

Cross-Border Real Estate Practice

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This article reviews selected developments in the area of cross-border real estate practice during 2014.²

I. Introduction

As many countries struggle to re-emerge from the financial collapse that affected world markets, countries have implemented, or attempted to implement, laws to address past problems and to encourage investment in the real estate markets. The legislatures in the United States, Ukraine, and Mexico have passed, or attempted to pass, laws that (1) require lenders to do more rigorous risk assessment of new loans or (2) bring more transparency and order to the real estate market by giving public access to the property register that contains pertinent information on real property title and encumbrances.

II. New Qualified Mortgage Regulations in the United States

The United States Congress issued new statutory requirements governing mortgage practices with the intent of restricting the practices that contributed to and exacerbated the 2007 financial crisis.³ Effective January 10, 2014, the Consumer Financial Protection Bureau's (CFPB) new mortgage regulations created fundamental changes in all aspects of the residential mortgage business.⁴ The new regulations resulted from the enactment of

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2. For developments during 2013, see Tracie R. Porter and Benjamin C. Rosen, Cross-Border Real Estate Practice, 48 INT'L LAW. 319 (2013).

3. *Summary of Final Rules*, Bureau of Consumer Financial Protection, at 1, 6, http://files.consumerfinance.gov/f/201307_cfpb_final-rule_titlexiv.pdf (last visited Mar. 10, 2015) [hereinafter Bureau of Consumer Financial Protection].

4. Amendments to the 2013 Mortgage Rules under the Real Estate Settlement Procedure Act (Regulation X) and the Truth in Lending Act (Regulation Z), 12 C.F.R. Parts 1024 and 1026 (2013).

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the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010⁵ in response to the financial crisis of 2007 and the collapse of the mortgage markets. The new regulations provide additional protections for consumers and require all industry participants to follow new lending and servicing standards.

Under the new regulations, lenders can make Qualified Mortgage (“QM”) loans or non-QM loans. The CFPB has deemed QM loans particularly “safe” for consumers. As a result, those loans have special protections, or a safe-harbor, from legal challenges, providing lenders with a presumption of compliance if they meet the Ability-to-Pay criteria. Thus, the Ability-to-Pay rule is another pertinent aspect of these new regulations because it helps define the QM criteria. The Ability-to-Pay Rule creates transparency of true mortgage costs by prohibiting lenders from offering low- or no-documentation mortgage loans that mask those costs.⁶

The Ability-to-Pay Rules also create a new category of mortgage known as the Qualified Mortgage,⁷ which is defined by various features associated with mortgages. Lenders making Qualified Mortgages must adhere to six specific criteria.⁸ First, the QM must not have an interest-only period. This feature is meant to avoid the payments-increase shock caused when the interest-only period ends and payment on the principal is added to the interest-only payment, making the mortgage unaffordable for borrowers.⁹

Second, the QM must not have negative amortization. Negative amortization means the mortgage principal balance increases with payments rather than decreases because the payment fails to cover the interest due on the mortgage.¹⁰ Lenders, therefore, add the interest to the principal balance, which ultimately causes borrowers to owe more money on the outstanding balance than they originally borrowed.

Third, the QM must not have more than a thirty-year repayment term. This feature affords borrowers a ceiling on repaying the loan and prevents lenders from taking advantage of borrowers by adding extra years of interest on the mortgage loan.¹¹

Fourth, the QM must not have balloon payment at the end of the term, with the exception of mortgages made to borrowers in rural and under-served areas.¹²

Fifth, the QM must not exceed forty-three percent of a borrower’s monthly gross, or pre-tax, income. This ratio is an improvement in some respects from past income ratios as

5. Pub. L. No. 111-203, 124 Stat. 1376 (2010). Section 1402 of the Dodd-Frank Act amended the Truth In Lending Act, Pub L. No. 90-321, 82 Stat. 146 (1968); see also CCH, *Dodd-Frank Wall Street Reform and Consumer Protection Act: Law, Explanation and Analysis* 581 (2010).

6. Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z) (2013 ATR Final Rule), 78 FR 6407 (Jan. 30, 2013). Bureau of Consumer Financial Protection, *supra* n. 3 at 2, 4.

7. Truth In Lending Act, Pub L. No. 90-321, 82 Stat. 146 (1968). See 15 U.S.C.A. § 129C(b) (West 2012).

8. See 12 C.F.R. § 1026.43 (with relevant subparts).

9. *Id.*

10. *Id.* Negative Amortization is also known as NegAm, deferred interest, or graduated payment mortgage. See 12 C.F.R. §§ 1026.18(s)(2)(ii) & (s)(7)(v).

11. See 12 C.F.R. § 1026.43 (with relevant subparts).

12. The regulations are not clear on what constitutes rural or under-served areas. *Underwriting Guidelines: USDA Rural Development Guaranteed Rural Housing Loan Program*, USDA, available at <http://www.rd.usda.gov/files/CA-SFHUnderwritingGuide.pdf>. In the author’s opinion, both these areas may still need this protection given the low-income levels of many Americans who might reside in rural and under-served areas.

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high as fifty percent of a borrower's gross income, which made many borrowers expend a significant amount of their actual take-home pay on housing costs.¹³

Sixth, and last, lenders must verify borrowers' proof of income or assets before making the mortgage loan.¹⁴ This feature aims to guarantee a borrower's ability to pay as well as to prevent fraud in mortgage lending, such as past abuses by lenders who made loans to borrowers with no proof of employment, income, or assets, which ultimately resulted in large mortgage loan defaults.

Some industry participants have criticized these new regulations. The American Bankers Association has noted that the new rules are extraordinarily complicated and are subject to ongoing and extensive amendments.¹⁵ Furthermore, the volume and complexity of the rules have created uncertainty for banks that, after the financial collapse, had been reluctant to issue new mortgage loans.¹⁶

In conclusion, the QM and Ability-to-Repay rules have highly technical and complex features given the various levels of legal protection for lenders and the combination of product pricing, loan features, and other factors that provide regulatory exemptions to minimize lenders' liability exposure. To minimize the risk of litigation for non-compliance or abusive lending practices under the new regulations, some banks may curtail residential mortgage lending until they have confidence that their origination and compliance systems provide greater certainty with respect to how the regulators, individuals, and state attorneys general will enforce the new rules.¹⁷

III. The Emerging Real Estate Market in the Ukraine

The current situation in the Ukrainian real estate market has been emulating the general dramatic deterioration of the national economy since the beginning of 2014, which was due to the unprecedented challenges faced by the Ukrainian People and the State, including the political toppling, territorial woes, and continued military tension in the eastern regions of Ukraine. On the positive side, during the last year, both presidential and parliamentary elections took place in Ukraine, resulting in the realignment of power toward more democratic pro-Western forces.¹⁸ High expectations for the recovery of Ukraine's national economy rest on the prospects of a free-trade zone with the European Union (EU), which is to be progressively implemented pursuant to the EU-Ukraine Association Agreement signed in 2014.¹⁹

The Ukrainian real estate market is being eyed by investors with interest, given the ample unexplored opportunities in the agricultural sector, under saturation of the com-

13. See Bureau of Consumer Financial Protection, *supra* n. 3 at 64. The Bureau notes that the specific 43 percent debt-to-income requirement applies only to qualified mortgages under 12 C.F.R. § 1026.43(e)(2).

14. See 12 C.F.R. § 1026.43 (with relevant subparts).

15. American Bankers Association, *Mortgage Reform in 2014* (March 2014), <http://www.aba.com/Press/Documents/MortgageReform2014.pdf>.

16. *Id.*

17. *Id.*

18. See *Ukraine's New Pro-Western Parliament Holds First Session*, EURONEWS (Nov. 27, 2014) <http://www.euronews.com/2014/11/27/ukraine-s-new-pro-western-parliament-holds-first-session>.

19. Complete text of the Agreement is available at: http://eeas.europa.eu/ukraine/assoagreement/assoagreement-2013_en.htm.

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mercial real estate market, and a pressing demand for investment into the energy and infrastructure segments.²⁰

A number of improvements in the legislative and operational environment have been implemented, such as granting public access to the data of the property register and master plans, and facilitation of registration of rights *in rem*. At the same time, certain outdated laws and restrictive practices, such as the land moratorium, which prohibits alienation of many agricultural lands, impede the inflow of investment into the Ukrainian real estate market.²¹ Although originally viewed as being of a temporary nature, the moratorium is qualified as permanent under the most recent governmental draft law,²² with the focus shifting toward reforming and liberalizing land lease. In particular, according to the draft law, regardless of the form of ownership and category of land, land lease rights may be alienated by the leaseholder without the lessor's consent.²³

The property register containing information on real property title and encumbrances became publicly accessible, which marked a crucial, long-awaited shift toward bringing more transparency and order to the real estate market.²⁴ Also, the amendments to the Law "On the Urban Planning" envisaged that all master (development) plans, including those that have been kept restricted since the Soviet times, are now to be opened to the public.²⁵ Access to the property register as well as to the master plans should be made publicly available on-line.

Over the past year, a new registration system enacted in 2013 has been undergoing further changes and improvements aimed at facilitating the registration procedure, namely shortening the procedure of ownership registration and simplifying registration of derivative rights *in rem*.²⁶ By the end of 2015, the government plans to carry through the transfer of the records from the previously existing land registers into the new register of property rights.²⁷

To increase budget revenues, the government has taken certain unpopular measures across various segments of the economy, including in the real estate field. The taxation

20. Investment market In Ukraine: H1 2014, DTZ (Aug. 3, 2014), http://www.dtz.com/Ukraine/Media_Centre/Latest_news/Investmentärketn+Ukraine+H1+2014.

21. Land Moratorium was first introduced in 2011 and was extended most recently on December 20, 2012. The 2012 law will take effect "On the Introduction of Amendments to the Land Code of Ukraine (With Respect to Agricultural Land Transactions)," *available at*: <http://zakon2.rada.gov.ua/laws/show/5494-17/print1329903557142087>.

22. On Amendments to Certain Legislative Acts of Ukraine Aimed at Improvement of Procedures for the Sale of Lease Rights to Agricultural Land (Jul. 18, 2014), <http://land.gov.ua/zakonovorcha-diialnist/633.html>.

23. *Id.*

24. The Property Register opened on November 25, 2014, with the coming into force of the Law of Ukraine "On Amendments to Some Legislative Acts of Ukraine on Determining Ultimate Beneficiaries of Legal Entities and Public Figures" *available at* <http://zakon4.rada.gov.ua/laws/show/1701-vii>.

25. All master plans were opened based on the Law of Ukraine No. 1170-VII "On amendments to some legislation acts of Ukraine due to the adoption of the law of Ukraine On Information and the Law of Ukraine On Access to Public Information (Apr. 18, 2014), *available at* <http://zakon4.rada.gov.ua/laws/show/1170-18>.

26. Procedural rules were amended with the enactment on February 12, 2014 of the "Procedure of State Registration of Real Estate Rights and their Encumbrances" as approved by the Resolution of the Cabinet of Ministers No.868 (Oct. 17, 2013), <http://zakon4.rada.gov.ua/laws/show/868-2013-%D0%BF>.

27. *Id.*

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basis for the purpose of levying tax on residential buildings (premises) was extended so as to cover not only the living area, but also the total area of property.²⁸

In 2014, important state reforms have been launched, aimed at downsizing bureaucracy, decentralizing power, enhancing local self-government, and supporting anti-corruption and lustration initiatives. The above measures give a dawning beacon of hope to the public society and business, while a tremendous amount of work still remains to be done.

28. Respective amendments to the Tax Code of Ukraine were introduced by the Law of Ukraine No.1166 “On Prevention of the Financial Disaster and Creation of Preconditions for the Economic Growth in Ukraine”, <http://zakon4.rada.gov.ua/laws/show/1166-18>. Commercial property has not yet become taxable, but lawmakers are discussing this prospect. See http://arzingier.ua/files/file/Real%20Estate%20Legal%20Alert_23_September%202014_eng.pdf.

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