



A Memo Regarding FDIC/CFPB Regulations on Property Tax Escrow Accounts



Florida Homestead Check, LLC has recently released an innovative product called “Smart Escrow™”. Smart Escrow™ uses FHC’s proprietary Homestead Check™ architecture to accurately estimate the property tax bill for the year of purchase and the following year for any homestead property purchased in Florida. It then uses this information to prepare a one-page report that recommends the amount of funds to be withheld at closing and the monthly payment to be established so as to establish a Property Tax escrow that will not require any significant adjustment the year of closing or the following year. Mortgage Lenders, Title Agents, and Realtors in Florida are familiar that every November when Property Tax bills are paid and Escrow Account Adjustments are made by servicers that many angry phone calls come in from Borrowers who have suffered large adjustments to their monthly mortgage payment, and quite often received requests for shortfall funding. In the past, the standard response was that there is no way to set up or estimate the property tax escrow accounts other than by using the prior year’s property tax bill.

In Florida, using the prior year’s property tax bill can be highly inaccurate, commonly on the low side, since homestead property tax increases are “locked down” by the Florida Save Our Homes Act. As an example, a homeowner that buys a property in 2000 will be paying taxes on approximately the same value as at the time of purchase 20 years later. A purchaser can easily buy a home for \$1MM that will carry a \$20,000 a year tax bill where the prior owner is only paying \$5,000 a year. Situations like these result in grossly underestimated property tax escrow accounts and large adjustments when the tax bill is received for the year following closing. Smart Escrow™ eliminates such occurrences in that it accurately estimates what the property tax bill will be after purchase, and also takes into account any “Portability” that the homeowner may have accrued in a prior home. Smart Escrow™ is the first product of its kind to be available for use by title agents, lenders, and servicers.

As we have introduced Smart Escrow™ to potential users, a common response that we hear is that they can't use it because there are many FDIC, CFPB, and State regulations regarding how property tax escrow accounts must be set up. This is actually not true. There are very few applicable regulations that govern how a lender or servicer may set up a property tax escrow account- in fact, there are two:

Florida Statute 501.137. This statute is unique in that it is a Florida law which requires lenders doing business in Florida to comply with a particular aspect of Florida's property tax laws. Basically, F.S. 501.137 says "In Florida, if you pay your property taxes in November you get a 4% discount. If you are a lender who sets up a property tax escrow account to pay a borrower's property taxes, then you are REQUIRED to pay the property tax bill in November so that the customer receives the 4% discount, and if you don't then you are responsible for making up the lost discount." This is of course a paraphrase, the actual language of the statute is shown on the attached Appendix.

We are currently working with legislators in Florida to amend F.S. 501.137 to add a provision that requires lenders to utilize the most accurate means of estimating property tax bills reasonably available, as opposed to only using the prior year's property tax bill as an estimate.

12 C.F.R. 1024.17(c)(ii)(7) is also a portion of Regulation X of the CFPB regulations, known as the Real Estate Settlement Procedures Act, or "RESPA" for short. This provision provides (bold added for emphasis):

*"(7) Servicer estimates of disbursement amounts. To conduct an escrow account analysis, the servicer shall estimate the amount of escrow account items to be disbursed. **If the servicer knows the charge for an escrow item in the next computation year, then the servicer shall use that amount in estimating disbursement amounts. If the charge is unknown to the servicer, the servicer may base the estimate on the preceding year's charge, or the preceding year's charge as modified by an amount not exceeding the most recent year's change in the national Consumer Price Index for all urban consumers (CPI, all items).** In cases of unassessed new construction, the servicer may base an estimate on the assessment of comparable residential property in the market area."*

The CFPB does not provide written interpretations through its current advisement program but instead will respond verbally to interpretation requests. We contacted the CFPB from the position of our commonly-owned title insurance agency operation and posed the following question:

"Since the above-cited regulation says that we MAY base the estimate on the preceding year's charge, CAN we use a third party service estimate that we believe to be much more accurate and set up the escrow account on the basis that given the information in that third party service's report, we "KNOW" the charge? Or are we stuck in using the prior year's tax bill as the estimate even though we know it to be highly inaccurate?"

On June 28th, 2020 we received a phone call back from David Friend, Esq., Senior Counsel, CFPB. Mr. Friend responded to the above-question that Section 1024.17 was not intended to be "binary" in that it would only give lenders the choice to either use the prior year's tax bill or an actual tax bill if it were provided for that year. He stated that there purposefully was no definition in Reg. X of "Known", and that the result is that lenders have the flexibility to utilize other methods of estimating the tax bill for the year following purchase of a property if they reasonably

believe that those other methods provide a more accurate estimate of the tax bill than the method of using the prior year's tax bill.

In the phone call, it was also discussed that we have received feedback from multiple mortgage lenders that they prefer to use the prior year's tax bill in such situations because it is almost always smaller than a more precise estimate of the future tax bill would be. As a result, they are able to achieve better DTI (Debt To Income) Ratios than they would be able to get using the more accurate estimate. Mr. Friend responded that when a federally backed mortgage is involved, if a mortgage lender knows that by using the prior year's tax bill that they are materially underestimating the future tax bill and are doing so to achieve improved DTIs that such action would be considered actionable federal mortgage fraud by CFPB.

Mr. Friend also advised that CFPB has instituted a pilot "Advisory Opinion" program, where it will at times issue a written opinion published in the Federal Register in response to requests for interpretations of CFPB regulations that it feels would be helpful. He encouraged me to forward an Advisory Opinion Request and this was done on July 29th, 2020. A copy of the request is attached to this memorandum, and if/when a response is received we will provide an update memorandum.

Hopefully, this information is useful to lenders and servicers who are considering using Smart Escrow™ or similar products. The CFPB has made it clear, via Mr. David Friend's communication, that doing so is allowed under 12 CFR 1024.17. By adopting the use of Smart Escrow™ or a similar technology based estimating solution lenders and servicers need no longer subject borrowers to large escrow account adjustments the year of purchase or the year thereafter.

Sincerely,

A handwritten signature in black ink, appearing to read "Blake F. Deal III". The signature is fluid and cursive, with a large loop at the end.

Blake F. Deal III
CEO