Consultants to the Factory Built Housing Industry

Deconstructing the High-Cost Mortgage Loan

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As many in the manufactured housing industry know, the new Dodd-Frank Regulations, specifically the Home Owners Equity Protection Act (HOEPA), which for the first time includes Purchase Money Transactions is very problematic for the manufactured housing industry. The reasons are more obscure than even those that know and understand finance have considered.

On the surface, the regulations declare that any loan carrying an APR higher than the following formulas will be considered High-Cost Mortgages.

Formula A Loans under $50,000 with an APR higher than APOR (Average Prime Offer Rate) plus 8.5% will be considered High Cost.

Formula B Loans over $50,000 with an APR higher than APOR plus 6.5% will be considered High Cost.

Most professionals in mortgage finance or manufactured housing finance believe the designation of a loan as High Cost is the new term for Predatory. Predatory loans are those loans made by loan sharks and others charging consumers exorbitantly high-interest rates to generate large profits for taking high-risk loans.

The result has been that very few loans of what now is termed a High-Cost Mortgage Loan are originated! Lenders do not want to be branded as predatory and no investor wants to buy High-Cost Loans.

The truth of the matter as it pertains to manufactured housing loans could not be further from the truth in this interpretation or branding. Manufactured Housing Lenders would prefer to charge consumers the lowest possible rate because that would lead to more homes being sold and more financing opportunities.

There are several facts that everyone must understand before examining my illustration in deconstructing the High-Cost Mortgage Loan interest rate.

Facts:

- The manufactured housing chattel (home-only business) does not have a secondary market. This means that lenders must portfolio their loans. This subjects each lender to various capital costs, various interest rate risks, and risk tolerance. Having a secondary market establishes a firm cost of funds rate. There is no better example than the benchmark used in the formulas above. The APOR is a treasury number that is essentially established by Freddie Mac for the best or prime mortgage rates for a given week. The Federal Government backs or provides a secondary market for approximately 90% of all mortgage loans originated in the country! Fannie Mae and Freddie Mac do not offer secondary home market-only transactions. FHA Title 1 and GNMA do offer a market but have made the cost or price to participate unreasonable and just a fraction of those loans are made.

- When considering the cost of funds one must consider that depository institutions often have lower costs of funds but also have a much lower tolerance for risk. So the manufactured housing customer who has less than a 650 credit score is generally not going to find a loan with a depository.

- That leaves private financial firms to borrow money to fund their operations. Imagine going to the bond market to raise funds to fund your business of originating manufactured housing loans. What rates do you think the market would charge? Certainly higher than those investment opportunities that have little or no risk.

- Now that you have borrowed the funds for the loans, consider borrowing funds for generally 5 years and then using those funds for loans that have terms of 15 or 20 years. The rate you charge the borrower has to include an interest rate hedge. How much will rates rise over 15 years? Remember that manufactured housing loans tend not to prepay because of refinancing opportunities. Refinancing occurs when there is a robust secondary market influencing rates. With no secondary market…..little or no refinancing. Lenders then could be holding a loan for the full 15-20 years.

- Every lender has to establish loss reserves. Since those numbers are proprietary consider that on an FHA Title 1 Loan they charge an upfront mortgage insurance premium of 2.25% and then charge an annual premium of 1%. And that is only covering 90% of the loss. The originating lender eats the other 10% plus any additional loss if the home sells for less than the appraised value.

- Low-balance loans have limitations on points and fees that can be charged. The Mortgage Bankers Association has testified that their costs of origination run more than $6000 per loan. Keep in mind this includes the cost of compliance which is probably the largest cost item in the equation. Manufactured housing lenders indicate their costs for a volume operation are in the range of $3000-$3500 per loan. Points and fees allowed generally do not cover the cost of origination!

- Servicing costs are not determined by the size of the loan. There is a myriad of fixed costs that any loan servicer has regardless of loan size. Consider the average mortgage loan is

$225,000. The GSE's allow .375% to .50% annually for loan servicing. Conservatively for a manufactured housing lender to recoup the same servicing dollars would require 1.5% annually as a servicing fee from the GSE's. Lenders would also argue that their costs are higher because of the need for interpersonal contact with the consumer instead of automated notices and they have fewer loans to spread their costs over.

Therefore when reviewing the Deconstruction of the High-Cost Mortgage Loan for manufactured housing, consider the facts above and realize that for a lender to make loans there has to be a profit margin. They cannot make loans at a loss.
Perhaps our consumer advocacy friends will join us in convincing the GSE's to make a secondary market for manufactured housing loans so lenders can fix their cost of funds and remove the interest rate hedge so we can make a better cheaper market for our manufactured housing consumers.

Loan Assumptions:

Loan Amount $50,000

Term 20 years

Life of Loan 8 years

APOR =2.75% + 6.5% = 9.25% max APR (APOR as of 7/21/16)
Sub 650 FICO customer.

Cost of Funds (generally for 5 yr. money) 4.50%

Interest Rate Hedge- 2.00% Comments: Most MH loans have a much lower repayment or payoff occurrence. Refinances are very limited generally because of the lack of exit strategy.

Reserves for Losses 1.30% Comments: Using FHA Title 1 as a Government insured loan on a home only transaction calls for 2.25% upfront + 1% annual (assume 8 yrs. on the books) generates $5125 dedicated for losses (90%) with lender responsible for 10% of loss plus any amount of additional loss if the home sold for less than appraised value. To generate the equivalent dollars would require approximately 1.30%annually dedicated for loss reserves. The average recovery on repossessions is 55% of UPB.

Unrecovered Origination Costs **.25%** Cost of origination and compliance= $3500 per loan (assume all 5pts. allowed in points and fees are dedicated to origination cost. That leaves $1000 to be recovered over 8 yrs. = roughly .25% per year added to the rate.

Servicing Costs **1.75% to 2.20%** GSE's allow mortgage lenders .375% to .50% annually for loan servicing. Avg. mortgage $225,000 = $845-$1100 per year for servicing. The cost of servicing a loan is not determined by the size of the loan. MH lenders incur the same if not higher costs to service because of the higher requirements for personal contact and less automated servicing as it relates to delinquent accounts. On a $50,000 loan, 1.75%-2.20% annual generates the same servicing dollars as the average mortgage.

Total Costs **9.80%-10.25%** **Before Overhead and Profit objectives. With points financed the APR will be in the 10.75%- 11.00% range which exceeds the maximum APR threshold before being declared a High-Cost Mortgage Loan!**

Additionally

Manufactured Housing Borrowers are not paying the following typical costs associated with a mortgage loan which can add potentially thousands of dollars more either being borrowed and financed or paid out of pocket!

Application Fees
Credit Report Fees
Title Insurance
Mortgage Insurance
Closing Agent Fees