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Tax and Legal Update

RESPA Reform – the Good, the Bad, and the Confusing

This series of articles (the first, "Revisiting the FHA Anti-flipping Rule," was featured in the May 2010 issue of *MOBILITY;* the second, "Short Sale Clawback Provisions," can be found in the August 2010 issue) examines three developments that relocation professionals should be aware of to ensure a successful real estate closing.

After years of discussion and a one year implementation period, the key provisions of HUD's RESPA Final Rule went into full effect on January 1, 2010. The most important aspects of the rule are the new Good Faith Estimate (GFE) and HUD-1 Settlement Statement and a system of tolerances limiting the amount by which certain costs estimated on the GFE may increase at closing. These changes are intended to help enable borrowers to compare loan offers between lenders and better understand the terms of their loan and various settlement costs. While this certainly will be a benefit to transferees on their destination home purchases, the eccentricities of the new forms complicate the process of determining which costs fall within reimbursement policies, and the tolerance system will introduce additional burdens on already cautious lenders.

Under the old RESPA rules, lenders were required to issue a GFE within three days of loan application, but there was no proscribed format, so different lenders would disclose charges under various terminology and categories. This lack of uniformity made it difficult to compare how costs associated with a loan differed among lenders.

Further, if actual costs at closing were more than the borrower expected, it was no easy matter to make line-by-line comparisons between the GFE and HUD-1. The new forms are intended to rectify this situation. The new GFE introduces detailed categories of charges, such as "Our Origination Charges" and "Title Services and Lender's Title Policy." HUD has given very specific guidance on which charges are included in each category and, in most cases, they may not be broken out into further itemization. This approach continues with the new HUD-1 Settlement Statement, which on many lines includes the same bundled categories of charges provided on the GFE. The settlement agent's ability to break out these categories into itemized charges is similarly restricted in the interest of providing borrowers simplified disclosures of the overall cost of a service.

HUD's approach to these new forms presents two problems for relocation service providers auditing the HUD-1 for expenses eligible for reimbursement. First, certain costs paid to the lender or title company may not be itemized on the HUD-1. They will be reflected in the aggregate total for "Our Origination Charge" or "Title Services and Lender's Title Insurance," but there will be no way to determine what services these costs are attributable to on the HUD-1 itself.

The second issue is that all charges listed on the GFE must be reflected in the borrower's column of the HUD-1, even if the seller actually will be paying for that service. This becomes a serious concern on destination transactions when the seller is paying for the owner's title policy, but the HUD-1 will show that cost in the transferee's column. There is a mechanism for reflecting who actually paid the charge on the first page of the HUD-1, but it will no longer be sufficient simply to look to a specific charge and quickly determine who paid for it. The solution for both of these problems will be some form of supplemental disclosure or fee sheet itemizing all necessary charges and accurately reflecting who is paying for each service. Closing agents are restricted in their ability to do such tasks on the HUD-1 itself, so it will be in everyone's best interest to communicate the need for this additional documentation as soon as possible.

The other key element of the new rule is a system of tolerances requiring the lender to reimburse the borrower if the actual costs for certain services quoted on the GFE exceed a set threshold. Each item on the GFE falls within one of three tolerance categories: costs that cannot increase at all; costs that in the aggregate can increase up to 10 percent; and costs that are not subject to any tolerance limit. There are circumstances when a lender can issue a revised GFE if they discover additional costs of which they were unaware at the time of issuing the GFE (e.g., power of attorney must be prepared and filed). However, if the tolerance is breached and the lender is unable to revise its GFE to reflect the additional expense, it will have to provide a credit to the borrower at closing or reimburse the excess within 30 days of closing. Because there will be instances where these payments are made to transferees outside of closing, it may be necessary to introduce tolerance-related concepts into reimbursement policies, to prevent duplicative payments. Further, this adds additional pressure to lenders, who now not only have to worry about loan quality but also whether tolerance reimbursements will cut into their origination fees. As business practices develop, it will be important to watch their approaches to controlling price accuracy through preferred vendor arrangements, indemnification agreements, and other creative avenues.

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