Buydown FAQs

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What types of buydowns are there?

Regulation Z only contemplates the following types of buydowns:

- Third-Party Buydown Reflected in Credit Contract
- Third-Party Buydown Not Reflected in Credit Contract
- Consumer Buydown
- Lender Buydown Reflected in Credit Contract
- Lender Buydown Not Reflected in Credit Contract
- Split Buydown

(see 12 CFR Pt. 1026, Supp. I, Paragraph 17[c][1] – 3 through 5)

<u>Which of these buydowns should be reflected in TILA disclosures?</u>

Regulation Z sets forth many variables which determine whether the terms of the buydown should be reflected in TILA's disclosures. In general, the following buydowns are reflected:

- *Third-Party Buydown Reflected in Credit Contract:* The Official Staff Commentary to Regulation Z ("the Commentary") specifically states that "if the third-party buydown is reflected in the credit contract between the consumer and the bank, the finance charge and all other disclosures affected by it must take the buydown into account as an amendment to the contract's interest rate provision." (12 CFR Pt. 1026, Supp. I, Paragraph 17[c][1] – 3.i)

- *Consumer Buydown:* Again, the Commentary clearly states that "consumer buydowns must be reflected as an amendment to the contract's interest rate provision in the disclosure of the finance charge and other disclosures affected by it given for that transaction." (*Ibid.* Paragraph 17[c][1] – 4)

- *Lender Buydown Reflected in Credit Contract:* The Commentary holds that "the disclosure of the finance charge and other disclosures affected by it for lender buydowns should be based on the terms of the legal obligation between the consumer and the creditor." (*Ibid.* Paragraph 17[c][1] – 4.ii) The Commentary then defers to the guidance it provides concerning third-party buydowns on how to treat buydowns either reflected or not reflected in the credit contract.

- *Split Buydown:* A split buydown is defined as a transaction in which "a third party (such as a seller) and a consumer both pay an amount to the creditor to reduce the interest rate." (*Ibid.* Paragraph 17[c][1] – 5). For such buydowns, a "creditor must include the portion paid by the consumer in the finance charge and disclose the corresponding payment levels . . . and composite annual percentage rate." (*Ibid.*) The portion paid by the third party and the corresponding reduction in the interest rate should also be reflected in the TILA disclosures only if "the lower rate is reflected in the credit contract." (*Ibid.*)

The following buydowns are *not* reflected in the disclosures:

- *Third-Party Buydown Not Reflected in Credit Contract:* The Commentary states that "if the third-party buydown is not reflected in the credit contract between the consumer and the bank . . . the disclosure of the finance charge and other disclosures affected by it given by the bank must not reflect the seller buydown in any way." (*Ibid.* Paragraph 17[c][1] – 3.ii)

- *Lender Buydown Not Reflected in Credit Contract:* The Commentary stipulates that "the disclosure of the finance charge and other disclosures affected by it for lender buydowns should be based on the terms of the legal obligation between the consumer and the creditor." (*Ibid.* Paragraph 17[c][1] – 4.ii) It then defers to the Commentary concerning third-party buydowns for guidance in determining whether the buydown should or should not be reflected in the disclosures.

- *Split Buydown:* A split buydown is defined as a transaction in which "a third party (such as a seller) and a consumer both pay an amount to the creditor to reduce the interest rate." (*Ibid.* Paragraph 17[c][1] – 5). As mentioned previously, the consumer portion of the buydown is reflected. The Commentary stipulates, however, that "the portion paid by the third party and the corresponding reduction in interest rate, however, should not be reflected in the disclosure of the finance charge and other disclosures affected by it unless the lower rate is reflected in the credit contract." (*Ibid.*)

Most of the criteria for determining whether a buydown should or should not be reflected on TILA disclosures is dependent upon whether the buydown is reflected in the "credit contract." What exactly is the "credit contract"?

While Regulation Z does not define the term "credit contract", such a contract would form a part of the "legal obligation" between the creditor and the consumer (see 12 CFR Pt. 1026, Supp. I, Paragraph 17[c][1] – 1). "The legal obligation is determined by applicable State law or other law." (*Ibid.*) "The legal obligation normally is presumed to be contained in the note or contract that evidences the agreement between the consumer and the creditor. But this presumption is rebutted if another agreement between the consumer and creditor legally modifies that note or contract. If the consumer and creditor informally agree to a modification of the legal obligation, the modification should not be reflected in the disclosures unless it rises to the level of a change in the terms of the legal obligation." (*Ibid.* Paragraph 17[c][1] – 2)

Would a "Buydown Agreement" be considered a part of the "credit contract" or "legal obligation" between the creditor and consumer?

This will depend upon what "State law or other law" (12 CFR Pt. 1026, Supp. I, Paragraph 17[c][1] – 1) consider to be the "legal obligation." Under the presumption given under the Commentary, the "legal obligation" is "the note or contract that evidences the agreement between the consumer and the creditor." (*Ibid.* Paragraph 17[c][1] – 2) Whether a "buydown agreement" modifies the terms of the “note or contract” depends on how it is structured and whether the “note or contract” ultimately reflects the lowered interest rate.

Other considerations include investor requirements. For example, FNMA specifically states that “the mortgage instruments must reflect the permanent payment terms rather than the terms of the buydown plan. In no event may the buydown plan change the terms of the mortgage note.” (FNMA 2017 Selling Guide B2-1.3-05) Thus, for a loan with a buydown to be acceptable to FNMA, the mortgage instruments should not reflect the terms of the buydown.

What parts of the Integrated Disclosures (Loan Estimate and Closing Disclosure) should the terms of the buydown be reflected in?

The Commentary does not provide an “item-by-item” list of what parts of the LE and CD the buydown should be reflected in. The fundamental requirement is that if a buydown is required to be reflected, it must be reflected in “the finance charge and all other disclosures affected by it” (12 CFR Pt. 1026, Supp. I, Paragraphs 17[c][1] – 3.i, 4, 4.ii, & 5). Thus, any disclosures affected by the finance charge should reflect the terms of the buydown.

What items which are listed in the Commentary include the following:

- The “Finance Charge” on page 5 of the CD (see *Ibid.*), except seller-paid buydown fees are not reflected in the finance charge, since these are considered seller’s points and are thus exempt from being considered a finance charge (see *Ibid.* Paragraphs 4[c][5] & 17[c][1] – 3.i);

- The “Annual Percentage Rate (APR)” on page 3 of the LE and page 5 of the CD (see *Ibid.* Paragraphs 17[c][1] – 3.i, 4.i.B, & 5);

- The “Projected Payments” table on the first page of the LE and CD (see *Ibid.* Paragraphs 17[c][1] – 3.i, 4.i.C, & 5); and

- “Product” on the first page of the LE and CD should reflect a step rate (see *Ibid.* Paragraph 17[c][1] – 4.i.C; note that this example is only provided in connection with a Consumer Buydown).

<u>Should seller-paid and/or lender-paid buydown funds be disclosed on the Closing Disclosure?</u>

Fundamentally, the CD must "reflect the terms to which the consumer and creditor are legally bound as of the outset of the transaction." (12 CFR Pt. 1026, Supp. I, Paragraph 17[c][1] – 1) More specifically, the CD must reflect "the actual terms of the credit transaction, and the actual costs associated with the settlement of that transaction." (*Ibid.* Paragraph 19[f][1][i] - 1)

For buydowns which the Commentary stipulates should be reflected in TILA's disclosures, it is clear that such buydowns are reflected in the "credit contract" and, as such, the buydown funds paid are a part of the legal obligation. These buydowns are:

- Third-Party Buydown Reflected in Credit Contract
- Consumer Buydown
- Lender Buydown Reflected in Credit Contract
- Split Buydown (to a certain extent)

All other buydowns are considered to not be reflected in the credit contract - which would lead to an initial conclusion that the buydown funds for these loans should also not be disclosed. However, the Commentary holds differently in an example they give in regards to a Third-Party Buydown Not Reflected in Credit Contract:

> ". . . the disclosure of the finance charge and other disclosures affected by it given by the bank must not reflect the seller buydown in any way. For example, the annual percentage rate and disclosures required under §§ 1026.18(g), 1026.18(s), 1026.37(c), and 1026.38(c) [payment tables on the TIL and the Integrated Disclosures], as applicable, would not take into account the reduction in the interest rate and payment level for the first two years resulting from the buydown. **The seller-paid amount is, however, disclosed as a credit from the seller in the summaries of transactions disclosed pursuant to § 1026.38(j) and (k).**" (12 CFR Pt. 1026, Supp. I, Paragraph 17[c][1] – 3.ii; emphasis added)

This guidance indicates that while the buydown should not be reflected in certain disclosures ("the finance charge and disclosures affected by it"), the actual buydown fee should still be disclosed. The Commentary specifies a particular place on the CD for seller-paid buydown amounts (Lines L.05 and N.08). However, no specific place is promulgated for lender-paid buydown amounts. Nevertheless, since guidance for the seller-paid buydowns also applies to lender-paid buydowns (see *Ibid.* Paragraph 17[c][1] – 4.ii), it is clear that the both types of buydowns should also be disclosed on the CD (when applicable) – albeit no particular place is specified. It's conceivable that lender-paid buydowns could be disclosed either in the "Paid by Others" column of Section A, or by including it as a general lender credit in Section J.

Further supporting this conclusion is the fact that the instructions to the CD for the "Loan Costs" tables specify that "all loan costs associated with the transaction" should be disclosed (12 CFR § 1026.38[f]). Instructions for the "Other Costs" tables also specify that "all costs in connection with the transaction, other than those disclosed [in the 'Loan Costs' table]" should be disclosed (*Ibid.* § 1026.38[g]). A buydown amount is a cost "associated with the transaction" and should, therefore, be disclosed.

<u>The buydown funds will not be placed into an escrow account. Does this make a difference?</u>

No. Regulation Z does not contain any regulations or guidance which would treat buydowns differently dependent upon whether the funds for the buydown are escrowed or not. The only time such an arrangement is mentioned is in an **example** provided in the Commentary for a Consumer Buydown:

> "To illustrate, in a mortgage transaction, the creditor and consumer agree to a note specifying a 14 percent interest rate. However, in a separate document, the consumer agrees to pay an amount to the creditor at consummation in return for lower payments for a portion of the mortgage term. **The amount paid by the consumer may be deposited in an escrow account or may be retained by the creditor.** Depending upon the buydown plan, the consumer's prepayment of the obligation may or may not result in a portion of the amount being credited or refunded to the consumer." (12 CFR Pt. 1026, Supp. I, Paragraph 17[c][1] – 4; emphasis added)

If anything, this example illustrates that whether an escrow account is established or not, the buydown funds are treated the same way.