MISSISSIPPI BUSINESS JOURNAL

Date: Friday, July 26, 2013
Location: JACKSON, MS
Circulation (DMA): 4,115 (87)
Type (Frequency): Magazine (W)
Page: 2,3
Section: Main
Keyword: Butler, Snow, O'Mara, Stevens and Cannada

MORTGAGE LENDING

Bursting balloons: New mortgage rules may deflate non-traditional lending

» Federal regulations that take effect Jan. 10 will make balloon mortgages too risky to issue in many Mississippi counties

By TED CARTER | STAFF WRITER
ted.carter@msbusiness.com

New federal mortgage lending rules soon to take effect will handcuff lenders in many rural Mississippi counties who make non-traditional mortgage loans and keep the loans on their books, bankers in the state say.

The rules are yet another piece of fallout from the banking crisis of the late part of the last decade. In this instance, lawmakers and regulators through the Dodd-Frank Financial Reform Act of 2010 set their sights on preventing a repeat of the unwarranted mortgage lending and selling of bundled toxic mortgages on secondary markets.

Caught in the regulatory sweep, however, is the longstanding practice in rural parts of Mississippi and elsewhere of letting homebuyers take out non-conforming mortgages that balloon after five or so years and are either refinanced into another balloon or converted to a conforming home loan. The balloon mortgages are deemed non-conforming and are kept off the secondary market.

But they appear headed for extinction, nonetheless.

New U.S. Consumer Financial Protection Bureau rules that take effect in early 2014 will make the balloon mortgages too risky to issue in many counties, thus ending the decades- old way of making home loans across rural Mississippi, bankers with both large and small banks in the state say.

Mississippi's smaller banks that meet a list of requirements will get until Jan. 10, 2016 to ease into the new regulatory era. Still other banks that operate in counties designated by the Consumer Financial Protection Bureau as "rural" or "underserved" are promised legal protections for the balloon lending.

Large banks over $2 billion in assets that serve rural communities will bear the full brunt of the rules starting Jan. 10.

Looking ahead, it's difficult to over-estimate the reach and ramifications of the new rules, at least in a rural state such as Mississippi where many banks initiate non-traditional loans, says Butler Snow banking attorney Ed Wilmesherr.

Under the parlance of the new rules, non-conforming mortgage translates to "rebuttable" mortgage, or one that can later be challenged by the borrower for a range of reasons relating to how the bank underwrote the loan. Just the opposite happens with "Qualified Loans," a classification the Consumer Financial Protection Bureau reserves for loans that meet rules for conforming loans. These get "safe harbor" from borrower lawsuits and thus will be attractive to investors in the secondary market.

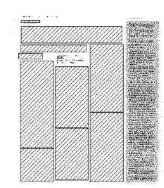
Dickey

"The ability-to-repay rule and qualified mortgage rule have the potential to perhaps be the most important regulatory developments in a very, very long time" short of passage of the Fair Lending Act and Equal Credit Opportunity Act, Wilmesherr said in an interview last week.

This is essentially because the rules that go into effect Jan. 10 get at who qualifies for a home loan, the pricing of the home loan and the potential liability for whomever makes the home loans, he said.

Non-conforming a mortgage mainstay

In rural regions of Mississippi and elsewhere, the non-conforming balloon loan — typically one that comes due after five years and is either refinanced or converted to a



Account: 19499A (366)
-7682

Date: Friday, July 26, 2013
Location: JACKSON, MS
Circulation (DMA): 4,115 (87)
Type (Frequency): Magazine (W)
Page: 2,3
Section: Main
Keyword: Butler, Snow, O'Mara, Stevens and Cannada

traditional loan — accounts for significant portions of a bank's mortgage business. Beyond typical reasons such as an inability of borrowers to meet down payment requirements, conforming loans require property appraisals by which the appraiser must include "comparable sales" of similar properties within close proximity and within a recent time period.

The task is made near impossible by the infrequent turnover of houses in the countryside, even if the homes were within the necessary comp sales radius, said Robert Barnes, president and CEO of Priority One Bank, a $510-million community bank based in Magee.

Unable to meet the collateral requirements and other mandates for a conforming loan, lenders resort to the non-conforming balloon loans, Barnes said.

The solution is to get the borrower into a balloon loan and try to put him into a conforming one after the first balloon, usually in five years, he said.

The long-held practice will be much too risky under the new Qualified Mortgage Loan rules, according to Barnes, who has been accustomed to making such loans since starting at Priority One as a loan officer in 1983.

He said he and other bankers worry that courts may invoke the new rules to order banks to pay a host of costs, including punitive damages and, ultimately, having to forgive the loan without foreclosing on the property that secured it.

In such a scenario, the American Bankers Association warned, the effects could ripple through a bank's entire portfolio. "In short, in the case of a proven violation, it is possible that the lender may find it more advantageous to actually forgive a significant portion of the remaining indebtedness, thereby raising issues as to the value of a portfolio of loans that may bear the same defects," the ABA cautioned in a recent national advisory.

Barnes' read is that lenders can still make the non-conforming loan, but "you're wide open" to legal trouble.

"Most banks aren't going to accept the liability at that level."

And that could include Priority One, which has 11 locations from Brandon to Hattiesburg.

"Those are going to be essentially eliminated," said Odean Busby, Priority One Bank chairman and this year's chair of the Mississippi Bankers Association.

Both Busby and Barnes say they are perplexed by the Consumer Financial Protection Bureau's targeting of balloon loans as part of a consumer protection strategy. "When we are carrying these mortgages in-house, we have the flexibility to make that work for everybody," Busby said.

"The sad part," Barnes said, "is that some of your rural markets just aren't going to be able to be served. I think that is just the opposite effect of what it intended."

With non-conforming loans ineligible for sale on the secondary market, banks such as Priority One keep the loans in their portfolios, a circumstance that Barnes says ensures diligent scrutiny of the borrower's repayment ability.

Added Busby: "They are going to underwrite those loans to the very best degree they can, because they are going to be collecting on those loans" for many years.

"The banker knows that customer. They know where the house is. They see that house day in and day out."

The American Bankers Association advisory suggests the Consumer Financial Protection Bureau is conflicted in its thinking

See **DEFLATE**, Page3

on non-qualified loans. "The Bureau has expressly recognized that in many instances, appropriate, prudent loans will not meet the QM requirements," the ABA advisory said, but added: "The Bureau encourages creditors to make non-QM loans."

But lenders should do so fully aware of the liabilities the non-qualified loans carry, the ABA warned.

"Lenders should understand the risks that attend making non-QM loans and the policies and robust controls that they will need to do so."

Worry Fits All Sizes

Ray Britt, longtime president & CEO of Mississippi's smallest bank, the $52-million Bank of Walnut Grove, said the new rules have given him "a lot to worry about."

Chief among the worries is the possible demise of the bank's customary origination of non-conforming loans, he said. "If we are unable to balloon, that is going to effectively take us out of our mortgages."

Count BancorpSouth a likely candidate to depart the balloon mortgage business as well, says Scott Dickey, president of the mortgage division of the $13.4 billion regional bank headquartered in Tupelo.

"We will try to stay within the Qualified Mortgage safe harbor bucket as far as the business we do," said Dickey, whose bank has nearly 300 locations in both urban and rural areas from Florida to Texas.

"As far as non-qualified mortgage loans, we're going into a gray area that I don't think many banks are going to play in," Dickey said.

The potential for trouble, especially from class action lawsuits, is too great, he said, repeating the lament of Priority One's Busby and Barnes and Bank of Walnut Grove's Britt.

"That's not an avenue we want to be blazing a trail into...," Dickey said of balloon mortgage lending in the new regulatory era that begins Jan. 10.

The more immediate task, he added, is for BancorpSouth to beef up its referral service to try to get the customer into a loan product that is Qualified Mortgage eligible.

"That's going to be our challenge."