

Secondary Mortgage Loans Requirements and Limitations

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Elements of Secondary Mortgage Loans



**LOAN =
ADVANCE OF
MONEY +
OBLIGATION TO
REPAY**



**PURPOSE OF
THE LOAN =
PERSONAL,
FAMILY, OR
HOUSEHOLD
PURPOSE**



**IMPROVEMENT
= IMPROVED BY
A DWELLING**



**MULTIPLE LIENS
= SUBJECT TO
ONE OR MORE
LIENS, SECURITY
INTEREST, PRIOR
MORTGAGES,
OR DEEDS OF
TRUST**

Retail Installment Contract ≠ Loan

- The financing of goods and services on a retail installment contract are subject to [Chapter 345](#) of the Texas Finance Code.
- Although a junior lien may be recorded in the real property records, a retail installment contract is not a secondary mortgage loan.
- The [Office of Consumer Credit Commissioner](#) is the primary regulator for retail installment contracts.

Purpose of Secondary Mortgage Loans

Purchase Money (a.k.a. Piggyback Loan)

Payment of Taxes (a loan not subject to Tex. Fin. Code, Ch. 351)

Owerty of partition (court order or written agreement)

Home Improvement Loan (Texas Property Code, Ch. 53)

Home Equity Loan (Article XVI, Section 50(a)(6) of Tx. Constitution)

Wrap Mortgage Loan (Tex. Fin. Code, Ch. 159)

Two Types of Secondary Mortgage Loans



Chapter 302 Secondary
Mortgage Loans



Chapter 342 Secondary
Mortgage Loans

Differences between the two types of Secondary Mortgage Loans

	Chapter 302 Secondary Mortgage Loan	Chapter 342 Secondary Mortgage Loan
Maximum Interest Rate	Less than or equal to 10% simple interest per annum	Chapter 303 rate Currently 18% simple interest per annum
Interest Earnings Method	Any calculation method so long as effective rate does not exceed 10% simple interest	Scheduled Installment Earnings Method True Daily Earnings Method
Late Charges (State Law)	Greater of 5% of the scheduled installment or \$7.50 after 10 days after the due date	5% of the scheduled installment after 10 days after the due date
Permissible Fees Limitations	Marginal Restrictions	Substantial Restrictions
Prepayment Penalty Allowed	Yes, unless prohibited by federal law	None allowed

Maximum Rate of Interest

➤ Non-Federally Preempted – Texas Finance Code, § 342.301

Alternative Rate (Chapter 303, TEXAS FINANCE CODE)

- Weekly Rate – Closed-end and Open-end
- Quarterly or Annualized Rate – Open-end (HELOC)

Currently, simple finance charge of 18% per annum

➤ Federally Preempted – No Limitation on Interest

Must comply with limitations and requirements applicable to an “alternative mortgage”

- ▶ Alternative Mortgage Transaction Parity Act of 1982 (12 U.S.C. § 3801 et seq. and 12 C.F.R. § 1004.1 thru 1004.4)

Maximum Rate of Interest

Alternative mortgage transaction means a loan, credit sale, or account:

1. that is secured by an interest in a residential structure that contains one to four units, whether or not that structure is attached to real property, including an individual condominium unit, cooperative unit, mobile home, or trailer, if it is used as a residence;
2. that is made primarily for personal, family, or household purposes; and
3. in which the interest rate or finance charge may be adjusted or renegotiated (must comply with Regulation Z and, on open-end transactions, the index must be readily available and beyond the control of the creditor and must be based upon a formula or schedule).

See Regulation D, 12 C.F.R. § 1004.2

Permissible Interest Earnings Method

- **Scheduled Installment Earnings Method** - A method to compute an interest charge by applying a daily rate to the unpaid balance of the principal amount as if each payment will be made on its scheduled installment date. A payment received before or after the due date does not affect the amount of the scheduled principal reduction.
- **True Daily Earnings Method** - A method to compute an interest charge by applying a daily rate to the unpaid balance of the principal amount. The earned finance charge is computed by multiplying the daily rate by the number of days the principal balance is outstanding.
- Daily Rate is $1/365$ of the equivalent contract rate (note rate)
- No Compounding of Interest (No Negative Amortization)

Late Charge Limitations (Both Types)

- **Contract required** = Promissory Note must contain a contractual provision authorizing the late charge (closed-end).
- **One late charge per installment**
- **Default Period** = 10 days after the installment due date
 - Payment due on the 1st cannot be assessed a late charge until the 12th.
- **No pyramiding of late fees** (see Regulation Z, 12 C.F.R. §1026.36(c)(2) and 7 Texas Administrative Code §83.703)
- **High-Cost Mortgage** If the secondary mortgage loan is a High-Cost Mortgage, the late charge is 4% of the past due payment after a 15-day grace period. See Regulation Z, 12 C.F.R. §1026.34(a)(8)

Secondary Mortgage Loan Permissible Fees or Charges (Ch. 342)

Permissible Fee or Charge	Description of Fee or Charge
Title Examination or Abstract of Title	Fee for examination of the public records to determine whether any defects or encumbrances exist in a given property's chain of title. Must be prepared by one of the following: (1) a Texas-licensed attorney who is not a salaried employee of the lender; (2) Texas-licensed title company; or (3) a property search company authorized to do business in Texas.
Title Insurance Premiums	An insurance policy that indemnifies against damage or loss arising from a defect in title to real property. The premium rates and endorsement fees are established by Texas Department of Insurance.
Document Preparation Fee	Fee charged by a Texas-licensed attorney to prepare the legal documents. Under Texas Government Code, §83.001(a), the fee for prepared by Texas-licensed attorney. Must be prepared by a non-salaried employee of the lender.
Recording Fees	Fees paid to a county clerk to record, perfect, or release a lien on real property. Fees are established by Texas Local Government Code, Chapter 118.
Appraisal Fees	Fees paid to a Texas-licensed appraiser that is not a salaried employee of the lender.
Credit Report Fees	Fee paid to a consumer reporting agency (actual fee only).
Survey Fee	Fee paid to a registered surveyor that is not a salaried employee of the lender to determine the legal boundaries of the property.

Secondary Mortgage Loan Permissible Fees or Charges (Ch. 342)

Permissible Fee or Charge	Description of Fee or Charge
Flood Determination Fee	Fee paid to determine whether the property is located in a flood plain. The Flood Disaster Protection Act requires mortgage lenders to determine the flood plain status of property before making a residential mortgage loan.
Credit Insurance Property Insurance Premiums	Credit life and credit accident and health insurance. Regulation Z, 12 C.F.R. §1026.36(i) prohibit the financing, directly or indirectly, any premiums or fees for credit insurance unless the premiums or fees are calculated and paid in full on a monthly basis. (No financed single-premium insurance allowed).
Property Insurance	Insurance that protects property against damage or loss to real or tangible personal property at a fixed location provided in a homeowners policy.
Private Mortgage Insurance	Insurance that protects mortgagee against default by the mortgagor.
Debt Cancellation Agreements	Non-insurance products that eliminate the debt if you die or cancels the monthly payment if you become ill or disabled. Regulation Z, 12 C.F.R. §1026.36(i) prohibit the financing, directly or indirectly, any fees for debt cancellation and debt suspension agreements unless the fees are calculated and paid in full on a monthly basis. (No financed single-premium insurance allowed).
Administrative Fee	Fee paid to lender to make a loan. Fee is limited to \$25.

Home Equity Fee Limitation – 2% Fee Limit

- **2% limitation on fees and charges** – The owner of the homestead property is not required to pay any fees that exceed two percent of the original principal amount of the Home Equity Loan excluding:
 - Per-diem interest
 - Contractual Interest (excluding origination fees and origination points)
 - Bona-fide Discount Points
 - Appraisal fees performed by a third-party appraiser excluding [appraisal management fees](#)
 - Property survey fees performed by a licensed or registered surveyor
 - Title insurance premiums (base premium plus lawful endorsements)
 - Abstract title fees (if less than the basic title insurance)
 - Optional Insurance (credit life and credit accident and health insurance)
 - Property Insurance Premiums (Homeowners insurance)
 - Charges Absorbed by the Lender
 - Escrow Reserves

Article XVI, Section 50(a)(6)(E) of the Texas Constitution and 7 Texas Administrative Code § 153.5

Permissible Interest Origination Fees

- **Seller's points.** Seller's points are lump sum payments made by the seller of a home to the buyer's lender to reduce the cost of the loan to the buyer.
- **Discount points.** Discount points a type of prepaid interest or fees mortgage borrowers can purchase that lowers the amount of interest they have to pay on subsequent payments.
- **Origination fees.** Origination points or fees are a type of prepaid interest that cover the lender's cost of underwriting or processing the loan.

Spreading of Points for Usury Purposes

[Texas Finance Code, §302.101](#) addresses the concept of spreading:

- (a) To determine whether a loan secured in any part by an interest in real property, including a lien, mortgage, or security interest, is usurious, the interest rate is computed by amortizing or spreading, using the actuarial method during the stated term of the loan, all interest at any time contracted for, charged, or received in connection with the loan.
- (b) If a loan described by Subsection (a) is paid in full before the end of the stated term of the loan and the amount of interest received for the period that the loan exists exceeds the amount that produces the maximum rate authorized by law for that period, the lender shall:
 - (1) refund the amount of the excess to the borrower; or
 - (2) credit the amount of the excess against amounts owing under the loan.”

Spreading of Points for Usury Purposes

- Seller's points, discount points, and origination fees are treated as interest and are aggregate with other interest charges for the purpose of a usury calculation
- For determining usury, seller's points, discount points, and origination fees are spread over the term of the obligation in determining whether the transaction is usurious (excessive interest).
- The court cases dealing with spreading are as follows: [Tanner Development Company v. Ferguson](#), 561 S.W.2d 777 (Tex. 1977); [Spanish Village v. American Mortgage Company](#), 586 S.W.2d 195 (Tex. App. - Tyler; 1979); and [Miller v. First State Bank](#), 551 S.W.2d 89 (Tex. App.- Fort Worth; 1977).

Spreading of Points for Usury Purposes

The first step in spreading is to determine the “true principal balance” of the loan.

- “True principal” is the amount loaned to the borrower by the lender and does not include any front-end or upfront interest. The “stated” principal on the face of a loan agreement is frequently more than the true principal, particularly in loans involving front-end interest where an amount is subtracted from the principal before advancement.
- In most cases, the “true principal” is the TILA amount financed (except for situations involving seller’s points).

Spreading of Points (Example)

Basic Terms of the Secondary Mortgage Loan		Principal Balance of the Loan subject to a Fin. Chg.	
Date of Loan	09/01/2023	Cash to Borrower	\$50,000.00
First Payment Due Date	10/01/2023	Discount Points (Financed)	\$ 5,000.00
Term of the Loan	120 months	Hazard Ins. Premium	\$ 850.00
Earnings Method	True Daily	Doc. Prep. Fee (TX-licensed attorney)	\$ 250.00
Amount Financed	\$52,192.01	Title Insurance Premium	\$ 717.01
Scheduled Fin. Chg.	\$106,598.40	Recording Fee	\$ 25.00
Total of Payments	\$106,598.40	Appraisal Fee	<u>\$ 350.00</u>
Monthly Pymt. Amount	\$888.32	Total Principal Balance	\$57,192.01
A.P.R.	16.43%		
Note Rate	14.00%	True Principal Balance	\$52,192.01

Spreading of Points

(Actual Payment History without Refund)

Payment Due Date	Date Payment Received	Actual Amount Paid	Interest Actually Paid	Principal Reduction	Remaining Principal Balance
09/01/2023					\$57,192.01
10/01/2023	10/03/2023	\$900.00	$\$57,192.01 \times .14 \div 365 \times 32 = \701.97	\$198.03	\$56,993.98
11/01/2023	11/05/2023	\$900.00	$\$56,993.98 \times .14 \div 365 \times 33 = \721.40	\$178.60	\$56,815.38
12/01/2023	12/03/2023	\$915.00	$\$56,815.38 \times .14 \div 365 \times 28 = \610.18	\$304.82	\$56,510.56
01/01/2024	01/15/2024	\$944.42	$\$56,510.56 \times .14 \div 365 \times 43 = \932.04 Late Charge = \$44.42 Interest Shortage Amount = \$32.04	\$ 0.00	\$56,510.56
02/01/2024	02/01/2024	\$900.00	$\$56,510.56 \times .14 \div 365 \times 17 = \368.48	\$499.48	\$56,011.08
Payoff	02/26/2024	\$56,548.17	$\$56,011.08 \times .14 \div 365 \times 25 = \537.09	\$56,011.08	\$ 0.00

Spreading of Points (Example)

The second step is to calculate the maximum interest charge using the following variables:

- true principal balance (\$52,192.01);
- 18% simple interest per annum (maximum rate);
- actual dates and actual payment amounts that were paid by the borrower; and
- true daily earnings method using the U.S. Rule.
 - United States Rule is a ruling of United States Supreme Court in *Story v. Livingston*, 38 U.S. (13 Pet.) 359, 371 (1839) that, in partial payments on a debt, each payment is applied first to interest and any remainder reduces the principal. Under this rule, accrued but unpaid interest cannot be added to the principal, and interest cannot be compounded.

Spreading of Points (Refund of Points Calculation)

Payment Due Date	Date Payment Received	Actual Amount Paid	Interest Actually Paid	Principal Reduction	Remaining Principal Balance
09/01/2023					\$52,192.01
10/01/2023	10/03/2023	\$900.00	$\$52,192.01 \times .18 \div 365 \times 32 = \823.63	\$ 76.37	\$52,115.64
11/01/2023	11/05/2023	\$900.00	$\$52,115.64 \times .18 \div 365 \times 33 = \848.13	\$ 51.87	\$52,063.77
12/01/2023	12/03/2023	\$915.00	$\$52,063.77 \times .18 \div 365 \times 28 = \718.91	\$196.09	\$51,867.68
01/01/2024	01/15/2024	\$944.42	$\$51,867.68 \times .18 \div 365 \times 43 = \$1,099.88$ Late Charge = \$44.42 Interest Shortage Amount = \$199.88	\$ 0.00	\$51,867.68
02/01/2024	02/01/2024	\$900.00	$\$51,867.68 \times .18 \div 365 \times 17 = \434.84	\$265.28	\$51,602.40
Payoff	02/26/2024	\$56,548.17	$\$51,602.40 \times .18 \div 365 \times 25 = \636.19	\$55,911.98	(\$4,309.58)

Spreading of Points (Refund of Points Calculation)

Of the original \$5,000 discount points collected at the time of the loan, the lender must refund \$4,309.58 to the borrower (otherwise the creditor will be in violation of Texas usury laws).

Secondary Mortgage Loans

Permissible Post-Closing Fees – Chapter 342

The permissible post-closing fees on a secondary mortgage loan are:

1. reasonable fees paid to the trustee to enforce the lien including posting for sale, selling, or releasing the property secured by a deed of trust;
2. reasonable fees paid to an attorney who is not an employee of the creditor in the collection of a delinquent secondary mortgage loan;
3. court costs and fees incurred in the collection of the loan or foreclosure of a lien created by the loan;
4. actual recording fees for release-of-lien paid to the county clerk's office; and
5. insufficient funds fee (N.S.F. fee) of \$30.

Texas Finance Code, §342.307 and §342.502

Prohibition on Other Fees – Chapter 342

- A lender may not directly or indirectly charge, contract for, or receive any amount that is not authorized by Chapter 342, Subchapter G including any fee, compensation, bonus, commission, brokerage, discount, expense, and any other charge of any nature.
- Unauthorized fees include:
 - payoff statement fees;
 - courier fees;
 - loan processing or underwriter fees;
 - escrow management fees;
 - commitment fees;
 - prepayment penalties;
 - settlement or closing fees;
 - tax certificate fees;
 - expedited payment fees; and
 - broker fees (if compensation greater than a loan without a broker).

Texas Finance Code, §342.502(a) and 7 Texas Administrative Code §83.707(b)

Federal Law Limitations

Federal law imposes additional restrictions and limitations on secondary mortgage loans including:

- Balloon payment limitations for high-cost mortgage loans (Regulation Z, 12 C.F.R. §1026.32)
- Disclosure requirements for high-cost mortgage loans (Regulation Z, 12 C.F.R. §1026.32); and
- No deferment, modification, extension, or renewal fees permitted on high-cost mortgage loans (Regulation Z, 12 C.F.R. §1026.32).

Questions?

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