Response to Comments on OFR's Proposed Shared Appreciation Regulations

OFR has received comments on its proposed Shared Appreciation Regulations first from a consortium of industry members who provide the product and the other from a law firm representing an undisclosed member of industry who intends to provide the product. The commentary in both letters focuses on the calculation of "Final Value." Specifically, industry requests that the homeowner have the flexibility in determining how it is calculated rather than forcing the use of the prior methodology. Other comments related to definitions of APR and "substantially similar form." OFR has considered all the comments provided and addresses them below.

1. Definitions.

One commenter sought to eliminate the use of the terms "Lender," "Borrower," and "Mortgage loan" in the regulation. They stated that a shared appreciation agreement is "not a loan and does not provide for traditional terms of credit." While what is or is not a loan may be a subject for debate in other states, the State of Maryland has settled it legislatively. Both CL §12-901(g)2 and §12-1001(j)2 state that a loan "includes an advance made in accordance with the terms of a shared appreciation agreement." As such, the use of the terms "lender," "borrower," and "mortgage loan" are appropriate in the context of the regulation. To amend the regulation as requested to use the terms "investor" in place of "lender" and "homeowner" in place of "borrower" would create additional confusion rather than eliminating it. Additionally, not every service provider will use the same terminology and allowing service providers to use their own terminology invites confusion and potential abuse.

Another commenter pointed to the regulation's definition of "Annual Percentage Rate" as a potential challenge for both providers and consumers. They state that the current definition in the regulation points to the definition and calculations in 12 CFR §1026.22(a) which includes a margin of error that may be difficult for lenders to meet with this specific product. Instead, the commenter requested that OFR adjust the definition to reference Appendix J of 12 CFR § 1026. However, the original definition in the proposed regulation points to 12 CFR §1026.22(a) that discusses accuracy in calculating the APR and the permissible allowance for a margin of error. This permissible margin of error allows rounding without rendering the disclosure inaccurate if it stays within the defined tolerance. This has potential relevance to shared appreciation mortgages and OFR believes it should be retained to allow for reasonable rounding and minor

errors. The section also permits the use of either the actuarial method or the United States rule for making the calculation. Appendix J references 12 CFR §1026.22(a) and explains how to calculate the actuarial method. These are two different pieces of information and therefore may not be appropriate to substitute without acknowledging that doing so is a substantive change. By pointing to 12 CFR §1026.22(a) OFR is allowing for the tolerance, but, while Appendix J does reference 12 CFR §1026, it does not specifically discuss tolerance levels. As such, changing the definition as suggested by the commenter may remove the tolerance, thereby increasing the burden on industry.

These comments could be addressed via guidance by explaining how APR could be handled to provide the necessary clarification on calculation.

2. Required Disclosures

A. Disclosure Timing

One comment focused on the waiver for the 72-hour notice requirement that exists in the statute. The commenter requested that OFR take the explicit permission to waive the 72-hour notice requirement that exists in statute and place it in the regulation. This is not necessary since, as noted, the right to the waiver exists in statutory law and therefore does not need to be repeated in the regulation.

B. Use of a “substantially similar” Form

One commenter noted that under .02A(2)a and .02A(4)a of the proposed regs, OFR provides flexibility to lenders with regards to the disclosure form, permitting the use of a “substantially similar” form in place of the one provided in the appendix to the regulations. While the commenter appreciated the flexibility, they requested greater clarity on what must be provided in the form for it to be “substantially similar” to the one OFR provides. The commenter provides some alternate language that would add the phrase “to the extent material, relevant, and applicable to the particular shared appreciation product being offered.” However, a lender may choose to use a form that they believe provides all the “material, relevant, and applicable” information, but upon OFR’s review of the form (potentially because of a complaint), OFR could determine it does not contain this information leading to unnecessary enforcement actions and litigation. While it is arguable that the same could result from the use of “substantially similar”

the alteration would not provide any material benefit. It would also constitute a substantive change from the proposed regulation given the alteration to the definition of “substantially similar.” In addition to the clarification of “substantially similar” the commenter also requested that OFR add a sentence permitting the lender to use “its native terminology” so long as the terms do not “change the accuracy of the disclosure.” This alteration could open the door for abuse by those who attempt to obscure the nature of the product by use of potentially misleading terminology. Additionally, this change would likely constitute a substantive change and require re-publication. It may make sense for both of these concerns to be addressed via guidance. OFR guidance can leverage the CFPB’s definition of “substantially similar” to provide guidance which includes required data points. If a provider is in doubt, they can seek the advice of OFR.

III. Calculation of Property Value

One commenter expressed concern that the requirement to use the same valuation method at the beginning of a shared appreciation loan and at the termination of the loan may prevent homeowners from seeking their own appraisals as well as creating confusion for lenders. When the regulations were proposed OFR’s desire was for consistency and to prevent potential abuse. Specifically, the lender and the borrower have differing levels of sophistication which could potentially allow the lender to steer the borrower to a low value method of calculation at inception and a high value method of calculation at final payment.

The providers also raise the concern that the potentially long gestation period of the shared appreciation agreement could result in the valuation method used at inception not being available at the time of final payment. OFR will address this in a later regulation to avoid delaying the publication of the proposed regulation and to allow for discussion with industry and advocates on this issue. By its very nature, this issue does not present an immediate concern and therefore can be adequately addressed at a future date.

A commenter also raised the question of the difference between a “financing agreement” which may use an estimated value while the “commitment” requires the use of a BPO, AVM, or Appraisal. However, the difference seen in the regulations is identical to the difference typical of an ordinary mortgage process. A financing agreement is traditionally provided early in the process where an estimate will suffice. Once the process moves to a commitment, a more

accurate form of valuation is required. The regulation is consistent with a typical mortgage process.

A commenter also questioned whether a lender and borrower could mutually agree to a different value for the property, particularly where there is loss event. The nature of a shared appreciation mortgage potentially discourages a homeowner from making significant upgrades and improvements to their home because the lender receives a share of the improved value. However, allowing a lender to inflate the final value alleging improper or deferred maintenance through assessing a higher value could lead to potential abuse of the consumer based on unequal bargaining power. Additionally, the lender may already have remedies for actions constituting waste.

The commenter wants to add language to 09.03.15.03(b) allowing for a value other than the sale price if property is uninhabitable. Where the consumer may be guilty of committing waste, the lender has remedies at law, specifically under their contract. As such, there are compelling policy reasons to not alter the proposed regulation to allow parties to mutually agree on an alternate property value at the termination of the agreement.

Iv. Calculating Values in Appendix A

A final comment related to calculating the final payment amount. Specifically, there was a concern that it was not explicit that the interest rate cap that exists in Commercial Law Title 12 Subtitle 10 applied to the calculation of the final payment amount. OFR does not believe that needs to be made explicit. If there is no cap under the contract, then the lender can show the statutory cap in the description. Further, creating a contract where the interest limit does not apply would be illegal under Maryland law. The legal rate of interest is implied. The form has been adjusted to say, "final payment not limited by contract, except for applicable Maryland law." This isn't a substantive change since it simply clarifies an existing legal requirement.

Another commenter noted that this final payment disclosure would create an issue with the way their contract is set up since their agreement allows for an essentially open-ended maturity date. Specifically, their shared appreciation agreements terminate no later than the 150th birthday of the youngest homeowner. The commenter feared this extremely long potential maturity date would result in a misleading final payment amount on the disclosure form. There is no need to alter the disclosure to allow for an open-ended, or at least extremely lengthy maturity. Instead,

the lender must simply be upfront with the consumer on the cost of the agreement if it goes to full maturity and then explain that it is unlikely to do so.