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Residential Mortgage Lender Survives ATR/QM Challenge

by Stephen Ornstein

In what appears to be a case of first impression, the U.S. District Court for the Southern District of Ohio rejected a consumer's ability-to-repay defense that was raised in an attempt to prevent foreclosure of the consumer's home. *Elliot v. First Federal Community Bank of Bucyrus*, filed on March 26, 2019, is instructive because, up to this point, there has been no defining judicial precedent interpreting the ability-to-repay/qualified mortgage regulations that the Consumer Financial Protection Bureau (CFPB) promulgated and that became effective on January 10, 2014.

These CFPB regulations generally require creditors to make a reasonable, good-faith determination at or before consummation of a consumer credit transaction secured by a dwelling that a consumer will have a reasonable ability to repay the loan according to its terms. The regulations provide a "safe harbor" for compliance with the ability-to-repay rules to creditors or assignees of loans that satisfy the definition of a qualified mortgage and are not higher-priced mortgage loans. They also provide a "rebuttable presumption" of compliance with the ability-to-repay rules to creditors or assignees for higher-priced mortgage loans, defined as loans with an APR exceeding the average prime offer rate by 1.5 or more percentage points for first-lien loans, or by 3.5 or more percentage points for subordinate-lien loans.

In *Elliot*, the plaintiff was an experienced realtor in his eighties, and at the time of the loan transaction in question was separated from his spouse. The defendant bank underwrote the loan based on the terms of the separation agreement between the couple, under which the plaintiff would receive monthly spousal support in addition to his monthly job income, social security payments, and certain rental income. The bank deemed the income from these sources sufficient to support payment of the mortgage. Under the separation agreement, the plaintiff took sole title to the property that had been the couple's marital home and was the sole mortgagor on the loan.

In underwriting the loan, the defendant bank relied on the repeated assurances that the couple was committed to the terms of the separation agreement, the fact that the couple had been longtime customers of the bank in good standing, and most importantly, that the plaintiff's debt-to-income ratio was below the 40% threshold established by the bank and that his 660 FICO score was above the bank's minimum threshold.

After the loan in question was originated, the relationship between the couple deteriorated; and in the divorce proceedings that ensued, the former spouses' property was re-divided, with the plaintiff receiving significantly reduced spousal support. The plaintiff was also fired from his job and incurred additional debts during the course

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of the divorce proceedings. As a result of these events, the plaintiff became delinquent in his mortgage payments and ultimately defaulted on the loan. The bank then sought to foreclose on the mortgaged property. The thrust of the plaintiff's claim is that the bank failed to make a "reasonable and good faith determination based on verified and documented information" that he had a "reasonable ability to repay the loan."

The court, in rejecting the plaintiff's claim and in granting summary judgment for the defendant bank, observed that "the bank did its due diligence to confirm Plaintiff would have the ability to make the payments on his mortgage," and the fact that the parties did not adhere to the settlement agreement when opting for divorce "was not an event that was reasonably foreseeable to the bank."

Notably, the court dismissed the plaintiff's assertion that the bank approved the loan in violation of Appendix Q which, pursuant to the CFPB's ability-to-repay/qualified mortgage regulations, establishes the standards lenders must use to calculate the borrower's total debt-to-income ratio (which cannot exceed 43% at the time of consummation) under the standard qualified mortgage definition. In particular, the plaintiff contended that the bank should not have considered the plaintiff's spousal support that he was receiving under the separation agreement and certain rental income as reliable sources of income under Appendix Q. The court, in refuting these arguments, ruled the bank's debt-to-income ratio determination was amply supported by the plaintiff's tax returns (which reflected the spousal support payments) and a written lease that evidenced the rental income received by the plaintiff.

In rendering its decision in favor of the defendant bank, the court ultimately permitted the bank to foreclose on the mortgaged property and collect ancillary fees (such as court costs, accruing interest, default interest) associated with the plaintiff's defaulting on the mortgage.

Alston & Bird Observations

The *Elliot* decision is significant because as the first-known precedent addressing the CFPB's ability-to-repay/qualified mortgage standards, the court's ruling is inherently sensible in upholding the defendant bank's ability-to-repay and qualified mortgage determinations. The essence of the court's ruling is that, before making the loan, the bank possessed ample evidence to document both that the loan met the CFPB's qualified mortgage criteria and that the plaintiff had the ability to make the monthly mortgage payments. The CFPB regulations require that lenders make these ability-to-repay and qualified mortgage determinations *before or at loan consummation*. Lenders are not required to anticipate—or be held responsible for—unforeseen events occurring *after* consummation that adversely impact their initial underwriting determination, such as divorces, serious illnesses, and job losses. Toward that end, *Elliot* is a victory for the mortgage industry that is consistent with the purpose and intent of CFPB regulations.

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