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Shopping for a mortgage? What you can expect under federal rules



Consumer Financial
Protection Bureau

You'll be offered a mortgage that's set up to be affordable.

When you apply for a mortgage, you may struggle to understand how big a monthly payment you can afford. You might assume that lenders and mortgage brokers will not make you a loan that you cannot afford. In the years leading up to the recent financial crisis, some mortgages looked affordable at first, but were set up with big increases in the payments. Lenders too often made mortgages to consumers who could not pay them back. As a result, many consumers ended up in delinquency and foreclosure.

Under federal mortgage rules, before a lender makes a mortgage loan, it must look at your financial information and make a determination that you can repay the loan. The ability to repay rule applies to mortgage loans made by most lenders. (It excludes certain types of loans, like home equity lines of credit, timeshare plans, reverse mortgages, and temporary loans.) There is also a category of loans, called “qualified mortgages,” that have more tightly controlled terms and features.

The rules help make sure that you get a mortgage loan you can afford. The rules also help make sure that responsible lenders aren't forced to compete with reckless lenders engaged in risky practices.

Although the rules provide you with protections, it's important to do your own analysis. Focus on what loan amount is affordable for you given your other priorities, not how much you qualify for. To know how much you can afford to repay, you'll need to take a hard look at your income, expenses, and savings priorities to see what fits comfortably within your budget.

The lender must determine your “ability to repay.”

Before you get a mortgage loan, the lender generally has to determine you have the ability to repay the loan.

The lender must collect and verify your financial information.

When you apply for a mortgage loan, you have to give the lender certain financial information. The lender has to check the information using reliable documents, such as a W-2 or pay stub. The lender generally must consider eight types of information:

1. Your current income or assets
2. Your current employment status
3. Your credit history
4. The monthly payment for the mortgage
5. Your monthly payments on other mortgage loans you get at the same time on the same property
6. Your monthly payments for other mortgage-related expenses (such as property taxes)
7. Your other debts
8. Your monthly debt payments, including the mortgage, compared to your monthly income (“debt-to-income ratio”)

The lender may also look at how much money you have left over each month after paying your debts.

You must have enough assets or income to pay back the loan.

The lender must determine that you can repay the loan. The lender may look at your current income and assets (except the value of the mortgaged property itself). The lender must also look at your debt-to-income ratio or at the amount of money you’ll have left over each month to pay for things like food and heat.

A lender can't determine your ability to repay using "teaser" rates.

The lender can't use a temporarily low rate, like an introductory or teaser rate, when it computes your monthly mortgage payment to determine whether you are able to repay the mortgage. For example, if the loan is an adjustable-rate mortgage, the lender will generally have to consider the highest interest rate that you may have to pay.

Exception: If the lender is refinancing you out of a risky loan.

In defined circumstances, the "ability-to-repay" requirements may not apply to a lender that is refinancing you from a riskier mortgage to a more stable mortgage. An example of a risky loan could be an interest-only loan. An example of a more stable mortgage could be a fixed-rate mortgage. This exception makes it easier for you to refinance into a less risky loan.

The lender can offer you a Qualified Mortgage.

A lender is presumed to have met the "ability-to-repay" requirements if the lender makes a Qualified Mortgage. A Qualified Mortgage must meet certain requirements. For example, the loan cannot have certain risky features that contributed to consumers' problems during the mortgage crisis.

Qualified Mortgages can't have certain loan features.

Qualified Mortgages cannot have the following loan features:

- An "interest-only" period, when you pay only the interest without paying down the principal
- "Negative amortization," when the loan principal increases over time, even though you are making payments
- "Balloon payments," which are larger-than-usual payments at the end of the loan term—though these are allowed in some limited circumstances
- Loan terms that are longer than 30 years

Qualified Mortgages limit how much of your income can go toward debt.

Qualified Mortgages generally require that your monthly debt, including the mortgage, isn't more than 43 percent of your monthly pre-tax income. In some circumstances, certain small lenders may also decide that debt of more than 43% is appropriate.

Temporarily, Qualified Mortgages can also be loans that can be bought by Fannie Mae or Freddie Mac or insured by certain government agencies, such as the Department of Agriculture, even if the debt ratio is higher than 43 percent. Additionally, loans that are insured or guaranteed by the Department of Housing and Urban Development, including through the Federal Housing Administration, are also qualified mortgages under rules issued by that agency.

Mortgages with high upfront points and fees are not Qualified Mortgages.

Qualified Mortgages don't allow lenders to charge you excessive upfront points and fees. The cost limits depend on the size of the loan. Third-party charges, such as the cost of a credit report, are usually not included in the limit. Qualified Mortgages also have limits on discount points (a percentage of the loan that you pay up front in return for a reduced interest rate).

Some Qualified Mortgages can have a balloon payment.

While a loan with a balloon payment generally cannot be a Qualified Mortgage, a small lender can make a loan with a balloon payment that is a Qualified Mortgage in certain circumstances. You can still opt for a balloon-payment mortgage when the lender meets the requirements to be considered a "small creditor," and your mortgage meets other criteria.

Qualified Mortgages protect lenders, too.

Lenders that make Qualified Mortgages get certain legal protections even if the borrower fails to repay the loan. For Qualified Mortgages, lenders get a "safe harbor" for loans that don't have higher than average interest rates. This means that if the loan meets the Qualified Mortgage definition, the lender is considered to be in compliance with the "ability-to-repay" rule. You can still legally challenge your lender under this rule if you can show that the loan does not meet the definition of a Qualified Mortgage.

For Qualified Mortgages that are higher-priced, with higher than average interest rates, the rule works differently. For those loans, lenders get a “rebuttable presumption” that they met the “ability-to-repay” rule. However, you can challenge that presumption. You would have to prove that the lender had information when it closed on your mortgage that shows you, in fact, did not have enough income to pay your mortgage and your debts and still handle your other living expenses. The “ability-to-repay” rule does not affect your rights to challenge a lender for violating any other federal consumer protection laws.

You'll have a more accurate idea of the home's value.

Many different factors can go into estimating a value for a home. These factors include sales of similar homes in the area, and other information about the property and the surrounding area. For example, the appraiser can estimate a higher value if the home or yard is bigger, or if the home has more bathrooms or a newer kitchen than other recently sold homes. If the home is smaller, needs repairs, or is missing features (like a second bathroom, for example), the appraiser can assign a lower value. The appraiser then determines the home's value based on differences between the home and recently sold homes in the area.

You'll receive copies of appraisals that your lender obtains.

You have convenient ways to review a valuation—an estimate of the home's value—before getting a loan. Specifically, if you apply for a first mortgage on a home, your lender:

- Has to tell you within three days of receiving your mortgage loan application that you will promptly get a copy of any appraisal
- Has to give you a free copy of any valuation, which may include commonly used reports like appraisal reports, automated valuation model reports, or broker's price opinions
- Has to provide these copies promptly after the reports are completed, or three days before your loan closes, whichever is earlier
- May ask you to waive the deadline so that any copies can be provided at closing
- Has to provide these copies to you promptly, even if your loan does not close
- May require you to pay a reasonable fee for the cost of obtaining the valuation

You can waive your right to look at appraisals in advance.

A lender can ask you to “waive” your right to get a copy of valuations three business days before closing. This means you agree that the lender does not have to provide you with a copy at least three days in advance of closing. Even if you waive this right, the lender still has to give you a copy of any valuations. If you waive this right and your loan closes, the lender can then give you a copy two days before, one day before, or on the day of the closing.

Think carefully before you agree not to get a copy of valuations three days in advance of closing. For example, it could take time to look over all the information in an appraisal and decide whether it makes sense to you.

Appraisals could help you spot unlawful lending discrimination.

Mortgage lenders consider your home’s value before they give you a home loan. The value should be based on your home’s characteristics, not on factors that would result in unlawful discrimination.

Discrimination in lending may occur where the appraisal or estimate of the home’s value is based on improper factors—for example, the racial or religious background of the neighborhood’s residents. Consideration of improper factors in a home valuation is often difficult to spot. That’s one reason why it is important to review the estimates of the home’s value provided by your lender. Make sure you understand the reports and see whether any parts of them don’t make sense to you.

Federal laws against discrimination in lending include the Equal Credit Opportunity Act and the Fair Housing Act. Under these laws, mortgage lenders can’t discriminate against you because of:

- Race
- Color
- National origin
- Sex
- Religion
- Marital status
- Age (provided you are old enough to enter a contract)

- Receipt of income from a public assistance program
- Exercising in good faith a right under the Consumer Credit Protection Act
- Familial status (for example, having children under 18 years old)
- Handicap or disability

Lenders generally can't consider these factors when deciding whether to offer you a loan. Lenders also generally may not consider these factors when setting your loan terms. There are special rules restricting when lenders may consider age and receipt of public assistance.

You'll be protected against conflicts of interest.

Consumers typically take out only a few home loans during their lives. As a result, they often rely on loan originators (like loan officers or mortgage brokers) to help them pick a loan. But before the financial crisis, some loan originators were paid more when consumers agreed to loans with higher rates or unfavorable terms. In addition, the training and qualification standards for loan originators varied widely.

Now, under federal law, certain payment practices are banned and loan originators must meet certain requirements.

Your lender can't charge you hidden fees.

In the past, companies sometimes paid their loan originators more for steering consumers into mortgages with higher rates or unfavorable features. You may not have realized that your mortgage loan originator would make more money if you agreed to a higher interest rate or other more costly loan terms.

Companies can no longer do that. They can't tie the loan originator's pay to the interest rate of your loan. They also can't pay a loan originator for getting you to use a company they're associated with—like a particular title company. If you're paying a mortgage broker to help you find a mortgage loan, the mortgage broker generally can't also be paid by the lender for your loan.

Your lender's employees will meet professional qualifications.

Loan originators must be qualified to make mortgage loans. If they are supposed to be licensed or registered under state or federal law, but they fail to satisfy these requirements, they will be violating the rule. Employees of particular lenders, like banks or certain nonprofits, don't have to have a license from a state. These employees generally have to pass background and reference checks. They also have to have training about how to properly make loans.

Your lender can't require arbitration.

Arbitration is a way to resolve disputes outside the court system. In arbitration, a person called an arbitrator listens to each side and decides how to resolve the dispute. Some tools that a plaintiff might use in court may not be as available in arbitration. In addition, compared to suing in court, your ability to appeal an arbitrator's decision is much more restricted.

Parties sometimes agree to arbitrate a dispute after it has arisen. This is often called "post-dispute arbitration" because the dispute occurs first and the parties only then agree to arbitrate it. You and your lender can use post-dispute arbitration if you both agree.

"Pre-dispute arbitration" clauses, which are often called "mandatory arbitration clauses," operate the other way around. Before any dispute occurs, a clause in the parties' contract states that they will resolve certain types of disputes in arbitration rather than in court. Generally lenders are no longer allowed to put mandatory arbitration clauses in contracts for mortgage loans and home equity lines of credit.

Your lender can't add the cost of credit insurance to your loan amount.

Credit insurance pays off all or some of your loan or suspends all or some of your loan payments if you die, become disabled, lose your job, or in other specified circumstances. If you borrow the money through your mortgage loan to pay for a credit insurance policy, your total loan amount

goes up and you pay more interest. Lenders are not allowed to include the cost of credit insurance in your loan amount.

You can still buy a credit insurance policy, and either pay for it up front, or make monthly premium payments separate from your mortgage payment. Special rules apply to credit unemployment insurance.

You'll be more protected if your loan has higher costs.

If a lender offers you a high-cost mortgage for your primary home, where the annual percentage rate (APR) or points and fees charged exceed certain threshold amounts, stronger consumer protections apply. You'll get additional consumer protections if this is a mortgage to buy your home, a loan to refinance the mortgage on your home, or a home equity loan or home equity line of credit (HELOC) that meets one of the following descriptions:

- A first mortgage with an APR of more than 6.5 percentage points higher than the average prime offer rate, which is an estimate of the rate people with very good credit typically pay for a similar first mortgage
- A loan of less than \$50,000 for a personal property dwelling (such as a manufactured home) that is also not secured by any real estate, with an APR of more than 8.5 percentage points higher than the average prime offer rate for a similar mortgage
- A second, subordinate, or junior mortgage with an APR of more than 8.5 percentage points higher than the average prime offer rate for a similar second mortgage
- A loan of less than \$20,000 with points and fees that total 8 percent of your loan or \$1,000 (whichever is less), or a loan of \$20,000 or more with points and fees in excess of 5 percent of your loan

For example, before making a loan that is a high-cost mortgage, your lender must:

- Provide you with information in advance that explains you are getting a high-cost mortgage, and stating the terms, costs, and fees associated with the loan
- Get certification from a housing counselor that you have received counseling about the particular high-cost mortgage the lender is offering you

You'll face fewer fees even if your loan is higher cost.

Federal law also limits or bans some loan features for high-cost mortgages. For example, if you have a high-cost mortgage, lenders can no longer add many kinds of fees and charges to the amount you borrow, a practice that led to abuses in the past.

For high-cost mortgages, the following fees are not allowed:

- Fees for paying all or part of your loan early (like when you refinance your mortgage), commonly called a prepayment penalty
- “Balloon payments”—big payments at the end of loans that are more than twice the regular payment amounts—except in special circumstances
- Late fees larger than 4 percent of your regular payment
- Most fees for getting a statement of how much you still owe on your mortgage (called a payoff statement)
- Fees for loan modifications, for example if you have trouble and can't pay your mortgage

Creditors or brokers are banned from advising homeowners refinancing into high-cost mortgages not to make their payments on an existing loan.

You'll benefit from stricter requirements for appraisals.

What's more, for certain higher-priced mortgage loans, which generally are loans with an annual interest rate of 1.5 or more percentage points higher than the average prime offer rate, your protections include:

- Your lender has to use a certified or licensed appraiser to value your home.
- The appraiser has to see the inside of your home.
- Three days before your loan closing, your lender must give you a free copy of all appraisals it obtained.

You'll see more complete information if you're buying a flipped home.

If you apply for a higher-priced mortgage that is covered by the rule, then an additional appraisal is required when the home you are buying is a “flip.” A flip is when:

- You buy a home from a seller who bought the home less than six months ago, and
- You pay a certain amount more than the seller paid for the home:
 - 10% more if the seller bought the home within the past 90 days.
 - 20% more if the seller bought the home in the past 91 to 180 days.

When you buy a “flipped” home, the lender must pay for a second appraisal of the home that also includes an inside inspection of the home. The lender cannot charge you for this second appraisal.

Not all flips are subject to this requirement, however. Flips in rural areas, for example, are exempt.

You might have to use an escrow account to hold money for taxes and insurance.

Escrow accounts hold money that some mortgage lenders collect every month along with your mortgage payment and use to pay your big bills like property taxes and homeowner's insurance premiums.

Escrow accounts can be a convenient way to manage your costs. They help you save a little each month toward big bills your lender pays for you as they come due. Having an escrow account helps ensure that homeowners better understand the overall costs of maintaining their home.

Certain lenders have to collect monthly escrow payments from you for higher-priced mortgage loans, for at least the first five years you have the mortgage.

If your home is in a community association that buys homeowner's insurance for everyone in the development, the lender may have to escrow only for property taxes. The kinds of communities

that might have a governing association that maintains a master homeowner’s insurance policy for all of the homes in the community include:

- Planned unit developments
- Condominiums
- Other “common interest” communities

Exception: Some loans don’t require escrow accounts.

The escrow requirement may not apply to some lenders, particularly lenders that mostly operate in rural areas or areas where few loans are made. If your lender meets four conditions, it may not have to collect escrow payments from you. In general, the four conditions are:

1. It lends mostly in rural areas or places where few loans are made.
2. Together with any of its affiliates, it makes no more than 500 mortgages a year.
3. It has assets less than \$2 billion.
4. It and its affiliates generally do not maintain escrow accounts for any mortgage loans they currently service.

If your lender meets all four of those requirements, but it plans to sell your loan to another company that doesn’t also meet the same four requirements, your lender will have to establish an escrow account for you if your loan is a higher-priced mortgage loan covered by the rule.

Exception: Some higher-priced mortgage loans are not covered.

The rules for higher-priced mortgage loans do not apply to all home loans. The rule for appraisals does not apply when you are applying for a higher-priced mortgage loan that is:

- A reverse mortgage
- A Qualified Mortgage
- Secured by a manufactured home, under specified conditions
- For a boat, trailer, or mobile home that is not a manufactured home
- For construction of a new home
- A temporary or bridge loan for 12 months or less
- A streamlined refinance mortgage, under specified conditions
- For an amount of \$25,000 or less

The rule for escrows does not apply to a higher-priced mortgage loan that is:

- Secured by shares in a cooperative
- To finance the initial construction of a dwelling
- A reverse mortgage
- Secured by a second, subordinate, or junior lien
- Open-end credit (such as a home equity line of credit)
- A temporary or bridge loan for 12 months or less

Where to find out more

Information about these and other rules is available at <http://consumerfinance.gov/regulations>.

You can get more mortgage facts and help at <http://consumerfinance.gov/mortgage>. Already have a mortgage? Take a look at the booklet, *Have a mortgage? What you can expect under federal rules*, posted on that page.

If you have a problem with your mortgage, you can also submit a complaint with the CFPB:

Online: www.consumerfinance.gov/complaint

By telephone: (we provide services in more than 180 languages)

8 a.m. to 8 p.m. ET, Monday–Friday:

(855) 411-CFPB (2372)

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