



Memo No. 15-03-26 ▪ Issue Date: March 26, 2015 ▪ Effective Date: April 3, 2015

New Construction - Payment Shock Letter

Overview

For new construction residential properties, there can be a significant increase in property taxes in year two of the loan due to the differences in improved versus unimproved property valuations. In these cases, the borrower pays taxes on unimproved land during the first tax year.

- Unimproved land means that no home or building has been built on the property.
- Improved land means the home has been completed and the land is considered to be improved. As a result, property taxes are based on the value of the home in addition to the land value.
- The increase in property taxes from year one to year two can cause payment shock for the borrower.

To ensure that borrowers qualify for their complete mortgage payment (including principal, interest, taxes, and insurance), Franklin American Mortgage Company (FAMC) underwrites all loans with an *estimated improved value*. This value is obtained from the local tax assessor's office and is used to calculate escrow payments for the borrower and is figured into overall ratios.

Payment Shock Letter

Effective April 3, 2015, for all new construction loans in which the borrower has the option to choose whether escrows will be established at the unimproved new construction level or the improved land value, a [Payment Shock Letter](#) must be executed prior to or at closing. A sample form is provided on the [next page](#) and an FAMC form is available in the Lending Guide > Compliance > Forms > Payment Shock.

The letter advises the borrower that should they choose the lower unimproved value that there may be a significant increase in property taxes for year two when the escrow account is analyzed, and they will be required to repay any shortage in the escrow account.

Brokered Loans

For brokered loans, the FAMC closer will send the [Payment Shock Letter](#) out to the Broker and Settlement Agent/Closing Attorney prior to loan closing and indicate which line should be initialed based on how the tax escrows were requested in Q.docs. The form is required to be signed prior to or at closing.

EMB Loans

For EMB loans utilizing third party documents, if the documents reflect an unimproved tax figure, the EMB auditor will verify there is a signed letter from the borrower stating they are aware of the payment shock which will occur once property taxes are reassessed.

If FAMC is drawing the documents, FAMC will send a copy of the [Payment Shock Letter](#) out to the Broker and Settlement Agent/Closing Attorney prior to closing and indicate which line should be initialed based on how the tax escrows were requested in Q.docs. FAMC will also accept a signed letter from the borrower stating they are aware of the payment shock that will occur when taxes are reassessed.

Please contact your Account Executive if you have any questions. We thank you for your continued business!

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Sample Payment Shock Letter

Consumer Disclosure for Voluntary Escrow Account Payments

IMPROVED LAND VS. UNIMPROVED LAND

When land is "unimproved", this typically means no home or building has been placed on the property. Land becomes "improved" once a home has been built. For the purpose of determining property tax obligations, State and local governments assess unimproved land at a lower value than improved land. The improved value therefore results in a higher property tax obligation.

Sample

WHAT IS "PAYMENT SHOCK"?

Payment shock occurs when your monthly payments into your escrow account substantially increase after the first year due to a significant rise in escrow items such as your property tax obligation.

Payment Shock is common with new housing construction, where the property tax assessment is based on the unimproved value of the land for the first calendar year but reassessed at the improved value of the land in the second calendar year.

VOLUNTARY AGREEMENT TO MAKE ESCROW PAYMENTS AHEAD OF SCHEDULE

The tax bills paid out of your escrow account are expected to increase substantially after the first calendar year due to your home being new construction. Under normal escrow practices, your monthly escrow payment in the second year could be much higher than in the first.

You may voluntarily choose to make the higher payment based on the improved value tax estimate in the first year to reduce or eliminate the monthly payment increase in the second year.

PLEASE INITIAL ONE OF THE FOLLOWING:

- _____ Yes, I voluntarily agree to pay the higher escrow payments. I further understand and agree that this voluntary agreement will expire after the first calendar year, at which time my escrow account will be re-analyzed.
- _____ No, I (we) do not wish to make higher payments. I (we) realize that my (our) escrow payment, which is included in my (our) mortgage payment, may increase substantially when the account is re-analyzed after the first calendar year.

Borrower

Date

Co-Borrower

Date

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