

Ohio mortgage lender loses first ability-to-repay challenge, on appeal

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A panel of judges this month sided with a borrower who challenged his mortgage lender's diligence in proving he could make his payments, showing for the first time how strictly courts will interpret ability-to-repay rules and laying a potential roadmap for other cases as defaults rise.

The US Court of Appeals for the Sixth Circuit on 8 July ruled that the First Federal Community Bank of Bucyrus improperly relied on the borrower's assertions that he would receive USD 2,200 in monthly spousal support from a separation agreement and additional rental income, instead of securing and reviewing final documents. The court reversed a 2019 district court decision that was based on the terms of separation that were later rewritten in divorce court, reducing the borrower's expected income.

According to the district court, that the borrower and his wife scrapped a separation agreement after the loan was originated was not an event that was reasonably foreseeable to the bank, as reported.

The blow to the Ohio bank came as more facts came to light, said Kris Kully, a partner at Mayer Brown who specializes in lender compliance. Because the bank never looked at the actual separation agreement, it erred, she said. The bank also didn't collect proof that the borrower was getting the rental income he claimed.

"Certainly, there's a lesson there," Kully said. As a legal matter, "it says 'hey lender, you need to follow the regulations. You can't cut corners.'"

To be sure, there is not much more to the case, Kully and fellow partner Laurence Platt said during the law firm's teleconference yesterday covering the Consumer Financial Protection Bureau's proposal to reshape the ATR rule and Qualified Mortgage definition. But it has nonetheless drawn a lot of attention from clients and others in the legal community, a spokesperson said.

Indeed, the ruling should be a warning to investors in residential loans, even those that are vetted by third-party due diligence firms before purchase, said Eric Kaplan, director of the housing finance program at the Milken Institute's Center for

Financial Markets. More ATR claims should be expected given the current circumstances facing millions of borrowers, he said.

“There will likely be lenders who made loans that fit this profile and who might be subject to claims, especially from borrowers who default after COVID-19 forbearance relief ends,” Kaplan said.

The Ohio loan was made under unusual circumstances, the appeals judges wrote in their decision. The bank initially denied the application and changed course only after meeting with the borrower’s then spouse, a good client who along with the borrower never missed a mortgage payment.

But the assurances of a good client didn’t change the fact that technical violations of the Truth in Lending Act generally result in liability, the judges wrote. Bank arguments that the borrower – who worked as a licensed real estate agent for more than three decades -- was aware that lenders relied on income stated on an application and yet lied about his income aren’t defenses in this case, they wrote.

When filing his appeal, the borrower, G Ralph Elliott, said that he was not the sophisticated borrower that the bank described, that the court overlooked his dependence on his wife and that his confusion ran so deep that he had trouble working his cell phone, as reported. Elliott and his then-wife, Virginia Golan, were 80 years old and 55 years old respectively when the original complaint was filed on 13 January 2017.

Elliott prevailed even as he was apparently responsible for the change in the separation agreement. In their decision, the appeals judges wrote that Elliott acknowledged that he testified in his divorce case that he decided not to abide by the agreement and instead sought more spousal support from the divorce court. During discovery, Golan said she paid the USD 2,200 for three months until Elliott refused to meet terms of the agreement, the judges wrote.

The appeals judges remanded the case back to the trial court for a decision on the damages.

The case is *G. Ralph Elliott v First Federal Community Bank of Bucyrus*, [2:17-CV-42](#) in US District Court for the Southern District of Ohio, Eastern Division.

The appeal is *G. Ralph Elliott v. First Federal Community Bank of Bucyrus*, on appeal from the United States District Court for the Southern District of Ohio, No. [19-3690](#).

by [Al Yoon](#)