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ARTICLES & INSIGHTS

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North Carolina Restrictions on High Cost Home Loans

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Over the last few years, there has been great interest among lenders and government regulators regarding the practice of making "high cost home loans" (HCHL). This interest has led to the implementation of state and federal laws designed to discourage, and often prohibit, these loans. North Carolina was the first state in the nation to pass its own statute restricting HCHL. Since passage of the North Carolina statute, several other states have passed similar legislation, and now there are numerous federal statutes and regulations that govern this form of lending. Our state's law is found in North Carolina General Statute Sec. 24-1.1E. While the vast majority of lenders that engage in high cost lending are honest and strive to ensure compliance with the law, some do not, and our State's law, like all such laws, is designed to avoid abusive and predatory lending practices.

If a borrower is an extreme credit risk, a HCHL may be the only avenue available to obtain credit and therefore, this type of loan is not prohibited in North Carolina. These loans are closely scrutinized, however, and certain actions by lenders, and certain fees and charges incurred with the loan, are clearly prohibited. An individual that needs to borrow against the equity in his home for an emergency, such as to avoid foreclosure, to pay other creditors, for health purposes, etc., may be subject to an unscrupulous lender, who, seeing the desperate state of the borrower, may tack on unfair and harsh fees, points and other charges as a condition for the loan. Individuals with equity in their home may be enticed to refinance their existing mortgage, or simply to borrow against the equity in the property, while having no realistic ability to repay the loan according to its terms. In this situation, an unscrupulous lender may hope that the borrower will default, and that upon the default, the lender can attempt to purchase the property at foreclosure, thereby reaping the benefit of the equity in the property at the expense of the borrower. There are many other scenarios that would fall under the restrictions imposed by our state's high cost loan statute.

Not only are these laws passed in order to significantly impact the ability to make a HCHL, but also to limit the circumstances where such loans would be permitted. Indirectly, these laws are also designed to discourage high cost loans by making it more difficult to sell the loans on the secondary market. Many private and government

agencies that either purchase or guarantee loans will not do so if they believe that the loan is in violation of a state or federal high cost loan statute. The assignee of a high cost loan may, in certain circumstances, also be liable to the borrower for damages. The assignee could also find the loan that it purchased or guaranteed significantly modified by a Court as a result of a lawsuit filed by the borrower. Such loans may be subject to a reduction in the interest rate and/or monthly payment, or waiver of all or a part of the interest due over the life of the loan. In addition, making a loan that is a violation of our state's statute may be considered an unfair and/or deceptive trade practice under Chapter 75 of the General Statutes. That chapter allows for recovery of, among other things, attorneys fees and treble damages. The potential assignee liability makes many purchasers and guarantors cautious. This caution has led to closer scrutiny of the loan-making process to ensure that any loan that borders on a high cost loan meets or exceeds all state and federal requirements. The assignment of the loan does not, however, relieve the original lender from liability. North Carolina's statute, for example, specifically prohibits a lender from "... shifting any loss, liability, or claim of any kind to the closing agent or closing attorney for any violation of this section."

If a loan: (1) meets certain principal amount requirements set out in our statute, (2) is incurred by an individual, (3) primarily for personal, family or household purposes, and (4) is secured by the borrower's principal residence, which can include a mobile home, then the loan is subject to our state's statute and could be considered a HCHL if certain other conditions are met. One of those conditions relates to fees and points charged on the loan. For example, assuming that the above four requirements are met, under North Carolina law, if the total points and fees paid by the borrower for a loan over \$20,000.00 exceeds 5% of the total loan amount, then the loan may be a HCHL. The calculation of the fees and points charged can include not only payments made directly to the lender, but also payments made to a mortgage broker involved in the transaction. Fees and charges included in this computation vary, but as an example, attorney's fees normally incurred in a loan closing are not included in the computation, unless the borrower did not have the right to choose the attorney. For the most part, a borrower has that right, but many lenders steer customers to an attorney that the lender may have a fee agreement with, and the question then arises whether the borrower actually had the option to use another attorney. Therefore, the issue for the lender is often a matter of disclosure and documentation, in order to show that this option was offered to the borrower.

Our state has placed other restrictions on lenders deciding to make a HCHL. For example, North Carolina requires that before the loan is made, the lender must receive certification that the borrower has undergone mortgage counseling from a counselor approved by the North Carolina Housing Finance Agency. In addition, the lender may not make a high cost loan unless it reasonably believes, at the time the loan is made, that the borrower has the ability to repay the loan as required by the loan documents. This analysis is based in part upon the borrower's current employment status, income, and any other financial resources. Again, this most likely places a burden upon the lender to document the borrower's ability to repay the loan and the basis upon which the lender relied in coming to that conclusion.

Many loans are originated by mortgage bankers or mortgage brokers. Under North

Carolina law, if the mortgage banker or broker is listed as the original payee in the loan documents, then it will be considered a “lender” for purposes of our State’s law and is thus liable for any HCHL that does not meet statutory requirements.

To make matters even more complicated, there have been numerous federal laws and regulations imposed on high cost, or what is often termed “predatory” lending. Many of these federal laws impose more stringent requirements on such lending and in many cases, can even preempt the state laws. All of this leads to the conclusion that while high cost lending is permitted in North Carolina, such lending is governed by many state and federal requirements. If you intend to engage in lending that may fall into this category, it is a good idea to familiarize yourself with these various laws.

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