the loan agreement may not require the consumer to make fully amortizing payments, but for purposes of the repayment ability determination under §1026.43(c)(5)(i), the creditor must convert any non-amortizing payments to fully amortizing payments.*

*4.* ***Substantially equal.*** *In determining whether monthly, fully amortizing payments are substantially equal, creditors should disregard minor variations due to payment-schedule irregularities and odd periods, such as a long or short first or last payment period. That is, monthly payments of principal and interest that repay the loan amount over the loan term need not be equal, but the monthly payments should be substantially the same without significant variation in the monthly combined payments of both principal and interest. For example, where no two monthly payments vary from each other by more than 1 percent (excluding odd periods, such as a long or short first or last payment period), such monthly payments would be considered substantially equal for purposes of this section. In general, creditors should determine whether the monthly, fully amortizing payments are substantially equal based on guidance provided in §1026.17(c)(3) (discussing minor variations), and §1026.17(c)(4)(i) through (iii) (discussing payment-schedule irregularities and measuring odd periods due to a long or short first period) and associated commentary.*

*5.* ***Examples.*** *The following are examples of how to determine the consumer's repayment ability based on substantially equal, monthly, fully amortizing payments as required under §1026.43(c)(5)(i) (all amounts shown are rounded, and all amounts are calculated using non-rounded values):*

*i.* ***Fixed-rate mortgage.*** *A loan in an amount of $200,000 has a 30-year loan term and a fixed interest rate of 7 percent. For purposes of §1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a payment of $1,331, which is the substantially equal, monthly, fully amortizing payment that will repay $200,000 over 30 years using the fixed interest rate of 7 percent.*

*ii.* ***Adjustable-rate mortgage with discount for five years.*** *A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted interest rate of 6 percent that is fixed for an initial period of five years, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual periodic interest rate adjustment cap. The index value in effect at consummation is 4.5 percent; the fully indexed rate is 7.5 percent (4.5 percent plus 3 percent). Even though the scheduled monthly payment required for the first five years is $1199, for purposes of §1026.43(c)(2)(iii) the creditor must determine the consumer's ability to repay the loan based on a payment of $1,398, which is the substantially equal, monthly, fully amortizing payment that will repay $200,000 over 30 years using the fully indexed rate of 7.5 percent.*

*iii.* ***Step-rate mortgage.*** *A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides that the interest rate will be 6.5 percent for the first two years of the loan, 7 percent for the next three years of the loan, and 7.5 percent thereafter. Accordingly, the scheduled payment* amounts are $1,264 for the first two years, $1,328 for the next three years, and $1,388 thereafter for the remainder of the term. For purposes of §1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a payment of $1,398, which is the substantially equal, monthly, fully amortizing payment that would repay $200,000 over 30 years using the fully indexed rate of 7.5 percent.

***43(c)(5)(ii) Special rules for loans with a balloon payment, interest-only loans, and negative amortization loans.***

***Paragraph 43(c)(5)(ii)(A).***

*1.* ***General.*** *For loans with a balloon payment, the rules differ depending on whether the loan is a higher-priced covered transaction, as defined under §1026.43(b)(4), or is not a higher-priced covered transaction because the annual percentage rate does not exceed the applicable threshold calculated using the applicable average prime offer rate (APOR) for a comparable transaction. “Average prime offer rate” is defined in §1026.35(a)(2); “higher-priced covered transaction” is defined in §1026.43(b)(4). For higher-priced covered transactions with a balloon payment, the creditor must consider the consumer's ability to repay the loan based on the payment schedule under the terms of the legal obligation, including any required balloon payment. For loans with a balloon payment that are not higher-priced covered transactions, the creditor should use the maximum payment scheduled during the first five years of the loan following the date on which the first regular periodic payment will be due. “Balloon payment” is defined in §1026.18(s)(5)(i).*

*2.* ***First five years after the date on which the first regular periodic payment will be due.*** *Under §1026.43(c)(5)(ii)(A)(1), the creditor must determine a consumer's ability to repay a loan with a balloon payment that is not a higher-priced covered transaction using the maximum payment scheduled during the first five years (60 months) after the date on which the first regular periodic payment will be due. To illustrate:*

*i. Assume a loan that provides for regular monthly payments and a balloon payment due at the end of a six-year loan term. The loan is consummated on August 15, 2014, and the first monthly payment is due on October 1, 2014. The first five years after the first monthly payment end on October 1, 2019. The balloon payment must be made on the due date of the 72nd monthly payment, which is September 1, 2020. For purposes of determining the consumer's ability to repay the loan under §1026.43(c)(2)(iii), the creditor need not consider the balloon payment that is due on September 1, 2020.*

*ii. Assume a loan that provides for regular monthly payments and a balloon payment due at the end of a five-year loan term. The loan is consummated on August 15, 2014, and the first monthly payment is due on October 1, 2014. The first five years after the first monthly payment end on October 1, 2019. The balloon payment must be made on the due date of the 60th monthly payment, which is September 1, 2019. For purposes of determining the consumer's ability to repay the loan under §1026.43(c)(2)(iii), the creditor must consider the balloon payment that is due on September 1, 2019.*

*3.* ***Renewable balloon-payment mortgage; loan term.*** *A balloon-payment mortgage that is not a higher-priced covered transaction could provide that a creditor is unconditionally obligated to renew a balloon-payment mortgage at the consumer's option (or is obligated to renew subject to conditions within the consumer's control). See comment 17(c)(1)-11 discussing renewable balloon-payment mortgages. For purposes of this section, the loan term does not include any period of time that could result from a renewal provision. To illustrate, assume a three-year balloon-payment mortgage that is not a higher-priced covered transaction contains an unconditional obligation to renew for another three years at the consumer's option. In this example, the loan term for the balloon-payment mortgage is three years, and not the potential six years that could result if the consumer chooses to renew the loan. Accordingly, the creditor must underwrite the loan using the maximum payment scheduled in the first five years after consummation, which includes the balloon payment due at the end of the three-year loan term. See comment 43(c)(5)(ii)(A)-4.ii, which provides an example of how to determine the consumer's repayment ability for a three-year renewable balloon-payment mortgage that is not a higher-priced covered transaction.*

*4.* ***Examples of loans with a balloon payment that are not higher-priced covered transactions.*** *The following are examples of how to determine the maximum payment scheduled during the first five years after the date on which the first regular periodic payment will be due (all amounts shown are rounded, and all amounts are calculated using non-rounded values):*

*i.* ***Balloon-payment mortgage with a three-year loan term; fixed interest rate.*** *A loan agreement provides for a fixed interest rate of 6 percent, which is below the APOR-calculated threshold for a comparable transaction; thus the loan is not a higher-priced covered transaction. The loan amount is $200,000, and the loan has a three-year loan term but is amortized over 30 years. The monthly payment scheduled for the first three years following consummation is $1,199, with a balloon payment of $193,367 due at the end of the third year. For purposes of §1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on the balloon payment of $193,367.*

*ii.* ***Renewable balloon-payment mortgage with a three-year loan term.*** *Assume the same facts above in comment 43(c)(5)(ii)(A)-4.i, except that the loan agreement also provides that the creditor is unconditionally obligated to renew the balloon-payment mortgage at the consumer's option at the end of the three-year term for another three years. In determining the maximum payment scheduled during the first five years after the date on which the first regular periodic payment will be due, the creditor must use a loan term of three years. Accordingly, for purposes of §1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on the balloon payment of $193,367.*

*iii.* ***Balloon-payment mortgage with a six-year loan term; fixed interest rate.*** *A loan provides for a fixed interest rate of 6 percent, which is below the APOR threshold for a comparable transaction, and thus, the loan is not a higher-priced covered transaction. The loan amount is $200,000, and the loan has a six-year loan term but is amortized over 30 years. The loan is consummated on March 15, 2014, and the monthly payment scheduled for the first six years following consummation is $1,199, with the first monthly payment due on May 1, 2014. The first five years after the date on which the first regular periodic payment will be due end on May 1, 2019. The balloon payment of $183,995 is required on the due date of the 72nd monthly payment, which is April 1, 2020 (more than five years after the date on which the first regular periodic payment will be due). For purposes of §1026.43(c)(2)(iii), the creditor may determine the consumer's ability to repay the loan based on the monthly payment of $1,199, and need not consider the balloon payment of $183,995 due on April 1, 2020.*

*5.* ***Higher-priced covered transaction with a balloon payment.*** *Where a loan with a balloon payment is a higher-priced covered transaction, the creditor must determine the consumer's repayment ability based on the loan's payment schedule, including any balloon payment. For example (all amounts are rounded): Assume a higher-priced covered transaction with a fixed interest rate of 7 percent. The loan amount is $200,000 and the loan has a ten year loan term, but is amortized over 30 years. The monthly payment scheduled for the first ten years is $1,331, with a balloon payment of $172,955. For purposes of §1026.43(c)(2)(iii), the creditor must consider the consumer's ability to repay the loan based on the payment schedule that fully repays the loan amount, including the balloon payment of $172,955.*

***Paragraph 43(c)(5)(ii)(B).***

*1.* ***General.*** *For loans that permit interest-only payments, the creditor must use the fully indexed rate or introductory rate, whichever is greater, to calculate the substantially equal, monthly payment of principal and interest that will repay the loan amount over the term of the loan remaining as of the date the loan is recast. For discussion regarding the fully indexed rate, and the meaning of “substantially equal,” see comments 43(b)(3)-1 through -5 and 43(c)(5)(i)-4, respectively. Under §1026.43(c)(5)(ii)(B), the relevant term of the loan is the period of time that remains as of the date the loan is recast to require fully amortizing payments. For a loan on which only interest and no principal has been paid, the loan amount will be the outstanding principal balance at the time of the recast. “Loan amount” and “recast” are defined in §1026.43(b)(5) and (b)(11), respectively. “Interest-only” and “Interest-only loan” are defined in §1026.18(s)(7)(iv).*

*2.* ***Examples.*** *The following are examples of how to determine the consumer's repayment ability based on substantially equal, monthly payments of principal and interest under §1026.43(c)(5)(ii)(B) (all amounts shown are rounded, and all amounts are calculated using non-rounded values):*

*i.* ***Fixed-rate mortgage with interest-only payments for five years.*** *A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a fixed interest rate of 7 percent, and permits interest-only payments for the first five years. The monthly payment of $1,167 scheduled for the first five years would cover only the interest due. The loan is recast on the due date of the 60th monthly payment, after which the scheduled monthly payments increase to $1,414, a monthly payment that repays the loan amount of $200,000 over the 25 years remaining as of the date the loan is recast (300 months). For purposes of §1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a payment of $1,414, which is the substantially equal, monthly, fully amortizing payment that would repay $200,000 over the 25 years remaining as of the date the loan is recast using the fixed interest rate of 7 percent.*

*ii.* ***Adjustable-rate mortgage with discount for three years and interest-only payments for five years.*** *A loan in an amount of $200,000 has a 30-year loan term, but provides for interest-only payments for the first five years. The loan agreement provides for a discounted interest rate of 5 percent that is fixed for an initial period of three years, after which the interest rate will adjust each year based on a specified index plus a margin of 3 percent, subject to an annual interest rate adjustment cap of 2 percent. The index value in effect at consummation is 4.5 percent; the fully indexed rate is 7.5 percent (4.5 percent plus 3 percent). The monthly payments for the first three years are $833. For the fourth year, the payments are $1,167, based on an interest rate of 7 percent, calculated by adding the 2 percent annual adjustment cap to the initial rate of 5 percent. For the fifth year, the payments are $1,250, applying the fully indexed rate of 7.5 percent. These first five years of payments will cover only the interest due. The loan is recast on the due date of the 60th monthly payment, after which the scheduled monthly payments increase to $1,478, a monthly payment that will repay the loan amount of $200,000 over the remaining 25 years of the loan (300 months). For purposes of §1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a monthly payment of $1,478, which is the substantially equal, monthly payment of principal and interest that would repay $200,000 over the 25 years remaining as of the date the loan is recast using the fully indexed rate of 7.5 percent.*

***Paragraph 43(c)(5)(ii)(C).***

*1.* ***General.*** *For purposes of determining the consumer's ability to repay a negative amortization loan, the creditor must use substantially equal, monthly payments of principal and interest based on the fully indexed rate or the introductory rate, whichever is greater, that will repay the maximum loan amount over the term of the loan that remains as of the date the loan is recast. Accordingly, before determining the substantially equal, monthly payments the creditor must first determine the maximum loan amount and the period of time that remains in the loan term after the loan is recast. “Recast” is defined in §1026.43(b)(11). Second, the creditor must use the fully indexed rate or introductory rate, whichever is greater, to calculate the substantially equal, monthly payment amount that will repay the maximum loan amount over the term of the loan remaining as of the date the loan is recast. For discussion regarding the fully indexed rate and the meaning of “substantially equal,” see comments 43(b)(3)-1 through -5 and 43(c)(5)(i)-4, respectively. For the meaning of the term “maximum loan amount” and a discussion of how to determine the maximum loan amount for purposes of §1026.43(c)(5)(ii)(C), see §1026.43(b)(7) and associated commentary. “Negative amortization loan” is defined in §1026.18(s)(7)(v).*

*2.* ***Term of loan.*** *Under §1026.43(c)(5)(ii)(C), the relevant term of the loan is the period of time that remains as of the date the terms of the legal obligation recast. That is, the creditor must determine substantially equal, monthly payments of principal and interest that will repay the maximum loan amount based on the period of time that remains after any negative amortization cap is triggered or any period permitting minimum periodic payments expires, whichever occurs first.*

*3.* ***Examples****. The following are examples of how to determine the consumer's repayment ability based on substantially equal, monthly payments of principal and interest as required under §1026.43(c)(5)(ii)(C) (all amounts shown are rounded, and all amounts are calculated using non-rounded values):*

*i.* ***Adjustable-rate mortgage with negative amortization.***

*A. Assume an adjustable-rate mortgage in the amount of $200,000 with a 30-year loan term. The loan agreement provides that the consumer can make minimum monthly payments that cover only part of the interest accrued each month until the date on which the principal balance reaches 115 percent of its original balance (i.e., a negative amortization cap of 115 percent) or for the first five years of the loan (60 monthly payments), whichever occurs first. The introductory interest rate at consummation is 1.5 percent. One month after consummation, the interest rate adjusts and will adjust monthly thereafter based on the specified index plus a margin of 3.5 percent. The index value in effect at consummation is 4.5 percent; the fully indexed rate is 8 percent (4.5 percent plus 3.5 percent). The maximum lifetime interest rate is 10.5 percent; there are no other periodic interest rate adjustment caps that limit how quickly the maximum lifetime rate may be reached. The minimum monthly payment for the first year is based on the initial interest rate of 1.5 percent. After that, the minimum monthly payment adjusts annually, but may increase by no more than 7.5 percent over the previous year's payment. The minimum monthly payment is $690 in the first year, $742 in the second year, and $797 in the first part of the third year.*

*B. To determine the maximum loan amount, assume that the interest rate increases to the maximum lifetime interest rate of 10.5 percent at the first adjustment (i.e., the due date of the first periodic monthly payment), and interest accrues at that rate until the loan is recast. Assume that the consumer makes the minimum monthly payments scheduled, which are capped at 7.5 percent from year-to-year, for the maximum possible time. Because the consumer's minimum monthly payments are less than the interest accrued each month, negative amortization occurs (i.e., the accrued but unpaid interest is added to the principal balance). Thus, assuming that the consumer makes the minimum monthly payments for as long as possible and that the maximum interest rate of 10.5 percent is reached at the first rate adjustment (i.e., the due date of the first periodic monthly payment), the negative amortization cap of 115 percent is reached on the due date of the 27th monthly payment and the loan is recast as of that date. The maximum loan amount as of the due date of the 27th monthly payment is $229,251, and the remaining term of the loan is 27 years and nine months (333 months).*

*C. For purposes of §1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a monthly payment of $1,716, which is the substantially equal, monthly payment of principal and interest that will repay the maximum loan amount of $229,251 over the remaining loan term of 333 months using the fully indexed rate of 8 percent. See comments 43(b)(7)-1 and -2 discussing the calculation of the maximum loan amount, and §1026.43(b)(11) for the meaning of the term “recast.”*

*ii.* ***Fixed-rate, graduated payment mortgage.*** *A loan in the amount of $200,000 has a 30-year loan term. The loan agreement provides for a fixed interest rate of 7.5 percent, and requires the consumer to make minimum monthly payments during the first year, with payments increasing 12.5 percent over the previous year every year for four years (the annual payment cap). The payment schedule provides for payments of $943 in the first year, $1,061 in the second year, $1,193 in the third year, $1,343 in the fourth year, and then requires $1,511 for the remaining term of the loan. During the first three years of the loan, the payments are less than the interest accrued each month, resulting in negative amortization. Assuming the minimum payments increase year-to-year up to the 12.5 percent payment cap, the consumer will begin making payments that cover at least all of the interest accrued at the end of the third year. Thus, the loan is recast on the due date of the 36th monthly payment. The maximum loan amount on that date is $207,662, and the remaining loan term is 27 years (324 months). For purposes of §1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a monthly payment of $1,497, which is the substantially equal, monthly payment of principal and interest that will repay the maximum loan amount of $207,662 over the remaining loan term of 27 years using the fixed interest rate of 7.5 percent.*

## Payment Calculation Simultaneous Loans - 12 CFR § 1026.43(c)(6)

### Regulatory Discussion

When calculating a consumer’s monthly payment in accordance with paragraph (c)(5), a creditor must consider the consumer’s payment on any simultaneous loan either:

* For a “covered transaction” (any consumer credit transaction that is secured by a dwelling), by following the rules in paragraph (c)(5); or
* For a HELOC, by using the payment required by the HELOC and the amount of the “covered transaction.”

### Regulatory Text

(6) **Payment calculation for simultaneous loans.** For purposes of making the evaluation required under paragraph (c)(2)(iv) of this section, a creditor must consider, taking into account any mortgage-related obligations, a consumer's payment on a simultaneous loan that is:

(i) A covered transaction, by following paragraph (c)(5)of this section; or

(ii) A home equity line of credit subject to §1026.40, by using the periodic payment required under the terms of the plan and the amount of credit to be drawn at or before consummation of the covered transaction.

### Regulatory Commentary

***43(c)(6) Payment calculation for simultaneous loans.***

*1.* ***Scope.*** *In determining the consumer's repayment ability for a covered transaction under §1026.43(c)(2)(iii), a creditor must include consideration of any simultaneous loan which it knows, or has reason to know, will be made at or before consummation of the covered transaction. For a discussion of the standard “knows or has reason to know,” see comment 43(c)(2)(iv)-2. For the meaning of the term “simultaneous loan,” see §1026.43(b)(12).*

*2.* ***Payment calculation—covered transaction.*** *For a simultaneous loan that is a covered transaction, as that term is defined under §1026.43(b)(1), a creditor must determine a consumer's ability to repay the monthly payment obligation for a simultaneous loan as set forth in §1026.43(c)(5), taking into account any mortgage-related obligations required to be considered under §1026.43(c)(2)(v). For the meaning of the term “mortgage-related obligations,” see §1026.43(b)(8).*

*3.* ***Payment calculation—home equity line of credit.*** *For a simultaneous loan that is a home equity line of credit subject to §1026.40, the creditor must consider the periodic payment required under the terms of the plan when assessing the consumer's ability to repay the covered transaction secured by the same dwelling as the simultaneous loan. Under §1026.43(c)(6)(ii), a creditor must determine the periodic payment required under the terms of the plan by considering the actual amount of credit to be drawn by the consumer at consummation of the covered transaction. The amount to be drawn is the amount requested by the consumer; when the amount requested will be disbursed, or actual receipt of funds, is not determinative. Any additional draw against the line of credit that the creditor of the covered transaction does not know or have reason to know about before or during underwriting need not be considered in relation to ability to repay. For example, where the creditor's policies and procedures require the source of down payment to be verified, and the creditor verifies that a simultaneous loan that is a HELOC will provide the source of down payment for the first-lien covered transaction, the creditor must consider the periodic payment on the HELOC by assuming the amount drawn is at least the down payment amount. In general, a creditor should determine the periodic payment based on guidance in the commentary to §1026.40(d)(5) (discussing payment terms).*

## Monthly DTI Ratio or Residual Income - 12 CFR § 1026.43(c)(7)

### Regulatory Discussion

If a creditor considers the consumer’s monthly debt-to-income ratio, the creditor must consider the ratio of the consumer’s “total monthly debt obligations” to the consumer’s “total monthly income.”

If a creditor considers the consumer’s monthly residual income the creditor must consider the consumer’s remaining income after subtracting the consumer’s “total monthly debt obligations” from the “total monthly income.”

Definitions are provided for:

* Total monthly debt obligations.
* Total monthly income

The commentary provides additional considerations.

### Regulatory Text

(7) **Monthly debt-to-income ratio or residual income**

(i) **Definitions.** For purposes of this paragraph (c)(7), the following definitions apply:

(A) **Total monthly debt obligations.** The term *total monthly debt obligations* means the sum of: the payment on the covered transaction, as required to be calculated by paragraphs (c)(2)(iii) and (c)(5) of this section; simultaneous loans, as required by paragraphs (c)(2)(iv) and (c)(6) of this section; mortgage-related obligations, as required by paragraph (c)(2)(v) of this section; and current debt obligations, alimony, and child support, as required by paragraph (c)(2)(vi) of this section.

(B) **Total monthly income.** The term *total monthly income* means the sum of the consumer's current or reasonably expected income, including any income from assets, as required by paragraphs (c)(2)(i) and (c)(4) of this section.

(ii) **Calculations**

(A) **Monthly debt-to-income ratio.** If a creditor considers the consumer's monthly debt-to-income ratio under paragraph (c)(2)(vii) of this section, the creditor must consider the ratio of the consumer's total monthly debt obligations to the consumer's total monthly income.

(B) **Monthly residual income.** If a creditor considers the consumer's monthly residual income under paragraph (c)(2)(vii) of this section, the creditor must consider the consumer's remaining income after subtracting the consumer's total monthly debt obligations from the consumer's total monthly income.

### Regulatory Commentary

***43(c)(7) Monthly debt-to-income ratio or residual income.***

*1.* ***Monthly debt-to-income ratio or monthly residual income.*** *Under §1026.43(c)(2)(vii), the creditor must consider the consumer's monthly debt-to-income ratio, or the consumer's monthly residual income, in accordance with the requirements in §1026.43(c)(7). In contrast to the qualified mortgage provisions in §1026.43(e), §1026.43(c) does not prescribe a specific monthly debt-to-income ratio with which creditors must comply. Instead, an appropriate threshold for a consumer's monthly debt-to-income ratio or monthly residual income is for the creditor to determine in making a reasonable and good faith determination of a consumer's ability to repay.*

*2.* ***Use of both monthly debt-to-income ratio and monthly residual income.*** *If a creditor considers the consumer's monthly debt-to-income ratio, the creditor may also consider the consumer's residual income as further validation of the assessment made using the consumer's monthly debt-to-income ratio.*

*3.* ***Compensating factors.*** *The creditor may consider factors in addition to the monthly debt-to-income ratio or residual income in assessing a consumer's repayment ability. For example, the creditor may reasonably and in good faith determine that a consumer has the ability to repay despite a higher debt-to-income ratio or lower residual income in light of the consumer's assets other than the dwelling, including any real property attached to the dwelling, securing the covered transaction, such as a savings account. The creditor may also reasonably and in good faith determine that a consumer has the ability to repay despite a higher debt-to-income ratio in light of the consumer's residual income.*

# Section 4: Refinancing of Non-Standard Mortgages 12 CFR § 1026.43(d)

## Definitions - 12 CFR § 1026.43(d)(1)

### Regulatory Discussion

This section begins with the definition of three terms specific to this section.

*Non-standard mortgage* includes any consumer credit transaction that is secured by a dwelling that is:

* An ARM with an introductory fixed interest rate for a period of one year or longer;
* An interest-only loan
* A negative amortization loan

*Standard mortgage* includes any consumer credit transaction that is secured by a dwelling:

* That provides for regular periodic payments (*with conditions*)
* For which the total points and fees payable in connection with the transaction do not exceed specified amounts
* For which the term does not exceed 40 years
* For which the interest rate is fixed for at least the first five years after consummation
* For which the proceeds from the loan are used solely for specific purposes

*Refinancing* is defined in §1026.20(a)

### Regulatory Text

**d. Refinancing of non-standard mortgages**

**(1) Definitions.** For purposes of this paragraph (d), the following definitions apply:

(i) **Non-standard mortgage***.* The term *non-standard mortgage* means a covered transaction that is:

(A) An adjustable-rate mortgage, as defined in §1026.18(s)(7)(i), with an introductory fixed interest rate for a period of one year or longer;

(B) An interest-only loan, as defined in §1026.18(s)(7)(iv); or

(C) A negative amortization loan, as defined in §1026.18(s)(7)(v).

(ii) **Standard mortgage.** The term *standard mortgage* means a covered transaction:

(A) That provides for regular periodic payments that do not:

(1) Cause the principal balance to increase;

(2) Allow the consumer to defer repayment of principal; or

(3) Result in a balloon payment, as defined in §1026.18(s)(5)(i);

(B) For which the total points and fees payable in connection with the transaction do not exceed the amounts specified in paragraph (e)(3) of this section;

(C) For which the term does not exceed 40 years;

(D) For which the interest rate is fixed for at least the first five years after consummation; and

(E) For which the proceeds from the loan are used solely for the following purposes:

(1) To pay off the outstanding principal balance on the non-standard mortgage; and

(2) To pay closing or settlement charges required to be disclosed under the Real Estate Settlement Procedures Act, 12 U.S.C. 2601 et seq.

(iii) **Refinancing.** The term refinancing has the same meaning as in §1026.20(a).

### Regulatory Commentary

***43(d) Refinancing of non-standard mortgages.***

***43(d)(1) Definitions.***

***43(d)(1)(i) Non-standard mortgage.***

***Paragraph 43(d)(1)(i)(A).***

*1.* ***Adjustable-rate mortgage with an introductory fixed rate.*** *Under §1026.43(d)(1)(i)(A), an adjustable-rate mortgage with an introductory fixed interest rate for one year or longer is considered a “non-standard mortgage.” For example, a covered transaction that has a fixed introductory rate for the first two, three, or five years and then converts to a variable rate for the remaining 28, 27, or 25 years, respectively, is a “non-standard mortgage.” A covered transaction with an introductory rate for six months that then converts to a variable rate for the remaining 29 and one-half years is not a “non-standard mortgage.”*

***43(d)(1)(ii) Standard mortgage.***

***Paragraph 43(d)(1)(ii)(A).***

*1.* ***Regular periodic payments****. Under §1026.43(d)(1)(ii)(A), a “standard mortgage” must provide for regular periodic payments that do not result in an increase of the principal balance (negative amortization), allow the consumer to defer repayment of principal (see comment 43(e)(2)(i)-2), or result in a balloon payment. Thus, the terms of the legal obligation must require the consumer to make payments of principal and interest on a monthly or other periodic basis that will repay the loan amount over the loan term. Except for payments resulting from any interest rate changes after consummation in an adjustable-rate or step-rate mortgage, the periodic payments must be substantially equal. For an explanation of the term “substantially equal,” see comment 43(c)(5)(i)-4. In addition, a single-payment transaction is not a “standard mortgage” because it does not require “regular periodic payments.” See also comment 43(e)(2)(i)-1.*

***Paragraph 43(d)(1)(ii)(D).***

*1.* ***First five years after consummation.*** *A “standard mortgage” must have an interest rate that is fixed for at least the first five years (60 months) after consummation. For example, assume an adjustable-rate mortgage that applies the same fixed interest rate to determine the first 60 payments of principal and interest due. The loan is consummated on August 15, 2013, and the first monthly payment is due on October 1, 2013. The date that is five years after consummation is August 15, 2018. The first interest rate adjustment occurs on September 1, 2018. This loan meets the criterion for a “standard mortgage” under §1026.43(d)(1)(ii)(D) because the interest rate is fixed until September 1, 2018, which is more than five years after consummation. For guidance regarding step-rate mortgages, see comment 43(e)(2)(iv)-3.iii.*

***Paragraph 43(d)(1)(ii)(E).***

*1.* ***Permissible use of proceeds.*** *To qualify as a “standard mortgage,” the loan's proceeds may be used for only two purposes: paying off the non-standard mortgage and paying for closing costs, including paying escrow amounts required at or before closing. If the proceeds of a covered transaction are used for other purposes, such as to pay off other liens or to provide additional cash to the consumer for discretionary spending, the transaction does not meet the definition of a “standard mortgage.”*

## Scope - 12 CFR § 1026.43(d)(2)

### Regulatory Discussion

This Section 4 *only applies to the refinancing of a* “non-standard mortgage” into a “standard mortgage.” Six conditions, items (i) through (vi) detailed in the regulatory text, must be met.

The commentary provides additional guidance on items (ii), (iv), (v), and (vi).

### Regulatory Text

(2) **Scope.** The provisions of this paragraph (d) apply to the refinancing of a non-standard mortgage into a standard mortgage when the following conditions are met:

(i) The creditor for the standard mortgage is the current holder of the existing non-standard mortgage or the servicer acting on behalf of the current holder;

(ii) The monthly payment for the standard mortgage is materially lower than the monthly payment for the non-standard mortgage, as calculated under paragraph (d)(5) of this section.

(iii) The creditor receives the consumer's written application for the standard mortgage no later than two months after the non-standard mortgage has recast.

(iv) The consumer has made no more than one payment more than 30 days late on the non-standard mortgage during the 12 months immediately preceding the creditor's receipt of the consumer's written application for the standard mortgage.

(v) The consumer has made no payments more than 30 days late during the six months immediately preceding the creditor's receipt of the consumer's written application for the standard mortgage; and

(vi) If the non-standard mortgage was consummated on or after January 10, 2014, the non-standard mortgage was made in accordance with paragraph (c) or (e) of this section, as applicable.

### Regulatory Commentary

***43(d)(2) Scope***

*1.* ***Written application.*** *For an explanation of the requirements for a “written application” in §1026.43(d)(2)(iii), (d)(2)(iv), and (d)(2)(v), see comment 19(a)(1)(i)-3.*

***Paragraph 43(d)(2)(ii)***

*1.* ***Materially lower.*** *The exemptions afforded under §1026.43(d)(3) apply to a refinancing only if the monthly payment for the new loan is “materially lower” than the monthly payment for an existing non-standard mortgage. The payments to be compared must be calculated based on the requirements under §1026.43(d)(5). Whether the new loan payment is “materially lower” than the non-standard mortgage payment depends on the facts and circumstances. In all cases, a payment reduction of 10 percent or more meets the “materially lower” standard.*

***Paragraph 43(d)(2)(iv)***

*1.* ***Late payment—12 months prior to application.*** *Under §1026.43(d)(2)(iv), the exemptions in §1026.43(d)(3) apply to a covered transaction only if, during the 12 months immediately preceding the creditor's receipt of the consumer's written application for a refinancing, the consumer has made no more than one payment on the non-standard mortgage more than 30 days late. (For an explanation of “written application,” see comment 43(d)(2)-1.) For example, assume a consumer applies for a refinancing on May 1, 2014. Assume also that the consumer made a non-standard mortgage payment on August 15, 2013, that was 45 days late. The consumer made no other late payments on the non-standard mortgage between May 1, 2013, and May 1, 2014. In this example, the requirement under §1026.43(d)(2)(iv) is met because the consumer made only one payment that was over 30 days late within the 12 months prior to applying for the refinancing (i.e., eight and one-half months prior to application).*

*2.* ***Payment due date.*** *Whether a payment is more than 30 days late is measured in relation to the contractual due date not accounting for any grace period. For example, if the contractual due date for a non-standard mortgage payment is the first day of every month, but no late fee will be charged as long as the payment is received by the 16th of the month, the payment due date for purposes of §1026.43(d)(2)(iv) and (v) is the first day of the month, not the 16th day of the month. Thus, a payment due under the contract on October 1st that is paid on November 1st is made more than 30 days after the payment due date.*

***Paragraph 43(d)(2)(v)***

*1.* ***Late payment—six months prior to application.*** *Under §1026.43(d)(2)(v), the exemptions in §1026.43(d)(3) apply to a covered transaction only if, during the six months immediately preceding the creditor's receipt of the consumer's written application for a refinancing, the consumer has made no payments on the non-standard mortgage more than 30 days late. (For an explanation of “written application” and how to determine the payment due date, see comments 43(d)(2)-1 and 43(d)(2)(iv)-2.) For example, assume a consumer with a non-standard mortgage applies for a refinancing on May 1, 2014. If the consumer made a payment on March 15, 2014, that was 45 days late, the requirement under §1026.43(d)(2)(v) is not met because the consumer made a payment more than 30 days late one and one-half months prior to application. If the number of months between consummation of the non-standard mortgage and the consumer's application for the standard mortgage is six or fewer, the consumer may not have made any payment more than 30 days late on the non-standard mortgage.*

***Paragraph 43(d)(2)(vi)***

*1.* ***Non-standard mortgage loan made in accordance with ability-to-repay or qualified mortgage requirements.*** *For non-standard mortgages that are consummated on or after January 10, 2014, §1026.43(d)(2)(vi) provides that the refinancing provisions set forth in §1026.43(d) apply only if the non-standard mortgage was made in accordance with the requirements of §1026.43(c) or (e), as applicable. For example, if a creditor originated a non-standard mortgage on or after January 10, 2014 that did not comply with the requirements of §1026.43(c) and was not a qualified mortgage pursuant to §1026.43(e), §1026.43(d) would not apply to the refinancing of the non-standard mortgage loan into a standard mortgage loan. However, §1026.43(d) applies to the refinancing of a non-standard mortgage loan into a standard mortgage loan, regardless of whether the non-standard mortgage loan was made in compliance with §1026.43(c) or (e), if the non-standard mortgage loan was consummated prior to January 10, 2014.*

## Exemption from Repayment Ability Requirements (ATR) - 12 CFR § 1026.43(d)(3)

### Regulatory Discussion

If the six conditions required under paragraph (d)(2) are satisfied and the creditor has considered:

* First, whether the consumer is likely to default on the existing mortgage once that loan is recast and
* Second, whether the new mortgage likely would prevent the consumer’s default

Then the creditor is exempt from the Repayment Ability requirements in Section 3, above.

**Regulatory Text**

(3) **Exemption from repayment ability requirements.** A creditor is not required to comply with the requirements of paragraph (c) of this section if:

(i) The conditions in paragraph (d)(2) of this section are met; and

(ii) The creditor has considered whether the standard mortgage likely will prevent a default by the consumer on the non-standard mortgage once the loan is recast.

### Regulatory Commentary

***43(d)(3) Exemption from repayment ability requirements.***

*1.* ***Two-part determination.*** *To qualify for the exemptions in §1026.43(d)(3), a creditor must have considered, first, whether the consumer is likely to default on the existing mortgage once that loan is recast and, second, whether the new mortgage likely would prevent the consumer's default.*

## Offer of Rate Discounts and Other Favorable Terms - 12 CFR § 1026.43(d)(4)

### Regulatory Discussion

Remembering paragraph (d), this Section 4, *only applies to the refinancing of a* “non-standard mortgage” into a “standard mortgage:”

* a creditor may offer to the consumer rate discounts and terms that are the same as, or better than, the rate discounts and terms that the creditor offers to new consumers,
* consistent with the creditor's *documented underwriting practices* and
* to the extent not prohibited by applicable State or Federal law

See the commentary for guidance on *documented underwriting practices*.

**Regulatory Text**

(4) **Offer of rate discounts and other favorable terms.** A creditor making a covered transaction under this paragraph (d) may offer to the consumer rate discounts and terms that are the same as, or better than, the rate discounts and terms that the creditor offers to new consumers, consistent with the creditor's documented underwriting practices and to the extent not prohibited by applicable State or Federal law.

### Regulatory Commentary

***43(d)(4) Offer of rate discounts and other favorable terms.***

*1.* ***Documented underwriting practices.*** *In connection with a refinancing made pursuant to §1026.43(d), §1026.43(d)(4) requires a creditor offering a consumer rate discounts and terms that are the same as, or better than, the rate discounts and terms offered to new consumers to make such an offer consistent with the creditor's documented underwriting practices. Section 1026.43(d)(4) does not require a creditor making a refinancing pursuant to §1026.43(d) to comply with the underwriting requirements of §1026.43(c). Rather, §1026.43(d)(4) requires creditors providing such discounts to do so consistent with documented policies related to loan pricing, loan term qualifications, or other similar underwriting practices. For example, assume that a creditor is providing a consumer with a refinancing made pursuant to §1026.43(d) and that this creditor has a documented practice of offering rate discounts to consumers with credit scores above a certain threshold. Assume further that the consumer receiving the refinancing has a credit score below this threshold, and therefore would not normally qualify for the rate discount available to consumers with high credit scores. This creditor complies with §1026.43(d)(4) by offering the consumer the discounted rate in connection with the refinancing made pursuant to §1026.43(d), even if the consumer would not normally qualify for that discounted rate, provided that the offer of the discounted rate is not prohibited by applicable State or Federal law. However, §1026.43(d)(4) does not require a creditor to offer a consumer such a discounted rate.*

## Payment Calculations - 12 CFR § 1026.43(d)(5)

### Regulatory Discussion

The calculation to determine whether the consumer’s monthly payment for a “standard mortgage” will be materially lower than the monthly payment for a “non-standard mortgage” requires the creditor to follow the specific provisions detailed in the regulatory text.

The commentary provides substantial guidance on, and examples of, these provisions.

**Regulatory Text**

(5) **Payment calculations.** For purposes of determining whether the consumer's monthly payment for a standard mortgage will be materially lower than the monthly payment for the non-standard mortgage, the following provisions shall be used:

(i) **Non-standard mortgage.** For purposes of the comparison conducted pursuant to paragraph (d)(2)(ii) of this section, the creditor must calculate the monthly payment for a non-standard mortgage based on substantially equal, monthly, fully amortizing payments of principal and interest using:

(A) The fully indexed rate as of a reasonable period of time before or after the date on which the creditor receives the consumer's written application for the standard mortgage;

(B) The term of the loan remaining as of the date on which the recast occurs, assuming all scheduled payments have been made up to the recast date and the payment due on the recast date is made and credited as of that date; and

(C) A remaining loan amount that is:

(1) For an adjustable-rate mortgage under paragraph (d)(1)(i)(A) of this section, the outstanding principal balance as of the date of the recast, assuming all scheduled payments have been made up to the recast date and the payment due on the recast date is made and credited as of that date;

(2) For an interest-only loan under paragraph (d)(1)(i)(B) of this section, the outstanding principal balance as of the date of the recast, assuming all scheduled payments have been made up to the recast date and the payment due on the recast date is made and credited as of that date; or

(3) For a negative amortization loan under paragraph (d)(1)(i)(C) of this section, the maximum loan amount, determined after adjusting for the outstanding principal balance.

(ii) **Standard mortgage.** For purposes of the comparison conducted pursuant to paragraph (d)(2)(ii) of this section, the monthly payment for a standard mortgage must be based on substantially equal, monthly, fully amortizing payments based on the maximum interest rate that may apply during the first five years after consummation.

### Regulatory Commentary

***43(d)(5) Payment calculations.***

***43(d)(5)(i) Non-Standard mortgage.***

*1.* ***Payment calculation for a non-standard mortgage.*** *In determining whether the monthly periodic payment for a standard mortgage is materially lower than the monthly periodic payment for the non-standard mortgage under §1026.43(d)(2)(ii), the creditor must consider the monthly payment for the non-standard mortgage that will result after the loan is “recast,” assuming substantially equal payments of principal and interest that amortize the remaining loan amount over the remaining term as of the date the mortgage is recast. For guidance regarding the meaning of “substantially equal,” see comment 43(c)(5)(i)-4. For the meaning of “recast,” see §1026.43(b)(11) and associated commentary.*

*2.* ***Fully indexed rate.*** *The term “fully indexed rate” in §1026.43(d)(5)(i)(A) for calculating the payment for a non-standard mortgage is generally defined in §1026.43(b)(3) and associated commentary. Under §1026.43(b)(3) the fully indexed rate is calculated at the time of consummation. For purposes of §1026.43(d)(5)(i), however, the fully indexed rate is calculated within a reasonable period of time before or after the date the creditor receives the consumer's written application for the standard mortgage. Thirty days is generally considered “a reasonable period of time.”*

*3.* ***Written application.*** *For an explanation of the requirements for a “written application” in §1026.43(d)(5)(i), see comment 19(a)(1)(i)-3.*

*4.* ***Payment calculation for an adjustable-rate mortgage with an introductory fixed rate.*** *Under §1026.43(d)(5)(i), the monthly periodic payment for an adjustable-rate mortgage with an introductory fixed interest rate for a period of one or more years must be calculated based on several assumptions.*

*i. First, the payment must be based on the outstanding principal balance as of the date on which the mortgage is recast, assuming all scheduled payments have been made up to that date and the last payment due under those terms is made and credited on that date. For example, assume an adjustable-rate mortgage with a 30-year loan term. The loan agreement provides that the payments for the first 24 months are based on a fixed rate, after which the interest rate will adjust annually based on a specified index and margin. The loan is recast on the due date of the 24th payment. If the 24th payment is due on September 1, 2014, the creditor must calculate the outstanding principal balance as of September 1, 2014, assuming that all 24 payments under the fixed rate terms have been made and credited timely.*

*ii. Second, the payment calculation must be based on substantially equal monthly payments of principal and interest that will fully repay the outstanding principal balance over the term of the loan remaining as of the date the loan is recast. Thus, in the example above, the creditor must assume a loan term of 28 years (336 monthly payments).*

*iii. Third, the payment must be based on the fully indexed rate, as described in §1026.43(d)(5)(i)(A).*

*5.* ***Example of payment calculation for an adjustable-rate mortgage with an introductory fixed rate.*** *The following example illustrates the rule described in comment 43(d)(5)(i)-4:*

*i. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted introductory interest rate of 5 percent that is fixed for an initial period of two years, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percentage points.*

*ii. The non-standard mortgage is consummated on February 15, 2014, and the first monthly payment is due on April 1, 2014. The loan is recast on the due date of the 24th monthly payment, which is March 1, 2016.*

*iii. On March 15, 2015, the creditor receives the consumer's written application for a refinancing after the consumer has made 12 monthly on-time payments. On this date, the index value is 4.5 percent.*

*iv. To calculate the non-standard mortgage payment that must be compared to the standard mortgage payment under §1026.43(d)(2)(ii), the creditor must use:*

*A. The outstanding principal balance as of March 1, 2016, assuming all scheduled payments have been made up to March 1, 2016, and the last payment due under the fixed rate terms is made and credited on March 1, 2016. In this example, the outstanding principal balance is $193,948.*

*B. The fully indexed rate of 7.5 percent, which is the index value of 4.5 percent as of March 15, 2015 (the date on which the application for a refinancing is received) plus the margin of 3 percent.*

*C. The remaining loan term as of March 1, 2016, the date of the recast, which is 28 years (336 monthly payments).*

*v. Based on these assumptions, the monthly payment for the non-standard mortgage for purposes of determining whether the standard mortgage monthly payment is lower than the non-standard mortgage monthly payment (see §1026.43(d)(2)(ii)) is $1,383. This is the substantially equal, monthly payment of principal and interest required to repay the outstanding principal balance at the fully indexed rate over the remaining term.*

*6.* ***Payment calculation for an interest-only loan.*** *Under §1026.43(d)(5)(i), the monthly periodic payment for an interest-only loan must be calculated based on several assumptions:*

*i. First, the payment must be based on the outstanding principal balance as of the date of the recast, assuming all scheduled payments are made under the terms of the legal obligation in effect before the mortgage is recast. For a loan on which only interest and no principal has been paid, the outstanding principal balance at the time of recast will be the loan amount, as defined in §1026.43(b)(5), assuming all scheduled payments are made under the terms of the legal obligation in effect before the mortgage is recast. For example, assume that a mortgage has a 30-year loan term, and provides that the first 24 months of payments are interest-only. If the 24th payment is due on September 1, 2015, the creditor must calculate the outstanding principal balance as of September 1, 2015, assuming that all 24 payments under the interest-only payment terms have been made and credited timely and that no payments of principal have been made.*

*ii. Second, the payment calculation must be based on substantially equal monthly payments of principal and interest that will fully repay the loan amount over the term of the loan remaining as of the date the loan is recast. Thus, in the example above, the creditor must assume a loan term of 28 years (336 monthly payments).*

*iii. Third, the payment must be based on the fully indexed rate, as described in §1026.43(d)(5)(i)(A).*

*7.* ***Example of payment calculation for an interest-only loan.*** *The following example illustrates the rule described in comment 43(d)(5)(i)-6:*

*i. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a fixed interest rate of 7 percent, and permits interest-only payments for the first two years (the first 24 payments), after which time amortizing payments of principal and interest are required.*

*ii. The non-standard mortgage is consummated on February 15, 2014, and the first monthly payment is due on April 1, 2014. The loan is recast on the due date of the 24th monthly payment, which is March 1, 2016.*

*iii. On March 15, 2015, the creditor receives the consumer's written application for a refinancing, after the consumer has made 12 monthly on-time payments. The consumer has made no additional payments of principal.*

*iv. To calculate the non-standard mortgage payment that must be compared to the standard mortgage payment under §1026.43(d)(2)(ii), the creditor must use:*

*A. The loan amount, which is the outstanding principal balance as of March 1, 2016, assuming all scheduled interest-only payments have been made and credited up to that date. In this example, the loan amount is $200,000.*

*B. An interest rate of 7 percent, which is the interest rate in effect at the time of consummation of this fixed-rate non-standard mortgage.*

*C. The remaining loan term as of March 1, 2016, the date of the recast, which is 28 years (336 monthly payments).*

*v. Based on these assumptions, the monthly payment for the non-standard mortgage for purposes of determining whether the standard mortgage monthly payment is lower than the non-standard mortgage monthly payment (see §1026.43(d)(2)(ii)) is $1,359. This is the substantially equal, monthly payment of principal and interest required to repay the loan amount at the fully indexed rate over the remaining term.*

*8.* ***Payment calculation for a negative amortization loan.*** *Under §1026.43(d)(5)(i), the monthly periodic payment for a negative amortization loan must be calculated based on several assumptions:*

*i. First, the calculation must be based on the maximum loan amount, determined after adjusting for the outstanding principal balance. If the consumer makes only the minimum periodic payments for the maximum possible time, until the consumer must begin making fully amortizing payments, the outstanding principal balance will be the maximum loan amount, as defined in §1026.43(b)(7). In this event, the creditor complies with §1026.43(d)(5)(i)(C)(3) by relying on the examples of how to calculate the maximum loan amount, see comment 43(b)(7)-3. If the consumer makes payments above the minimum periodic payments for the maximum possible time, the creditor must calculate the maximum loan amount based on the outstanding principal balance. In this event, the creditor complies with §1026.43(d)(5)(i)(C)(3) by relying on the examples of how to calculate the maximum loan amount in comment 43(d)(5)(i)-10.*

*ii. Second, the calculation must be based on substantially equal monthly payments of principal and interest that will fully repay the maximum loan amount over the term of the loan remaining as of the date the loan is recast. For example, if the loan term is 30 years and the loan is recast on the due date of the 60th monthly payment, the creditor must assume a remaining loan term of 25 years (300 monthly payments).*

*iii. Third, the payment must be based on the fully indexed rate as of the date of the written application for the standard mortgage.*

*9.* ***Example of payment calculation for a negative amortization loan if only minimum payments made.*** *The following example illustrates the rule described in comment 43(d)(5)(i)-8:*

*i. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides that the consumer can make minimum monthly payments that cover only part of the interest accrued each month until the date on which the principal balance increases to the negative amortization cap of 115 percent of the loan amount, or for the first five years of monthly payments (60 payments), whichever occurs first. The loan is an adjustable-rate mortgage that adjusts monthly according to a specified index plus a margin of 3.5 percent.*

*ii. The non-standard mortgage is consummated on February 15, 2014, and the first monthly payment is due on April 1, 2014. Assume that the consumer has made only the minimum periodic payments. Assume further that, based on the calculation of the maximum loan amount required under §1026.43(b)(7) and associated commentary, the negative amortization cap of 115 percent would be reached on June 1, 2016, the due date of the 27th monthly payment.*

*iii. On March 15, 2015, the creditor receives the consumer's written application for a refinancing, after the consumer has made 12 monthly on-time payments. On this date, the index value is 4.5 percent.*

*iv. To calculate the non-standard mortgage payment that must be compared to the standard mortgage payment under §1026.43(d)(2)(ii), the creditor must use:*

*A. The maximum loan amount of $229,251 as of June 1, 2016;*

*B. The fully indexed rate of 8 percent, which is the index value of 4.5 percent as of March 15, 2015 (the date on which the creditor receives the application for a refinancing) plus the margin of 3.5 percent; and*

*C. The remaining loan term as of June 1, 2016, the date of the recast, which is 27 years and nine months (333 monthly payments).*

*v. Based on these assumptions, the monthly payment for the non-standard mortgage for purposes of determining whether the standard mortgage monthly payment is lower than the non-standard mortgage monthly payment (see §1026.43(d)(2)(ii)) is $1,716. This is the substantially equal, monthly payment of principal and interest required to repay the maximum loan amount at the fully indexed rate over the remaining term.*

*10.* ***Example of payment calculation for a negative amortization loan if payments above minimum amount made.*** *The following example illustrates the rule described in comment 43(d)(5)(i)-8:*

*i. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides that the consumer can make minimum monthly payments that cover only part of the interest accrued each month until the date on which the principal balance increases to the negative amortization cap of 115 percent of the loan amount, or for the first five years of monthly payments (60 payments), whichever occurs first. The loan is an adjustable-rate mortgage that adjusts monthly according to a specified index plus a margin of 3.5 percent. The introductory interest rate at consummation is 1.5 percent. One month after consummation, the interest rate adjusts and will adjust monthly thereafter based on the specified index plus a margin of 3.5 percent. The maximum lifetime interest rate is 10.5 percent; there are no other periodic interest rate adjustment caps that limit how quickly the maximum lifetime rate may be reached. The minimum monthly payment for the first year is based on the initial interest rate of 1.5 percent. After that, the minimum monthly payment adjusts annually, but may increase by no more than 7.5 percent over the previous year's payment. The minimum monthly payment is $690 in the first year, $742 in the second year, $798 in the third year, $857 in the fourth year, and $922 in the fifth year.*

*ii. The non-standard mortgage is consummated on February 15, 2014, and the first monthly payment is due on April 1, 2014. Assume that the consumer has made more than the minimum periodic payments, and that after the consumer's 12th monthly on-time payment the outstanding principal balance is $195,000. Based on the calculation of the maximum loan amount after adjusting for this outstanding principal balance, the negative amortization cap of 115 percent would be reached on March 1, 2019, the due date of the 60th monthly payment.*

*iii. On March 15, 2015, the creditor receives the consumer's written application for a refinancing, after the consumer has made 12 monthly on-time payments. On this date, the index value is 4.5 percent.*

*iv. To calculate the non-standard mortgage payment that must be compared to the standard mortgage payment under §1026.43(d)(2)(ii), the creditor must use:*

*A. The maximum loan amount of $229,219 as of March 1, 2019.*

*B. The fully indexed rate of 8 percent, which is the index value of 4.5 percent as of March 15, 2015 (the date on which the creditor receives the application for a refinancing) plus the margin of 3.5 percent.*

*C. The remaining loan term as of March 1, 2019, the date of the recast, which is exactly 25 years (300 monthly payments).*

*v. Based on these assumptions, the monthly payment for the non-standard mortgage for purposes of determining whether the standard mortgage monthly payment is lower than the non-standard mortgage monthly payment (see §1026.43(d)(2)(ii)) is $1,769. This is the substantially equal, monthly payment of principal and interest required to repay the maximum loan amount at the fully indexed rate over the remaining term.*

***43(d)(5)(ii) Standard mortgage.***

*1.* ***Payment calculation for a standard mortgage.*** *In determining whether the monthly periodic payment for a standard mortgage is materially lower than the monthly periodic payment for a non-standard mortgage, the creditor must consider the monthly payment for the standard mortgage that will result in substantially equal, monthly, fully amortizing payments (as defined in §1026.43(b)(2)) using the rate as of consummation. For guidance regarding the meaning of “substantially equal” see comment 43(c)(5)(i)-4. For a mortgage with a single, fixed rate for the first five years after consummation, the maximum rate that will apply during the first five years after consummation will be the rate at consummation. For a step-rate mortgage, however, the rate that must be used is the highest rate that will apply during the first five years after consummation. For example, if the rate for the first two years after the date on which the first regular periodic payment will be due is 4 percent, the rate for the following two years is 5 percent, and the rate for the next two years is 6 percent, the rate that must be used is 6 percent.*

*2.* ***Example of payment calculation for a standard mortgage.*** *The following example illustrates the rule described in comment 43(d)(5)(ii)-1: A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for an interest rate of 6 percent that is fixed for an initial period of five years, after which time the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual interest rate adjustment cap. The creditor must determine whether the standard mortgage monthly payment is materially lower than the non-standard mortgage monthly payment (see §1026.43(d)(2)(ii)) based on a standard mortgage payment of $1,199. This is the substantially equal, monthly payment of principal and interest required to repay $200,000 over 30 years at an interest rate of 6 percent.*

# Section 5: Qualified Mortgages

# 12 CFR § 1026.43(e)

## Safe Harbor and Presumption of Compliance - 12 CFR § 1026.43(e)(1)

### Regulatory Discussion

A safe harbor with the repayment ability requirements of paragraph (c) (discussed in Section 3, above) is provided to a creditor (or assignee) of:

* a “*qualified mortgage*” that
* is not a “*higher-priced covered transaction*”

A presumption of compliance with the repayment ability requirements of paragraph (c) (discussed in Section 3, above) is provided to a creditor (or assignee) of:

* a “*qualified mortgage*” that
* is a “*higher-priced covered transaction*”

### To rebut the presumption of compliance, it must be proven:

### the creditor did not make a reasonable and good faith determination of the consumer's repayment ability,

### by showing that the consumer's income, debt obligations, alimony, child support, and the consumer's monthly payment

### would leave the consumer with insufficient residual income or assets with which to meet living expenses.

**Regulatory Text**

(1) **Safe harbor and presumption of compliance**

(i) **Safe harbor for loans that are not higher-priced covered transactions.** A creditor or assignee of a qualified mortgage, as defined in paragraphs (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section, that is not a higher-priced covered transaction, as defined in paragraph (b)(4) of this section, complies with the repayment ability requirements of paragraph (c) of this section.

(ii) **Presumption of compliance for higher-priced covered transactions.**

(A) A creditor or assignee of a qualified mortgage, as defined in paragraph (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section, that is a higher-priced covered transaction, as defined in paragraph (b)(4) of this section, is presumed to comply with the repayment ability requirements of paragraph (c) of this section.

(B) To rebut the presumption of compliance described in paragraph (e)(1)(ii)(A) of this section, it must be proven that, despite meeting the prerequisites of paragraph (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section, the creditor did not make a reasonable and good faith determination of the consumer's repayment ability at the time of consummation, by showing that the consumer's income, debt obligations, alimony, child support, and the consumer's monthly payment (including mortgage-related obligations) on the covered transaction and on any simultaneous loans of which the creditor was aware at consummation would leave the consumer with insufficient residual income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan with which to meet living expenses, including any recurring and material non-debt obligations of which the creditor was aware at the time of consummation.

**Regulatory Commentary**

***43(e)(1) Safe harbor and presumption of compliance.***

*1.* ***General.*** *Section 1026.43(c) requires a creditor to make a reasonable and good faith determination at or before consummation that a consumer will be able to repay a covered transaction. Section 1026.43(e)(1)(i) and (ii) provide a safe harbor and presumption of compliance, respectively, with the repayment ability requirements of §1026.43(c) for creditors and assignees of covered transactions that satisfy the requirements of a qualified mortgage under §1026.43(e)(2), (e)(4), or (f). See §1026.43(e)(1)(i) and (ii) and associated commentary.*

***43(e)(1)(i) Safe harbor for transactions that are not higher-priced covered transactions.***

*1.* ***Safe harbor.*** *To qualify for the safe harbor in §1026.43(e)(1)(i), a covered transaction must meet the requirements of a qualified mortgage under §1026.43(e)(2), (e)(4), or (f) and must not be a higher-priced covered transaction, as defined in §1026.43(b)(4). For guidance on determining whether a loan is a higher-priced covered transaction, see comment 43(b)(4)-1.*

***43(e)(1)(ii) Presumption of compliance for higher-priced covered transactions.***

*1.* ***General.*** *Under §1026.43(e)(1)(ii), a creditor or assignee of a qualified mortgage under §1026.43(e)(2), (e)(4), or (f) that is a higher-priced covered transaction is presumed to comply with the repayment ability requirements of §1026.43(c). To rebut the presumption, it must be proven that, despite meeting the standards for a qualified mortgage (including either the debt-to-income standard in §1026.43(e)(2)(vi) or the standards of one of the entities specified in §1026.43(e)(4)(ii)), the creditor did not have a reasonable and good faith belief in the consumer's repayment ability. Specifically, it must be proven that, at the time of consummation, based on the information available to the creditor, the consumer's income, debt obligations, alimony, child support, and the consumer's monthly payment (including mortgage-related obligations) on the covered transaction and on any simultaneous loans of which the creditor was aware at consummation would leave the consumer with insufficient residual income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan with which to meet living expenses, including any recurring and material non-debt obligations of which the creditor was aware at the time of consummation, and that the creditor thereby did not make a reasonable and good faith determination of the consumer's repayment ability. For example, a consumer may rebut the presumption with evidence demonstrating that the consumer's residual income was insufficient to meet living expenses, such as food, clothing, gasoline, and health care, including the payment of recurring medical expenses of which the creditor was aware at the time of consummation, and after taking into account the consumer's assets other than the value of the dwelling securing the loan, such as a savings account. In addition, the longer the period of time that the consumer has demonstrated actual ability to repay the loan by making timely payments, without modification or accommodation, after consummation or, for an adjustable-rate mortgage, after recast, the less likely the consumer will be able to rebut the presumption based on insufficient residual income and prove that, at the time the loan was made, the creditor failed to make a reasonable and good faith determination that the consumer had the reasonable ability to repay the loan.*

## Qualified Mortgage Definition - 12 CFR § 1026.43(e)(2)

### Regulatory Discussion

In general, “*qualified mortgage*” means a consumer credit transaction that is secured by a dwelling that satisfies the following six conditions:

* That provides for regular periodic payments that are substantially equal (*see additional limitations in (2)(i)(A) through (C)*)
* For which the loan term does not exceed 30 years
* For which the total points and fees payable in connection with the loan do not exceed specified amounts
* For which the creditor underwrites the loan, taking into account the monthly payment for mortgage-related obligations (*see requirements in (2)(iv)(A) and (B)(1) through (2)*)
* For which the creditor considers and verifies, at or before consummation, certain information (*see requirements in (2)(v)(A) and (B)*)
* For which the ratio of the consumer's total monthly debt to total monthly income at the time of consummation does not exceed 43 percent (*see calculation in (2)(vi)(A) and (B)(1) through (2)*)

Note: exceptions to this general definition will be covered in paragraphs (e)(4), (5) and (6) of this Section 5, as well as in paragraph (f) in Section 6.

The commentary provides additional substantial guidance on conditions (i), (ii), (iv), (v) and (vi).

**Regulatory Text**

(2) **Qualified mortgage defined—general***.* Except as provided in paragraph (e)(4), (e)(5), (e)(6), or (f) of this section, a qualified mortgage is a covered transaction:

(i) That provides for regular periodic payments that are substantially equal, except for the effect that any interest rate change after consummation has on the payment in the case of an adjustable-rate or step-rate mortgage, that do not:

(A) Result in an increase of the principal balance;

(B) Allow the consumer to defer repayment of principal, except as provided in paragraph (f) of this section; or

(C) Result in a balloon payment, as defined in §1026.18(s)(5)(i), except as provided in paragraph (f) of this section;

(ii) For which the loan term does not exceed 30 years;

(iii) For which the total points and fees payable in connection with the loan do not exceed the amounts specified in paragraph (e)(3) of this section;

(iv) For which the creditor underwrites the loan, taking into account the monthly payment for mortgage-related obligations, using:

(A) The maximum interest rate that may apply during the first five years after the date on which the first regular periodic payment will be due; and

(B) Periodic payments of principal and interest that will repay either:

(1) The outstanding principal balance over the remaining term of the loan as of the date the interest rate adjusts to the maximum interest rate set forth in paragraph (e)(2)(iv)(A) of this section, assuming the consumer will have made all required payments as due prior to that date; or

(2) The loan amount over the loan term;

(v) For which the creditor considers and verifies at or before consummation the following:

(A) The consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan, in accordance with appendix Q and paragraphs (c)(2)(i) and (c)(4) of this section; and

(B) The consumer's current debt obligations, alimony, and child support in accordance with appendix Q and paragraphs (c)(2)(vi) and (c)(3) of this section; and

(vi) For which the ratio of the consumer's total monthly debt to total monthly income at the time of consummation does not exceed 43 percent. For purposes of this paragraph (e)(2)(vi), the ratio of the consumer's total monthly debt to total monthly income is determined:

(A) Except as provided in paragraph (e)(2)(vi)(B) of this section, in accordance with the standards in appendix Q;

(B) Using the consumer's monthly payment on:

(1) The covered transaction, including the monthly payment for mortgage-related obligations, in accordance with paragraph (e)(2)(iv) of this section; and

(2) Any simultaneous loan that the creditor knows or has reason to know will be made, in accordance with paragraphs (c)(2)(iv) and (c)(6) of this section.

**Regulatory Commentary**

***43(e)(2) Qualified mortgage defined – general.***

***Paragraph 43(e)(2)(i)***

*1.* ***Regular periodic payments.*** *Under §1026.43(e)(2)(i), a qualified mortgage must provide for regular periodic payments that may not result in an increase of the principal balance (negative amortization), deferral of principal repayment, or a balloon payment. Thus, the terms of the legal obligation must require the consumer to make payments of principal and interest, on a monthly or other periodic basis, that will fully repay the loan amount over the loan term. The periodic payments must be substantially equal except for the effect that any interest rate change after consummation has on the payment in the case of an adjustable-rate or step-rate mortgage. In addition, because §1026.43(e)(2)(i) requires that a qualified mortgage provide for regular periodic payments, a single-payment transaction may not be a qualified mortgage.*

*2.* ***Deferral of principal repayment.*** *Under §1026.43(e)(2)(i)(B), a qualified mortgage's regular periodic payments may not allow the consumer to defer repayment of principal, except as provided in §1026.43(f). A loan allows the deferral of principal repayment if one or more of the periodic payments may be applied solely to accrued interest and not to loan principal. Deferred principal repayment also occurs if the payment is applied to both accrued interest and principal but the consumer is permitted to make periodic payments that are less than the amount that would be required under a payment schedule that has substantially equal payments that fully repay the loan amount over the loan term. Graduated payment mortgages, for example, allow deferral of principal repayment in this manner and therefore may not be qualified mortgages.*

***Paragraph 43(e)(2)(ii)***

*1.* ***General.*** *The 30-year term limitation in §1026.43(e)(2)(ii) is applied without regard to any interim period between consummation and the beginning of the first full unit period of the repayment schedule. For example, assume a covered transaction is consummated on March 20, 2014 and the due date of the first regular periodic payment is April 30, 2014. The beginning of the first full unit period of the repayment schedule is April 1, 2014 and the loan term therefore ends on April 1, 2044. The transaction would comply with the 30-year term limitation in §1026.43(e)(2)(ii).*

***Paragraph 43(e)(2)(iv)***

*1.* ***Maximum interest rate during the first five years.*** *For a qualified mortgage, the creditor must underwrite the loan using a periodic payment of principal and interest based on the maximum interest rate that may apply during the first five years after the date on which the first regular periodic payment will be due. Creditors must use the maximum rate that could apply at any time during the first five years after the date on which the first regular periodic payment will be due, regardless of whether the maximum rate is reached at the first or subsequent adjustment during the five-year period.*

*2.* ***Fixed-rate mortgage.*** *For a fixed-rate mortgage, creditors should use the interest rate in effect at consummation. “Fixed-rate mortgage” is defined in §1026.18(s)(7)(iii).*

*3.* ***Interest rate adjustment caps.*** *For an adjustable-rate mortgage, creditors should assume the interest rate increases after consummation as rapidly as possible, taking into account the terms of the legal obligation. That is, creditors should account for any periodic interest rate adjustment cap that may limit how quickly the interest rate can increase under the terms of the legal obligation. Where a range for the maximum interest rate during the first five years is provided, the highest rate in that range is the maximum interest rate for purposes of §1026.43(e)(2)(iv). Where the terms of the legal obligation are not based on an index plus margin or formula, the creditor must use the maximum interest rate that occurs during the first five years after the date on which the first regular periodic payment will be due. To illustrate:*

*i.* ***Adjustable-rate mortgage with discount for three years.*** *Assume an adjustable-rate mortgage has an initial discounted rate of 5 percent that is fixed for the first three years, measured from the first day of the first full calendar month following consummation, after which the rate will adjust annually based on a specified index plus a margin of 3 percent. The index value in effect at consummation is 4.5 percent. The loan agreement provides for an annual interest rate adjustment cap of 2 percent, and a lifetime maximum interest rate of 12 percent. The first rate adjustment occurs on the due date of the 36th monthly payment; the rate can adjust to no more than 7 percent (5 percent initial discounted rate plus 2 percent annual interest rate adjustment cap). The second rate adjustment occurs on the due date of the 48th monthly payment; the rate can adjust to no more than 9 percent (7 percent rate plus 2 percent annual interest rate adjustment cap). The third rate adjustment occurs on the due date of the 60th monthly payment; the rate can adjust to no more than 11 percent (9 percent rate plus 2 percent annual interest rate cap adjustment). The maximum interest rate during the first five years after the date on which the first regular periodic payment will be due is 11 percent (the rate on the due date of the 60th monthly payment). For further discussion of how to determine whether a rate adjustment occurs during the first five years after the date on which the first regular periodic payment will be due, see comment 43(e)(2)(iv)-7.*

*ii.* ***Adjustable-rate mortgage with discount for three years.*** *Assume the same facts as in paragraph 3.i except that the lifetime maximum interest rate is 10 percent, which is less than the maximum interest rate in the first five years after the date on which the first regular periodic payment will be due of 11 percent that would apply but for the lifetime maximum interest rate. The maximum interest rate during the first five years after the date on which the first regular periodic payment will be due is 10 percent.*

*iii.* ***Step-rate mortgage.*** *Assume a step-rate mortgage with an interest rate fixed at 6.5 percent for the first two years, measured from the first day of the first full calendar month following consummation, 7 percent for the next three years, and then 7.5 percent for the remainder of the loan term. The maximum interest rate during the first five years after the date on which the first regular periodic payment will be due is 7.5 percent.*

*4.* ***First five years after the date on which the first regular periodic payment will be due.*** *Under §1026.43(e)(2)(iv)(A), the creditor must underwrite the loan using the maximum interest rate that may apply during the first five years after the date on which the first regular periodic payment will be due. To illustrate, assume an adjustable-rate mortgage with an initial fixed interest rate of 5 percent for the first five years, measured from the first day of the first full calendar month following consummation, after which the interest rate will adjust annually to the specified index plus a margin of 6 percent, subject to a 2 percent annual interest rate adjustment cap. The index value in effect at consummation is 5.5 percent. The loan consummates on September 15, 2014, and the first monthly payment is due on November 1, 2014. The first rate adjustment to no more than 7 percent (5 percent plus 2 percent annual interest rate adjustment cap) occurs on the due date of the 60th monthly payment, which is October 1, 2019, and therefore, the rate adjustment occurs during the first five years after the date on which the first regular periodic payment will be due. To meet the definition of qualified mortgage under §1026.43(e)(2), the creditor must underwrite the loan using a monthly payment of principal and interest based on an interest rate of 7 percent.*

*5.* ***Loan amount.*** *To meet the definition of qualified mortgage under §1026.43(e)(2), a creditor must determine the periodic payment of principal and interest using the maximum interest rate permitted during the first five years after the date on which the first regular periodic payment will be due that repays either:*

*i. The outstanding principal balance as of the earliest date the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due can take effect under the terms of the legal obligation, over the remaining term of the loan. To illustrate, assume a loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted interest rate of 5 percent that is fixed for an initial period of three years, measured from the first day of the first full calendar month following consummation, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual interest rate adjustment cap and a lifetime maximum interest rate of 9 percent. The index value in effect at consummation equals 4.5 percent. Assuming the interest rate increases after consummation as quickly as possible, the rate adjustment to the lifetime maximum interest rate of 9 percent occurs on the due date of the 48th monthly payment. The outstanding principal balance on the loan at the end of the fourth year (after the 48th monthly payment is credited) is $188,218. The creditor will meet the definition of qualified mortgage if it underwrites the covered transaction using the monthly payment of principal and interest of $1,564 to repay the outstanding principal balance of $188,218 over the remaining 26 years of the loan term (312 months) using the maximum interest rate during the first five years of 9 percent; or*

*ii. The loan amount, as that term is defined in §1026.43(b)(5), over the entire loan term, as that term is defined in §1026.43(b)(6). Using the same example above, the creditor will meet the definition of qualified mortgage if it underwrites the covered transaction using the monthly payment of principal and interest of $1,609 to repay the loan amount of $200,000 over the 30-year loan term using the maximum interest rate during the first five years of 9 percent.*

*6.* ***Mortgage-related obligations.*** *Section 1026.43(e)(2)(iv) requires creditors to take the consumer's monthly payment for mortgage-related obligations into account when underwriting the loan. For the meaning of the term “mortgage-related obligations,” see §1026.43(b)(8) and associated commentary.*

*7.* ***Examples.*** *The following are examples of how to determine the periodic payment of principal and interest based on the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due for purposes of meeting the definition of qualified mortgage under §1026.43(e) (all payment amounts shown are rounded, and all amounts are calculated using non-rounded values; all initial fixed interest rate periods are measured from the first day of the first full calendar month following consummation):*

*i.* ***Fixed-rate mortgage.*** *A loan in an amount of $200,000 has a 30-year loan term and a fixed interest rate of 7 percent. The maximum interest rate during the first five years after the date on which the first regular periodic payment will be due for a fixed-rate mortgage is the interest rate in effect at consummation, which is 7 percent under this example. The monthly fully amortizing payment scheduled over the 30 years is $1,331. The creditor will meet the definition of qualified mortgage if it underwrites the loan using the fully amortizing payment of $1,331.*

*ii.* ***Adjustable-rate mortgage with discount for three years.***

*A. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted interest rate of 5 percent that is fixed for an initial period of three years, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual interest rate adjustment cap and a lifetime maximum interest rate of 9 percent. The index value in effect at consummation is 4.5 percent. The loan is consummated on March 15, 2014, and the first regular periodic payment is due May 1, 2014. The loan agreement provides that the first rate adjustment occurs on April 1, 2017 (the due date of the 36th monthly payment); the second rate adjustment occurs on April 1, 2018 (the due date of the 48th monthly payment); and the third rate adjustment occurs on April 1, 2019 (the due date of the 60th monthly payment). Under this example, the maximum interest rate during the first five years after the date on which the first regular periodic payment due is 9 percent (the lifetime interest rate cap), which applies beginning on April 1, 2018 (the due date of the 48th monthly payment). The outstanding principal balance at the end of the fourth year (after the 48th payment is credited) is $188,218.*

*B. The transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using the monthly payment of principal and interest of $1,564 to repay the outstanding principal balance at the end of the fourth year of $188,218 over the remaining 26 years of the loan term (312 months), using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 9 percent. Alternatively, the transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using the monthly payment of principal and interest of $1,609 to repay the loan amount of $200,000 over the 30-year loan term, using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 9 percent.*

*iii.* ***Adjustable-rate mortgage with discount for five years.***

*A. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted interest rate of 6 percent that is fixed for an initial period of five years, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual interest rate adjustment cap. The index value in effect at consummation is 4.5 percent. The loan consummates on March 15, 2014 and the first regular periodic payment is due May 1, 2014. Under the terms of the loan agreement, the first rate adjustment to no more than 8 percent (6 percent plus 2 percent annual interest rate adjustment cap) is on April 1, 2019 (the due date of the 60th monthly payment), which occurs less than five years after the date on which the first regular periodic payment will be due. Thus, the maximum interest rate under the terms of the loan during the first five years after the date on which the first regular periodic payment will be due is 8 percent.*

*B. The transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using the monthly payment of principal and interest of $1,436 to repay the outstanding principal balance at the end of the fifth year of $186,109 over the remaining 25 years of the loan term (300 months), using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 8 percent. Alternatively, the transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using the monthly payment of principal and interest of $1,468 to repay the loan amount of $200,000 over the 30-year loan term, using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 8 percent.*

*iv.* ***Adjustable-rate mortgage with discount for seven years.***

*A. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted interest rate of 6 percent that is fixed for an initial period of seven years, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual interest rate adjustment cap. The index value in effect at consummation is 4.5 percent. The loan is consummated on March 15, 2014, and the first regular periodic payment is due May 1, 2014. Under the terms of the loan agreement, the first rate adjustment is on April 1, 2021 (the due date of the 84th monthly payment), which occurs more than five years after the date on which the first regular periodic payment will be due. Thus, the maximum interest rate under the terms of the loan during the first five years after the date on which the first regular periodic payment will be due is 6 percent.*

*B. The transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using the monthly payment of principal and interest of $1,199 to repay the loan amount of $200,000 over the 30-year loan term using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 6 percent.*

*v.* ***Step-rate mortgage.***

*A. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides that the interest rate is 6.5 percent for the first two years of the loan, 7 percent for the next three years, and then 7.5 percent for remainder of the loan term. The maximum interest rate during the first five years after the date on which the first regular periodic payment will be due is 7.5 percent, which occurs on the due date of the 60th monthly payment. The outstanding principal balance at the end of the fifth year (after the 60th payment is credited) is $187,868.*

*B. The transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using a monthly payment of principal and interest of $1,388 to repay the outstanding principal balance of $187,868 over the remaining 25 years of the loan term (300 months), using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 7.5 percent. Alternatively, the transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using a monthly payment of principal and interest of $1,398 to repay $200,000 over the 30-year loan term using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 7.5 percent.*

***Paragraph 43(e)(2)(v)***

*1.* ***General.*** *For guidance on satisfying §1026.43(e)(2)(v), a creditor may rely on commentary to §1026.43(c)(2)(i) and (vi), (c)(3), and (c)(4).*

*2.* ***Income or assets****. Section 1026.43(e)(2)(v)(A) requires creditors to consider and verify the consumer's current or reasonably expected income or assets. For purposes of this requirement, the creditor must consider and verify, at a minimum, any income specified in appendix Q. A creditor may also consider and verify any other income in accordance with §1026.43(c)(2)(i) and (c)(4); however, such income would not be included in the total monthly debt-to-income ratio determination required by §1026.43(e)(2)(vi).*

*3.* ***Debts.*** *Section 1026.43(e)(2)(v)(B) requires creditors to consider and verify the consumer's current debt obligations, alimony, and child support. For purposes of this requirement, the creditor must consider and verify, at a minimum, any debt or liability specified in appendix Q. A creditor may also consider and verify other debt in accordance with §1026.43(c)(2)(vi) and (c)(3); however, such debt would not be included in the total monthly debt-to-income ratio determination required by §1026.43(e)(2)(vi).*

***Paragraph 43(e)(2)(vi)***

*1.* ***Calculation of monthly payment on the covered transaction and simultaneous loans.*** *As provided in appendix Q, for purposes of §1026.43(e)(2)(vi), creditors must include in the definition of “debt” a consumer's monthly housing expense. This includes, for example, the consumer's monthly payment on the covered transaction (including mortgage-related obligations) and on simultaneous loans. Accordingly, §1026.43(e)(2)(vi)(B) provides the method by which a creditor calculates the consumer's monthly payment on the covered transaction and on any simultaneous loan that the creditor knows or has reason to know will be made.*

## Limits on Points and Fees for Qualified Mortgages - 12 CFR § 1026.43(e)(3)

### Regulatory Discussion

A consumer credit transaction that is secured by a dwelling is not a “*qualified mortgage*” (as defined in (e)(2), above) *unless* the total “*points and fees”* (defined in §1026.32(b)(1)) do not exceed the limits established in (3)(i)(A) through (E) as detailed in the regulatory text.

Note: these limits are adjusted annually on January 1st.

There are special rules for transactions consummated on or before January 10, 2021.

If the creditor (or assignee) determines after consummation that the total points and fees exceed the limits in paragraph (e)(3)(i), the loan *is not precluded* from being a “*qualified mortgage,*” *provided the conditions* in (e)(iii)(A), (B)(1) through (3), and (C) *are satisfied*.

In the event the special rules are applicable, the creditor (or assignee) must pay to the consumer the amount (that is not less than the sum) specified in (e)(iv)(A) and (B).

The commentary provides additional guidance on this information.

**Regulatory Text**

(3) ***Limits on points and fees for qualified mortgages.***

(i) Except as provided in paragraph (e)(3)(iii) of this section, a covered transaction is not a qualified mortgage unless the transaction's total points and fees, as defined in §1026.32(b)(1), do not exceed:

(A) For a loan amount greater than or equal to $100,000 (indexed for inflation): 3 percent of the total loan amount;

(B) For a loan amount greater than or equal to $60,000 (indexed for inflation) but less than $100,000 (indexed for inflation): $3,000 (indexed for inflation);

(C) For a loan amount greater than or equal to $20,000 (indexed for inflation) but less than $60,000 (indexed for inflation): 5 percent of the total loan amount;

(D) For a loan amount greater than or equal to $12,500 (indexed for inflation) but less than $20,000 (indexed for inflation): $1,000 (indexed for inflation);

(E) For a loan amount less than $12,500 (indexed for inflation): 8 percent of the total loan amount.

(ii) The dollar amounts, including the loan amounts, in paragraph (e)(3)(i) of this section shall be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index for All Urban Consumers (CPI-U) that was reported on the preceding June 1. See the official commentary to this paragraph (e)(3)(ii) for the current dollar amounts.

(iii) For covered transactions consummated on or before January 10, 2021, if the creditor or assignee determines after consummation that the transaction's total points and fees exceed the applicable limit under paragraph (e)(3)(i) of this section, the loan is not precluded from being a qualified mortgage, provided:

(A) The loan otherwise meets the requirements of paragraphs (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section, as applicable;

(B) The creditor or assignee pays to the consumer the amount described in paragraph (e)(3)(iv) of this section within 210 days after consummation and prior to the occurrence of any of the following events:

(1) The institution of any action by the consumer in connection with the loan;

(2) The receipt by the creditor, assignee, or servicer of written notice from the consumer that the transaction's total points and fees exceed the applicable limit under paragraph (e)(3)(i) of this section; or

(3) The consumer becoming 60 days past due on the legal obligation; and

(C) The creditor or assignee, as applicable, maintains and follows policies and procedures for post-consummation review of points and fees and for making payments to consumers in accordance with paragraphs (e)(3)(iii)(B) and (e)(3)(iv) of this section.

(iv) For purposes of paragraph (e)(3)(iii) of this section, the creditor or assignee must pay to the consumer an amount that is not less than the sum of the following:

(A) The dollar amount by which the transaction's total points and fees exceeds the applicable limit under paragraph (e)(3)(i) of this section; and

(B) Interest on the dollar amount described in paragraph (e)(3)(iv)(A) of this section, calculated using the contract interest rate applicable during the period from consummation until the payment described in this paragraph (e)(3)(iv) is made to the consumer.

**Regulatory Commentary**

***43(e)(3) Limits on points and fees for qualified mortgages.***

***Paragraph 43(e)(3)(i)***

*1.* ***Total loan amount.*** *The term “total loan amount” is defined in §1026.32(b)(4)(i). For an explanation of how to calculate the “total loan amount” under §1026.43(e)(3)(i), see comment 32(b)(4)(i)-1.*

*2.* ***Calculation of allowable points and fees.*** *A creditor must determine which category the loan falls into based on the face amount of the note (the “loan amount” as defined in §1026.43(b)(5)). For categories with a percentage limit, the creditor must apply the allowable points and fees percentage to the “total loan amount,” which may be different than the loan amount. A creditor must calculate the allowable amount of points and fees for a qualified mortgage as follows:*

*i. First, the creditor must determine the “tier” into which the loan falls based on the loan amount. The loan amount is the principal amount the consumer will borrow, as reflected in the promissory note or loan contract. See §1026.43(b)(5). For example, if the loan amount is $55,000, the loan falls into the tier for loans greater than or equal to $20,000 but less than $60,000, to which a 5 percent cap on points and fees applies. For tiers with a prescribed dollar limit on points and fees (e.g., for loans from $60,000 up to $100,000, the limit is $3,000), the creditor does not need to do any further calculations.*

*ii. Second, for tiers with a percentage limit, the creditor must determine the total loan amount based on the calculation for the total loan amount under comment 32(b)(4)(i)-1. If the loan amount is $55,000, for example, the total loan amount may be a different amount, such as $52,000.*

*iii. Third, the creditor must apply the percentage cap on points and fees to the total loan amount. For example, for a loan of $55,000 where the total loan amount is $52,000, the allowable points and fees are 5 percent of $52,000, or $2,600.*

*3.* ***Sample determination of allowable points and fees.***

*i. A covered transaction with a loan amount of $105,000 falls into the first points and fees tier, to which a points and fees cap of 3 percent of the total loan amount applies. See §1026.43(e)(3)(i)(A). Therefore, if the calculation under comment 32(b)(4)(i)-1 results in a total loan amount of $102,000, then the allowable total points and fees for this loan are 3 percent of $102,000, or $3,060.*

*ii. A covered transaction with a loan amount of $75,000 falls into the second points and fees tier, to which a points and fees cap of $3,000 applies. See §1026.43(e)(3)(i)(B). The allowable total points and fees for this loan are $3,000, regardless of the total loan amount.*

*iii. A covered transaction with a loan amount of $50,000 falls into the third points and fees tier, to which a points and fees cap of 5 percent of the total loan amount applies. See §1026.43(e)(3)(i)(C). Therefore, if the calculation under comment 32(b)(4)(i)-1 results in a total loan amount of $48,000, then the allowable total points and fees for this loan are 5 percent of $48,000, or $2,400.*

*iv. A covered transaction with a loan amount of $15,000 falls into the fourth points and fees tier, to which a points and fees cap of $1,000 applies. See §1026.43(e)(3)(i)(D). The allowable total points and fees for this loan are $1,000, regardless of the total loan amount.*

*v. A covered transaction with a loan amount of $10,000 falls into the fifth points and fees tier, to which a points and fees cap of 8 percent of the total loan amount applies. See §1026.43(e)(3)(i)(E). Therefore, if the calculation under comment 32(b)(4)(i)-1 results in a total loan amount of $7,000, then the allowable total points and fees for this loan are 8 percent of $7,000, or $560.*

***Paragraph 43(e)(3)(ii)***

*1.* ***Annual adjustment for inflation.*** *The dollar amounts, including the loan amounts, in §1026.43(e)(3)(i) will be adjusted annually on January 1 by the annual percentage change in the CPI-U that was in effect on the preceding June 1. The Bureau will publish adjustments after the June figures become available each year.*

*i. For 2015 [Text omitted]*

*ii. For 2016 [Text omitted]*

*iii. For 2017, reflecting a 1.1 percent increase in the CPI-U that was reported on the preceding June 1, a covered transaction is not a qualified mortgage unless the transactions total points and fees do not exceed:*

*A. For a loan amount greater than or equal to $102,894: 3 percent of the total loan amount;*

*B. For a loan amount greater than or equal to $61,737 but less than $102,894: $3,087;*

*C. For a loan amount greater than or equal to $20,579 but less than $61,737: 5 percent of the total loan amount;*

*D. For a loan amount greater than or equal to $12,862 but less than $20,579: $1,029;*

*E. For a loan amount less than $12,862: 8 percent of the total loan amount.*

***Paragraph 43(e)(3)(iii)***

*1.* ***Payment to the consumer.*** *The creditor or assignee, as applicable, complies with §1026.43(e)(3)(iii)(B) if it pays to the consumer the amount described in §1026.43(e)(3)(iv) within 210 days after consummation and prior to the occurrence of any of the events in §1026.43(e)(3)(iii)(B)(1) through (3). A creditor or assignee, as applicable, does not comply with §1026.43(e)(3)(iii)(B) if it pays to the consumer the amount described in §1026.43(e)(3)(iv) more than 210 days after consummation or after the occurrence of any of the events in §1026.43(e)(3)(iii)(B)(1) through (3). Payment may be made by any means mutually agreeable to the consumer and the creditor or assignee, as applicable, or by check. If payment is made by check, the creditor or assignee complies with §1026.43(e)(3)(iii)(B) if the check is delivered or placed in the mail to the consumer within 210 days after consummation.*

*2.* ***60 days past due.*** *Section 1026.43(e)(3)(iii)(B)(3) provides that, to comply with §1026.43(e)(3)(iii)(B), the creditor or assignee must pay to the consumer the amount described in §1026.43(e)(3)(iv) prior to the consumer becoming 60 days past due on the legal obligation. For this purpose, “past due” means the failure to make a periodic payment (in one full payment or in two or more partial payments) sufficient to cover principal, interest, and, if applicable, escrow under the terms of the legal obligation. Other amounts, such as any late fees, are not considered for this purpose. For purposes of §1026.43(e)(3)(iii)(B)(3), a periodic payment is 30 days past due when it is not paid on or before the due date of the following scheduled periodic payment and is 60 days past due when, after already becoming 30 days past due, it is not paid on or before the due date of the next scheduled periodic payment. For purposes of §1026.43(e)(3)(iii)(B)(3), the creditor or assignee may treat a received payment as applying to the oldest outstanding periodic payment. The following example illustrates the meaning of 60 days past due for purposes of §1026.43(e)(3)(iii)(B)(3):*

*i. Assume a loan is consummated on October 15, 2015, that the consumer's periodic payment is due on the 1st of each month, and that the consumer timely made the first periodic payment due on December 1, 2015. For purposes of §1026.43(e)(3)(iii)(B)(3), the consumer is 30 days past due if the consumer fails to make a payment (sufficient to cover the scheduled January 1, 2016 periodic payment of principal, interest, and, if applicable, escrow) on or before February 1, 2016. For purposes of §1026.43(e)(3)(iii)(B)(3), the consumer is 60 days past due if the consumer then also fails to make a payment (sufficient to cover the scheduled January 1, 2016 periodic payment of principal, interest, and, if applicable, escrow) on or before March 1, 2016. For purposes of §1026.43(e)(3)(iii)(B)(3), the consumer is not 60 days past due if the consumer makes a payment (sufficient to cover the scheduled January 1, 2016 periodic payment of principal, interest, and, if applicable, escrow) on or before March 1, 2016.*

*3.* ***Post-consummation policies and procedures.*** *The policies and procedures described in §1026.43(e)(3)(iii)(C) need not require that a creditor or assignee, as applicable, conduct a post-consummation review of all loans originated by the creditor or acquired by the assignee, nor must such policies and procedures require a creditor or assignee to apply §1026.43(e)(3)(iii) and (iv) for all loans for which the total points and fees are found to exceed the applicable limit under §1026.43(e)(3)(i).*

***Paragraph 43(e)(3)(iv)***

*1.* ***Interest rate.*** *For purposes of §1026.43(e)(3)(iv)(B), interest is calculated using the contract interest rate applicable during the period from consummation until the payment described in §1026.43(e)(3)(iv) is made to the consumer. In an adjustable-rate or step-rate transaction in which more than one interest rate applies during the period from consummation until payment is made to the consumer, the minimum payment amount is determined by calculating interest on the dollar amount described in §1026.43(e)(3)(iv)(A) at each such interest rate for the part of the overall period during which that rate applies. However, §1026.43(e)(3)(iv) provides that, for purposes of §1026.43(e)(3)(iii), the creditor or assignee can pay to the consumer an amount that exceeds the sum of the amounts described in §1026.43(e)(3)(iv)(A) and (B). Therefore, a creditor or assignee may, for example, elect to calculate interest using the maximum interest rate that may apply during the period from consummation until payment is made to the consumer. See comment 43(e)(3)(iii)-1 for guidance on making payments to the consumer.*

*2.* ***Relationship to RESPA tolerance cure.*** *Under Regulation X (12 CFR 1024.7(i)), if any charges at settlement exceed the charges listed on the good faith estimate of settlement costs by more than the amounts permitted under 12 CFR 1024.7(e), the loan originator may cure the tolerance violation by reimbursing the amount by which the tolerance was exceeded at settlement or within 30 calendar days after settlement. Similarly, under §1026.19(f)(2)(v), if amounts paid by the consumer exceed the amounts specified under §1026.19(e)(3)(i) or (ii), the creditor complies with §1026.19(e)(1)(i) if the creditor refunds the excess to the consumer no later than 60 days after consummation. The amount paid to the consumer pursuant to §1026.43(e)(3)(iv) may be offset by the amount paid to the consumer pursuant to 12 CFR 1024.7(i) or §1026.19(f)(2)(v), to the extent that the amount paid to the consumer pursuant to 12 CFR 1024.7(i) or §1026.19(f)(2)(v) is being applied to fees or charges included in points and fees pursuant to §1026.32(b)(1). However, a creditor or assignee has not satisfied §1026.43(e)(3)(iii) unless the total amount described in §1026.43(e)(3)(iv), including any offset due to a payment made pursuant to 12 CFR 1024.7(i) or §1026.19(f)(2)(v), is paid to the consumer within 210 days after consummation and prior to the occurrence of any of the events in §1026.43(e)(3)(iii)(B)(1) through (3).*

## Qualified Mortgage Defined – Special Rules - 12 CFR § 1026.43(e)(4)

### Regulatory Discussion

As an exception to the general definition of a “*qualified mortgage*” in paragraph (e)(2), above, this paragraph (e)(4) also includes as a “qualified mortgage” transactions that not only satisfy the requirements of paragraphs (e)(2)(i) through (iii) but also satisfies:

One or more of the following criteria, which requires a loan (except with regard to matters wholly unrelated to ability to repay):

* be eligible:
  + to be purchased or guaranteed by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation; or
  + to be purchased or guaranteed by any limited-life regulatory entity succeeding the charters of either entity, above;
* be eligible to be insured by the U.S. Department of Housing and Urban Development;
* be eligible to be guaranteed by the U.S. Department of Veteran Affairs;
* be eligible to be guaranteed by the U.S. Department of Agriculture; or
* be eligible to be insured by the Rural Housing Service.

Note: each special rule described above shall expire on the effective date of a rule issued by each respective agency; and, unless otherwise expired as stated herein, these special rules are only available for covered transactions consummated on or before January 10, 2021.

See the commentary for additional information.

**Regulatory Text**

(4) **Qualified mortgage defined - special rules**

(i) **General.** Notwithstanding paragraph (e)(2) of this section, a qualified mortgage is a covered transaction that satisfies:

(A) The requirements of paragraphs (e)(2)(i) through (iii) of this section; and

(B) One or more of the criteria in paragraph (e)(4)(ii) of this section.

(ii) **Eligible loans.** A qualified mortgage under this paragraph (e)(4) must be one of the following at consummation:

(A) A loan that is eligible, except with regard to matters wholly unrelated to ability to repay:

(1) To be purchased or guaranteed by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367(a) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(a)); or

(2) To be purchased or guaranteed by any limited-life regulatory entity succeeding the charter of either the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation pursuant to section 1367(i) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(i));

(B) A loan that is eligible to be insured, except with regard to matters wholly unrelated to ability to repay, by the U.S. Department of Housing and Urban Development under the National Housing Act (12 U.S.C. 1707 *et seq.*);

(C) A loan that is eligible to be guaranteed, except with regard to matters wholly unrelated to ability to repay, by the U.S. Department of Veterans Affairs;

(D) A loan that is eligible to be guaranteed, except with regard to matters wholly unrelated to ability to repay, by the U.S. Department of Agriculture pursuant to 42 U.S.C. 1472(h); or

(E) A loan that is eligible to be insured, except with regard to matters wholly unrelated to ability to repay, by the Rural Housing Service.

(iii) **Sunset of special rules.**

(A) Each respective special rule described in paragraph (e)(4)(ii)(B), (C), (D), or (E) of this section shall expire on the effective date of a rule issued by each respective agency pursuant to its authority under TILA section 129C(b)(3)(ii) to define a qualified mortgage.

(B) Unless otherwise expired under paragraph (e)(4)(iii)(A) of this section, the special rules in this paragraph (e)(4) are available only for covered transactions consummated on or before January 10, 2021.

**Regulatory Commentary**

***43(e)(4) Qualified mortgage defined – special rules.***

*1.* ***Alternative definition.*** *Subject to the sunset provided under §1026.43(e)(4)(iii), §1026.43(e)(4) provides an alternative definition of qualified mortgage to the definition provided in §1026.43(e)(2). To be a qualified mortgage under §1026.43(e)(4), the transaction must satisfy the requirements under §1026.43(e)(2)(i) through (iii), in addition to being one of the types of loans specified in §1026.43(e)(4)(ii)(A) through (E).*

*2.* ***Termination of conservatorship.*** *Section 1026.43(e)(4)(ii)(A) requires that a covered transaction be eligible for purchase or guarantee by the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (or any limited-life regulatory entity succeeding the charter of either) operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617). The special rule under §1026.43(e)(4)(ii)(A) does not apply if Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either) has ceased operating under the conservatorship or receivership of the Federal Housing Finance Agency. For example, if either Fannie Mae or Freddie Mac (or succeeding limited-life regulatory entity) ceases to operate under the conservatorship or receivership of the Federal Housing Finance Agency, §1026.43(e)(4)(ii)(A) would no longer apply to loans eligible for purchase or guarantee by that entity; however, the special rule would be available for a loan that is eligible for purchase or guarantee by the other entity still operating under conservatorship or receivership.*

*3.* ***Timing.*** *Under §1026.43(e)(4)(iii), the definition of qualified mortgage under paragraph (e)(4) applies only to loans consummated on or before January 10, 2021, regardless of whether Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either) continues to operate under the conservatorship or receivership of the Federal Housing Finance Agency. Accordingly, §1026.43(e)(4) is available only for covered transactions consummated on or before the earlier of either:*

*i. The date Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either), respectively, cease to operate under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617); or*

*ii. January 10, 2021, as provided by §1026.43(e)(4)(iii).*

*4.* ***Eligible for purchase, guarantee, or insurance except with regard to matters wholly unrelated to ability to repay.*** *To satisfy §1026.43(e)(4)(ii), a loan need not be actually purchased or guaranteed by Fannie Mae or Freddie Mac or insured or guaranteed by one of the Agencies (the U.S. Department of Housing and Urban Development (HUD), U.S. Department of Veterans Affairs (VA), U.S. Department of Agriculture (USDA), or Rural Housing Service (RHS)). Rather, §1026.43(e)(4)(ii) requires only that the creditor determine that the loan is eligible (i.e., meets the criteria) for such purchase, guarantee, or insurance at consummation. For example, for purposes of §1026.43(e)(4), a creditor is not required to sell a loan to Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either) for that loan to be a qualified mortgage; however, the loan must be eligible for purchase or guarantee by Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either), including satisfying any requirements regarding consideration and verification of a consumer's income or assets, credit history, debt-to-income ratio or residual income, and other credit risk factors, but not any requirements regarding matters wholly unrelated to ability to repay. To determine eligibility for purchase, guarantee or insurance, a creditor may rely on a valid underwriting recommendation provided by a GSE automated underwriting system (AUS) or an AUS that relies on an Agency underwriting tool; compliance with the standards in the GSE or Agency written guide in effect at the time; a written agreement between the creditor or a direct sponsor or aggregator of the creditor and a GSE or Agency that permits variation from the standards of the written guides and/or variation from the AUSs, in effect at the time of consummation; or an individual loan waiver granted by the GSE or Agency to the creditor. For creditors relying on the variances of a sponsor or aggregator, a loan that is transferred directly to or through the sponsor or aggregator at or after consummation complies with §1026.43(e)(4). In using any of the four methods listed above, the creditor need not satisfy standards that are wholly unrelated to assessing a consumer's ability to repay that the creditor is required to perform. Matters wholly unrelated to ability to repay are those matters that are wholly unrelated to credit risk or the underwriting of the loan. Such matters include requirements related to the status of the creditor rather than the loan, requirements related to selling, securitizing, or delivering the loan, and any requirement that the creditor must perform after the consummated loan is sold, guaranteed, or endorsed for insurance such as document custody, quality control, or servicing. Accordingly, a covered transaction is eligible for purchase or guarantee by Fannie Mae or Freddie Mac, for example, if:*

*i. The loan conforms to the relevant standards set forth in the Fannie Mae Single-Family Selling Guide or the Freddie Mac Single-Family Seller/Servicer Guide in effect at the time, or to standards set forth in a written agreement between the creditor or a sponsor or aggregator of the creditor and Fannie Mae or Freddie Mac in effect at that time that permits variation from the standards of those guides;*

*ii. The loan has been granted an individual waiver by a GSE, which will allow purchase or guarantee in spite of variations from the applicable standards; or*

*iii. The creditor inputs accurate information into the Fannie Mae or Freddie Mac AUS or another AUS pursuant to a written agreement between the creditor and Fannie Mae or Freddie Mac that permits variation from the GSE AUS; the loan receives one of the recommendations specified below in paragraphs A or B from the corresponding GSE AUS or an equivalent recommendation pursuant to another AUS as authorized in the written agreement; and the creditor satisfies any requirements and conditions specified by the relevant AUS that are not wholly unrelated to ability to repay, the non-satisfaction of which would invalidate that recommendation:*

*A. An “Approve/Eligible” recommendation from Desktop Underwriter (DU); or*

*B. A risk class of “Accept” and purchase eligibility of “Freddie Mac Eligible” from Loan Prospector (LP).*

*5.* ***Repurchase and indemnification demands.*** *A repurchase or indemnification demand by Fannie Mae, Freddie Mac, HUD, VA, USDA, or RHS is not dispositive of qualified mortgage status. Qualified mortgage status under §1026.43(e)(4) depends on whether a loan is eligible to be purchased, guaranteed, or insured at the time of consummation, provided that other requirements under §1026.43(e)(4) are satisfied. Some repurchase or indemnification demands are not related to eligibility criteria at consummation. See comment 43(e)(4)-4. Further, even where a repurchase or indemnification demand relates to whether the loan satisfied relevant eligibility requirements as of the time of consummation, the mere fact that a demand has been made, or even resolved, between a creditor and GSE or agency is not dispositive for purposes of §1026.43(e)(4). However, evidence of whether a particular loan satisfied the §1026.43(e)(4) eligibility criteria at consummation may be brought to light in the course of dealing over a particular demand, depending on the facts and circumstances. Accordingly, each loan should be evaluated by the creditor based on the facts and circumstances relating to the eligibility of that loan at the time of consummation. For example:*

*i. Assume eligibility to purchase a loan was based in part on the consumer's employment income of $50,000 per year. The creditor uses the income figure in obtaining an approve/eligible recommendation from DU. A quality control review, however, later determines that the documentation provided and verified by the creditor to comply with Fannie Mae requirements did not support the reported income of $50,000 per year. As a result, Fannie Mae demands that the creditor repurchase the loan. Assume that the quality control review is accurate, and that DU would not have issued an approve/eligible recommendation if it had been provided the accurate income figure. The DU determination at the time of consummation was invalid because it was based on inaccurate information provided by the creditor; therefore, the loan was never a qualified mortgage under §1026.43(e)(4).*

*ii. Assume that a creditor delivered a loan, which the creditor determined was a qualified mortgage at the time of consummation under §1026.43(e)(4), to Fannie Mae for inclusion in a particular To-Be-Announced Mortgage Backed Security (MBS) pool of loans. The data submitted by the creditor at the time of loan delivery indicated that the various loan terms met the product type, weighted-average coupon, weighted-average maturity, and other MBS pooling criteria, and MBS issuance disclosures to investors reflected this loan data. However, after delivery and MBS issuance, a quality control review determines that the loan violates the pooling criteria. The loan still meets eligibility requirements for Fannie Mae products and loan terms. Fannie Mae, however, requires the creditor to repurchase the loan due to the violation of MBS pooling requirements. Assume that the quality control review determination is accurate. Because the loan still meets Fannie Mae's eligibility requirements, it remains a qualified mortgage based on these facts and circumstances.*

## QM – Small Creditor Portfolio Loans - 12 CFR § 1026.43(e)(5)

### Regulatory Discussion

As an exception to the general definition of a “*qualified mortgage*” in paragraph (e)(2), above, this paragraph (e)(5) also includes as a “qualified mortgage” transactions that not only satisfy the requirements of paragraphs of (e)(2) (except for (e)(2)(vi)) but also satisfies the requirements of (e)(5)(i)(B) through (D), below.

Note: a “qualified mortgage” extended under this exception immediately loses its status as such if legal title to the qualified mortgage is sold, assigned, or otherwise transferred to another person (see exceptions in (e)(5)(ii)(A) through (D), below.

See the commentary for additional information.

**Regulatory Text**

(5) **Qualified mortgage defined—small creditor portfolio loans.**

(i) Notwithstanding paragraph (e)(2) of this section, a qualified mortgage is a covered transaction:

(A) That satisfies the requirements of paragraph (e)(2) of this section other than the requirements of paragraph (e)(2)(vi) and without regard to the standards in appendix Q to this part;

(B) For which the creditor considers at or before consummation the consumer's monthly debt-to-income ratio or residual income and verifies the debt obligations and income used to determine that ratio in accordance with paragraph (c)(7) of this section, except that the calculation of the payment on the covered transaction for purposes of determining the consumer's total monthly debt obligations in paragraph (c)(7)(i)(A) shall be determined in accordance with paragraph (e)(2)(iv) of this section instead of paragraph (c)(5) of this section;

(C) That is not subject, at consummation, to a commitment to be acquired by another person, other than a person that satisfies the requirements of paragraph (e)(5)(i)(D) of this section; and

(D) For which the creditor satisfies the requirements stated in §1026.35(b)(2)(iii)(B) and (C).

(ii) A qualified mortgage extended pursuant to paragraph (e)(5)(i) of this section immediately loses its status as a qualified mortgage under paragraph (e)(5)(i) if legal title to the qualified mortgage is sold, assigned, or otherwise transferred to another person except when:

(A) The qualified mortgage is sold, assigned, or otherwise transferred to another person three years or more after consummation of the qualified mortgage;

(B) The qualified mortgage is sold, assigned, or otherwise transferred to a creditor that satisfies the requirements of paragraph (e)(5)(i)(D) of this section;

(C) The qualified mortgage is sold, assigned, or otherwise transferred to another person pursuant to a capital restoration plan or other action under 12 U.S.C. 1831o, actions or instructions of any person acting as conservator, receiver, or bankruptcy trustee, an order of a State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law, or an agreement between the creditor and such an agency; or

(D) The qualified mortgage is sold, assigned, or otherwise transferred pursuant to a merger of the creditor with another person or acquisition of the creditor by another person or of another person by the creditor.

**Regulatory Commentary**

***Paragraph 43(e)(5)***

*1.* ***Satisfaction of qualified mortgage requirements.*** *For a covered transaction to be a qualified mortgage under §1026.43(e)(5), the mortgage must satisfy the requirements for a qualified mortgage under §1026.43(e)(2), other than the requirements regarding debt-to-income ratio. For example, a qualified mortgage under §1026.43(e)(5) may not have a loan term in excess of 30 years because longer terms are prohibited for qualified mortgages under §1026.43(e)(2)(ii). Similarly, a qualified mortgage under §1026.43(e)(5) may not result in a balloon payment because §1026.43(e)(2)(i)(C) provides that qualified mortgages may not have balloon payments except as provided under §1026.43(f). However, a covered transaction need not comply with §1026.43(e)(2)(vi), which prohibits consumer monthly debt-to-income ratios in excess of 43 percent. A covered transaction therefore can be a qualified mortgage under §1026.43(e)(5) even though the consumer's monthly debt-to-income ratio is greater than 43 percent.*

*2.* ***Debt-to-income ratio or residual income.*** *Section 1026.43(e)(5) does not prescribe a specific monthly debt-to-income ratio with which creditors must comply. Instead, creditors must consider a consumer's debt-to-income ratio or residual income calculated generally in accordance with §1026.43(c)(7) and verify the information used to calculate the debt-to-income ratio or residual income in accordance with §1026.43(c)(3) and (4). However, §1026.43(c)(7) refers creditors to §1026.43(c)(5) for instructions on calculating the payment on the covered transaction. Section 1026.43(c)(5) requires creditors to calculate the payment differently than §1026.43(e)(2)(iv). For purposes of the qualified mortgage definition in §1026.43(e)(5), creditors must base their calculation of the consumer's debt-to-income ratio or residual income on the payment on the covered transaction calculated according to §1026.43(e)(2)(iv) instead of according to §1026.43(c)(5). Creditors are not required to calculate the consumer's monthly debt-to-income ratio in accordance with appendix Q to this part as is required under the general definition of qualified mortgages by §1026.43(e)(2)(vi).*

*3.* ***Forward commitments.*** *A creditor may make a mortgage loan that will be transferred or sold to a purchaser pursuant to an agreement that has been entered into at or before the time the transaction is consummated. Such an agreement is sometimes known as a “forward commitment.” A mortgage that will be acquired by a purchaser pursuant to a forward commitment does not satisfy the requirements of §1026.43(e)(5), whether the forward commitment provides for the purchase and sale of the specific transaction or for the purchase and sale of transactions with certain prescribed criteria that the transaction meets. However, a forward commitment to another person that also meets the requirements of §1026.43(e)(5)(i)(D) is permitted. For example, assume a creditor that is eligible to make qualified mortgages under §1026.43(e)(5) makes a mortgage. If that mortgage meets the purchase criteria of an investor with which the creditor has an agreement to sell loans after consummation, then the loan does not meet the definition of a qualified mortgage under §1026.43(e)(5). However, if the investor meets the requirements of §1026.43(e)(5)(i)(D), the mortgage will be a qualified mortgage if all other applicable criteria also are satisfied.*

*4.* ***Creditor qualifications.*** *To be eligible to make qualified mortgages under §1026.43(e)(5), a creditor must satisfy the requirements stated in §1026.35(b)(2)(iii)(B) and (C). Section 1026.35(b)(2)(iii)(B) requires that, during the preceding calendar year, or, if the application for the transaction was received before April 1 of the current calendar year, during either of the two preceding calendar years, the creditor and its affiliates together extended no more than 2,000 covered transactions, as defined by §1026.43(b)(1), secured by first liens, that were sold, assigned, or otherwise transferred to another person, or that were subject at the time of consummation to a commitment to be acquired by another person. Section 1026.35(b)(2)(iii)(C) requires that, as of the preceding December 31st, or, if the application for the transaction was received before April 1 of the current calendar year, as of either of the two preceding December 31sts, the creditor and its affiliates that regularly extended, during the applicable period, covered transactions, as defined by §1026.43(b)(1), secured by first liens, together, had total assets of less than $2 billion, adjusted annually by the Bureau for inflation.*

*5.* ***Requirement to hold in portfolio.*** *Creditors generally must hold a loan in portfolio to maintain the transaction's status as a qualified mortgage under §1026.43(e)(5), subject to four exceptions. Unless one of these exceptions applies, a loan is no longer a qualified mortgage under §1026.43(e)(5) once legal title to the debt obligation is sold, assigned, or otherwise transferred to another person. Accordingly, unless one of the exceptions applies, the transferee could not benefit from the presumption of compliance for qualified mortgages under §1026.43(e)(1) unless the loan also met the requirements of another qualified mortgage definition.*

*6.* ***Application to subsequent transferees.*** *The exceptions contained in §1026.43(e)(5)(ii) apply not only to an initial sale, assignment, or other transfer by the originating creditor but to subsequent sales, assignments, and other transfers as well. For example, assume Creditor A originates a qualified mortgage under §1026.43(e)(5). Six months after consummation, Creditor A sells the qualified mortgage to Creditor B pursuant to §1026.43(e)(5)(ii)(B) and the loan retains its qualified mortgage status because Creditor B complies with the limits on asset size and number of transactions. If Creditor B sells the qualified mortgage, it will lose its qualified mortgage status under §1026.43(e)(5) unless the sale qualifies for one of the §1026.43(e)(5)(ii) exceptions for sales three or more years after consummation, to another qualifying institution, as required by supervisory action, or pursuant to a merger or acquisition.*

*7.* ***Transfer three years after consummation.*** *Under §1026.43(e)(5)(ii)(A), if a qualified mortgage under §1026.43(e)(5) is sold, assigned, or otherwise transferred three years or more after consummation, the loan retains its status as a qualified mortgage under §1026.43(e)(5) following the transfer. The transferee need not be eligible to originate qualified mortgages under §1026.43(e)(5). The loan will continue to be a qualified mortgage throughout its life, and the transferee, and any subsequent transferees, may invoke the presumption of compliance for qualified mortgages under §1026.43(e)(1).*

*8.* ***Transfer to another qualifying creditor.*** *Under §1026.43(e)(5)(ii)(B), a qualified mortgage under §1026.43(e)(5) may be sold, assigned, or otherwise transferred at any time to another creditor that meets the requirements of §1026.43(e)(5)(i)(D). That section requires that a creditor together with all its affiliates, extended no more than 2,000 first-lien covered transactions that were sold, assigned, or otherwise transferred by the creditor or its affiliates to another person, or that were subject at the time of consummation to a commitment to be acquired by another person; and have, together with its affiliates that regularly extended covered transactions secured by first liens, total assets less than $2 billion (as adjusted for inflation). These tests are assessed based on transactions and assets from the calendar year preceding the current calendar year or from either of the two calendar years preceding the current calendar year if the application for the transaction was received before April 1 of the current calendar year. A qualified mortgage under §1026.43(e)(5) transferred to a creditor that meets these criteria would retain its qualified mortgage status even if it is transferred less than three years after consummation.*

*9.* ***Supervisory sales.*** *Section 1026.43(e)(5)(ii)(C) facilitates sales that are deemed necessary by supervisory agencies to revive troubled creditors and resolve failed creditors. A qualified mortgage under §1026.43(e)(5) retains its qualified mortgage status if it is sold, assigned, or otherwise transferred to another person pursuant to: A capital restoration plan or other action under 12 U.S.C. 1831o; the actions or instructions of any person acting as conservator, receiver or bankruptcy trustee; an order of a State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law; or an agreement between the creditor and such an agency. A qualified mortgage under §1026.43(e)(5) that is sold, assigned, or otherwise transferred under these circumstances retains its qualified mortgage status regardless of how long after consummation it is sold and regardless of the size or other characteristics of the transferee. Section 1026.43(e)(5)(ii)(C) does not apply to transfers done to comply with a generally applicable regulation with future effect designed to implement, interpret, or prescribe law or policy in the absence of a specific order by or a specific agreement with a governmental agency described in §1026.43(e)(5)(ii)(C) directing the sale of one or more qualified mortgages under §1026.43(e)(5) held by the creditor or one of the other circumstances listed in §1026.43(e)(5)(ii)(C). For example, a qualified mortgage under §1026.43(e)(5) that is sold pursuant to a capital restoration plan under 12 U.S.C. 1831o would retain its status as a qualified mortgage following the sale. However, if the creditor simply chose to sell the same qualified mortgage as one way to comply with general regulatory capital requirements in the absence of supervisory action or agreement it would lose its status as a qualified mortgage following the sale unless it qualifies under another definition of qualified mortgage.*

*10.* ***Mergers and acquisitions.*** *A qualified mortgage under §1026.43(e)(5) retains its qualified mortgage status if a creditor merges with, is acquired by, or acquires another person regardless of whether the creditor or its successor is eligible to originate new qualified mortgages under §1026.43(e)(5) after the merger or acquisition. However, the creditor or its successor can originate new qualified mortgages under §1026.43(e)(5) only if it complies with all of the requirements of §1026.43(e)(5) after the merger or acquisition. For example, assume a creditor that originates 250 covered transactions each year and originates qualified mortgages under §1026.43(e)(5) is acquired by a larger creditor that originates 10,000 covered transactions each year. Following the acquisition, the small creditor would no longer be able to originate §1026.43(e)(5) qualified mortgages because, together with its affiliates, it would originate more than 500 covered transactions each year. However, the §1026.43(e)(5) qualified mortgages originated by the small creditor before the acquisition would retain their qualified mortgage status.*

## QM Balloon Payment Loams - 12 CFR § 1026.43(e)(6)

### Regulatory Discussion

Note: this exception only applies to transactions for which the application was received before April 1, 2016.

As an exception to the general definition of a “*qualified mortgage*” in paragraph (e)(2), above, this paragraph (e)(6) also includes as a “qualified mortgage” transactions that not only satisfy the requirements of paragraphs in (e)(2) but also:

* satisfies the requirements of paragraph (f) (in Section 6, below); and
* the creditor satisfies the requirements of §1026.35(b)(2)(iii)(B) and (C)

**Regulatory Text**

(6) **Qualified mortgage defined - temporary balloon-payment qualified mortgage rules.**

(i) Notwithstanding paragraph (e)(2) of this section, a qualified mortgage is a covered transaction:

(A) That satisfies the requirements of paragraph (f) of this section other than the requirements of paragraph (f)(1)(vi); and

(B) For which the creditor satisfies the requirements stated in §1026.35(b)(2)(iii)(B) and (C).

(ii) The provisions of this paragraph (e)(6) apply only to covered transactions for which the application was received before April 1, 2016.

**Regulatory Commentary**

*None.*

# Section 6: Balloon Payment Qualified Mortgages

# 12 CFR § 1026.43(f)

## Exemption – 12 CFR § 1026.43(f)(1)

### Regulatory Discussion

As an exception to the general definition of a “*qualified mortgage*” in paragraph (e)(2), above, this paragraph (f)(1) also includes as a “qualified mortgage” transactions that not only satisfy the requirements of paragraphs in (e)(2) but also provides for a balloon payment, provided the six conditions in paragraphs (f)(1)(i) through (vi) are satisfied.

The commentary provides additional important information on each of the six conditions.

### Regulatory Text

(1) ***Exemption.*** Notwithstanding paragraph (e)(2) of this section, a qualified mortgage may provide for a balloon payment, provided:

(i) The loan satisfies the requirements for a qualified mortgage in paragraphs (e)(2)(i)(A), (e)(2)(ii), (e)(2)(iii), and (e)(2)(v) of this section, but without regard to the standards in appendix Q;

(ii) The creditor determines at or before consummation that the consumer can make all of the scheduled payments under the terms of the legal obligation, as described in paragraph (f)(1)(iv) of this section, together with the consumer's monthly payments for all mortgage-related obligations and excluding the balloon payment, from the consumer's current or reasonably expected income or assets other than the dwelling that secures the loan;

(iii) The creditor considers at or before consummation the consumer's monthly debt-to-income ratio or residual income and verifies the debt obligations and income used to determine that ratio in accordance with paragraph (c)(7) of this section, except that the calculation of the payment on the covered transaction for purposes of determining the consumer's total monthly debt obligations in (c)(7)(i)(A) shall be determined in accordance with paragraph (f)(iv)(A) of this section, together with the consumer's monthly payments for all mortgage-related obligations and excluding the balloon payment;

(iv) The legal obligation provides for:

(A) Scheduled payments that are substantially equal, calculated using an amortization period that does not exceed 30 years;

(B) An interest rate that does not increase over the term of the loan; and

(C) A loan term of five years or longer.

(v) The loan is not subject, at consummation, to a commitment to be acquired by another person, other than a person that satisfies the requirements of paragraph (f)(1)(vi) of this section; and

(vi) The creditor satisfies the requirements stated in §1026.35(b)(2)(iii)(A), (B), and (C).

### Regulatory Commentary

***43(f)(1) Exemption.***

***Paragraph 43(f)(1)(i)***

*1.* ***Satisfaction of qualified mortgage requirements.*** *Under §1026.43(f)(1)(i), for a mortgage that provides for a balloon payment to be a qualified mortgage, the mortgage must satisfy the requirements for a qualified mortgage in paragraphs (e)(2)(i)(A), (e)(2)(ii), (iii), and (v). Therefore, a covered transaction with balloon payment terms must provide for regular periodic payments that do not result in an increase of the principal balance, pursuant to §1026.43(e)(2)(i)(A); must have a loan term that does not exceed 30 years, pursuant to §1026.43(e)(2)(ii); must have total points and fees that do not exceed specified thresholds pursuant to §1026.43(e)(2)(iii); and must satisfy the consideration and verification requirements in §1026.43(e)(2)(v).*

***Paragraph 43(f)(1)(ii)***

*1.* ***Example.*** *Under §1026.43(f)(1)(ii), if a qualified mortgage provides for a balloon payment, the creditor must determine that the consumer is able to make all scheduled payments under the legal obligation other than the balloon payment. For example, assume a loan in an amount of $200,000 that has a five-year loan term, but is amortized over 30 years. The loan agreement provides for a fixed interest rate of 6 percent. The loan consummates on March 3, 2014, and the monthly payment of principal and interest scheduled for the first five years is $1,199, with the first monthly payment due on April 1, 2014. The balloon payment of $187,308 is required on the due date of the 60th monthly payment, which is April 1, 2019. The loan can be a qualified mortgage if the creditor underwrites the loan using the scheduled principal and interest payment of $1,199, plus the consumer's monthly payment for all mortgage-related obligations, and satisfies the other criteria set forth in §1026.43(f).*

*2.* ***Creditor's determination.*** *A creditor must determine that the consumer is able to make all scheduled payments other than the balloon payment to satisfy §1026.43(f)(1)(ii), in accordance with the legal obligation, together with the consumer's monthly payments for all mortgage-related obligations and excluding the balloon payment, to meet the repayment ability requirements of §1026.43(f)(1)(ii). A creditor satisfies §1026.43(f)(1)(ii) if it uses the maximum payment in the payment schedule, excluding any balloon payment, to determine if the consumer has the ability to make the scheduled payments.*

***Paragraph 43(f)(1)(iii)***

*1.* ***Debt-to-income or residual income.*** *A creditor must consider and verify the consumer's monthly debt-to-income ratio or residual income to meet the requirements of §1026.43(f)(1)(iii). To calculate the consumer's monthly debt-to-income or residual income for purposes of §1026.43(f)(1)(iii), the creditor may rely on the definitions and calculation rules in §1026.43(c)(7) and its accompanying commentary, except for the calculation rules for a consumer's total monthly debt obligations (which is a component of debt-to-income and residual income under §1026.43(c)(7)). For purposes of calculating the consumer's total monthly debt obligations under §1026.43(f)(1)(iii), the creditor must calculate the monthly payment on the covered transaction using the payment calculation rules in §1026.43(f)(1)(iv)(A), together with all mortgage-related obligations and excluding the balloon payment.*

***Paragraph 43(f)(1)(iv)***

*1.* ***Scheduled payments.*** *Under §1026.43(f)(1)(iv)(A), the legal obligation must provide that scheduled payments must be substantially equal and determined using an amortization period that does not exceed 30 years. Balloon payments often result when the periodic payment would fully repay the loan amount only if made over some period that is longer than the loan term. For example, a loan term of 10 years with periodic payments based on an amortization period of 20 years would result in a balloon payment being due at the end of the loan term. Whatever the loan term, the amortization period used to determine the scheduled periodic payments that the consumer must pay under the terms of the legal obligation may not exceed 30 years.*

*2.* ***Substantially equal.*** *The calculation of payments scheduled by the legal obligation under §1026.43(f)(1)(iv)(A) are required to result in substantially equal amounts. This means that the scheduled payments need to be similar, but need not be equal. For further guidance on substantially equal payments, see comment 43(c)(5)(i)-4.*

*3.* ***Interest-only payments.*** *A mortgage that only requires the payment of accrued interest each month does not meet the requirements of §1026.43(f)(1)(iv)(A).*

***Paragraph 43(f)(1)(v)***

*1.* ***Forward commitments.*** *A creditor may make a mortgage loan that will be transferred or sold to a purchaser pursuant to an agreement that has been entered into at or before the time the transaction is consummated. Such an agreement is sometimes known as a “forward commitment.” A balloon-payment mortgage that will be acquired by a purchaser pursuant to a forward commitment does not satisfy the requirements of §1026.43(f)(1)(v), whether the forward commitment provides for the purchase and sale of the specific transaction or for the purchase and sale of transactions with certain prescribed criteria that the transaction meets. However, a purchase and sale of a balloon-payment qualified mortgage to another person that separately meets the requirements of §1026.43(f)(1)(vi) is permitted. For example: assume a creditor that meets the requirements of §1026.43(f)(1)(vi) makes a balloon-payment mortgage that meets the requirements of §1026.43(f)(1)(i) through (iv); if the balloon-payment mortgage meets the purchase criteria of an investor with which the creditor has an agreement to sell such loans after consummation, then the balloon-payment mortgage does not meet the definition of a qualified mortgage in accordance with §1026.43(f)(1)(v). However, if the investor meets the requirement of §1026.43(f)(1)(vi), the balloon-payment qualified mortgage retains its qualified mortgage status.*

***Paragraph 43(f)(1)(vi)***

*1.* ***Creditor qualifications.*** *Under §1026.43(f)(1)(vi), to make a qualified mortgage that provides for a balloon payment, the creditor must satisfy three criteria that are also required under §1026.35(b)(2)(iii)(A), (B) and (C), which require:*

*i. During the preceding calendar year or during either of the two preceding calendar years if the application for the transaction was received before April 1 of the current calendar year, the creditor extended a first-lien covered transaction, as defined in §1026.43(b)(1), on a property that is located in an area that is designated either “rural” or “underserved,” as defined in §1026.35(b)(2)(iv), to satisfy the requirement of §1026.35(b)(2)(iii)(A) (the rural-or-underserved test). Pursuant to §1026.35(b)(2)(iv), an area is considered to be rural if it is: A county that is neither in a metropolitan statistical area, nor a micropolitan statistical area adjacent to a metropolitan statistical area, as those terms are defined by the U.S. Office of Management and Budget; a census block that is not in an urban area, as defined by the U.S. Census Bureau using the latest decennial census of the United States; or a county or a census block that has been designated as “rural” by the Bureau pursuant to the application process established in 2016. See Application Process for Designation of Rural Area under Federal Consumer Financial Law; Procedural Rule, 81 FR 11099 (Mar. 3, 2016). An area is considered to be underserved during a calendar year if, according to HMDA data for the preceding calendar year, it is a county in which no more than two creditors extended covered transactions secured by first liens on properties in the county five or more times.*

*A. The Bureau determines annually which counties in the United States are rural or underserved as defined by §1026.35(b)(2)(iv)(A)(1) or §1026.35(b)(2)(iv)(B) and publishes on its public Web site lists of those counties to assist creditors in determining whether they meet the criterion at §1026.35(b)(2)(iii)(A). Creditors may also use an automated tool provided on the Bureau's public Web site to determine whether specific properties are located in areas that qualify as “rural” or “underserved” according to the definitions in §1026.35(b)(2)(iv) for a particular calendar year. In addition, the U.S. Census Bureau may also provide on its public Web site an automated address search tool that specifically indicates if a property address is located in an urban area for purposes of the Census Bureau's most recent delineation of urban areas. For any calendar year that begins after the date on which the Census Bureau announced its most recent delineation of urban areas, a property is located in an area that qualifies as “rural” according to the definitions in §1026.35(b)(2)(iv) if the search results provided for the property by any such automated address search tool available on the Census Bureau's public Web site do not identify the property as being in an urban area. A property is also located in an area that qualifies as “rural,” if the Bureau has designated that area as rural under §1026.35(b)(2)(iv)(A)(3) and published that determination in the Federal Register. See Application Process for Designation of Rural Area under Federal Consumer Financial Law; Procedural Rule, 81 FR 11099 (Mar. 3, 2016).*

*B. For example, if a creditor extended during 2017 a first-lien covered transaction that is secured by a property that is located in an area that meets the definition of rural or underserved under §1026.35(b)(2)(iv), the creditor meets this element of the exception for any transaction consummated during 2018.*

*C. Alternatively, if the creditor did not extend in 2017 a transaction that meets the definition of rural or underserved test under §1026.35(b)(2)(iv), the creditor satisfies this criterion for any transaction consummated during 2018 for which it received the application before April 1, 2018, if it extended during 2016 a first-lien covered transaction that is secured by a property that is located in an area that meets the definition of rural or underserved under §1026.35(b)(2)(iv).*

*ii. During the preceding calendar year, or, if the application for the transaction was received before April 1 of the current calendar year, during either of the two preceding calendar years, the creditor together with its affiliates extended no more than 2,000 covered transactions, as defined by §1026.43(b)(1), secured by first liens, that were sold, assigned, or otherwise transferred to another person, or that were subject at the time of consummation to a commitment to be acquired by another person, to satisfy the requirement of §1026.35(b)(2)(iii)(B).*

*iii. As of the preceding December 31st, or, if the application for the transaction was received before April 1 of the current calendar year, as of either of the two preceding December 31sts, the creditor and its affiliates that regularly extended covered transactions secured by first liens, together, had total assets that do not exceed the applicable asset threshold established by the Bureau, to satisfy the requirement of §1026.35(b)(2)(iii)(C). The Bureau publishes notice of the asset threshold each year by amending comment 35(b)(2)(iii)-1.iii.*

## Transfer of Balloon Loans - 12 CFR § 1026.43(f)(2)

### Regulatory Discussion

This paragraph provides that a balloon-payment “qualified mortgage” will immediately lose its status as such if legal title to the balloon-payment qualified mortgage is sold, assigned, or otherwise transferred to another person (subject to the exceptions in (f)(2)(i) through (iv).

The commentary provides additional information on each of the exceptions.

### Regulatory Text

(2) ***Post-consummation transfer of balloon-payment qualified mortgage.*** A balloon-payment qualified mortgage, extended pursuant to paragraph (f)(1), immediately loses its status as a qualified mortgage under paragraph (f)(1) if legal title to the balloon-payment qualified mortgage is sold, assigned, or otherwise transferred to another person except when:

(i) The balloon-payment qualified mortgage is sold, assigned, or otherwise transferred to another person three years or more after consummation of the balloon-payment qualified mortgage;

(ii) The balloon-payment qualified mortgage is sold, assigned, or otherwise transferred to a creditor that satisfies the requirements of paragraph (f)(1)(vi) of this section;

(iii) The balloon-payment qualified mortgage is sold, assigned, or otherwise transferred to another person pursuant to a capital restoration plan or other action under 12 U.S.C. 1831o, actions or instructions of any person acting as conservator, receiver or bankruptcy trustee, an order of a State or Federal governmental agency with jurisdiction to examine the creditor pursuant to State or Federal law, or an agreement between the creditor and such an agency; or

(iv) The balloon-payment qualified mortgage is sold, assigned, or otherwise transferred pursuant to a merger of the creditor with another person or acquisition of the creditor by another person or of another person by the creditor.

### Regulatory Commentary

***43(f)(2) Post-consummation transfer of balloon-payment qualified mortgage.***

*1.* ***Requirement to hold in portfolio.*** *Creditors generally must hold a balloon-payment qualified mortgage in portfolio to maintain the transaction's status as a qualified mortgage under §1026.43(f)(1), subject to four exceptions. Unless one of these exceptions applies, a balloon-payment qualified mortgage is no longer a qualified mortgage under §1026.43(f)(1) once legal title to the debt obligation is sold, assigned, or otherwise transferred to another person. Accordingly, unless one of the exceptions applies, the transferee could not benefit from the presumption of compliance for qualified mortgages under §1026.43(f)(1) unless the loan also met the requirements of another qualified mortgage definition.*

*2.* ***Application to subsequent transferees.*** *The exceptions contained in §1026.43(f)(2) apply not only to an initial sale, assignment, or other transfer by the originating creditor but to subsequent sales, assignments, and other transfers as well. For example, assume Creditor A originates a qualified mortgage under §1026.43(f)(1). Six months after consummation, Creditor A sells the qualified mortgage to Creditor B pursuant to §1026.43(f)(2)(ii) and the loan retains its qualified mortgage status because Creditor B complies with the conditions relating to operating in rural or underserved areas, asset size, and number of transactions. If Creditor B sells the qualified mortgage, it will lose its qualified mortgage status under §1026.43(f)(1) unless the sale qualifies for one of the §1026.43(f)(2) exceptions for sales three or more years after consummation, to another qualifying institution, as required by supervisory action, or pursuant to a merger or acquisition.*

***Paragraph 43(f)(2)(i)***

*1.* ***Transfer three years after consummation.*** *Under §1026.43(f)(2)(i), if a balloon-payment qualified mortgage under §1026.43(f)(1) is sold, assigned, or otherwise transferred three years or more after consummation, the balloon-payment qualified mortgage retains its status as a qualified mortgage under §1026.43(f)(1) following the sale. The transferee need not be eligible to originate qualified mortgages under §1026.43(f)(1)(vi). The balloon-payment qualified mortgage will continue to be a qualified mortgage throughout its life, and the transferee, and any subsequent transferees, may invoke the presumption of compliance for qualified mortgages under §1026.43(f)(1).*

***Paragraph 43(f)(2)(ii)***

*1.* ***Transfer to another qualifying creditor.*** *Under §1026.43(f)(2)(ii), a balloon-payment qualified mortgage under §1026.43(f)(1) may be sold, assigned, or otherwise transferred at any time to another creditor that meets the requirements of §1026.43(f)(1)(vi). That section requires that a creditor: (1) Extended a first-lien covered transaction, as defined in §1026.43(b)(1), on a property located in a rural or underserved area; (2) together with all affiliates, extended no more than 2,000 first-lien covered transactions that were sold, assigned, or otherwise transferred by the creditor or its affiliates to another person, or that were subject at the time of consummation to a commitment to be acquired by another person; and (3) have, together with its affiliates that regularly extended covered transactions secured by first liens, total assets less than $2 billion (as adjusted for inflation). These tests are assessed based on transactions and assets from the calendar year preceding the current calendar year or from either of the two calendar years preceding the current calendar year if the application for the transaction was received before April 1 of the current calendar year. A balloon-payment qualified mortgage under §1026.43(f)(1) transferred to a creditor that meets these criteria would retain its qualified mortgage status even if it is transferred less than three years after consummation.*

***Paragraph 43(f)(2)(iii)***

*1.* ***Supervisory sales.*** *Section 1026.43(f)(2)(iii) facilitates sales that are deemed necessary by supervisory agencies to revive troubled creditors and resolve failed creditors. A balloon-payment qualified mortgage under §1026.43(f)(1) retains its qualified mortgage status if it is sold, assigned, or otherwise transferred to another person pursuant to: (1) A capital restoration plan or other action under 12 U.S.C. 1831o; (2) the actions or instructions of any person acting as conservator, receiver, or bankruptcy trustee; (3) an order of a State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law; or (4) an agreement between the creditor and such an agency. A balloon-payment qualified mortgage under §1026.43(f)(1) that is sold, assigned, or otherwise transferred under these circumstances retains its qualified mortgage status regardless of how long after consummation it is sold and regardless of the size or other characteristics of the transferee. Section 1026.43(f)(2)(iii) does not apply to transfers done to comply with a generally applicable regulation with future effect designed to implement, interpret, or prescribe law or policy in the absence of a specific order by or a specific agreement with a governmental agency described in §1026.43(f)(2)(iii) directing the sale of one or more qualified mortgages under §1026.43(f)(1) held by the creditor or one of the other circumstances listed in §1026.43(f)(2)(iii). For example, a balloon-payment qualified mortgage under §1026.43(f)(1) that is sold pursuant to a capital restoration plan under 12 U.S.C. 1831o would retain its status as a qualified mortgage following the sale. However, if the creditor simply chose to sell the same qualified mortgage as one way to comply with general regulatory capital requirements in the absence of supervisory action or agreement the transaction would lose its status as a qualified mortgage following the sale unless it qualifies under another definition of qualified mortgage.*

***Paragraph 43(f)(2)(iv)***

### *1. Mergers and acquisitions. A qualified mortgage under §1026.43(f)(1) retains its qualified mortgage status if a creditor merges with, is acquired by another person, or acquires another person regardless of whether the creditor or its successor is eligible to originate new balloon-payment qualified mortgages under §1026.43(f)(1) after the merger or acquisition. However, the creditor or its successor can originate new balloon-payment qualified mortgages under §1026.43(f)(1) only if it complies with all of the requirements of §1026.43(f)(1) after the merger or acquisition. For example, assume a small creditor that originates 250 first-lien covered transactions each year and originates balloon-payment qualified mortgages under §1026.43(f)(1) is acquired by a larger creditor that originates 10,000 first-lien covered transactions each year. Following the acquisition, the small creditor would no longer be able to originate balloon-payment qualified mortgages because, together with its affiliates, it would originate more than 500 first-lien covered transactions each year. However, the balloon-payment qualified mortgages originated by the small creditor* before the acquisition would retain their qualified mortgage status.

# Section 7: Prepayment Penalties

# 12 CFR § 1026.43(g)

## Prepayment Penalties - 12 CFR § 1026.43(g)

### Regulatory Discussion

In general, a consumer credit transaction that is secured by a dwelling *must not include* any *prepayment penalties* unless four conditions are satisfied.

1. The prepayment penalty is otherwise permitted by law;
2. The APR cannot increase after consummation;
3. The transaction meet the definition of a “qualified mortgage;” and
4. The transaction is not a “high-priced mortgage loan.”

### Regulatory Text

(g) ***Prepayment penalties***

(1) ***When permitted.*** A covered transaction must not include a prepayment penalty unless:

(i) The prepayment penalty is otherwise permitted by law; and

(ii) The transaction:

(A) Has an annual percentage rate that cannot increase after consummation;

(B) Is a qualified mortgage under paragraph (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section; and

(C) Is not a higher-priced mortgage loan, as defined in §1026.35(a).

### Regulatory Commentary

*None.*

## Prepayment Penalty Limits - 12 CFR § 1026.43(g)(2)

### Regulatory Discussion

If prepayment penalties are permitted, there are two limitations which must be applied; as detailed in (g)(2)(i) and (i)(A) and (B).

### Regulatory Text

(2) ***Limits on prepayment penalties.*** A prepayment penalty:

(i) Must not apply after the three-year period following consummation; and

(ii) Must not exceed the following percentages of the amount of the outstanding loan balance prepaid:

(A) 2 percent, if incurred during the first two years following consummation; and

(B) 1 percent, if incurred during the third year following consummation.

### Regulatory Commentary

***43(g)(2) Limits on prepayment penalties.***

*1.* ***Maximum period and amount.*** *Section 1026.43(g)(2) establishes the maximum period during which a prepayment penalty may be imposed and the maximum amount of the prepayment penalty. A covered transaction may include a prepayment penalty that may be imposed during a shorter period or in a lower amount than provided under §1026.43(g)(2). For example, a covered transaction may include a prepayment penalty that may be imposed for two years after consummation and that equals 1 percent of the amount prepaid in each of those two years.*

## Alternative Offer Required - 12 CFR § 1026.43(g)(3)

### Regulatory Discussion

If a creditor offers a consumer a credit transaction that is secured by a dwelling that contains a prepayment penalty, the creditor must also offer the consumer an alternative transaction without a prepayment penalty.

The alternative transaction, without a prepayment penalty, is subject to five conditions (as detailed in (g)(3)(i)(A) and (B), and (ii) through (v).

The commentary provides additional guidance on conditions (i), (iv) and (v).

### Regulatory Text

(3) ***Alternative offer required.*** A creditor must not offer a consumer a covered transaction with a prepayment penalty unless the creditor also offers the consumer an alternative covered transaction without a prepayment penalty and the alternative covered transaction:

(i) Has an annual percentage rate that cannot increase after consummation and has the same type of interest rate as the covered transaction with a prepayment penalty; for purposes of this paragraph (g), the term “type of interest rate” refers to whether a transaction:

(A) Is a fixed-rate mortgage, as defined in §1026.18(s)(7)(iii); or

(B) Is a step-rate mortgage, as defined in §1026.18(s)(7)(ii);

(ii) Has the same loan term as the loan term for the covered transaction with a prepayment penalty;

(iii) Satisfies the periodic payment conditions under paragraph (e)(2)(i) of this section;

(iv) Satisfies the points and fees conditions under paragraph (e)(2)(iii) of this section, based on the information known to the creditor at the time the transaction is offered; and

(v) Is a transaction for which the creditor has a good faith belief that the consumer likely qualifies, based on the information known to the creditor at the time the creditor offers the covered transaction without a prepayment penalty.

### Regulatory Commentary

***43(g)(3) Alternative offer required.***

***Paragraph 43(g)(3)(i)***

*1.* ***Same type of interest rate.*** *Under §1026.43(g)(3)(i), if a creditor offers a consumer a covered transaction with a prepayment penalty, the creditor must offer the consumer an alternative covered transaction without a prepayment penalty and with an annual percentage rate that cannot increase after consummation. Under §1026.43(g)(3)(i), if the covered transaction with a prepayment penalty is a fixed-rate mortgage, as defined in §1026.18(s)(7)(iii), then the alternative covered transaction without a prepayment penalty must also be a fixed-rate mortgage. Likewise, if the covered transaction with a prepayment penalty is a step-rate mortgage, as defined in §1026.18(s)(7)(ii), then the alternative covered transaction without a prepayment penalty must also be a step-rate mortgage.*

***Paragraph 43(g)(3)(iv)***

*1.* ***Points and fees.*** *Whether or not an alternative covered transaction without a prepayment penalty satisfies the points and fees conditions for a qualified mortgage is determined based on the information known to the creditor at the time the creditor offers the consumer the transaction. At the time a creditor offers a consumer an alternative covered transaction without a prepayment penalty under §1026.43(g)(3), the creditor may know the amount of some, but not all, of the points and fees that will be charged for the transaction. For example, a creditor may not know that a consumer intends to buy single-premium credit unemployment insurance, which would be included in the points and fees for the covered transaction. The points and fees condition under §1026.43(g)(3)(iv) is satisfied if a creditor reasonably believes, based on information known to the creditor at the time the offer is made, that the amount of points and fees to be charged for an alternative covered transaction without a prepayment penalty will be less than or equal to the amount of points and fees allowed for a qualified mortgage under §1026.43(e)(2)(iii).*

***Paragraph 43(g)(3)(v)***

*1.* ***Transactions for which the consumer likely qualifies.*** *Under §1026.43(g)(3)(v), the alternative covered transaction without a prepayment penalty the creditor must offer under §1026.43(g)(3) must be a transaction for which the creditor has a good faith belief the consumer likely qualifies. For example, assume the creditor has a good faith belief the consumer can afford monthly payments of up to $800. If the creditor offers the consumer a fixed-rate mortgage with a prepayment penalty for which monthly payments are $700 and an alternative covered transaction without a prepayment penalty for which monthly payments are $900, the requirements of §1026.43(g)(3)(v) are not met. The creditor's belief that the consumer likely qualifies for the covered transaction without a prepayment penalty should be based on the information known to the creditor at the time the creditor offers the transaction. In making this determination, the creditor may rely on information provided by the consumer, even if the information subsequently is determined to be inaccurate.*

## Offer Through a Mortgage Broker - 12 CFR § 1026.43(g)(4)

### Regulatory Discussion

If a creditor offers a consumer a credit transaction that is secured by a dwelling, *through a mortgage broker*, that contains a prepayment penalty, the creditor must also:

* present the mortgage broker an alternative transaction without a prepayment penalty that satisfies the five conditions of paragraph (g)(3), above; and
* establish an agreement with the broker that the consumer will be presented an alternative transaction without a prepayment penalty offered by either:
  + the creditor; or
  + another creditor.

The commentary provides additional information.

### Regulatory Text

(4) ***Offer through a mortgage broker.*** If the creditor offers a covered transaction with a prepayment penalty to the consumer through a mortgage broker, as defined in §1026.36(a)(2), the creditor must:

(i) Present the mortgage broker an alternative covered transaction without a prepayment penalty that satisfies the requirements of paragraph (g)(3) of this section; and

(ii) Establish by agreement that the mortgage broker must present the consumer an alternative covered transaction without a prepayment penalty that satisfies the requirements of paragraph (g)(3) of this section, offered by:

(A) The creditor; or

(B) Another creditor, if the transaction offered by the other creditor has a lower interest rate or a lower total dollar amount of discount points and origination points or fees.

### Regulatory Commentary

***43(g)(4) Offer through a mortgage broker.***

*1.* ***Rate sheet.*** *Under §1026.43(g)(4), where the creditor offers covered transactions with a prepayment penalty to consumers through a mortgage broker, as defined in §1026.36(a)(2), the creditor must present the mortgage broker an alternative covered transaction that satisfies the requirements of §1026.43(g)(3). Creditors may comply with this requirement by providing a rate sheet to the mortgage broker that states the terms of such an alternative covered transaction without a prepayment penalty.*

*2.* ***Alternative to creditor's offer.*** *Section 1026.43(g)(4)(ii) requires that the creditor provide, by agreement, for the mortgage broker to present the consumer an alternative covered transaction that satisfies the requirements of §1026.43(g)(3) offered by either the creditor or by another creditor, if the other creditor offers a covered transaction with a lower interest rate or a lower total dollar amount of discount points and origination points or fees. The agreement may provide for the mortgage broker to present both the creditor's covered transaction and an alternative covered transaction offered by another creditor with a lower interest rate or a lower total dollar amount of origination discount points and points or fees. See comment 36(e)(3)-3 for guidance in determining which step-rate mortgage has a lower interest rate.*

*3.* ***Agreement.*** *The creditor's agreement with a mortgage broker for purposes of §1026.43(g)(4) may be part of another agreement with the mortgage broker, for example, a compensation agreement. Thus, the creditor need not enter into a separate agreement with the mortgage broker with respect to each covered transaction with a prepayment penalty.*

## Creditor that is a Loan Originator - 12 CFR § 1026.43(g)(5)

### Regulatory Discussion

If a creditor is a “loan originator” and presents a consumer a credit transaction that is secured by a dwelling *offered by a person to which the creditor would assign the transaction after consummation, the creditor must*:

* present the consumer an alternative transaction without a prepayment penalty that satisfies the five conditions of paragraph (g)(3), above, offered by:
  + the assignee; or
  + another person.

The commentary provides additional information.

### Regulatory Text

(5) ***Creditor that is a loan originator.*** If the creditor is a loan originator, as defined in §1026.36(a)(1), and the creditor presents the consumer a covered transaction offered by a person to which the creditor would assign the covered transaction after consummation, the creditor must present the consumer an alternative covered transaction without a prepayment penalty that satisfies the requirements of paragraph (g)(3) of this section, offered by:

(i) The assignee; or

(ii) Another person, if the transaction offered by the other person has a lower interest rate or a lower total dollar amount of origination discount points and points or fees.

### Regulatory Commentary

***43(g)(5) Creditor that is a loan originator.***

*1.* ***Loan originator.*** *The definition of “loan originator” in §1026.36(a)(1) applies for purposes of §1026.43(g)(5). Thus, a loan originator includes any creditor that satisfies the definition of loan originator but makes use of “table-funding” by a third party. See comment 36(a)-1.i and ii.*

*2.* ***Lower interest rate.*** *Under §1026.43(g)(5), a creditor that is a loan originator must present an alternative covered transaction without a prepayment penalty that satisfies the requirements of §1026.43(g)(3) offered by either the assignee for the covered transaction or another person, if that other person offers a transaction with a lower interest rate or a lower total dollar amount of origination points or fees or discount points. See comment 36(e)(3)-3 for guidance in determining which step-rate mortgage has a lower interest rate.*

## Applicability - 12 CFR § 1026.43(g)(6)

### Regulatory Discussion

This Section only applies if a consumer a credit transaction that is secured by a dwelling:

* is consummated with a prepayment penalty; and is not violated if:
* a transaction without a prepayment penalty is consummated; or
* a transaction is not consummated.

### Regulatory Text

(6) ***Applicability****.* This paragraph (g) applies only if a covered transaction is consummated with a prepayment penalty and is not violated if:

(i) A covered transaction is consummated without a prepayment penalty; or

(ii) The creditor and consumer do not consummate a covered transaction.

### Regulatory Commentary

*None.*

# Section 8: Evasion; Open-End Credit

# 12 CFR § 1026.43(h)

## Evasion; Open End Credit - 12 CFR § 1026.43(h)

### Regulatory Discussion

This section simply prohibits a creditor from structuring a loan as an open-end plan (HELOC) to evade the requirements of §1026.43.

### Regulatory Text

(h) ***Evasion; open-end credit****.* In connection with credit secured by a consumer's dwelling that does not meet the definition of open-end credit in §1026.2(a)(20), a creditor shall not structure the loan as an open-end plan to evade the requirements of this section.

### Regulatory Commentary

***43(h) Evasion; open-end credit.***

*1.* ***Subject to closed-end credit rules.*** *Where a creditor documents a loan as open-end credit but the features and terms, or other circumstances, demonstrate that the loan does not meet the definition of open-end credit in §1026.2(a)(20), the loan is subject to the rules for closed-end credit, including §1026.43.*

# Section 9: Appendix Q to Part 1026:

# Standards for Determining Monthly Debt and Income

***Introduction***

This section is a direct quote from the regulation. If you are underwriting a standard qualified mortgage under Regulation Z, or if you are underwriting a loan for sale to Freddie Mac or Fannie Mae, these rules must be followed to the letter. Some banks, in the interest of simplicity, will choose to follow these rules regardless of loan type. Make sure that you understand your bank’s rules regarding the use of these standards.

***Regulatory Text***

Section 1026.43(e)(2)(vi) provides that, to satisfy the requirements for a qualified mortgage under § 1026.43(e)(2), the ratio of the consumer’s total monthly debt to total monthly income at the time of consummation cannot exceed 43 percent. Section 1026.43(e)(2)(vi)(A) requires the creditor to calculate the ratio of the consumer’s total monthly debt to total monthly income using the following standards, with additional requirements for calculating debt and income appearing in § 1026.43(e)(2)(vi)(B).

***I. Consumer Eligibility***

**A. Stability of Income.**

***1. Effective Income.***Income may not be used in calculating the consumer’s income ratios if it comes from any source that cannot be verified, is not stable, or will not continue.

***2. Verifying Employment History.***

a. The creditor must verify the consumer’s employment for the most recent two full years, and the consumer must:

i. Explain any gaps in employment that span one or more months, and

ii. Indicate if he/she was in school or the military for the recent two full years, providing evidence supporting this claim, such as college transcripts, or discharge papers.

b. Allowances can be made for seasonal employment, typical for the building trades and agriculture, if documented by the creditor.

*Note:* A consumer with a 25 percent or greater ownership interest in a business is considered self-employed and will be evaluated as a self-employed consumer for underwriting purposes.

***3. Analyzing a Consumer’s Employment Record.***

a. When analyzing the probability of continued employment, creditors must examine:

i. The consumer’s past employment record;

ii. The employer’s confirmation of continued employment.

b. Favorably consider a consumer for a mortgage if he/she changes jobs frequently within the same line of work, but continues to advance in income or benefits. In this analysis, income stability takes precedence over job stability.

***4. Consumers Returning to Work after an Extended Absence.*** A consumer’s income may be considered effective and stable when recently returning to work after an extended absence if he/she:

a. Is employed in the current job for six months or longer; and

b. Can document a two year work history prior to an absence from employment using:

i. Traditional employment verifications; and/or

ii. Copies of IRS Form W-2s or pay stubs.

*Note:* An acceptable employment situation includes individuals who took several years off from employment to raise children, then returned to the workforce.

c. Important: Situations not meeting the criteria listed above may not be used in qualifying. Extended absence is defined as six months.

**B. Salary, Wage and Other Forms of Income.**

***1. General Policy on Consumer Income Analysis.***

a. The income of each consumer who will be obligated for the mortgage debt must be analyzed to determine whether his/her income level can be reasonably expected to continue through at least the first three years of the mortgage loan.

b. In most cases, a consumer’s income is limited to salaries or wages. Income from other sources can be considered as effective, when properly verified and documented by the creditor.

Notes:

i. Effective income for consumers planning to retire during the first three-year period must include the amount of:

a. Documented retirement benefits;

b. Social Security payments; or

c. Other payments expected to be received in retirement.

ii. Creditors must not ask the consumer about possible, future maternity leave.

***2. Overtime and Bonus Income.***

a. Overtime and bonus income can be used to qualify the consumer if he/she has received this income for the past two years, and it will likely continue. If the employment verification states that the overtime and bonus income is unlikely to continue, it may not be used in qualifying.

b. The creditor must develop an average of bonus or overtime income for the past two years. Periods of overtime and bonus income less than two years may be acceptable, provided the creditor can justify and document in writing the reason for using the income for qualifying purposes.

***3. Establishing an Overtime and Bonus Income Earning Trend.***

a. The creditor must establish and document an earnings trend for overtime and bonus income. If either type of income shows a continual decline, the creditor must document in writing a sound rationalization for including the income when qualifying the consumer.

b. A period of more than two years must be used in calculating the average overtime and bonus income if the income varies significantly from year to year.

***4. Qualifying Part-Time Income.***

a. Part-time and seasonal income can be used to qualify the consumer if the creditor documents that the consumer has worked the part-time job uninterrupted for the past two years, and plans to continue. Many low and moderate income families rely on part-time and seasonal income for day to day needs, and creditors should not restrict consideration of such income when qualifying these consumers.

b. Part-time income received for less than two years may be included as effective income, provided that the creditor justifies and documents that the income is likely to continue.

c. Part-time income not meeting the qualifying requirements may not be used in qualifying.

*Note:* For qualifying purposes, “part-time” income refers to employment taken to supplement the consumer’s income from regular employment; part-time employment is not a primary job and it is worked less than 40 hours.

***5. Income from Seasonal Employment.***

a. Seasonal income is considered uninterrupted, and may be used to qualify the consumer, if the creditor documents that the consumer:

i. Has worked the same job for the past two years, and

ii. Expects to be rehired the next season.

b. Seasonal employment includes:

i. Umpiring baseball games in the summer; or

ii. Working at a department store during the holiday shopping season.

***6. Primary Employment Less Than 40 Hour Work Week.***

a. When a consumer’s primary employment is less than a typical 40-hour work week, the creditor should evaluate the stability of that income as regular, on-going primary employment.

b. Example: A registered nurse may have worked 24 hours per week for the last year. Although this job is less than the 40-hour work week, it is the consumer’s primary employment, and should be considered effective income.

***7. Commission Income.***

a. Commission income must be averaged over the previous two years. To qualify commission income, the consumer must provide:

i. Copies of signed tax returns for the last two years; and

ii. The most recent pay stub.

b. Consumers whose commission income was received for more than one year, but less than two years may be considered favorably if the underwriter can:

i. Document the likelihood that the income will continue, and

ii. Soundly rationalize accepting the commission income.

*Notes:*

i. Unreimbursed business expenses must be subtracted from gross income.

ii. A commissioned consumer is one who receives more than 25 percent of his/her annual income from commissions.

iii. A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns, and the cost of the transcript may be charged to the consumer.

***8. Qualifying Commission Income Earned for Less Than One Year.***

a. Commission income earned for less than one year is not considered effective income. Exceptions may be made for situations in which the consumer’s compensation was changed from salary to commission within a similar position with the same employer.

b. A consumer may also qualify when the portion of earnings not attributed to commissions would be sufficient to qualify the consumer for the mortgage.

***9. Employer Differential Payments.*** If the employer subsidizes a consumer’s mortgage payment through direct payments, the amount of the payments:

a. Is considered gross income, and

b. Cannot be used to offset the mortgage payment directly, even if the employer pays the servicing creditor directly.

***10. Retirement Income.*** Retirement income must be verified from the former employer, or from Federal tax returns. If any retirement income, such as employer pensions or 401(k)’s, will cease within the first full three years of the mortgage loan, such income may not be used in qualifying.

***11. Social Security Income.*** Social Security income must be verified by the Social Security Administration or on Federal tax returns. If any benefits expire within the first full three years of the loan, the income source may not be used in qualifying.

*Notes:*

i. The creditor must obtain a complete copy of the current awards letter.

ii. Not all Social Security income is for retirement-aged recipients; therefore, documented continuation is required.

iii. Some portion of Social Security income may be “grossed up” if deemed nontaxable by the IRS.

***12. Automobile Allowances and Expense Account Payments.***

a. Only the amount by which the consumer’s automobile allowance or expense account payments exceed actual expenditures may be considered income.

b. To establish the amount to add to gross income, the consumer must provide the following:

i. IRS Form 2106, Employee Business Expenses, for the previous two years; and

ii. Employer verification that the payments will continue.

c. If the consumer uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income.

d. Expenses that must be treated as recurring debt include:

i. The consumer’s monthly car payment; and

ii. Any loss resulting from the calculation of the difference between the actual expenditures and the expense account allowance.

**C. Consumers Employed by a Family Owned Business.**

***1. Income Documentation Requirement.***

In addition to normal employment verification, a consumer employed by a family owned business is required to provide evidence that he/she is not an owner of the business, which may include:

a. Copies of signed personal tax returns, or

b. A signed copy of the corporate tax return showing ownership percentage.

*Note:* A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns, and the cost of the transcript may be charged to the consumer.

**D. General Information on Self-Employed Consumers and Income Analysis.**

***1. Definition: Self Employed Consumer.*** A consumer with a 25 percent or greater ownership interest in a business is considered self-employed.

***2. Types of Business Structures.*** There are four basic types of business structures. They include:

a. Sole proprietorships;

b. Corporations;

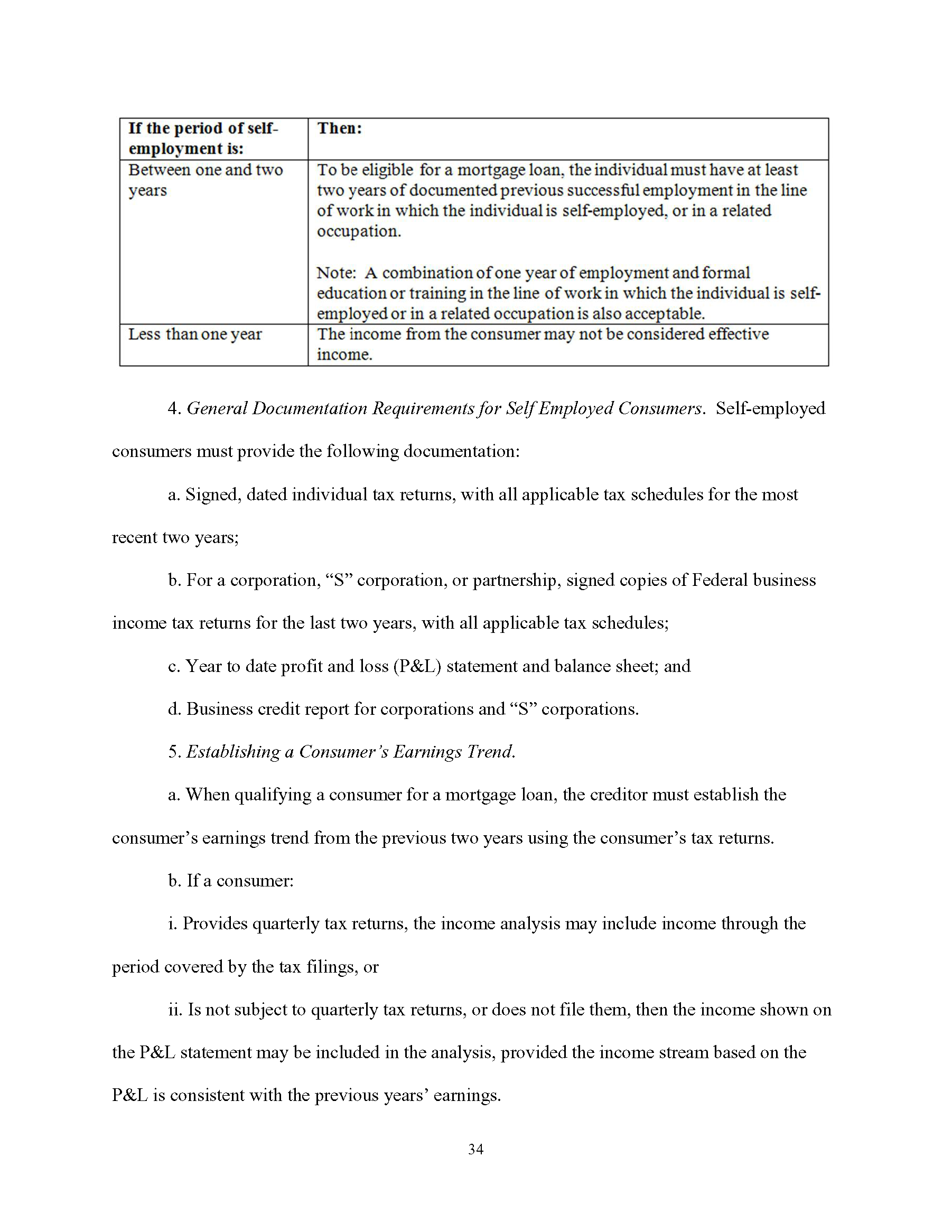
c. Limited liability or “S” corporations; and

d.Partnerships.

***3. Minimum Length of Self Employment.***

a. Income from self-employment is considered stable, and effective, if the consumer has been self-employed for two or more years.

b. Due to the high probability of failure during the first few years of a business, the requirements described in the table below are necessary for consumers who have been self-employed for less than two years.



***4. General Documentation Requirements for Self Employed Consumers.*** Self-employed consumers must provide the following documentation:

a. Signed, dated individual tax returns, with all applicable tax schedules for the most recent two years;

b. For a corporation, “S” corporation, or partnership, signed copies of Federal business income tax returns for the last two years, with all applicable tax schedules;

c. Year to date profit and loss (P&L) statement and balance sheet.

***5. Establishing a Consumer’s Earnings Trend.***

a. When qualifying a consumer for a mortgage loan, the creditor must establish the consumer’s earnings trend from the previous two years using the consumer’s tax returns.

b. If a consumer:

i. Provides quarterly tax returns, the income analysis may include income through the period covered by the tax filings, or

ii. Is not subject to quarterly tax returns, or does not file them, then the income shown on the P&L statement may be included in the analysis, provided the income stream based on the P&L is consistent with the previous years’ earnings.

c. If the P&L statements submitted for the current year show an income stream considerably greater than what is supported by the previous year’s tax returns, the creditor must base the income analysis solely on the income verified through the tax returns.

d. If the consumer’s earnings trend for the previous two years is downward and the most recent tax return or P&L is less than the prior year’s tax return, the consumer’s most recent year’s tax return or P&L must be used to calculate his/her income.

***6. Analyzing the Business’s Financial Strength:***

a. To determine if the business is expected to generate sufficient income for the consumer’s needs, the creditor must carefully analyze the business’s financial strength, including the:

i. Source of the business’s income;

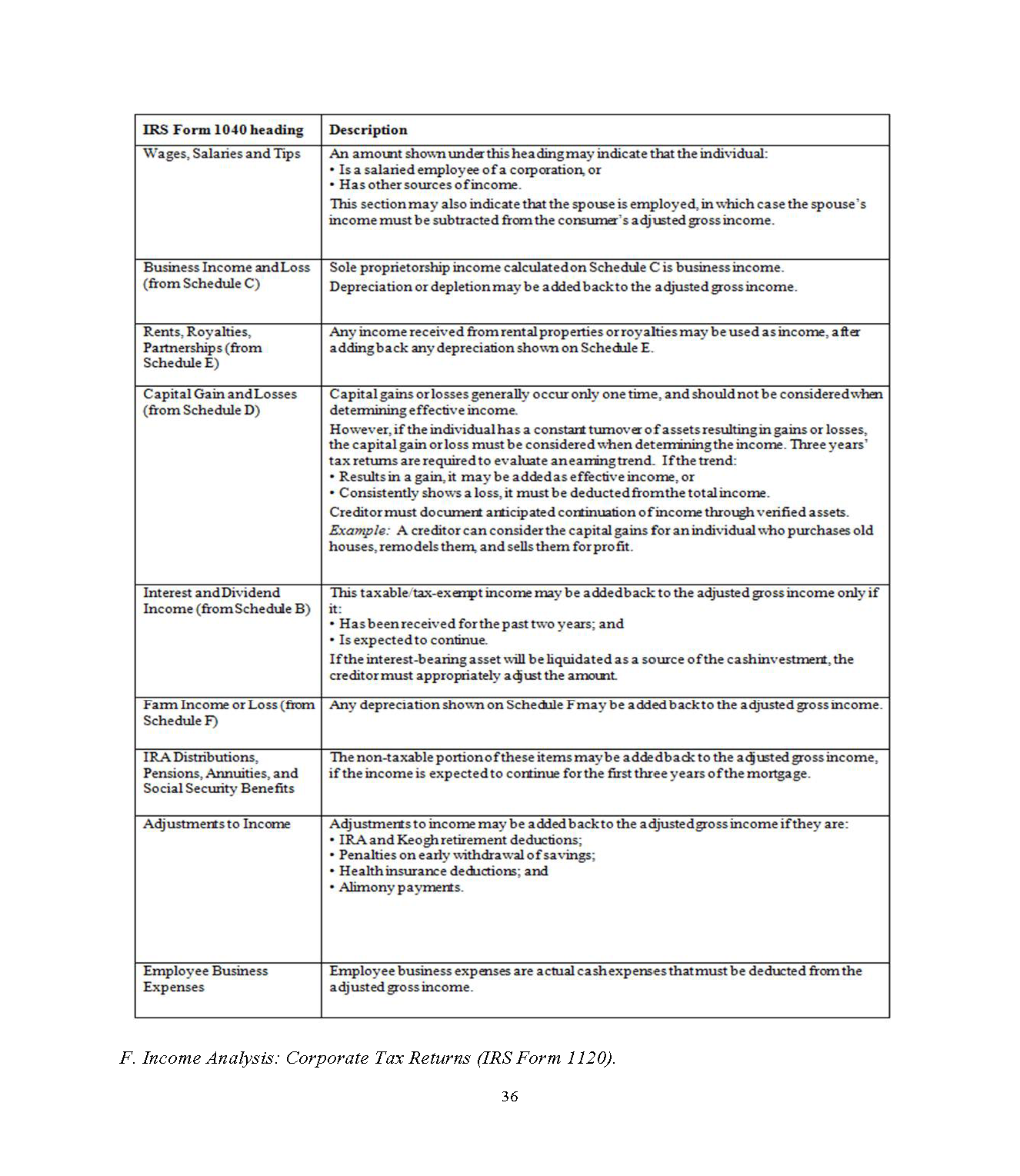
ii. General economic outlook for similar businesses in the area.

b. Annual earnings that are stable or increasing are acceptable, while businesses that show a significant decline in income over the analysis period are not acceptable.

**E. Income Analysis: Individual Tax Returns (IRS Form 1040).**

***1. General Policy on Adjusting Income Based on a Review of IRS Form 1040.*** The amount shown on a consumer’s IRS Form 1040 as adjusted gross income must either be increased or decreased based on the creditor’s analysis of the individual tax return and any related tax schedules.

***2. Guidelines for Analyzing IRS Form 1040.*** The table on the next page contains guidelines for analyzing IRS Form 1040:

****

**F. Income Analysis: Corporate Tax Returns (IRS Form 1120).**

***1. Description:*** Corporation. A corporation is a State-chartered business owned by its stockholders.

***2. Need To Obtain Consumer Percentage of Ownership Information.***

a. Corporate compensation to the officers, generally in proportion to the percentage of ownership, is shown on the:

i. Corporate tax return IRS Form 1120; and

ii. Individual tax returns.

b. When a consumer’s percentage of ownership does not appear on the tax returns, the creditor must obtain the information from the corporation’s accountant, along with evidence that the consumer has the right to any compensation.

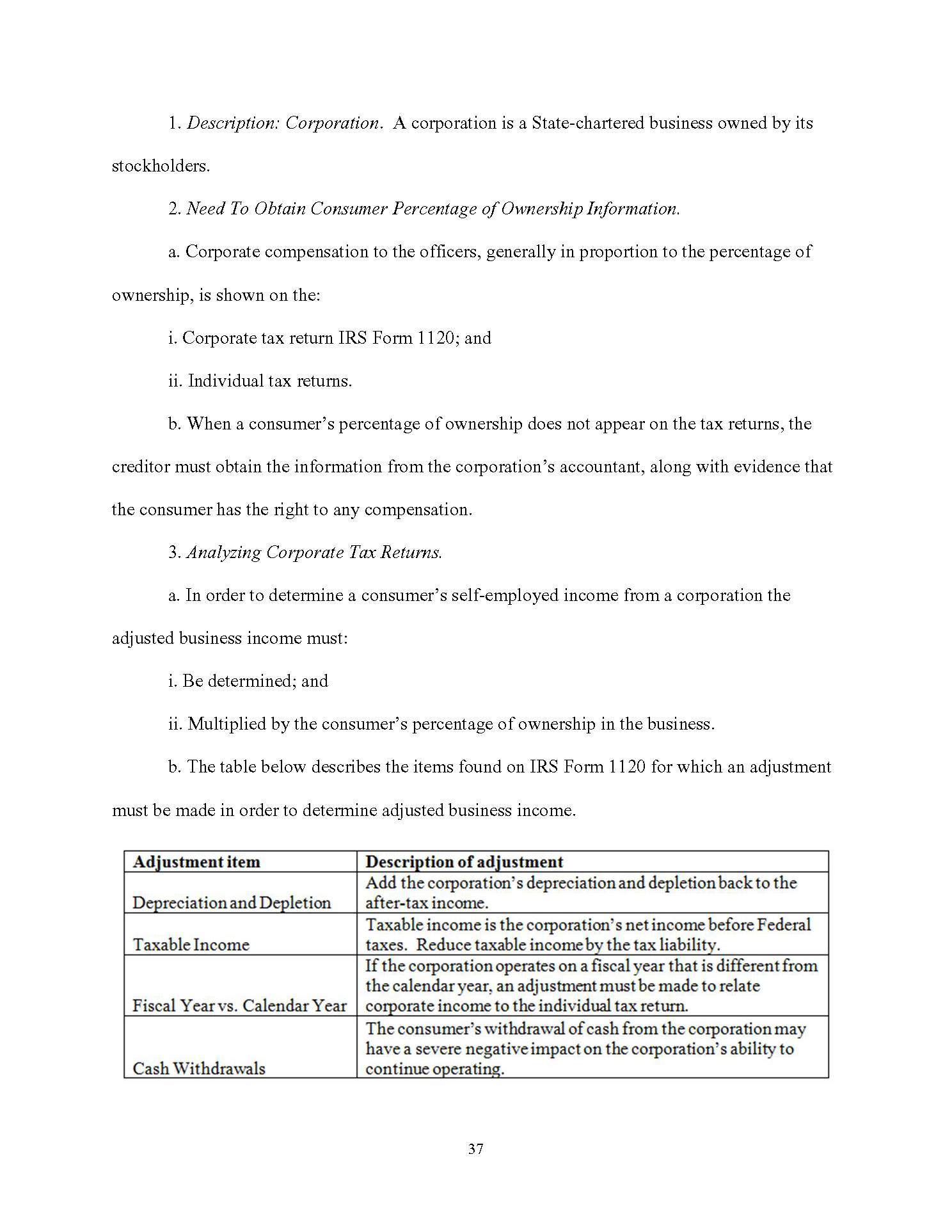
***3. Analyzing Corporate Tax Returns.***

a. In order to determine a consumer’s self-employed income from a corporation the adjusted business income must:

i. Be determined; and

ii. Multiplied by the consumer’s percentage of ownership in the business.

b. The table below describes the items found on IRS Form 1120 for which an adjustment must be made in order to determine adjusted business income.

****

**G. Income Analysis: “S” Corporation Tax Returns (IRS Form 1120S).**

***1. Description: “S” Corporation.***

a. An “S” corporation is generally a small, start-up business, with gains and losses passed to stockholders in proportion to each stockholder’s percentage of business ownership.

b. Income for owners of “S” corporations comes from IRS Form W-2 wages, and is taxed at the individual rate. The IRS Form 1120S, Compensation of Officers line item is transferred to the consumer’s individual IRS Form 1040.

***2. Analyzing “S” Corporation Tax Returns.***

a. “S” corporation depreciation and depletion may be added back to income in proportion to the consumer’s share of the corporation’s income.

b. In addition, the income must also be reduced proportionately by the total obligations payable by the corporation in less than one year.

c. Important: The consumer’s withdrawal of cash from the corporation may have a severe negative impact on the corporation’s ability to continue operating, and must be considered in the income analysis.

**H. Income Analysis: Partnership Tax Returns (IRS Form 1065).**

***1. Description: Partnership.***

a. A partnership is formed when two or more individuals form a business, and share in profits, losses, and responsibility for running the company.

b. Each partner pays taxes on his/her proportionate share of the partnership’s net income.

***2. Analyzing Partnership Tax Returns.***

a. Both general and limited partnerships report income on IRS Form 1065, and the partners’ share of income is carried over to Schedule E of IRS Form 1040.

b. The creditor must review IRS Form 1065 to assess the viability of the business. Both depreciation and depletion may be added back to the income in proportion to the consumer’s share of income.

c. Income must also be reduced proportionately by the total obligations payable by the partnership in less than one year.

d. Important: Cash withdrawals from the partnership may have a severe negative impact on the partnership’s ability to continue operating, and must be considered in the income analysis.

***II. Non-Employment Related Consumer Income***

**A. Alimony, Child Support, and Maintenance Income Criteria.**

Alimony, child support, or maintenance income may be considered effective, if:

1. Payments are likely to be received consistently for the first three years of the mortgage;

2. The consumer provides the required documentation, which includes a copy of the:

i. Final divorce decree;

ii. Legal separation agreement;

iii. Court order; or

iv. Voluntary payment agreement; and

3. The consumer can provide acceptable evidence that payments have been received during the last 12 months, such as:

i. Cancelled checks;

ii. Deposit slips;

iii. Tax returns; or

iv. Court records.

*Notes:*

i. Periods less than 12 months may be acceptable, provided the creditor can adequately document the payer’s ability and willingness to make timely payments.

ii. Child support may be “grossed up” under the same provisions as non-taxable income sources.

**B. Investment and Trust Income.**

***1. Analyzing Interest and Dividends.***

a. Interest and dividend income may be used as long as tax returns or account statements support a two-year receipt history. This income must be averaged over the two years.

b. Subtract any funds that are derived from these sources, and are required for the cash investment, before calculating the projected interest or dividend income.

***2. Trust Income.***

a. Income from trusts may be used if guaranteed, constant payments will continue for at least the first three years of the mortgage term.

b. Required trust income documentation includes a copy of the Trust Agreement or other trustee statement, confirming the:

i. Amount of the trust;

ii. Frequency of distribution; and

iii. Duration of payments.

c. Trust account funds may be used for the required cash investment if the consumer provides adequate documentation that the withdrawal of funds will not negatively affect income. The consumer may use funds from the trust account for the required cash investment, but the trust income used to determine repayment ability cannot be affected negatively by its use.

***3. Notes Receivable Income.***

a. In order to include notes receivable income to qualify a consumer, he/she must provide:

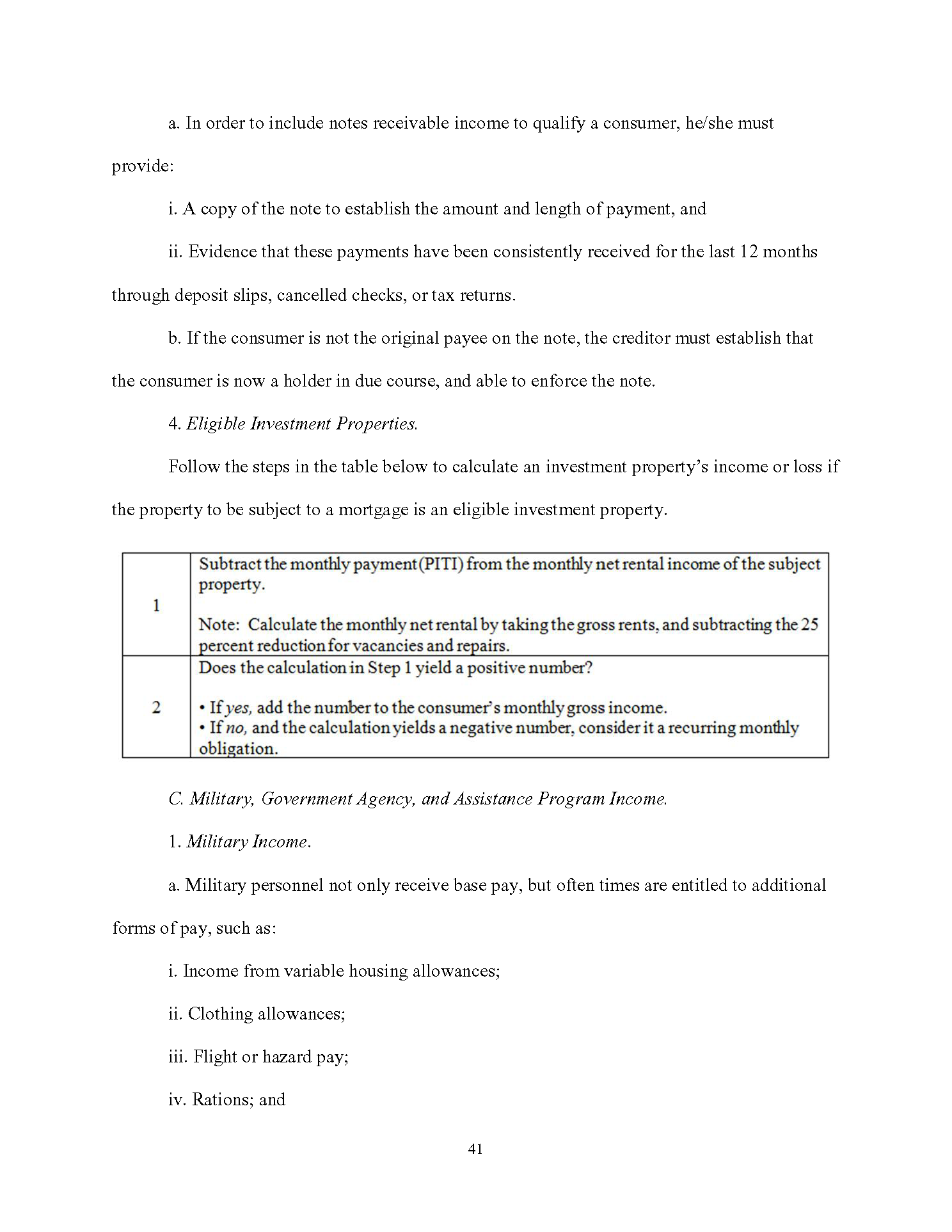
i. A copy of the note to establish the amount and length of payment, and

ii. Evidence that these payments have been consistently received for the last 12 months through deposit slips, cancelled checks, or tax returns.

b. If the consumer is not the original payee on the note, the creditor must establish that the consumer is now a holder in due course, and able to enforce the note.

***4. Eligible Investment Properties.***

Follow the steps in the table below to calculate an investment property’s income or loss if the property to be subject to a mortgage is an eligible investment property.



**C. Military, Government Agency, and Assistance Program Income.**

***1. Military Income.***

a. Military personnel not only receive base pay, but often times are entitled to additional forms of pay, such as:

i. Income from variable housing allowances;

ii. Clothing allowances;

iii. Flight or hazard pay;

iv. Rations; and

v. Proficiency pay.

b. These types of additional pay are acceptable when analyzing a consumer’s income as long as the probability of such pay to continue is verified in writing.

*Note:* The tax-exempt nature of some of the above payments should also be considered.

***2. VA Benefits.***

a. Direct compensation for service-related disabilities from the Department of Veterans Affairs (VA) is acceptable, provided the creditor receives documentation from the VA.

b. Education benefits used to offset education expenses are not acceptable.

***3. Government Assistance Programs.***

a. Income received from government assistance programs is acceptable as long as the paying agency provides documentation indicating that the income is expected to continue for at least three years.

b. If the income from government assistance programs will not be received for at least three years, it may not be used in qualifying.

c. Unemployment income must be documented for two years, and there must be reasonable assurance that this income will continue. This requirement may apply to seasonal employment.

***4. Mortgage Credit Certificates.***

a. If a government entity subsidizes the mortgage payments either through direct payments or tax rebates, these payments may be considered as acceptable income.

b. Either type of subsidy may be added to gross income, or used directly to offset the mortgage payment, before calculating the qualifying ratios.

***5. Homeownership Subsidies.***

a. A monthly subsidy may be treated as income, if a consumer is receiving subsidies under the housing choice voucher home ownership option from a public housing agency (PHA). Although continuation of the homeownership voucher subsidy beyond the first year is subject to Congressional appropriation, for the purposes of underwriting, the subsidy will be assumed to continue for at least three years.

b. If the consumer is receiving the subsidy directly, the amount received is treated as income. The amount received may also be treated as nontaxable income and be “grossed up” by 25 percent, which means that the amount of the subsidy, plus 25 percent of that subsidy may be added to the consumer’s income from employment and/or other sources.

c. Creditors may treat this subsidy as an “offset” to the monthly mortgage payment (that is, reduce the monthly mortgage payment by the amount of the home ownership assistance payment before dividing by the monthly income to determine the payment-to-income and debt-to-income ratios). The subsidy payment must not pass through the consumer’s hands.

d. The assistance payment must be:

i. Paid directly to the servicing creditor; or

ii. Placed in an account that only the servicing creditor may access.

*Note:* Assistance payments made directly to the consumer must be treated as income.

**D. Rental Income.**

***1. Analyzing the Stability of Rental Income.***

a. Rent received for properties owned by the consumer is acceptable as long as the creditor can document the stability of the rental income through:

i. A current lease;

ii. An agreement to lease, or

iii. A rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal, or military renters, or property rehabilitation).

b. A separate schedule of real estate is not required for rental properties as long as all properties are documented on the Uniform Residential Loan Application.

*Note:* The underwriting analysis may not consider rental income from any property being vacated by the consumer, except under the circumstances described below.

***2. Rental Income from Consumer Occupied Property.***

a. The rent for multiple unit property where the consumer resides in one or more units and charges rent to tenants of other units may be used for qualifying purposes.

b. Projected rent for the tenant-occupied units only may:

i. Be considered gross income, only after deducting vacancy and maintenance factors, and

ii. Not be used as a direct offset to the mortgage payment.

***3. Income from Roommates in a Single Family Property.***

a. Income from roommates in a single family property occupied as the consumer’s primary residence is not acceptable. Rental income from boarders however, is acceptable, if the boarders are related by blood, marriage, or law.

b. The rental income may be considered effective, if shown on the consumer’s tax return. If not on the tax return, rental income paid by the boarder may not be used in qualifying.

***4. Documentation Required To Verify Rental Income.*** Analysis of the following required documentation is necessary to verify all consumer rental income:

a. IRS Form 1040 Schedule E; and

b. Current leases/rental agreements.

***5. Analyzing IRS Form 1040 Schedule E.***

a. The IRS Form 1040 Schedule E is required to verify all rental income. Depreciation shown on Schedule E may be added back to the net income or loss.

b. Positive rental income is considered gross income for qualifying purposes, while negative income must be treated as a recurring liability.

c. The creditor must confirm that the consumer still owns each property listed, by comparing Schedule E with the real estate owned section of the URLA.

***6. Using Current Leases To Analyze Rental Income.***

a. The consumer can provide a current signed lease or other rental agreement for a property that was acquired since the last income tax filing, and is not shown on Schedule E.

b. In order to calculate the rental income:

i. Reduce the gross rental amount by 25 percent for vacancies and maintenance;

ii. Subtract PITI and any homeowners association dues; and

iii. Apply the resulting amount to income, if positive, or recurring debts, if negative.

***7. Exclusion of Rental Income From Property Being Vacated by the Consumer.***

Underwriters may not consider any rental income from a consumer’s principal residence that is being vacated in favor of another principal residence, except under the conditions described below:

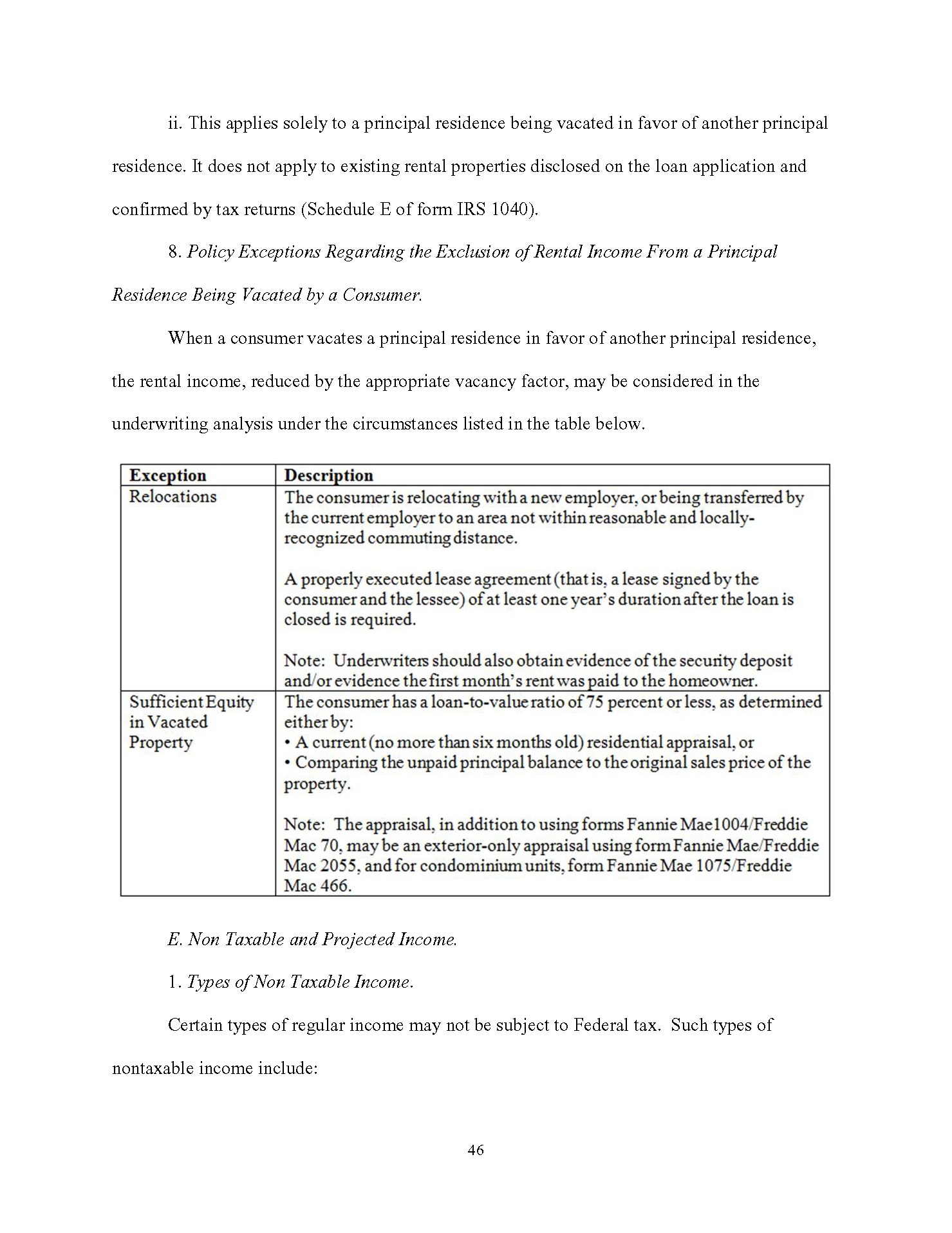
*Notes:*

i. This policy assures that a consumer either has sufficient income to make both mortgage payments without any rental income, or has an equity position not likely to result in defaulting on the mortgage on the property being vacated.

ii. This applies solely to a principal residence being vacated in favor of another principal residence. It does not apply to existing rental properties disclosed on the loan application and confirmed by tax returns (Schedule E of form IRS 1040).

***8. Policy Exceptions Regarding the Exclusion of Rental Income From a Principal Residence Being Vacated by a Consumer.***

When a consumer vacates a principal residence in favor of another principal residence, the rental income, reduced by the appropriate vacancy factor, may be considered in the underwriting analysis under the circumstances listed in the table below.



**E. Non Taxable and Projected Income.**

***1. Types of Non Taxable Income.***

Certain types of regular income may not be subject to Federal tax. Such types of nontaxable income include:

a. Some portion of Social Security, some Federal government employee retirement income, Railroad Retirement Benefits, and some State government retirement income:

b. Certain types of disability and public assistance payments;

c. Child support;

d. Military allowances; and

e. Other income that is documented as being exempt from Federal income taxes.

***2. Adding Non Taxable Income to a Consumer’s Gross Income.***

a. The amount of continuing tax savings attributed to regular income not subject to Federal taxes may be added to the consumer’s gross income.

b. The percentage of non-taxable income that may be added cannot exceed the appropriate tax rate for the income amount. Additional allowances for dependents are not acceptable.

c. The creditor:

i. Must document and support the amount of income grossed up for any non-taxable income source, and

ii. Should use the tax rate used to calculate the consumer’s last year’s income tax.

*Note:* If the consumer is not required to file a Federal tax return, the tax rate to use is 25 percent.

***3. Analyzing Projected Income.***

a. Projected or hypothetical income is not acceptable for qualifying purposes. However, exceptions are permitted for income from the following sources:

i. Cost-of-living adjustments;

ii. Performance raises; and

iii. Bonuses.

b. For the above exceptions to apply, the income must be:

i. Verified in writing by the employer; and

ii. Scheduled to begin within 60 days of loan closing.

***4. Projected Income for New Job.***

a. Projected income is acceptable for qualifying purposes for a consumer scheduled to start a new job within 60 days of loan closing if there is a guaranteed, non-revocable contract for employment.

b. The creditor must verify that the consumer will have sufficient income or cash reserves to support the mortgage payment and any other obligations between loan closing and the start of employment. Examples of this type of scenario are teachers whose contracts begin with the new school year, or physicians beginning a residency after the loan closes fall under this category.

c. The loan is not eligible for endorsement if the loan closes more than 60 days before the consumer starts the new job. To be eligible for endorsement, the creditor must obtain from the consumer a pay stub or other acceptable evidence indicating that he/she has started the new job.

***III. Consumer Liabilities: Recurring Obligations***

***1. Types of Recurring Obligation. Recurring obligations include:***

a. All installment loans;

b. Revolving charge accounts;

c. Real estate loans;

d. Alimony;

e. Child support; and

f. Other continuing obligations.

***2. Debt to Income Ratio Computation for Recurring Obligations.***

a. The creditor must include the following when computing the debt to income ratios for recurring obligations:

i. Monthly housing expense; and

ii. Additional recurring charges extending ten months or more, such as

a. Payments on installment accounts;

b. Child support or separate maintenance payments;

c. Revolving accounts; and

d. Alimony.

b. Debts lasting less than ten months must be included if the amount of the debt affects the consumer’s ability to pay the mortgage during the months immediately after loan closing, especially if the consumer will have limited or no cash assets after loan closing.

*Note:* Monthly payments on revolving or open-ended accounts, regardless of the balance, are counted as a liability for qualifying purposes even if the account appears likely to be paid off within 10 months or less.

***3. Revolving Account Monthly Payment Calculation.*** If the credit report shows any revolving accounts with an outstanding balance but no specific minimum monthly payment, the payment must be calculated as the greater of:

a. 5 percent of the balance; or

b. $10.

*Note:* If the actual monthly payment is documented from the creditor or the creditor obtains a copy of the current statement reflecting the monthly payment, that amount may be used for qualifying purposes.

***4. Reduction of Alimony Payment for Qualifying Ratio Calculation.*** Since there are tax consequences of alimony payments, the creditor may choose to treat the monthly alimony obligation as a reduction from the consumer’s gross income when calculating qualifying ratios, rather than treating it as a monthly obligation.

***IV. Consumer Liabilities: Contingent Liability***

***1. Definition: Contingent Liability.*** A contingent liability exists when an individual is held responsible for payment of a debt if another party, jointly or severally obligated, defaults on the payment.

***2. Application of Contingent Liability Policies.*** The contingent liability policies described in this topic apply unless the consumer can provide conclusive evidence from the debt holder that there is no possibility that the debt holder will pursue debt collection against him/her should the other party default.

***3. Contingent Liability on Mortgage Assumptions.*** Contingent liability must be considered when the consumer remains obligated on an outstanding FHA-insured, VA-guaranteed, or conventional mortgage secured by property that:

a. Has been sold or traded within the last 12 months without a release of liability, or

b. Is to be sold on assumption without a release of liability being obtained.

***4. Exemption From Contingent Liability Policy on Mortgage Assumptions.*** When a mortgage is assumed, contingent liabilities need not be considered if the:

a. Originating creditor of the mortgage being underwritten obtains, from the servicer of the assumed loan, a payment history showing that the mortgage has been current during the previous 12 months, or

b. Value of the property, as established by an appraisal or the sales price on the HUD-1 Settlement Statement from the sale of the property, results in a loan-to-value (LTV) ratio of 75 percent or less.

***5. Contingent Liability on Cosigned Obligations.***

a. Contingent liability applies, and the debt must be included in the underwriting analysis, if an individual applying for a mortgage is a cosigner/co-obligor on:

i. A car loan;

ii. A student loan;

iii. A mortgage; or

iv. Any other obligation.

b. If the creditor obtains documented proof that the primary obligor has been making regular payments during the previous 12 months, and does not have a history of delinquent payments on the loan during that time, the payment does not have to be included in the consumer’s monthly obligations.

***V. Consumer Liabilities: Projected Obligations and Obligations Not Considered Debt***

***1. Projected Obligations.***

a. Debt payments, such as a student loan or balloon-payment note scheduled to begin or come due within 12 months of the mortgage loan closing, must be included by the creditor as anticipated monthly obligations during the underwriting analysis.

b. Debt payments do not have to be classified as projected obligations if the consumer provides written evidence that the debt will be deferred to a period outside the 12-month timeframe.

c. Balloon-payment notes that come due within one year of loan closing must be considered in the underwriting analysis.

***2. Obligations Not Considered Debt.*** Obligations not considered debt, and therefore not subtracted from gross income, include:

a. Federal, State, and local taxes;

b. Federal Insurance Contributions Act (FICA) or other retirement contributions, such as 401(k) accounts (including repayment of debt secured by these funds):

c. Commuting costs;

d. Union dues;

e. Open accounts with zero balances;

f. Automatic deductions to savings accounts;

g. Child care; and

h. Voluntary deductions.