

American Dream or Procedural Nightmare

HUD Proposes Homebuyer Bill of Rights Designed to Empower Purchasers

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While owning a home is the "American dream," the process of purchasing one can become a nightmare. In a sympathetic response to the expense and hassle increasingly experienced by homebuyers, the Department of Housing and Urban Development (HUD) recently published proposed rules that would amount to a Homebuyer Bill of Rights.

This Bill of Rights would reform the regulatory requirements under the Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. 2601, by supplying homebuyers with greater and more timely information in the nature and costs of the settlement process and with protection from unnecessarily high settlement charges that have developed over the years in the residential real estate industry.

EMERGE MORTGAGE BROKERS

At the time RESPA was enacted, single-family mortgages were mainly originated and held by commercial banks, savings and loan institutions and mortgage bankers. In the 1980s, however, mortgage brokers, with the rise of secondary mortgage market financing, began competing with these traditional loan originators. Typically, mortgage brokers render retail lending services, including counseling borrowers on loan options, collecting application materials, ordering required reports and assembling information required to consummate the home purchase. As such, mortgage brokers are generally viewed by borrowers as shopping on their behalf. This impression frequently deters borrowers from doing their own shopping for a loan originator and for other required settlement services that best meets their needs.

Mortgage brokers are paid for their services either directly by the borrower, indirectly



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by the lender or wholesale lender who purchases the loan or by a combination of both. Over the past decade, there has been litigation concerning the legality of indirect fees to mortgage brokers. Most courts have followed the HUD's finding that the legality of these fees turn on whether the total compensation to the mortgage broker is reasonably related to the total value of the services actually provided to the borrower.

DISCLOSURE REQUIREMENTS

HUD has not revised the current disclosure requirements under RESPA in decades. The backbone of the disclosure requirements are the Good Faith Estimate (GFE) and HUD-1/1A forms. The current GFE contains a list of approximately 20 common settlement charges that the borrower is likely to incur at settlement and provides a place for the amount or range of each charge. The HUD-1/1A discloses these charges in major categories at settlement.

Current rules require the loan originator to provide the GFE to the borrower shortly after the borrower applies for the loan. In practice, loan originators frequently direct the borrower to fully complete the loan application and pay a significant fee covering the cost of a property appraisal and credit check before the borrower receives the GFE. In most cases, by the time the borrower receives the GFE, he or she has already selected that loan originator, paid the fee, and feels invested — making it highly unlikely he or she will

choose another loan originator or other third — party settlement service providers.

To make matters worse, when the borrower receives the GFE after applying for the loan, the estimated settlement cost information is often unreliable and usually proves to be lower than originally estimated. By requiring a long listing on the GFE of each estimated settlement charge, the current rules not only fail to adequately highlight the major costs incurred at settlement, but also lead to a proliferation of charges without any actual increase in the work performed. For example, the current rules encourage loan originators to charge for several separate services — loan origination, document review and document preparation. It is sometimes difficult for the borrower to understand the explicit purpose for each of the services provided by the same loan originator. The same holds true for title and other third-party settlement service providers. As a result, it is common for these service providers to increase profits by charging "junk" fees for services that have little or no value in relation to the charge.

While the current rules require that a GFE be made in good faith and bear a reasonable relationship to the charge the borrower is likely to pay at settlement, they do not establish any bright lines to assure that there is, in fact, a reasonable relationship between these estimates and ultimate costs at settlement. Under the rules, charges on the GFE are to be disclosed as a dollar amount or range. RESPA contains no sanctions for an inaccurate or incomplete GFE, or even for the outright failure to provide a GFE to the borrower.

PROPOSED RULES UNDER RESPA

Disclosing Mortgage Broker's Role and Associated Fees

The proposed rules fundamentally change the way in which mortgage broker's services

and fees are disclosed and represented. Unlike the current disclosure requirements, which fail to adequately direct the borrower's attention to the amount that the mortgage broker actually charges, the proposed rules require that any payment the mortgage broker receives from a lending institution be reported on the GFE as a lender payment to the borrower. The proposed disclosure rules also require mortgage brokers to make clear, at the outset, the maximum amount of compensation they could receive from the mortgage transaction, and include that amount in the GFE. Under these rules, mortgage brokers would thus be unable to increase their compensation without the borrower's knowledge.

The proposed rules clarify the mortgage broker's role. Mortgage brokers would be obligated to advise borrowers that they do not offer loans from all funding sources and cannot guarantee the best terms available in the marketplace. The new GFE would also require mortgage brokers to describe their services and disabuse borrowers of the notion that they are their agent, an impression that can lead borrowers into believing that mortgage brokers are acting in their best interest, and prevent them from shopping for the best deal on settlement services.

Improving HUD's Good Faith Estimate Settlement Cost Disclosure

The proposed rule makes the GFE firmer and more useful for shopping purposes. First, the proposed rules limit the fees that mortgage brokers may charge borrowers at the loan application stage. Under the proposed rules, borrowers need only provide basic credit information and the address of the property to be secured by the mortgage, and mortgage brokers would be prohibited from charging borrowers any significant fee to receive a GFE. The GFE would be

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ment relied on a Michigan case involving a hotel and its guest's reasonable expectation that its hotel charge would be used to cover the hotelier's expenses, including the purchase of insurance. Thus, the land-

would be needed because it will be implied as a matter of law. Subrogation is an equitable remedy based on the common law concept that the burden for ultimate discharge of

the by the tenant, the tenant is a co-insured even though it is not expressly named in the policy.

Pennsylvania has yet to make a clear state-

less of the express terms of its own policies, the insurer may have more insureds than it originally envisioned, *probably* not the insurer's "actual" intent.

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conditioned on the borrower's credit approval following the final underwriting and appraisal of the property. The fees paid by borrowers for the GFE would be for the cost of generating the GFE itself and would exclude amounts used to defray the cost of subsequent settlement services. This provision would encourage shopping and lessen the likelihood that fees for the GFE are unearned. Second, the new GFE would group and consolidate all fees and charges into major settlement cost categories. This approach would discourage loan originators and other settlement service providers from conjuring up a long list of junk fees merely to increase profits. Third, the revised GFE would aid in shopping after the application stage by requiring loan originators to distinguish those third party settlement services that have been selected by the loan originator and are required and those that the borrower may shop independently. The proposed rule would allow borrowers to shop for these services even after the borrower has selected the loan originator. Fourth, the proposed rules would allow loan originators to offer

package arrangements with third party settlement service providers. This proposal would lower prices for borrowers to close the mortgage transaction. Fifth, the proposed rule would require loan originators not to exceed the amounts reported in the GFE by more than 10 percent, absent unforeseeable and extraordinary circumstances, for their total compensation, third party settlement services and government charges through settlement. The inclusion of these tolerances ensures that borrowers can either find prices within the estimates in the marketplace or come back to the loan originator for help identifying service providers who will accept those estimates, thus injecting discipline into these estimates while providing a margin for unforeseeable and extraordinary market fluctuations.

REGULATORY BARRIERS

The proposed rules would also remove regulatory barriers to making available to borrowers packages of settlement services and mortgage loans.

Section 8 of RESPA specifically prohibits any payment for the referral of business, kickbacks, splits of fees and unearned fees in connection with mortgage transactions. Settlement service providers are thus prevented from offering these package arrangements and from drawing on their vast knowledge of the marketplace at the expense of borrowers. HUD believes that package arrangements would increase competition between settlement service providers, dramatically lowering the cost of closing mortgage transactions in the future.

To establish these objectives, HUD pro-

poses a carefully defined safe harbor under RESPA for Guaranty Mortgage Package (GMP) transactions. Any entity may qualify for the safe harbor as long as it offers a GMP. The packager must offer the GMP to the borrower after the borrower submits the loan application, but before the borrower pays any fee to the packager. Among other things, the GMP must include: (1) a price for a comprehensive package of loan origination and all other settlement services required by the lender to close the mortgage; (2) a mortgage loan with an interest rate guarantee; and (3) a written offer to guarantee the price for settlement services and the interest rate of the mortgage loan through settlement. The written offer would describe the package as including all services required by the lender to close the mortgage but would not itemize the specific services to be provided. The packager would, however, be required to inform the borrower of all settlement services which are excluded from the package.

In all, HUD believes that the "homebuyer bill of rights" will require greater disclosure, allow borrowers more choice, limit excessive settlement fees and encourage competition in the marketplace. These reform measures, if enacted, will help keep the American dream from turning into a procedural nightmare.

HOMEBUYER BILL OF RIGHTS

Under the proposed "homebuyer bill of rights" homebuyers have the right:

- To receive settlement cost information early in the process, allowing the homebuyer to shop for the mortgage product and settlement services that best meet their needs;

- To have the disclosed costs be as firm as possible, thereby avoiding surprises at settlement;

- To benefit from new products, competition and technological innovations that would lower settlement costs;

- To have access to better borrower education and simplified disclosure; and

- To know they are protected through vigorous RESPA enforcement and a level playing field for all industry providers.

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