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New York Law Journal Reprint— Real Estate Update—New Rules Aim to Curb Excessive Closing Costs

After extensive study, the federal Department of Housing and Urban Development has issued new rules under the Real Estate Settlement Procedures Act (RESPA), 12 U.S.C 2601-2617, of 1996. The regulations represent a victory for borrowers since they will impose on lenders and their allies more pricing and product accountability.[1]

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

The law, combined with its rules and regulations, seek to:

- Require greater disclosure of loan terms and closing fees;
- Encourage consumers to do comparison shopping for loans and closing cost vendors;
- Cause transparency and real competition to drive loan and closing costs down;
- Protect consumers from unnecessarily high closing costs; and
- Provide a balanced and competitive market for all closing cost vendors.[3]

Achieving These Goals

Under the new regulations, borrowers will, shortly after the application's completion, better understand the loan product being offered as well as the real cost of a 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, although they bore almost no resemblance to the new forms. Yesterday's toothless, incomprehensible and relatively useless GFE has been replaced with this three-page compressive GRE 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 includes the loan amount, term, the interest rate, terms under which the loan's interest rate may increase, payment penalties, and balloon payments.

While the GFE must set forth the fees of the lender's attorney, it is not required that it 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 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 closings. Via itemization, borrowers will now know who got how much money at closing, including the lender and each vendor.

An Abuse Unmasked

While 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 be better at preventing. In *Cohen v. JPMorgan Chase*,[4] the Plaintiff brought a class action in Federal Court over an ostensible $225 "Post Closing Fee."

The suit demonstrated that the consumer was being charged only in New York and Connecticut, a now obsolete fee, for the expenses the bank would have if, as, and when the bank would want 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 would, however, have revealed that this fee was going to be charged and it saw no analog

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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 becomes 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 any time until 60 days before closing, provided there is a disclosure in the GFE warning that there may be a revised GFE in that period.

The Price Guarantee

Once issuing the GFE, the lender 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 charge for the specific interest rates selected. The overall sum of the amounts listed for the purchaser's and lender's title insurance and services and governmental recording charges can only increase 10 percent at closing when the borrower uses companies recommended by the lender. When the borrower chooses a title company not recommended by the lender, there is no limitation to an increase in fees. Other fees without price increase restrictions include the cost of homeowner's insurance, the daily interest charges, and sums deposited for the escrow account.

Amending the GFE

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

- A change in the loan as a result of an act of God, war, disaster or other emergency;
- When the borrower provides inaccurate information relied upon by lender;
- When new information surfaces that had not been relied upon when the lender completed the GFE; or
- Other information learned, such as a boundary disputes, the need for flood insurance or environmental problems that impact the loan.

When a "changed circumstance" occurs, the lender must issue a new GFE within three business days of receiving the new information and this information must be retained for three years. Lenders may only change those parts pertaining to the specific changed circumstance causing the amended GFE.

One common changed circumstance occurs when 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 filed in the closing file. The new HUD-1 totals the cost of the loan and compares it to the requirements of the GFE, allowing for the notice of 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 itemized item unless the charge is an "average charge."

Average charges are amounts paid for a closing service provider to another on behalf of borrowers and sellers for a particular class of transactions involving federally related mortgage loans and can include things like credit reports, flood certifications, appraisals, title searches and third party attorneys. Per page recording fees also allow for average charge calculations.

Flattening Fees

The new regulations' goal of flattening fees finds expression through an effective plan to stop unsubstantiated and numerous extra fees padded to and increasing 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 lumping them into the total lender and title insurance bills, the GFE/HUD-1 ensures that the borrower will not have any unexpected fees at closing.

This is especially true with regard to the fees charged by title companies. While title fees generally come within the 10 percent permissible flex, that flex includes title companies along with other charges like appraisals, credit reports, surveys, and pest inspections. They must therefore be shared so that the total of the increases in all these items lumped together is less than 10 percent above the GFE amount. If the overall flex is over 10 percent, the lender has to absorb it. By being grouped with the overall flex with the bank having to absorb new fees that arise at closing, the title company will have to choose between foregoing these charges or biting the hand of the bank that recommended it. If any one of these kinds of services subject to the group flex of 10 percent needs to go over the 10 percent, it 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

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amending the GFE. However, this requires a genuine change in circumstances and not merely a late decision to charge more money.

However, for third-party vendors like title companies, simply issuing a new GFE is not their decision to make. If they prefer that the lender not have to absorb any new charges, they will have to either:

- Get better at predicting what services they need to perform and what to charge for them;
- Write the additional charges into the initial estimate as part of the entire package, at the risk of appearing uncompetitive; or
- Be prepared to sustain losses in those cases where the services they actually perform exceed the 10 percent flex.

Thus, to a certain extent, the title companies are being punished by being placed in the position of having their fees controlled without their expenses being similarly controlled. This may well require a general upward shift of their fee structure throughout the industry.

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 that the numbers are matching. While that kind of task can be delegated to a paralegal, it is the attorney's responsibility to make sure it's right.

Complex Loan Structures

The modern economy is not limited to straightforward deals. While these simple transactions are still common enough across the nation, 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 GFE and HUD-1, but the HUD-1 must clearly describe who the players are and what other players were in the deal.

Penalties

RESPA is not generally 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 federal and state agencies. Authorized private causes of action under RESPA entitle a successful plaintiff to attorneys' fees. However, the amounts involved may be so small that the borrower may go to small claims court.

The regulations deem certain activities to be violations of the statute. These include failure to follow any of the requirements that we have set forth earlier. 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 the 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. It seems clear that violations would be so clear that any solvent lender would take advantage of the opportunity to cure harmlessly within the allotted thirty 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 there is a kickback scheme, 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 for quite a few years now.

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

Discounts

The new RESPA regulations are very strict on the subject of discounts. While generally speaking, a lender can offer a discount, that is not true when it comes to new construction. At the heart of RESPA is the concept of genuineness. Therefore, in its layout of the new regulations, HUD wanted to make sure that smoke and mirrors vanished from these transactions. Therefore, the regulations are so structured that a lender that is claiming to give a discount cannot create an offsetting fee somewhere else so as to make the 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. What is forbidden is that the service provider kicks back to the lender anything more than the lender's equity interest in the service provider if, in fact, there is an ownership interest of the provider by the lender.

There is no requirement that the GFE sets forth any particular number of recommended vendors. However, it must set forth what if any relationship it has with the vendors it recommends and to what extent it has in the recent past recommended those vendors. The old rules had no requirement for any such disclosure.

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 figure out what the bottom line of the loan expense is to be. Whatever legerdemain there may be in arriving at the figures, under the new RESPA regulations, the total loan cost shows up loud and clear.

Brokers' Complaints

Under the newly revised GFE, mortgage brokers who have no affiliation with the actual 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" or "YSP." However, the 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 real life consumers would treat the various proposed

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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, not the 100 percent the brokers would want.

Conclusion

While 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 thing right. They put much into studying how consumers would react to the new forms and rules in the real world and it appears that the work was well worth the effort. For some, it will take some work to get accustomed to the new honesty, but rather like for controls on the securities industry, it had become long obvious that it was not a good idea to simply leave people to their own devices.

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Endnotes:

[1] HUD News Release, 11/12/2008.
[2] We refer the reader to 24 CFR 3500 for all the specifics of the new regulations to which we allude.
[3] HUD News Release, 11/12/08.
[4] 608 F.Supp.2d 330 (EDNY 2009).
[5] *Cohen v. JPMorgan Chase & Co. et ano*, 608 F.Supp.2d 330 (EDNY 2009).
[6] HUD website section: "More on RESPA." http://www.hud.gov/offices/hsg/ramh/res/respamor.cfm.
[7] 12 U.S.C. 2607(d)(4).
[8] 2009 WL 2259085 (D.D.C. 2009).

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