

MARKET COMMENTARY

Building a Better Construction Loan Disclosure— Construction Only Loans Under TRID 2.0

On July 7, 2017, the Consumer Financial Protection Bureau (CFPB) issued a final rule amending its TILA-RESPA Integrated Disclosures (TRID) rule. The final rule amending TRID (which we will refer to as “TRID 2.0”) may be found [here](#).



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TRID 2.0 is already optionally effective, but it will be mandatory for loans subject to TRID that are applied for on or after October 1, 2018. Among other things, TRID 2.0 included significant clarifications and changes for construction loans. This paper focuses on clarifications and changes relevant to lenders who do construction-only transactions.

Sale Price/Estimated Property Value/ Appraised Property Value

In TRID 2.0, the CFPB clarifies some details around this disclosure at the top of the first page of the Loan Estimate and Closing Disclosure that are relevant to construction loans. If the real estate on which the new construction will be located is being purchased with the loan funds, the disclosure must be of the contract sales price. If that is not known when providing the Loan Estimate, an estimated/appraised value may be disclosed for the sales price until the information is obtained.

In a transaction without a seller—for example, the dwelling or other improvement is being built on land already owned by the borrower—at the lender’s option, the

estimated property value or appraised value for the Loan Estimate may be with or without the value of the improvements. For the Closing Disclosure, if the property value used for the purpose of approving the loan included the improvements, the value disclosed on the Closing Disclosure must also include the value of the improvements.

Product

If the construction loan has interest only payments, as is typical, the “Interest Only” payment feature would be disclosed rather than the balloon payment, as the highest priority payment feature. The time period of the “Interest Only” feature that is disclosed is the period during which interest-only payments are actually made and excludes any final balloon payment of principal and interest. For example, the product disclosure for a fixed rate, interest-only construction loan with a term of 12 months in which there will be 11 monthly interest payments and a final balloon payment of principal and interest is “11 mo. Interest Only, Fixed Rate.”



The maximum payment would be calculated based on the maximum principal amount that could be outstanding during the construction phase...”

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Adjustments in Payments—Loan Terms and Adjustable Payments Tables

Loan Terms

Under the pre-amendment TRID rule, if Appendix D is relied upon for providing disclosures for a multiple advance construction loan and interest is payable only on the amount actually advanced, the lender is allowed to assume that the one-half of the commitment amount is outstanding at the contract interest rate for the entire construction period. The Loan Terms table requires disclosure of whether the Loan Amount, Interest Rate, and Monthly Principal & Interest can increase after closing, as reflected by this column heading:

Can This Amount Increase After Closing?

Under the pre-amendment TRID rule, because Appendix D I.A.1. allows for the assumption that half of the commitment amount is outstanding for the entire construction period, for a fixed-rate construction-only loan, this question relating to the periodic payment amount would have been answered with a “NO” as reflected below in Figure 1.

This changes in TRID 2.0. Although a lender will continue to be able to rely on this assumption for the purpose of estimating the initial periodic payment and the periodic payments for the Projected Payments table, TRID 2.0 provides that when disclosing payment adjustments in the Loan Terms and the Adjustable Payments table, the lender must disclose that “YES” the payment could change. The TRID 2.0 commentary further provides specific examples for the expected disclosures for the first two bullet points for a 10-month construction loan, specifically: “Adjusts every mo. starting in mo. 1” and “Can go as high as \$<maximum periodic principal and interest payment> in year 1.” The maximum payment would be calculated based on the maximum principal amount that could be outstanding during the construction phase (and presumably for adjustable rate loan, at the maximum interest rate).

Figure 2 shown below illustrates how the new Monthly Principal & Interest row will appear under TRID 2.0 for a ten-month fixed-rate construction-only loan.

Monthly Principal & Interest <i>See Projected Payments below for your Estimated Total Monthly Payment</i>	\$761.78	NO
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Figure 1

Monthly Principal & Interest <i>See Projected Payments below for your Estimated Total Monthly Payment</i>	\$761.78	YES <ul style="list-style-type: none"> • Adjusts every mo. starting in mo. 1 • Can go as high as \$1,524 in year 1 • Includes only interest and no principal until mo. 9 • See AP table on page 2 for details
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Figure 2



If the inspection and handling fees are to be collected after closing, TRID 2.0 provides that such costs will be disclosed in a new section of the Addendum to both of these forms labeled “Inspection and Handling Fees Collected After Closing.”

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Adjustable Payments

TRID 2.0 specifically provides that the Adjustable Payments table will be required for construction-only loans (it does not print under the pre-amendment rules). TRID 2.0 modifies the requirement for the First Change/Amount disclosure in the Adjustable Payments table for a construction loan to provide that the lender is not required to disclose a payment amount or range of payment amounts for the first payment change but would disclose the number of the earliest possible payment reflecting a change, such as “1st payment.”

There are no provisions in TRID 2.0 specific to either the Subsequent Changes or the Maximum Payment row in the table, however. The pre-amendment rules govern those—except for the fact that they now apply to construction-only loans. For the Subsequent Changes, since each construction periodic payment may change, the appropriate disclosure is clearly “Every payment.” For the Maximum Payment, “[t]he disclosure required by §1026.37(i)(5) must state the... maximum potential amount of a regular periodic principal and interest payment under the terms of the legal obligation, as well as the payment number of the first periodic principal and interest payment that can reach such amount.” Additionally, “[i]f the disclosed payment is only potential...the disclosure states the earliest payment number when such payment can be reached with the preceding text, ‘as early as.’” Therefore, the disclosed payment amount and number for a construction-only loan would be the maximum possible monthly (or other periodic) payment during the construction loan “as early as” the payment number of the first periodic principal and interest payment that can reach that maximum payment.

Closing Costs Details—Loan Costs— Inspection and Handling Fees

Inspection and handling fees are fees charged for the staging of disbursements, and may include draw fees. The total inspection and handling fees collected at or prior to closing will be disclosed in the Loan Costs area of Closing Cost Details for the Loan Estimate and Closing Disclosure. While not addressed in TRID 2.0, despite the requirement that the total be disclosed, other requirements of TRID might result in inspection and handling fees being disclosed in separate sections. For example, if draw fees are being paid to the lender but inspection fees are going to a third-party inspector for whom the borrower cannot shop, the draw fees might be disclosed in the Origination Charges section and the inspection fees in the Services You Cannot Shop For/Services Borrower Did Not Shop For section.

If the inspection and handling fees are to be collected after closing, TRID 2.0 provides that such costs will be disclosed in a new section of the Addendum to both of these forms labeled “Inspection and Handling Fees Collected After Closing.” Fees that print in this section would not be factored into the various Loan Costs sections subtotals, the D. Loan Costs subtotal, or the Total Closing Costs in the Calculating Cash to Close table. However, they would be factored into the good faith tolerance testing, the In 5 Years disclosure, and the Total of Payments disclosure. Additionally, they will likely be finance charges factored into the Finance Charge, Amount Financed, and APR disclosures, as well as potentially HOEPA and Qualified Mortgage Points and Fees.



Accompanying the requirement to disclose the construction costs or construction escrow holdback in the Summaries of Transaction—Borrower’s Transaction, the CFPB has updated the rules relating to the Calculating Cash to Close table calculations...”

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Calculating Cash to Close/Summaries of Transaction/Payments and Payoffs

For construction loans where the real estate is being purchased, the regulatory formulas for Calculating Cash to Close have presented problems for properly disclosing the cash that the borrower will either have to bring to or receive from the closing. Prior to the publication of the TRID 2.0 final rule, the CFPB had been recommending (and the proposed version of TRID 2.0 would have required) that construction costs be disclosed in the Section H. Other section of the Other Costs portion of the Closing Costs Details rather than in the Summaries of Transaction—Borrower’s Transaction. When this is done, the Total Closing Costs is increased by the amount of the loan proceeds targeted for construction costs or the construction escrow holdback. So, a loan with \$5,345 in closing costs and \$200,000 in loan proceeds earmarked for construction costs might have disclosed Total Closing Costs of \$205,345. This resulted in a final Calculating Cash to Close that was generally accurate, because the significantly increased Total Closing Costs would be offset by the disclosure of a significant negative Closing Costs Financed.

In the TRID 2.0 final rule, the CFPB instead requires that these be disclosed in the Summaries of Transaction—Borrower’s Transaction when the Standard form is being used and the Payoffs and Payments section when the Alternate form is being used. This would be similar to how other payments out of loan proceeds are treated. In the supplementary materials published with the TRID 2.0 final rule, the CFPB indicated that they were persuaded by comments that pointed out that the construction costs were the reason for obtaining the loan, similar to the sale price, and not something that consumers would

perceive as a closing cost. Additionally, some commenters pointed out that where closing costs were so inflated by the inclusion of construction costs, it would be harder to identify the higher non-construction-cost-related closing costs. For example, if the example loan described above had an additional \$2,000 in origination charges, a Total Closing Costs of \$207,345 does not seem as significant an increase over \$205,345 as \$7,345 would seem over \$5,345.

Accompanying the requirement to disclose the construction costs or construction escrow holdback in the Summaries of Transaction—Borrower’s Transaction, the CFPB has updated the rules relating to the Calculating Cash to Close table calculations in a way that should result in the calculations working for construction purchase loans. What follows here provides a simple summary of the changes relevant to making the calculations work for construction purchase loans and an examples of the effect of the new calculations. The essence of the changes in TRID 2.0 is to make the Calculating Cash to Close table work for construction purchase loans:

- For purchase loans involving improvements to be made to the property (i.e., construction), the rules allow the non-purchase formula for the Down Payment/Funds from Borrower and Funds for Borrower rows to be applied to construction purchase loans. This factors the construction costs into that calculation.
- When the construction costs are factored into the Down Payment/Funds from Borrower and Funds for Borrower calculation, they do not need to be factored into the Adjustments and Other Credits calculation.

Some examples of the results of these formula changes:

- Example Purchase Scenario:
 - Loan Amount: \$250,000
 - Lot Sales Price: \$50,000
 - Construction Costs: \$200,000
 - Closing Costs: \$5,345

Calculating Cash to Close Table:

Calculating Cash to Close		Use this table to see what has changed from your Loan Estimate.		
	Loan Estimate	Final	Did this change?	
Total Closing Costs (J)	\$5,345	\$5,345.00	NO	
Closing Costs Paid Before Closing	\$0	-\$10.00	YES • You paid these Closing Costs before closing	
Closing Costs Financed (Paid from your Loan Amount)	\$0	\$0	NO	
Down Payment/Funds from Borrower	\$0	\$0	NO	
Deposit	\$0	\$0	NO	
Funds for Borrower	\$0	\$0	NO	
Seller Credits	\$0	\$0	NO	
Adjustments and Other Credits	\$0	\$0	NO	
Cash to Close	\$5,345	\$5,335.00		

Figure 3

- Second Example Purchase Scenario:
 - Loan Amount: \$250,000
 - Lot Sales Price: \$75,000
 - Construction Costs: \$200,000
 - Closing Costs: \$5,345

Calculating Cash to Close		Use this table to see what has changed from your Loan Estimate.		
	Loan Estimate	Final	Did this change?	
Total Closing Costs (J)	\$5,345	\$5,345.00	NO	
Closing Costs Paid Before Closing	\$0	-\$10.00	YES • You paid these Closing Costs before closing	
Closing Costs Financed (Paid from your Loan Amount)	\$0	\$0	NO	
Down Payment/Funds from Borrower	\$0	\$0	NO	
Deposit	\$0	\$0	NO	
Funds for Borrower	\$25,000	\$25,000.00	NO	
Seller Credits	\$0	\$0	NO	
Adjustments and Other Credits	\$0	\$0	NO	
Cash to Close	\$30,345	\$30,335.00		

Figure 4



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Conclusion

There are a number of clarifications and changes in the TRID 2.0 rule that are specific to construction loans. As mentioned above, this paper focuses on the clarifications and changes in TRID 2.0 that apply to construction-only loans where the lender is not necessarily making both the construction and the permanent or “take-out” loan.

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