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REPORT

RESPA

The Real Estate Settlement Procedures Act has governed costs associated with residential mortgage transactions since 1974, but it became the subject of significant controversy as reports surfaced of abuses by lenders and third-party service providers. After many halting attempts to overhaul the RESPA rules, the Department of Housing and Urban Development in November 2008 issued new regulations that have been generally hailed as providing needed reforms. In this analysis, the authors review the highlights of the new rules, which took effect in January, and assess their likely impacts on consumers and on participants in the home mortgage transactions industry.

Understanding, Complying With New Real Estate Settlement Procedures Act Rules

BY ADAM LEITMAN BAILEY AND DOV TREIMAN

After extensive study, the Department of Housing and Urban Development (HUD) has issued new rules under the Real Estate Settlement Procedures Act (RESPA) of 1974 (12 U.S.C. 2601-2617). The regulations represent a victory for borrowers because they will impose on lenders and their allies more pricing and product accountability.[1]

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Purpose and Goals. Applying to federally related mortgage loans, and not private investor and commercial transactions,[2] the amended law required HUD to develop and prescribe rules and standard forms governing the purchase of real estate.

Although the new regulations only apply to federally related first and second mortgage loans on private

[1] HUD news release, 11/12/2008.

[2] We refer the reader to 24 CFR 3500 for all of the specifics of the new regulations to which we allude.

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housing on and after Jan. 1, 2010, many lenders have been utilizing the new forms since summer 2009, and even transactions exempt from the law have adhered to its requirements.

The new law's lofty goals, combined with its rules and regulations seek to:

1) Require greater disclosure of loan terms and closing fees;

2) encourage consumers to do comparison shopping for loans and closing cost vendors;

3) promote transparency and real competition to drive loan and closing costs down;

4) protect consumers from unnecessarily high closing costs; and

5) provide a balanced and competitive market for all closing service vendors. [3]

Achieving These Goals. Under the new regulations, borrowers will, shortly after completing the loan application, better understand the loan product being offered as well as the real cost of the loan and relevant closing fees. The chief tools the law uses to achieve its goals are the mandatory Good Faith Estimate (GFE) and HUD-1 Closing Statement forms.

GFEs and HUD-1s already existed under the 1974 law, although they bore almost no resemblance to the new forms. Yesterday's toothless, incomprehensible and relatively useless GFE has been replaced with a three-page, compressive GFE form—one adopted by HUD only after the kinds of market studies one would normally expect from a major corporation looking to launch a new product line.

By means of the lender's completion of the new GFE form, the consumer can now accurately understand the loan product offered and make an easy comparison to other loan products offered by competing lenders. The new GFE provides information on the loan amount, term, interest rate, terms under which the loan's interest rate may increase, payment penalties, and balloon payments.

Although the GFE must set forth the lender's attorney's fees amount, it is not required to set forth any expenses the borrower has that have essentially nothing to do with the lender such as, for example, the borrower's privately retained counsel.

Similarly, the GFE may include a suggested title company, but if the borrower chooses to independently select a title company, the fees involved are outside of the RESPA restrictions.

The new GFE requires all fees that will be charged at the closing to be listed at the time the lender issues the good faith estimate. Naturally, interest rates may change depending on promises in the GFE.

The new HUD-1 form used at the closing is designed to display any discrepancies between the promised closing costs and the real ones, but with limited exceptions. This form should ensure that key final terms of the loan are disclosed to the borrower at the closing. Via itemization, borrowers will know who would be due how much money at closing, including the lender and each vendor.

An Abuse Unmasked. Although the changes to RESPA are undeniably sweeping, an examination of a reported case under the old rules highlights the kind of problems the new regulations were designed to prevent. In *Cohen v. J.P. Morgan Chase,*[4] the plaintiff brought a class action in federal court over an ostensible $225 ''Post Closing Fee.''

The suit demonstrated that consumers were being charged only in New York and Connecticut a now-obsolete fee for expenses the bank would have to pay if and when it chooses to sell the note. The court, finding issues of fact, denied summary judgment but strongly indicated that the fee was for a service of no benefit whatsoever to the consumer and that upon the resolution of the facts, the court would disallow it.[5]

The new GFE, however, would have revealed that this fee was going to be charged and that it had no analog in the fees charged by other banks, making it far less likely to occur.

The New GFE. HUD requires lenders to issue the GFE by mail, e-mail, fax, or other high-speed method within three days of receiving the applicant's name, monthly income, Social Security number, property address, and an estimate of the property's value. No GFE is necessary when a loan is denied before the third business day after the receipt of an application. All GFEs automatically expire within 10 days, when the loan commitment expires, or upon the passing of another date given by the lender. The most notable exception to this timing rule applies to newly constructed properties, where the GFE may change at any time until 60 days before closing, provided there is a disclosure in the GFE warning that there may be a revised GFE during that period.

The Price Guarantee. Once the lender issues the GFE, it must guarantee to the borrower the accuracy of the amounts listed for transfer taxes and for the costs of the loan, including origination fees, points, and the interest rate. The sums listed for, title insurance, services, and governmental recording charges may not increase by more than 10 percent at closing when the borrower uses service providers recommended by the lender. If the borrower chooses, for example, a title company not recommended by the lender, the rules do not limit possible increases in fees. Other fees that may increase without restrictions include the cost of homeowner's insurance, the daily interest charges, and sums deposited for the escrow account.

Amending the GFE. Despite these restrictions, the regulations, under the rubric of ''changed circumstances,'' provide for ways the lender can amend or deviate from the GFE. A GFE may be amended upon changed circumstances which include:

1) A change in the loan as a result of an act of God, war, disaster, or other emergency;

2) when a borrower provides inaccurate information that was relied upon by the lender;

3) when new information surfaces that had not been relied upon when the lender completed the GFE; or

4) when other information surfaces, such as a boundary dispute, that impacts the loan.

When a changed circumstance occurs, the lender must issue a new GFE within three business days of receiving the new information and it must be retained for three years. Lenders may only change those parts per-

[3] HUD news release 11/12/08.

[4] 608 F.Supp.2d 330 (E.D.N.Y. 2009).

[5] *Cohen v. J.P. Morgan Chase & Co. et ano,* 608 F.Supp.2d 330 (E.D.N.Y. 2009).

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taining to the specific changed circumstance causing the amended GFE.

An example of a common change in circumstance is where on the eve of closing the borrower announces the need to attend the closing through an attorney in fact. Formerly, the lender's attorney's fee for drafting a power of attorney would simply be added to the HUD-1 as an additional fee that arose after the original GFE. However, under the new RESPA regulations, the lender must issue an amended GFE.

Newly Constructed Properties. Construction loans may or may not be covered by RESPA. If they are for two years or more, they are covered. If they are bridge loans or swing loans, they are not. Temporary financing is not covered by RESPA, but if it is to be converted to permanent financing, it is.

The HUD-1's New Purpose. Because of its linkage to the GFE, the HUD-1 will no longer be a document merely to be filled out at closing, signed, and placed in the closing file. The new HUD-1 totals the cost of the loan and compares it to the requirements of the GFE, allowing the borrower to see any discrepancy between the GFE and the HUD-1.

However, there is some degree of flexibility in the GFE/HUD-1. To allow lenders some flexibility when obtaining pricing from third-party vendors, lenders may use so-called ''average charges'' for closing services.

Use of Average Charge. The amount stated on the HUD-1 for any itemized service cannot exceed the amount actually received by the settlement service provider for that item unless the charge is an ''average charge.''

Average charges are amounts paid to a closing service provider on behalf of buyers and sellers for a particular class of transactions involving federally related mortgage loans and can include items such as credit reports, flood certifications, appraisals, title searches, and third-party attorneys, based on average charge calculations.

Flattening Fees. The new regulations' goal of flattening fees is designed to prohibit unsubstantiated extra fees that increase the closing bill. By abolishing the itemization of excess charges such as overnight couriers, preparation fee, closing fee, mailings, and administrative and processing fees and by requiring that they be included in the total lender and title insurance bills, the GFE/HUD-1 ensures the borrower will have no unexpected fees at closing.

This is especially true with regard to fees charged by title companies. Although title fees generally come within the 10 percent permissible flex, that variation *includes* title company charges, along with other charges like appraisals, credit reports, surveys, and pest inspections. They must therefore be allocated so that the total cumulative increases for these items is less than 10 percent above the GFE amount. The lender must absorb any expenses over the 10 percent threshold. The regulations provide that if any services subject to the 10 percent ceiling cause the total charges to exceed 10 percent, the title company can ask the lender to issue an amended GFE.

To avoid the 10 percent tolerance cap, any new fees arising from changes in circumstances will now require amending the GFE. However, this requires a genuine change in circumstances and not merely a late decision to charge more money.

Issuing a new GFE is not the third-party vendor's decision to make. If they prefer that the lender not have to absorb new charges, they will have to:

1. improve their ability to predict what services they need to perform and what to charge for them;

2. include the additional charges in the initial estimate, at the risk of appearing uncompetitive; or

3. be prepared to sustain losses in those cases where the services they actually perform exceed the 10 percent ceiling.

Under RESPA, only a foolhardy lawyer would simply accept the lender's figures without putting the HUD-1 side by side with the GFE and going line by line, making sure the numbers match. Although such tasks can be delegated to a paralegal, it is the attorney's responsibility to make sure it's right.

Complex Loan Structures. The modern real estate market is not limited to straightforward deals. Though these simple transactions are still common enough, so too are more complex mortgage structures involving first and second mortgages, assignments, subordination agreements, and other variations on the ancient themes. RESPA's new regulation of this, however, is relatively simple. If there is a new loan from a new federally related lender, there must be a GFE and HUD-1 for each such loan in the deal. If the loan is merely changing hands, there need be only one set of GFEs and HUD-1s, but the HUD-1 must clearly describe who the players are and what other players were in the deal.

Penalties. RESPA is not intended to create a new area of business for litigators. It sets up private causes of action and is also intended to be enforced by the appropriate federal and state agencies. Authorized private causes of action under RESPA entitle a successful plaintiff to compensation for attorney's fees. However, the amounts involved may be so small that the borrower may have to seek satisfaction in small claims court.

The regulations deem certain activities to be violations of the statute. These include failure to follow any of the requirements set forth above. Both the regulations and the statute are somewhat vague about what can happen to mortgage brokers and lenders who fail to abide by RESPA's requirements. However, remedies the federal agencies can impose include disqualification from conducting lending business.

If upon examination of a HUD-1, it appears that there was an overcharge, it is up to the lender to make good on that within 30 days. If the lender fails to do so, treble damages can be imposed and collected in a private cause of action, but the plaintiff can also file a complaint with HUD and seek administrative remedies against the lender and/or mortgage broker.[6]

If a kickback scheme is involved in the transaction, it can result in a year's incarceration and/or a $10,000 fine. This statutory authority for prosecuting kickbacks as a crime has actually been on the books even before the amended RESPA rules.

[6] HUD website section: ''More on RESPA.'' http://www.hud.gov/offices/hsg/ramh/res/respamor.cfm

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RESPA also authorized injunctive actions by HUD and the states' attorneys general.[7]

Discounts. The new RESPA regulations are strict in regard to discounts. Although generally speaking, a lender may offer a discount, the rules bar discounts in relation to new construction. At the heart of RESPA is the concept of genuineness. Therefore, in promulgating the new regulations, HUD wanted to make sure that smoke and mirrors vanished from these transactions. Therefore, the regulations are structured to prevent a lender that claims to give a discount from creating an offsetting fee somewhere else to make the apparent discount entirely illusory.

Where the GFE claims that a particular service as set forth on the GFE represents a discount when provided by a particular vendor, the regulations specify, ''The discount must be a true discount below the prices that are otherwise generally available, and must not be made up by higher costs elsewhere in the settlement process.''

The use of such discounts to induce borrowers to use particular services is not forbidden by the RESPA regulations. However, the service provider is forbidden from providing kickbacks to the lender over and above an amount representing the lender's equity interest in the service provider, if in fact such a relationship exists.

There is no requirement that the GFE set forth any particular number of recommended vendors. However, it must set forth what if any relationship the lender has with the vendors it does recommend and to what extent it has in the recent past recommended those vendors. The old rules did not require such disclosures.

Obviously, the consumer is overwhelmingly more likely to select the vendor indicated on the GFE, at least because the GFE provides a form of cap on how much that vendor will finally be able to charge.

Of course, the consumer is encouraged to look at the bottom line of the GFE to determine the maximum costs associated with the loan. Whatever legerdemain may be used in arriving at the figures, under the new RESPA regulations, the total loan cost shows up clearly.

Mortgage Brokers' Complaints. Under the newly revised GFE, mortgage brokers who have no affiliation with the lender must set forth in the form and in the HUD-1 just what their profit is on the deal, known in the industry as the ''yield spread premium'' (YSP). However, in-house brokers employed by the lenders have to make no such disclosure. This is seen, correctly enough, as lopsided by the brokers. However, HUD conducted numerous market studies to determine how actual consumers would treat the various proposed forms of GFE. According to those studies, as reported in *National Association of Mortgage Brokers, Inc. v. Donovan*,[8] in some 80 percent of cases, consumers using the new GFE were able to realize that when it comes to comparison shopping, the bottom line is the *bottom* line and the figures on the way to getting there, while informative, are not determinative of how big a check one has to write. So even though the brokers had to separately disclose their profit, if they were cheaper than a brokerless transaction, the consumer selected them.

Those studies notwithstanding, the brokers remain unconvinced and in all fairness to their position, the consumers only had an 80 percent accuracy rate in spotting the bargain.

Conclusion. Although the new RESPA regulations are not being greeted by cheering crowds, least of all by mortgage brokers, on the whole, it looks like HUD got this right. They put much effort into studying how consumers would react to the new forms and rules in the real world and it appears that the work was worthwhile.

[7] 12 U.S.C. 2607(d)(4)

[8] 2009 WL 2259085 (D.D.C. 2009).

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