Edition 02-10 | Nov 10

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AN ACCOUNTANT'S PERSPECTIVE

On the Mortgage Industry

BY JEANETTE K. EMMONS, CPA

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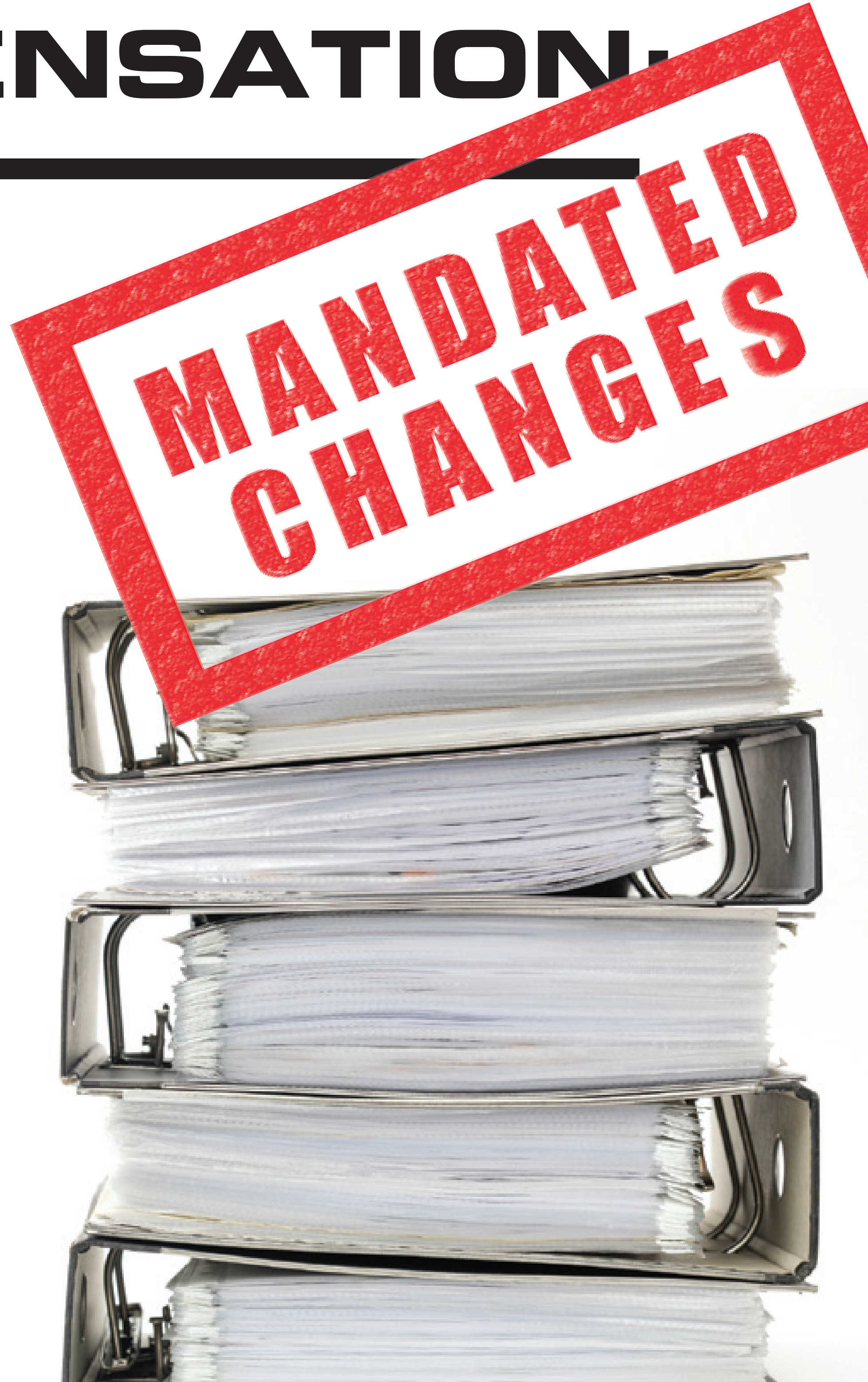
LOAN ORIGINATOR COMPENSATION:



Loan originator compensation — It seems to be all anyone's talking about these days. New laws are resulting in the need for a complete overhaul of most loan originator compensation packages. Due to the mandated changes briefly outlined below, every lender will be looking to develop a new compensation package for originators to keep or attract the best producers while complying with the multitude of new rules and regulations. We recommend that Lenders act quickly to begin rewriting their compensation policies.

A consultation with their tax and legal professionals is in order to explore potential tax advantaged compensation plans that could be incorporated into the new compensation landscape and to ensure compliance with these new requirements.

Please keep in mind that each separate law or communication listed below is likely to have its own separate and distinct definition for common words such as "originator" and "compensation" and they are all packed full of legal jargon, therefore we recommend that the provisions of these requirements be reviewed carefully with compliance and/or legal experts.

THE FEDERAL RESERVE

On August 16, 2010, the Federal Reserve issued the final rules to amend Regulation Z Part 226.36. These rules, effective April 1, 2011, add specific prohibitions on loan originator compensation as listed below (from the Federal Reserve's Highlights):

- Prohibit payments to the loan originator that are based on the loan's interest rate or other terms. Compensation that is based on a fixed percentage of the loan amount is permitted.
- Prohibit a mortgage broker or loan officer from receiving payments directly from a consumer, while also receiving compensation from the creditor or another person.
- Prohibit a mortgage broker or loan officer from "steering" a consumer to a lender offering less favorable terms in order to increase the broker's or loan officer's compensation.
- Provide a safe harbor to facilitate compliance with the anti-steering rule. The safe harbor is met if:
    - The consumer is presented with loan offers for each type of transaction in which the consumer expresses an interest (that is, a fixed rate loan, adjustable rate loan, or a reverse mortgage); and
    - The loan options presented to the consumer include the following:
        1. the lowest interest rate for which the consumer qualifies;
        2. the lowest points and origination fees, and
        3. the lowest rate for which the consumer qualifies for a loan with no risky features, such as a prepayment penalty, negative amortization, or a balloon payment in the first seven years.

THE DEPARTMENT OF LABOR

Further, the Department of Labor interpretation 2010-1 released on March 24, 2010 concludes that "based upon a thorough analysis of the relevant factors, the Administrator has determined that mortgage loan officers who perform the typical duties described above have a primary duty of making sales for their employers and, therefore, do not qualify as bona fide administrative employees exempt under section 13(a)(1) of the Fair Labor Standards Act, 29 U.S.C. § 213(a)(1)." If loan originators do not qualify for the Administrative Exemption they could be non-exempt employees who would therefore qualify for minimum wage and overtime.

THE DODD-FRANK WALL STREET REFORM ACT

Finally, the Dodd-Frank Wall Street Reform Act ("the Act") weighs in on loan originator compensation. The Act "establishes new prohibitions against steering for all mortgage loans that prohibit yield spread premiums and other compensation to the mortgage originator that varies based on terms of the mortgage loan, including rate," according to the Mortgage Bankers' Association summary of the bill. Additionally, as a part of the ability to repay requirement, the Act allows for a safe harbor limit on loan points and fees at no more than 3 percent of the loan amount.

For more information on loan originator compensation mandate, please feel free to contact:

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BY KENNETH J. DEGRAW, CPA, CFP®, CRFA®, CFE, PARTNER

PROPERTY TAX LIENS, FORECLOSURE AND OTHER CALAMITIES

It is no secret that borrowers, both residential and commercial, are experiencing significant financial stress. Lenders need to have processes in place to monitor the signs of financial stress exhibited by a borrower in order to timely exercise their rights under the loan agreement.

One of the first public signs of impending problems is a borrower's failure to pay property taxes when due and the imposition of a tax lien is often a good indicator that the loan and the collateral are in trouble. It will not be long before the borrower will fail to pay the scheduled installments on the loan.

One option available to the lender is to acquire the rights to the delinquent property taxes via tax sales. In New Jersey, property taxes are a continuous super-priority lien on the underlying real estate. All municipalities hold at least one tax sale per year. The tax sale is an auction process enabling successful bidders to acquire a certificate evidencing their right to receive the future payment of the taxes.

If you purchase a tax lien, you acquire all of the rights that the municipality had against the delinquent property owner, including the right to charge and collect interest (up to 18% per year) on the amount you paid to acquire the tax lien. In addition, you also acquire the right to foreclose on the property. Your lien has the highest priority permitted by New Jersey. This means that your lien will be superior to every other lien (including any and all mortgages), except Federal liens. Bidders have the option to acquire subsequent tax certificates, and if they are not acquired, a tax sale certificate will be sold at the next tax sale. Any subsequent certificate issued will override any prior certificate. To protect their interest, the winning lien holder should record it in the Deed Room at the County Clerk's Office within 90 days of the sale. After two years, a lien holder can begin proceedings in Superior Court to foreclose on the property. If foreclosure is perfected, then the name on the deed is changed to that of the lien holder who can then take possession of the property.

There are several differences between tax sale foreclosures and mortgage foreclosures. Unlike mortgage foreclosure, in most cases, proceedings to foreclose a tax sale certificate are not followed by a public sale of the property. A certified copy of a final judgment in a tax foreclosure proceeding (if the United States is not a lien holder) can be recorded immediately and once recorded, any equity a property owner may have will be entirely lost.

Borrowers are not without options to at least delay the ultimate foreclosure, including the filing of a Chapter 13 Bankruptcy. When the Bankruptcy Petition is filed, the automatic stay goes into effect and stops the continuation of foreclosure proceedings. This allows the

property owner the ability to propose a plan to repay the taxes and preserve their property.

A lender needs to remain vigilant to protect their rights under the agreement with the borrower. Monitoring public filings such as tax sales is critical to that process.

For more information on process in lender monitoring, please feel free to contact:

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BY DAVID POILLUCCI, CPA, MST, SENIOR TAX MANAGER

ENHANCED DEPRECIATION BENEFITS FOR BUSINESSES

The recently enacted Small Business Jobs Act of 2010 includes an assortment of tax law changes that will affect businesses. Two of the most noteworthy changes allow for faster cost recovery (depreciation) of business property. The details are summarized below.

ENHANCED SMALL BUSINESS EXPENSING (SECTION 179 EXPENSING).

In order to help businesses quickly recover the cost of certain capital expenses, taxpayers can elect to write-off the cost of these expenses in the year of acquisition in lieu of recovering these costs over time through depreciation. This expensing election generally applies machinery, equipment and certain computer software. Under the new law, for tax years beginning in 2010 and 2011, taxpayers can elect to expense up to $500,000 of qualifying property. The amount elected to be expensed is reduced dollar-for-dollar by the excess of the total investment in qualified property that exceeds $2,000,000.

The new law also makes certain real property eligible for expensing. For property placed in service in tax years beginning in 2010 or 2011, the up-to-$500,000 of property that can be expensed can include up to $250,000 of qualified real property. For mortgage bankers, leasehold improvements made to property may qualify under this new provision.

EXTENSION OF 50% BONUS FIRST-YEAR DEPRECIATION.

In addition to the Section 179 expensing, the new law permits businesses to deduct 50% of the cost of capital expenditures placed in service in during 2010. The first year write-off applies to new tangible personal property acquired for use in an active trade or business. Qualified property includes most machinery; equipment or other tangible personal property; most computer software; and certain leasehold improvements.

PROPER TAX PLANNING

Congress has provided these tax incentives for small to mid-sized business with the objective of simulating capital spending in a lagging economy. These benefits provide taxpayers with immediate cash flow resulting from acceleration of the cost recovery for fixed asset purchases. However, this benefit is paid for by forgoing depreciation deductions in future years. While this strategy has typically been recommended in the past, careful 2010 tax planning should anticipate an environment of higher income tax rates beginning in 2011. Based on the expiration of the Bush Administration tax cuts; taxpayers who elect to deduct capital expenditures in 2010 will realize an immediate 35% tax savings while giving up future depreciation deductions at a 39.6% tax rate (these are federal individual rates at the top marginal bracket).

For more information on tax related questions, please feel free to contact:

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COMPLIANCE AND NEGOTIATIONS:
Evaluating Your Warehouse Line Covenants

BY JESSICA OFFER, CPA, SEMI-SENIOR ACCOUNTANT

In recent times we have seen a constricting economy and a tightening of credit, and both of these factors have made it more difficult to conduct business as usual. Although we face an evolving industry, with new rules and regulations upon us, one thing is for certain - warehouse lines are the lifeline or heart of most mortgage lending businesses. With the end of the year upon us and many financial institutions increasing their lending capacity or reentering the warehouse market, it's time to consider evaluating your agreements for compliance with required restrictions and financial covenants, and for the potential to negotiate more favorable terms either by amending existing agreements or entering into new arrangements.

KEEPING THE WATCHFUL EYE

Regardless of whether it's monthly or quarterly, monitoring your covenants is the key to mitigating defaults or if unavoidable, identifying the default will exist. In the event of a covenant default, it is beneficial to take a proactive approach in contacting your lender representative to notify him or her of the breach in order to facilitate corrective measures, such as strategies to get back in compliance and obtainment of a waiver letter. Not all covenant breaches result in severe consequences; however, legally the bank has a right to take all actions as dictated by your agreement.

TO AID IN THE MONITORING PROCESS, HERE ARE SOME ITEMS FOR CONSIDERATION:
Summarize all agreements – organize key information including terms, restrictions, and financial covenants in a centralized document for easy access and to facilitate identifying potential defaults.
Create a template of covenant calculations to assist in computations.
Create a compliance checklist.
Use of forecasts to predict potential problem areas.
Make the use of these templates and checklists part of the regular monthly or quarterly closing procedures.

GIVE AND TAKE

Due to changes in the economic environment or changes in your business, it might be time to reevaluate your warehouse covenants. Perhaps covenants that were favorable at the time of origination are no longer suitable given your current business situation or future business plans. If your agreements are not due to expire shortly, there will be fees involved in renegotiating an existing agreement, however, obtaining more favorable covenants, may be worth the price. If agreements are due to expire shortly, consider consulting with multiple lenders to understand the different arrangements available. The more information one has the greater your ability to negotiate the terms in your agreement.

When negotiating covenants, here are a few items for consideration:

- Preparation
    - Review financial forecasts of your business and whether anticipated earnings and/or net worth would meet required amounts.
    - Keep in mind expected future transactions and whether they would be allowed under the agreement.
    - Be aware of conflicts with other agreements already in place.
- Put yourself in the bank's shoes – what would you request of a client and why?
- Explore possible relationships with new lenders

If renegotiating an existing agreement, don't start from scratch! Review old agreements for clauses and restrictions you wish you could have amended on the prior agreement.

For assistance in creating covenant compliance checklist and calculation template or review of warehouse agreements, please contact a member of our Mortgage Banking Services Group at 908.526.6363.

FORECLOSURE DELAYS REQUIRE CREATIVE SOLUTIONS

BY NORRIS MCLAUGHLIN & MARCUS TEAM

Mortgage lenders are only too aware of the extended time frame to complete judicial foreclosures. New Jersey, New York and Pennsylvania are among the judicial foreclosure states with the longest time frames. On average, uncontested New Jersey commercial foreclosures take from 24 to 28 months to complete. Although there are delays at each point in the foreclosure process, the longest delays are with the Foreclosure Unit of the Superior Court which processes uncontested foreclosures. Once the foreclosure judgment is entered, the foreclosure sale is conducted by the sheriff in the county in which the mortgaged property is located.

Uncontested New York commercial foreclosures normally take from 9 to 18 months to complete. In New York, a referee is appointed to compute the amount due on the mortgage and to determine if the property can be sold in one parcel. The referee is a court appointed attorney who issues a report as to the amount due based on the lender's submissions of proofs and conducts the actual foreclosure sale. The longest delays in New York arise from the need for court approval of the referee's report.

The time frame for uncontested commercial foreclosures in Pennsylvania ranges from 4 months to 20 months depending on the county. Most delays arise from large sale volumes in certain counties. The differing sale procedures followed by each sheriff make the foreclosure process in Pennsylvania more difficult.

These time frames relate only to uncontested foreclosures. Contesting answers and bankruptcy filings can add many months (and possibly years) to the foreclosure process.

Creative approaches to foreclosure actions are required in response to these delays. These approaches include simultaneous suits on the note and guarantees in New Jersey, non-judicial foreclosures in New York, confessions of judgment in Pennsylvania and federal court foreclosures in all jurisdictions. Other ways to circumvent foreclosure delays are receiver sales, bankruptcy sales, deeds in lieu of foreclosure and consent judgments.

Lending institutions and other loan servicers are well advised to consult with attorneys having the necessary experience and sophistication to deal with all relevant foreclosure issues.

Norris McLaughlin & Marcus is a 140 attorney law firm headquartered in Bridgewater, NJ with offices in New York City and Allentown, PA. Contributors to this article were Joel N. Jacobson and Alison L. Galer in the NJ Office, Melissa A. Pena in the NYC office and Richard Somach in the PA office.

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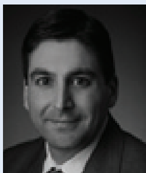

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