

Department of Legislative Services
Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE

Senate Bill 594

(Senator Haines)

Finance

Credit Regulation - Mortgage Lending - Prepayment Penalties

This bill prohibits lenders from requiring or authorizing the imposition of a prepayment penalty, fee, premium, or other charge in connection with any prepayment of a subprime loan secured by residential real property.

The bill does not impair a presently existing obligation or contract right. The bill applies prospectively and does not affect any loan contract executed before October 1, 2008.

Fiscal Summary

State Effect: The bill would not directly affect State finances or operations.

Local Effect: The bill would not directly affect local finances or operations.

Small Business Effect: Potential minimal.

Analysis

Bill Summary: The bill defines “annual percentage rate” according to federal law. “Fully indexed rate” is defined as the index rate applicable to a mortgage loan for residential real property at the time it is originated, plus the margin that will apply after the expiration of an introductory interest rate. “Residential real property” is defined as owner-occupied real property with dwelling accommodations for four or fewer families. The bill also specifically defines a “subprime loan” as either • an adjustable rate mortgage loan secured by a first lien on residential real property, with an interest rate that can increase but not decrease below the fully indexed rate at the time of origination, and

for which the annual percentage rate (APR) is greater than two percentage points above the yield on comparable U.S. Treasury securities; or • any other mortgage loan similarly secured for which the APR is greater than three percentage points above the yield on comparable U.S. Treasury securities.

The bill prohibits lenders from requiring or authorizing the imposition of penalties, fees, premiums, or other charges for a subprime loan in the event that the loan is prepaid in whole or in part. This prohibition does not apply to a subprime loan with a principal amount that exceeds the conforming subprime loan size limit for a single-family dwelling as established by the Federal National Mortgage Association.

Current Law: For a noncommercial loan that is secured by a mortgage or deed of trust on the borrower's primary residence, except to the extent expressly provided otherwise in the loan contract, a borrower may prepay all or part of the outstanding balance under the loan at any time. In the event that the entire loan is prepaid, the lender must refund or credit the borrower with the unearned portion of the precomputed interest charge.

If specified in a loan contract, a prepayment charge or penalty on the prepayment of the unpaid principal balance of the loan is not interest under the State's usury laws if the loan is secured by a home, a combination of home and business property, or agricultural property. A prepayment charge may also be imposed on certain commercial loans of \$5,000 or less. Prepayment penalties may only be imposed on prepayments made within 3 years from the date the loan is made and may not exceed an amount equal to 2 month's advance interest on the aggregate amount of all prepayments made in any 12-month period in excess of one-third of the amount of the original loan.

The Federal National Mortgage Association's current first mortgage loan size limits for a single-family dwelling are • \$417,000 for one-family loans; • \$533,850 for two-family loans; • \$645,300 for three-family loans; and • \$801,950 for four-family loans. The limit for second mortgages is \$208,500.

Background: By all accounts, recent changes in the real estate market and the economy in general have led to a marked increase in foreclosure events both nationwide and in Maryland. Many such foreclosures have involved residential properties that have been financed through subprime loans and nonbank loan originators, leading to heightened concern regarding the lending practices that surround these nontraditional financing methods. Opinions differ regarding the exact number of recent foreclosures in Maryland, as well as the severity of the situation, but all sources report a substantial recent increase in foreclosure activity in the State.

In November 2007, the Homeownership Preservation Task Force reported that the total of all foreclosure events in the State during the second quarter of 2007 numbered 4,092, an increase of 344% when compared to the 920 events in the second quarter of 2006. According to the National Delinquency Survey (NDS) from the Mortgage Banker's Association, in the second quarter of 2007, 4.19% of all mortgage loans for one-to-four unit residential properties reported serviced in Maryland were past due. Furthermore, 1.46% of all loans for similar properties during this period were seriously delinquent, meaning 90 days or more delinquent or in the process of foreclosure. This is an increase from 3.26% past due and 0.96% seriously delinquent in the second quarter of 2006.

The Homeownership Preservation Task Force was established by the Governor in June 2007 to develop an action plan to address rising foreclosures and preserve homeownership in Maryland. The Legal and Regulatory Reform Workgroup of the task force reviewed existing laws, regulations, and practices relating to mortgage lending and foreclosures and developed recommendations to promote homeownership. The bill reflects several recommendations of the task force. The Attorney General also formed a workgroup to provide input on issues relating to lending practices in Maryland. In addition, the Senate Finance and Judicial Proceedings committees and the House Economic Matters and Environmental Matters committees held hearings during the 2007 interim to examine various aspects of mortgage lending practices and the foreclosure process.

Additional Information

Prior Introductions: Similar bills were introduced in 2006 and 2004. HB 216 of 2006 received an unfavorable report by the House Economic Matters Committee. SB 878 of 2004 was withdrawn before being heard.

Cross File: None.

Information Source(s): Department of Labor, Licensing, and Regulation; Department of Legislative Services

Fiscal Note History: First Reader - February 8, 2008
mll/ljm

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