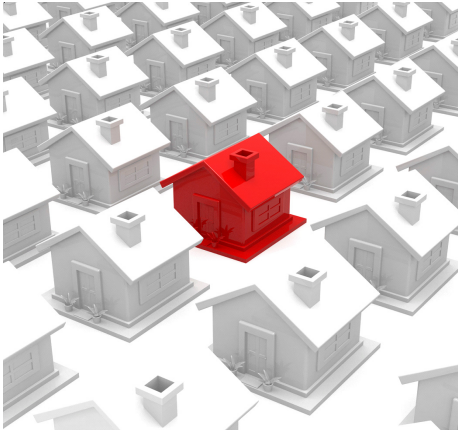




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HUD Issues New Rules Requiring Good Faith Estimate of Loan Costs

On November 12, 2008, the U.S. Department of Housing and Urban Development ("HUD") issued a long-anticipated Final Rule amending the regulatory framework of the Real Estate Settlement Procedures Act ("RESPA"). This Final Rule, the first change in RESPA settlement procedures in more than 30 years, requires lenders and mortgage brokers to provide borrowers with a Good Faith Estimate that clearly discloses key loan terms and closing costs.

In conjunction with the Final Rule, HUD also issued a standardized Good Faith Estimate form and a revised HUD-1 Settlement Statement form. The use of these forms will become mandatory on January 1, 2010. The entire Final Rule, complete with HUD commentary, can be found at <http://www.hud.gov/offices/hsg/sfh/res/finalrule.pdf>.

HUD initially proposed these changes in March of 2008, which was HUD's latest attempt at controversial and widespread revisions that have been brewing for over a decade. HUD received and considered over 12,000 comments to the proposed rule, mostly focused on the complexity of the Good Faith Estimate and the ultimate burden on lenders and benefit to consumers. Industry groups maintain the Final Rule is still deficient in many respects, arguing that because it may overlap with regulations issued by the Board of Directors of the Federal Reserve under the Truth in Lending Act, it creates the possibility of conflicting and ambiguous requirements for lenders and brokers that may need to be addressed with further changes that may in turn increase compliance costs for lenders and brokers. Consumer advocates also maintain the Final Rule is deficient, although for different reasons. They argue that it fails to stop some incentives, such as yield-spread premiums, for risky lending practices that contributed to the current problems in the mortgage market. Consumer advocates argue that the Final Rule also fails to address the most basic need for consumers — helping them determine whether they can actually afford a loan.

Under the Final Rule, loan originators will be required to provide borrowers with a Good Faith Estimate three days after the loan originator's receipt of all necessary information. Although the ultimate responsibility for providing the Good Faith Estimate falls with the lender, the lender need not provide an additional Good Faith Estimate if one was provided by a mortgage broker.

Loan originators must collect, at a minimum, the potential borrower's name, Social Security number, gross monthly income, property address, estimated value of the property, and amount of the proposed mortgage loan. The originator may also request any additional information it believes is necessary to issue the Good Faith Estimate. To prevent overly burdensome documentation demands and to facilitate loan shopping, the loan originator may not, as a condition to issuing a Good Faith Estimate, require supplemental or verifying documentation. For example, although the originator can (and must) have the borrower's gross monthly income in order to issue a Good Faith Estimate, the originator may not request that the borrower verify that information with pay stubs or tax returns before issuing the Good Faith Estimate. The loan originator may request such information only after the formal application process has begun.

As with revised regulations governing Truth in Lending disclosures (found at 12 C.F.R. 226.119(a) — July 30, 2008), loan originators may not charge a fee before issuing a Good Faith Estimate except in connection with the cost of obtaining the buyer's credit report. This means that the buyer may not be charged any appraisal or inspection fees before the Good Faith Estimate is issued.

The Good Faith Estimate itself requires the loan originator to disclose an abundance of information, all with the intent of helping consumers shop for the lowest-cost loan. That information includes the interest rate and the timing and cost of the interest rate lock; estimated cost of all settlement charges, including title insurance and recording fees; and the loan terms, including the amount, term, origination fees, estimated monthly payment, whether the rate is variable or fixed, and whether there is a prepayment penalty or balloon payment. The interest rate must be available to the consumer until the date disclosed on the Good Faith Estimate (which date is determined by the loan originator), and settlement charges and other loan terms must be available for up to 10 business days after the estimate is provided. A sample of the standardized Good Faith Estimate can be found at <http://www.hud.gov/content/releases/goodfaithestimate.pdf>.

One of the most significant requirements under the Final Rule is the addition of a meaningful disclosure of yield-spread premiums or other payments made to mortgage brokers that are directly based on the rate of the borrower's loan. In response to concerns that such disclosures would create a consumer bias against mortgage brokers and as more specifically detailed in the commentary to the Final Rule, HUD conducted what it called "rigorous testing" and concluded that the Good Faith Estimate helped consumers choose the lowest-cost loan nine out of 10 times, regardless of whether it was originated by lender or a broker.

Since the purpose of the Good Faith Estimate is to help consumers make informed decisions, loan originators have an express obligation to provide accurate information up front. Thus, the final cost and terms of the loan and closing process must reflect the original Good Faith Estimate, except under certain specific circumstances. In particular, the following information may not be changed once it has been disclosed on the Good Faith Estimate: the loan origination fee, the credit or charge (points) for the applicable interest rate, the adjusted origination charges (after interest rate lock), and any government-imposed transfer taxes or conveyance fees.

In contrast, the total estimated settlement costs may increase by up to 10 percent in the aggregate at settlement. These costs include fees for required services (such as appraisals), the providers of which are selected by the lender or selected by the borrower from a list of lender-approved providers; title services and title insurance (including the cost of any owner's or lender's policy of title insurance); and government recording charges.

A third class of charges may change without limit at settlement — services, such as title insurance, rendered by providers not identified by the lender. The initial deposit for the borrower's escrow account, daily interest charges and the cost of homeowner's insurance may also change without limit.

Notwithstanding the foregoing limits, the lender may, under what this regulation refers to as "changed circumstances," issue a revised Good Faith Estimate with terms related to the loan or settlement costs that supersede the original Good Faith Estimate. HUD defines "changed circumstances" as acts of God, war, disaster, or other emergency; information provided by the borrower and relied upon in providing the Good Faith Estimate that later proved inaccurate; and other circumstances that are particular to the borrower or transaction, including boundary disputes, the need for flood insurance, or other environmental problems. "Changed circumstances" do not include market price fluctuations or changes in the minimum required information stated above (such as the

borrower's income or credit report) unless it is determined such information was inaccurate at the time it was initially provided by the borrower. If a revised Good Faith Estimate is provided, the reasons for doing so must be documented, and the documentation must be retained for three years.

The rule also adds a page to the HUD-1 Settlement Statement. That page facilitates a comparison between final closing costs and loan terms with those listed on the estimate. To help borrowers compare their Good Faith Estimate with the final settlement statement, each designated line in the revised HUD-1 will now include a reference to the relevant line from the Good Faith Estimate. HUD estimates that, by improving these upfront disclosures and limiting the amount estimated charges can change, consumers will save, on average, nearly \$700 in total closing costs.

HUD has also provided a grace period during which lenders and settlement service providers may correct actual or potential violations of RESPA's new disclosure and tolerance requirements. Lenders and settlement service providers will now have 30 days from the date of closing to correct errors or violations and repay consumers any overcharges.

This Final Rule represents a substantial change in the regulatory environment surrounding mortgage loans and the settlement process. In addition to the significant changes that lenders and brokers will need to make to their loan application process in order to ensure full compliance with the Good Faith Estimate requirements, there will be many practical business arrangements that will have to be made. For example, the lender is bound by the cost of settlement services represented in the Good Faith Estimate (as modified by the 10 percent tolerance limit), but these are not costs that the lender can necessarily control. Prior arrangements or understandings with settlement service providers may be necessary to ensure that the lender is representing a fair and accurate estimate of those costs. Although the use of the Good Faith Estimate and new HUD-1 is not mandatory until January of 2010, given the extent to which this Final Rule promises to impact the mortgage lending business it would be advisable for lenders and brokers to begin analyzing current procedures against the new regulations and implementing the necessary changes as soon as practicable.