FEDERAL STANDARD ABSTRACT
TITLE NEWS

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Title News

LLC Publication Requirements: Amendments to the Amendments

In our May 2006 issue we advised that the Legislature had amended the publication requirements for LLCs and other Entities and that failure to comply could result in personal liability for the members. The Legislature has re-amended the requirements back to the six weeks' publication period, and has affirmed that failure to comply will neither result in a suspension of the entity's authority to conduct business or defend a lawsuit nor in the members' personal liability for the Entity's contractual obligations. The Legislature's consideration of stricter publication requirements and harsh penalties is surprising in the face of the fact that most states do not require any publication at all.

NYC Department of Buildings Publishes Violation Reference Guide

The NYC Department of Buildings ("DOB") has published a very useful guide concerning the 25 most recurrent building violations. The Guide is available for free, on-line, and in two Parts. Part 1 is a 16-page user-friendly pdf file and covers from issuance, notice and kinds of violations, to hearings and procedures to cure. Part 2 is an in-depth coverage of the 25 most common violations, which amount to over 80% of all violations issued. The Guide can be found at *http://www.nyc.gov/html/dob/html/news/pr_ecb_viol_ref_guide_070306.shtml*.

Perfecting the Closing

High-Cost Loans: Bank Attorneys Beware!

Every seasoned bank attorney has had the unpleasant experience of faxing the HUD-1 statement to the lender prior to funding and being informed that the HUD-1 was disapproved because there were too many APR-fees, because it did not meet underwriting guidelines, or –if the lender is from another state- because there cannot be a settlement closing fee in addition to a notary fee. Closing attorneys, who are usually uninformed in banking compliance regulation, gape in awe at the exposure to a vast, uncharted area of law. This article will attempt to explain one of the risks underwriting departments look out for, namely: Loans underwritten as regular loans, but that become high-cost loans at closing because of unforeseen fees.

What is a High-Cost Loan?

As its name implies, a high-cost loan is a loan that exacts unusually high charges. The legal definition of what constitutes "high-cost" is manifold. This article will only explain the scenario that is most likely to be of relevance to bank attorneys: loans that were originated as regular residential loans but became high-cost loans at closing because of closing fees unforeseen by the lender. For the purposes of this article, a high-cost loan is a mortgage loan (1) from an institutional lender (2) to a natural person, (3) covering property improved or to be improved by a 1-4 family residence intended to be the borrower's primary residence, (4) for no more than $300,000, and (5) which finance charges exceed 5% of the principal of the loan (or 6%, if it is a second mortgage) (Banking Law Sec. 6-1.1 (d)(e)(g)). The first four items are self-explanatory. The last one requires clarification.

What are Finance Charges?

Finance charges are costs associated with obtaining a loan. In other words, they are charges that are not paid in a comparable cash transaction. Hence, pre-paid interest, processing fees, origination points, escrow service charges, and the bank attorney's fees are finance charges. Most fees paid to lenders and mortgage brokers are finance charges. On the other hand, charges that are commonly paid in cash transactions are not finance charges. For example, title searches, surveys, seller's points, and escrows for real estate taxes and insurance are not considered finance charges. Amounts paid to third parties, such as a life-insurance company, are finance charges if payment is required by the lender. Recording and title insurance charges, even if paid solely to secure the lender's lien, are excluded. Finance charges are sometimes referred to as "APR-fees" because the annual percentage rate is calculated based on them. The classification of finance charges can be difficult at times. The attached Finance Charge Chart published by the Office of the Comptroller of the Currency provides some help.

The explanation in the preceding paragraph corresponds to finance charges under the Truth-in-Lending Act and its regulations. For the purposes of determining whether a loan is a high-cost loan, the New York statute alters the definition in two important ways.[1] First, interest is not considered a finance charge (Banking Law Sec. 6-1.1 (f)); hence, pre-paid interest is excluded. Second, any fees paid to a third party affiliated with the lender are considered finance charges, even if they would normally be excluded (Banking Law Sec. 6-1.1 (f)(ii)). For example, title insurance premiums are not finance charges, unless the title company is an affiliate of the lender or the mortgage broker. "Affiliate" is not simply a business partner but is defined by "control" of one entity by the other (see 12 US.C. Sec. 1841 et sequitur). Oftentimes a mortgage broker's affiliation to a title company or surveyor may be unknown to the lender but becomes obvious to the closing attorney. Unknown affiliations are one risk that closing attorneys may be in a better position to prevent than lenders, because lenders in New York do not typically interact with title companies prior to closing.

In addition to affiliations unknown to the lender, special attention must be given to settlement fees the lender might not have envisioned. Typical examples are travel fees, adjournment fees, legal overtime, and courier fees. All of those fees become finance charges if charged by the bank's closing attorney. Some lenders affirm that patriot and bankruptcy searches are finance

[1] To say that the New York statute refers to "finance charges" is a license for simplification. In reality, it creates a new classification, "fees and points", which is similar to the definition of finance charges, save for the two variations that follow.

charges reasoning no such searches would be necessary in a comparable cash transaction; i.e. neither the buyer nor the seller would be interested in searches on the buyer. This point can be debated because the Patriot Act imposes a duty on sellers to run a search on buyers and because sellers occasionally sell partially on credit.

Applications

Suppose Lender offers a loan in the amount of $100,000 to Borrower. Lender collects 3 points, or $3,000, plus its regular processing and various fees amounting to $750. Lender knows the bank attorney will charge $750 for his settlement closing fee, so Lender prepares its disclosures assuming that the finance charges will add up to $4,500, which would be $500 below the 5% ($5,000, in this example) threshold. As it happens, the closing is adjourned and re-scheduled. The second time, however, Lender charges a $125 adjournment fee, still confident of being $375 under the high-cost loan threshold. Unbeknownst to Lender, however, the closing attorney charges his own $150 adjournment fee and a $150 travel fee, while the title company charges a $50 courier fee and $75 escrow service charge. In sum, the finance charges add up to $5,050 and the loan may have become a high-cost loan.

Notice that if the loan amount had been $50,000, then it may have been a high-cost loan at the outset. The 3 points would have been $1,500, the bank fees still $750 and the settlement closing fee still $750. The fees would have added up to $3,000, while the threshold would have been 5% of $50,000, or $2,500. The lower the loan amount, the higher the risk a loan may become high-cost because standard unvarying fees represent a higher percentage of the loan.

Consequences of High-Cost Loans

The law requires that a lender considering a high-cost loan supply the borrower with a number of disclosures prior to and at closing, and that the borrower’s ability to pay be evaluated with a higher degree of scrutiny. Moreover, these loans cannot have negative amortization, an increased default interest rate, balloon payments within the first 15 years, or be used as home-improvement loans, among many other restrictions. Needless to say, a lender who unexpectedly closes a high-cost loan will have certainly violated the disclosure requirements, probably the heightened underwriting scrutiny, and may have placed the borrower in an illegal loan program.

The consequences of violating the above requirements vary depending on the lender and mortgage broker’s good faith, on the appropriateness of the lender’s procedures, and on the lender’s initiative to detect and correct the violation. If the lender notices a bona fide error after closing and approaches the borrower in good faith, the borrower will generally be entitled to choose between (1) making the high-cost loan satisfy the statutory requirement, or (2) altering the terms of the loan in a manner beneficial to the borrower so that it is no longer a high-cost loan. Bona fide errors include clerical, calculation, computer malfunction and programming, and printing errors (Banking Law Sec. 6-1.4 (b)). Fees added to the HUD-1 Settlement Statement at closing are probably not bona fide errors because they do not fall within any of the above, because the lender is probably aware that finance charges are occasionally added at closing, and with that knowledge the lender could have revised its procedures or instruct its attorneys about the risk. In fact, BNY Mortgage Company, LLC established as its policy that it would not close any high-cost loans, and instructed its closing attorneys to advise the closing department whenever overall closing costs exceed 8%. The 8% threshold appears to be a rule of thumb to avoid confusion in the finance charges.

All other violations may be cured within 30 days after closing with proper restitution as above. Failure to cure timely will render the lender liable to the borrower for any or all of the following: (a) actual, consequential, and incidental damages, (b) closing costs to be fully refunded to the borrower, (c) forfeiture and refund of all interest, (d) five thousand dollars per violation or twice the amount of closing costs, and (e), in the case of intentional violations, voidance of the loan with the lender having no right to collect the principal (Banking Law Sec. 6-1.7). The borrower is entitled to allege these violations as an affirmative defense in a foreclosure action (Real Property Actions and Procedures Law Sec. 1302 (2)).

Words of Caution

The information in this article is insufficient to decide with certainty whether a loan has become a high-cost loan. Underwriting departments regularly disagree on whether certain fees are finance charges, since the classification may become rather subjective. Moreover, the law allows some fees to be excluded for the purpose of determining a high-cost loan that are too extensive to explore in this article. The objective of this article is to provide a closing attorney with the information necessary to detect suspicious loans so that the lender's underwriting department may be contacted to review the closing fees, if necessary. This can also be a powerful weapon for a purchaser who wishes to avoid a closing by showing that the purchase loan would be illegal or an attorney representing a borrower in default. For more information on high-cost loans, visit the New York State Banking Department website at *http://www.banking.state.ny.us/index.htm*. For more information on finance charges and other Truth-in-Lending regulation download the Comptroller's Truth in Lending Handbook from the Office of the Comptroller of the Currency website at *http://www.occ.treas.gov/handbook/til.pdf.*

If you have any questions or comments, or if you have an inquiry that you would like us to address in upcoming issues, please contact us at fsa@federalstandardabstract.com.

Finance Charge Chart