

FEDERAL STANDARD ABSTRACT

TITLE NEWS

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Title News

New HUD Rules Coming into Effect on January 1, 2010

I. Introduction

The U.S. Department of Housing and Urban Development (HUD) has issued new rules implementing the Real Estate Settlement Procedures Act of 1974 (RESPA) which will come into effect on January 1, 2010. The new rules introduce substantial changes in residential real estate closings. HUD estimates that by the transparency and accountability brought upon by these new rules every residential mortgage borrower will save approximately \$668 in closing costs.

II. The New Good Faith Estimate

II.a. Overview of the Good Faith Estimate

The centerpiece of the new rules is the introduction of a detailed Good Faith Estimate (GFE) and the requirement that it be honored through the closing. The current rules merely call for a GFE without much regulation. As a matter of fact, GFEs today are usually a one-page printout with a list of fees and sometimes a description of the terms of the loan -i.e. interest rate, term, monthly payment, whether it is

adjustable and whether there is a prepayment penalty. The new GFE is a three-page form that calls for all these items in addition to providing new tools for consumers to evaluate loans. The reader is strongly suggested to read the following paragraphs with copies of the new GFE and the HUD-1 Settlement Statement (HUD-1) forms ready at hand in order to follow the explanation. Copies of these new forms and other explanatory documents can be obtained at http://www.hud.gov/offices/hsg/ramh/res/respa_hm.cfm.

II.b. Variations between GFE and Charges at Closing

After describing the terms of the loan on page 1, page 2 of the GFE addresses the closing costs or "settlement charges." The charges are divided into three tiers: (a) charges that cannot change; (b) charges that may change up to 10%, and (c) charges that may change. All charges payable to a lender or a mortgage broker may not change. Lenders and brokers are expected to commit to the amounts listed on the GFE. Transfer taxes must also be disclosed and may not change.

Charges that may change up to 10% are services required by the lender,

but that are provided by a third-party chosen by the lender or the mortgage broker. Typical examples include: title charges (not just title insurance, but also every item required by the lender, such as municipal searches, endorsements, or special searches), government recording charges, flood certification, tax service fee, credit report fee, attorney closing fees, and appraisals. Charges that may change altogether are charges that are required by the lender, but provided by a third-party chosen by the borrower, and not from a specific list of providers approved by the lender. Therefore, whether title charges, appraisal fees, or survey fees -for example- may change up to 10% only or may change altogether depends on who hired the provider. If the provider is chosen by lender (or by the borrower from the lender's list), then the final charge may only vary up to 10% from the fee quoted on the GFE. If the lender allows the borrower to hire her own provider, the lender takes no responsibility for variations between the GFE and the fee at closing. The short-term interest and the initial escrow deposit for real property taxes and homeowners insurance may also change completely from the GFE as they depend on the timing of the closing.

II.c. Description of Charges

Another innovation in the GFE is the description of the charges. Currently, a GFE lists numerous fees owed to the lender, the broker and the title company, with descriptions such as "Application Fee",

"Processing Fee", "Administration Fee", "Underwriting Fee", "Doc Prep Fee", "Courier Fee", etc. The new rules take the position that administrative fees (such as the examples just given) may not be listed separately. Rather, all administrative fees payable to the lender or the broker are to be rolled into the "origination charge", and all title fees required by the lender are to appear as one figure, or not be charged at all. The point is to provide comprehensive figures to aid the borrower in comparing quotes from different lenders. As will be shown below, this way of presenting charges is to be observed in the HUD-1 as well. The Title insurance premium for Owner's coverage may be listed separately as it is not required by the lender.

II.d. Yield Spread Premiums

The last innovation on the GFE appears on page 3 and addresses Yield Spread Premiums (YSP). YSPs are monies paid by the lender on the borrower's behalf to a mortgage broker for procuring the loan. It is not a referral fee. RESPA prohibits the payment of referral fees in connection with mortgage loans covered under it. The YSP is a way to finance fees otherwise charged to the borrower at closing: instead of charging the borrower, say, 1% (i.e. 1 point) at closing, the lender pays the 1%, and charges the borrower a slightly higher interest rate. The payment by the lender to the broker is called YSP; i.e. it is the "spread" between the rate the lender was willing to offer and what the borrower agreed to pay.

The HUD report casts doubts as to whether the YSP is a useful tool for financing broker's fees or whether it has degenerated into a referral fee. Page 3 of the GFE introduces the "tradeoff table" to shed light into YSPs. The "tradeoff table" shows three columns for comparison: (a) the loan described on the GFE, (b) the same with lower settlement charges, but higher interest rate and monthly payments, and (c) the same loan with a lower interest rate and monthly payments, but higher settlement charges. The implication is that by comparing the cost and benefit of paying more at closing and obtaining a lower rate, the borrower can easily identify what she is getting for the YSP. The borrower will be able to see whether it is to her benefit to pay broker's fees at closing, or whether to let the lender pay the broker and raise the interest rate accordingly.

II.e. Issuing Procedure and "Changed Circumstances"

Lenders and mortgage brokers have a duty to issue a GFE within three days of receiving sufficient information from the prospective borrower to prepare it. Before the GFE is issued and accepted, the lender or broker may not charge any fees, other than a credit report fee. Once issued, the GFE must be honored for at least ten days by the lender or broker. If it is then accepted by the borrower, it may not be amended, except under "changed circumstances." Examples of the latter include Acts of God, war,

disasters, and new or changed information regarding the borrower's credit quality, the value of the property, environmental problems, flood insurance, or title disputes.

III. The New HUD-1

III.a. Listing Charges on the New HUD-1

The new rules also introduce a new HUD-1 form which is three pages long. The first two pages look very much like the current HUD-1, but work rather differently. The idea introduced in the GFE that no party may list administrative fees applies to the HUD-1. No courier fees, administrative, doc prep, processing or underwriting fees may appear on the HUD-1, regardless of whom they are payable to. The HUD-1 should generally be filled-out using only the available fields (i.e. the available lines with their pre-printed descriptions) for charges payable to the lender, the mortgage broker or for providers chosen by the lender. Charges payable to parties hired by the borrower can be listed in the 1300 series and even on an additional addendum page.

In addition, the practice of listing every item on the borrower's column has changed. HUD now requires that every payee only appear once in the HUD-1. For example, line 801 may disclose the origination charge and line 802, the credit or charge for points. But only the result of adding these two figures is to be shown in the column of borrower's funds, in line 803. Similarly, specific title charges may call for disclosure, such

as “closing fee” in line 1102, or “lender’s title insurance fee” in line 1104, but all title and closing fees are to be disclosed in one lump sum in line 1101. Lines showing a preprinted “\$” sign are to be used for required disclosures, and only lines without the “\$” sign are to be used for figures on the borrower’s column.

These instructions carry many implications. In the first place, the pre-printed lines are to be used as pre-printed, which means that the numbering becomes relevant. The fee due to the lender will now always appear on line 803 (“Your adjusted origination charge”), the fee due to the title company will always be on line 1101 (“Title services and lender’s title insurance”), and total recording fees will appear on line 1201 (“Government recording charges”). Second, charges that have a pre-printed line with a “\$” must be filled-in for disclosure purposes. Notably, the HUD-1 must disclose the “agent’s portion of the total title insurance premium” (line 1107) and the “underwriter’s portion of the total title insurance premium” (line 1108). Third, charges required by the lender that do not have a pre-printed line may not be itemized, unless the provider is chosen by the borrower. There is no line for municipal or bankruptcy searches, nor a line for “notary fees” or “title closer fees.” These fees may not be itemized on the HUD-1, but this does not mean that they cannot be charged. It appears that they should be added in the lump sum due to the title company in line 1101, and possibly added to the bank

attorney’s fee and listed in line 1102 as well.

III.b. Cross-reference Tools

The new HUD-1 contains cross-reference tools to spot differences in charges from the GFE. First, the terminology of the charge in both documents must be the same. That is one of the reasons why the descriptions on the pre-printed lines may not be edited. Second, the specific lines in the HUD-1 contain references by number to the appropriate box in the GFE. For example, lines 801, 802 and 803 contain the references GFE #1, GFE #2, and GFE A, respectively, which are the boxes that quote the same item on the GFE.

The last tool for detecting differences from the GFE appears on the third page of the HUD-1. It is a chart, to be filled out by the settlement agent with information provided by the lender, organizing all charges in the three tiers (i.e. charges that cannot change, that may only change up to 10%, and that may change completely) and disclosing what each charge was on the GFE and what the final charge is on the HUD-1.

IV. Variations from GFE to HUD-1, Consequences and Tolerance

In the event charges vary between the GFE and the HUD-1 beyond what is allowed, the lender must correct the HUD-1 and reimburse the borrower for any discrepancies between the HUD-1 and the GFE within 30 days of closing. It appears

that the lender is obliged to make the reimbursement even if the charge that caused the discrepancy was not payable to the lender.

V. Potential Conflicts with New York Practice

V.a. Introduction

Needless to say, the new HUD-1 rules have been sanctioned for the entire nation. However, it is no secret that New York practice varies with that of most other states. In this section we will attempt to identify and answer potential conflicts of the new HUD rules with our local practice.

V.b. Where Do We List the Bank Attorney's and the Title Closer's fees?

In most of the nation, there are no bank attorneys in residential transactions. Their role is carried out by a settlement company (usually a division of the title company) or by the borrower's attorney. Hence, the nationwide new GFE and HUD-1 do not provide a specific line or box for the bank attorney, even though it is a service obviously chosen by the lender (or from its list) and charged on the borrower. It appears that the bank attorney's fee would be best added to the title company's fee and charged in GFE box #4 and HUD-1 line 1101, "title services and lender's title insurance." The GFE, page 2, box 4, describes this charge as including "the services of a title or settlement agent, for example, and title insurance to protect the lender, if required." The fee would further

have to be itemized in HUD-1 line 1102, "settlement of closing", which line would also have to be used to disclose the title closer's pick up, as there is no other line for "closing fee." The only objection to this approach is that this would result in a lump sum disclosed in line 1101 to be distributed to three parties: title company, title closer and bank attorney. Similarly, line 1102 would show a lump sum for the bank attorney's fee and the title closer's fee added together. This could be a violation of the HUD rules, since the HUD-1 should disclose exactly how much is party is collecting.

V.c. Survey Fees

Surveyors, as they are typically hired by the borrower, could be listed in the 1300 series, as a service required for the lender but that the borrower may shop for. As a service hired by the borrower (and not from the lender's approved list), the fee can vary from the GFE without consequences.

V.d. The Mortgage Recording Tax

Unlike the vast majority of states, New York imposes a well-known mortgage recording tax. The question here is whether this should be disclosed as a charge that may not change, or as a charge that may change up to 10%. "Transfer taxes" are listed as charges that may not change, but "government recording taxes" may change up to 10%. It appears that it would be more appropriate to show the mortgage tax as a charge that cannot change because the description of "transfer

taxes” on the GFE, page 2, box 8, reads “These charges are for state and local fees on mortgages and home sales” (underlining added). The drafter of the form may have been aiming at the mortgage recording tax. The draft might have been under the assumption that the tax accrues for the act of *making* a mortgage, as opposed to for *recording* it.

The greater problem with the mortgage tax, at any rate, is not its classification but its calculation. Nowadays, different counties and cities in the state have different mortgage tax rates. More importantly, the nuances of the New York City mortgage tax are a trap even for seasoned title companies and attorneys (mortgage tax aggregation, negative amortization, and different rates for commercial and residential properties and loan amounts come to mind). Lenders and mortgage brokers issuing GFEs in New York City and strongly recommended to contact us before to calculate the appropriate mortgage tax. Besides, how can HUD reasonably expect lenders and mortgage brokers to calculate the mortgage tax and recording fees accurately in mortgage assignments and consolidations?

V.e. Other Fees in Need of Classification

Our New York practice runs into many fees that cannot be easily classified under the new HUD rules. We can only present the issue, but we cannot even present a possible solution at this point. For example,

in an assignment of mortgage, how is the fee due to the payoff lender and its attorney to be classified? As a third party hired by the borrower? But then again, there is only one provider and the assignment is required by the lender, or the mortgage tax quote on the GFE will be wrong. How about all fees due to coops and their attorneys? The borrower cannot shop for providers here, but the lender has no control over the coop fees.

VI. Conclusion

The ideas introduced by HUD are interesting and may result in overall savings once they are implemented. However, the cost of implementation cannot be disregarded. In New York, this is all the more important because our local practice appears to differ substantially with nationwide standards. Some questions, such as how to disclose the bank attorney’s fees in the GFE and HUD-1, have no reliable answer as of yet. Payments to the title closer (traditionally considered a gratuity and not a fee), as well as miscalculations of the mortgage tax and the mansion tax can easily result in inadvertent variations from the GFE. In order to avoid variations between the GFE and the HUD-1, lenders will find themselves working with title companies and bank attorneys from the very beginning to ensure the GFE issued is as accurate as possible.

VII. *Further Reading*

This article does not purport to be a full explanation of the new HUD rules. This article merely points to the highlights of the rule that we have identified. HUD has issued a comprehensive FAQ, which can be found [here](http://www.hud.gov/offices/hsg/ramh/res/respa_hm.cfm): http://www.hud.gov/offices/hsg/ramh/res/respa_hm.cfm. The document referred in this article as the "HUD report" is entitled "Regulatory Impact Analysis and Initial Regulatory Flexibility Analysis FR-5180-F-02" and can also be found at that website. In addition, HUD is expected to issue

a new set of instructions regarding how to use the new HUD-1 (and possibly also the new GFE), which would replace the current Appendix A to Part 3500 of the pre-2010 rules. In addition, the Office of Thrift Supervision has announced that it will issue revisions to its examination procedures to incorporate the new HUD rules before they become effective. The OTS's procedures are very important because it will disclose how it will check for compliance with the HUD rule by banks supervised by the OTS (i.e. by federally-chartered banks and federal savings and loan associations).

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