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DEPARTMENT OF BANKING AND INSURANCE  
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HOLLY C. BAKKE  
*Commissioner*

Bulletin No. 04-22

TO: ALL INTERESTED PARTIES

FROM: HOLLY C. BAKKE, COMMISSIONER

RE: THE NEW JERSEY HOME OWNERSHIP SECURITY ACT OF 2002

The New Jersey Department of Banking and Insurance ("Department") is issuing this Bulletin as a supplement to the previously issued Bulletin 03-15, issued on July 24, 2003 and Bulletin 03-30, issued on November 18, 2003 (collectively referred to as the "prior Bulletins"), in response to additional questions that have been raised about the New Jersey Home Ownership Security Act of 2002 (the "Act"), N.J.S.A. 46:10B-22 et seq., signed into law on May 1, 2003, and amended by P.L. 2004, c. 84, enacted July 6, 2004. For purposes of consistency, the question numbering continues from Bulletin 03-30.

Since the issuance of the first two Bulletins, the Legislature has amended the Act to provide the Department with regulatory authority to be exercised in consultation and collaboration with the Department of Law and Public Safety, Division of Consumer Affairs. While doing so, the Legislature, in the Statements to the Senate Commerce Committee and Assembly Financial Institutions and Insurance Committee, explicitly confirmed as accurate the Department's interpretations of the Act as set forth in the prior Bulletins.

Building upon such confirmation, the Department intends to codify certain of those interpretations in rules in the interest of providing further guidance to the public. The Department anticipates that notice of these proposed rules likely will be published in the New Jersey Register in the coming months. Although the rules initially proposed will primarily codify certain Department interpretations of the Act as set forth in the prior Bulletins, the proposed new rules also will address several additional issues that have been raised and for which the Department believes it is appropriate to provide guidance to interested parties. The initial set of proposed rules are not intended to address every issue that may have been raised regarding implementation of the Act. Based on its ongoing implementation of the Act, the Department intends to propose additional rules to address other issues regarding such implementation in the future as deemed necessary and appropriate.

**Points and Fees**

### **Question 25:**

An issue was raised as to whether the rate threshold under the Act is identical to that under the Home Ownership and Equity Protection Act of 1994, 15 U.S.C. §1602(aa) (“HOEPA”). Specifically, does the Act use the HOEPA definition of points and fees, or does it use the Act's definition of points and fees as a part of the interest rate calculation for the rate threshold.

The Department has determined that the definition of “points and fees” in HOEPA should be used in making the calculation for the interest rate threshold. The definition of “rate threshold” in the Act provides that the threshold is reached if the “loan is considered a ‘mortgage’ under section 12 of the federal ‘Home Ownership and Equity Protection Act of 1994’ . . . .” In order to give full effect to this specific statutory language, the definition of “points and fees” in HOEPA, rather than the general definition of “rate” in the Act, which references “points and fees as set forth in this Act,” should be used in calculating the interest rate threshold. The Department construes that the specific language in the definition of “rate threshold” controls over the more general definition of “rate.”

### **Question 26:**

A question was raised as to whether Federal Housing Authority (“FHA”) and Veterans Administration (“VA”) funding fees are included in “points and fees” under the Act.

The VA and FHA lending programs charge applicants a guarantee fee and a mortgage insurance fee, respectively. These fees are charged to all applicants, except that the amount charged may vary from applicant to applicant based on underwriting criteria.

Consistent with the Department's analysis regarding mortgage insurance premiums and private mortgage insurance premiums, set forth in Question 24 of Bulletin 03-30, the Department has concluded that these fees should not be part of the equation as to whether the points and fees threshold for high-cost loans has been exceeded. Because the FHA fee is a mortgage insurance provision of the loan, and because the VA fee, notwithstanding its being a guarantee fee, operates in substantial part like a mortgage insurance premium, they are for all intents and purposes mortgage insurance. Accordingly, the Department has concluded that the Act excludes those fees from the points and fees calculation. This conclusion is based on the fact that the Act's points and fees definition specifically includes sections 15 U.S.C. 1605(a)(1) through (4) and does not include section 1605(a)(5), which refers to "premium or other charge for any guarantee or insurance protecting the creditor against the obligor's default or other credit loss."

### **Question 27:**

An issue was raised as to whether costs paid by the seller are included in the points and fees threshold calculation (for example, 7% total fees with 3% paid by the seller and 4% paid by the borrower, hoping to avoid the high cost loan category by keeping the borrower's points and fees below the 4.5% trigger).

In resolving this issue, the Department is guided by the clear and unambiguous Legislative findings and declarations of the Act, which include the Act's purpose to protect homeowners from "overreaching lenders who provide loans with unnecessarily high costs" and "to encourage lending at reasonable rates with reasonable terms."

The threshold calculation to which this question pertains is referenced in the definition of a “high-cost home loan” as set forth in the Act at N.J.S.A. 46:10B-24. That definition provides, in pertinent part, that a “high-cost home loan” means a home loan for which the principal amount of the loan does not exceed \$350,000, which amount shall be adjusted annually..., in **which the terms of the loan** meet or exceed one or more of the thresholds as defined in this section. (emphasis added) Moreover, the Act defines “threshold” in pertinent part, as "that the total points and fees **payable by the borrower** at or before the loan closing, excluding either a conventional prepayment penalty or up to two bona fide discount points, exceed: (a) 4.5% of the total loan amount if the total loan amount is \$40,000 or more; ...”(emphasis added)

Given the clear legislative intent, the Department has concluded that in answering this question it is appropriate to focus upon the emphasized text in the definition of high-cost home loan as noted above. Thus, where the terms of a loan for \$40,000 or more require the payment of points and fees that total more than 4.5% of the loan amount, notwithstanding that the borrower successfully negotiates contractual terms under which the seller agrees to pay a portion of the points so as to reduce the total points and fees paid by the borrower to less than 4.5% of the loan amount, the loan would be considered a high-cost home loan under the Act.

A contrary conclusion would potentially frustrate the purpose of the Act by allowing transactions to be divided into separate parts or by allowing lenders to utilize subterfuges to evade the provisions of the Act. To that end, the Act provides that it is a violation of this act for any person, in bad faith, to attempt to avoid the application of this act by either dividing any loan transaction into separate parts; or through any other such subterfuge, with the intent of evading the provisions of the act. N.J.S.A. 46:10B-27d(1) and (2).

For example, in collusion with a borrower a seller might increase the selling price of a property for the sole purpose of recouping the points the seller had agreed to pay to prevent the purchaser’s loan from appearing to be a high-cost home loan. In such a case, while the documentation on the transaction would indicate that the points paid by the borrower fell below the 4.5% threshold, in reality the borrower would be paying all of the points, with some of that payment going directly to the lender and the balance reimbursing the seller for the points the seller had paid. The Department believes that this is precisely the type of subterfuge which N.J.S.A. 46:10B-27d was intended to prevent. If the contractual selling price is not changed, the payment of fees by the seller has the effect of lowering the de facto selling price by the amount of the fees paid. In short, the cost of the fees is taken into account in the selling price of the property irrespective of whether the seller nominally pays them. When the borrower repays the loan, he or she is also paying any fees originally paid by the seller at closing.

Based upon the foregoing, the Department has concluded that if a seller pays a fee that would be included in points and fees if it were paid by the borrower, the fee should be included when calculating the total points and fees threshold.

### **Construction Loans:**

#### **Question 28:**

A question was raised as to whether construction loans are covered under the Act. Construction loans are special short-term loans that are used to build dwellings or other structures. The usual fee structures of these loans, because of the risks and costs of monitoring construction, may exceed the thresholds for high-cost loans under the Act.

The largest category of construction loans - loans made to builders - do not fall under the Act for the following reasons. The Act only applies to loans to natural persons. Therefore, loans to corporations, limited partnerships, and limited liability companies are not covered. Moreover, the Act only applies to loans made primarily for personal, family or household purposes. Accordingly, loans made to finance the builder's business purpose of construction are not subject to the Act, even if the builder is a sole proprietor.

With respect to construction loans taken out by consumers, some by their terms convert automatically into permanent financing at the end of construction. The Department has concluded that these loans are subject to the Act. The original agreement is the only agreement between the lender and the borrower, and all rights between the two parties are established in that agreement. The Department believes that there is essentially only one loan in this situation. The Department also notes that making such loans subject to the Act is consistent with the treatment of loans under the Licensed Lenders Act N.J.S.A. 17:11C-1 et seq., also enforced by the Department.

The other category of construction loans taken out by consumers are loans that are either separate agreements from the permanent financing or that do not convert automatically to permanent financing. This type of loan requires additional analysis. First, the Department notes that, to its knowledge, construction loans were not discussed as a type of predatory loan during the deliberations on the Act, either during initial passage or when the amendatory language was recently added. Moreover, upon considering the Legislative history of the Act, the Department has concluded that the Legislature did not intend to include this special type of loan under the Act.

For these reasons, the Department believes that the Act does not apply and it will not enforce the Act regarding construction loans entered into by consumers, unless they automatically convert to permanent financing.

### **Late Payment Penalties**

#### **Question 29:**

A question was raised as to whether a lender may charge a late payment penalty for payments that are 14 days late, notwithstanding the language in the Act at N.J.S.A. 46:10B-25d(2) that provides that such penalties can only be imposed if the payment is 15 days late.

An example cited would be where a lender makes a loan payable biweekly and late payment charges are assessed after 14 days if payment has not been received. The question was raised whether the lender must adhere to the 15 day provision in N.J.S.A. 46:10B-25d(2) for such loans that are subject to the Act.

While the Department recognizes that some lenders allow loans to be payable bi-weekly, in which case late payment charges are assessed after 14 days, the language of the Act is clear on this point. A late payment fee may not be charged until the payment is 15 days or more past due. The Department has no authority to waive this explicit statutory requirement.

10/28/04  
Date

/s/ Holly C. Bakke  
Holly C. Bakke

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