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RESPA REDUX: What You Don't Know Can Kill Your Closing

A Really Bad Hangover

The metaphysical morning after the two-year banking industry toga party ended, the residential real estate landscape was littered with casualties. Out-of-control foreclosures, banks going belly up, hulking condo towers lying vacant and housing inventory increasing like the gusher in the Gulf. In short, the banks had a “lending problem” and Congress was arranging an intervention.

A Twelve-Step Program for Lenders

With a view towards protecting consumers from unscrupulous lenders, and in many ways, from themselves, Congress enacted significant changes to the Real Estate Settlement and Procedures Act, known in the trade as “RESPA”. The thrust of the legislation is to bring greater transparency and accuracy to the disclosure of closing costs that a buyer will incur in connection with the purchase of a residential property. The centerpiece of the revised statute is an overhaul of a formerly innocuous document called the Good Faith Estimate or “GFE”. In the past, the GFE was given to the borrower soon after the application, with a list of all costs that the borrower would incur in connection with the loan and with the transaction in general. In many cases, the GFE was a work of fiction and borrowers often incurred costs not on the GFE or costs far in excess of the amounts reflected on the document. Even lenders far from the world of the subprime predators, often misstated items on the GFE,

sometimes accidentally, sometimes not. However it happened, a mistake on the GFE rarely caused a closing not to happen. As mentioned, the party's over and so is providing the consumer with an inaccurate GFE.

Get Out Your Calculators

At a recent illuminating CLE program at [American Land Services Dan Shlufman](#), a mortgage broker and attorney, outlined the many technical changes to the loan initiation and closing process that will no doubt cause some number of loans not to fund and closings not to take place. The federal government has imposed a no tolerance policy for mistakes in the disclosure of many closing costs, such as mortgage broker and lender fees, various title charges and transfer taxes payable by the borrower (the "mansion tax" in New York). The GFE, which was once a one page throw away that no one studied very closely, is now a four-page document that must be prepared and reviewed with extreme caution. As a result of changes in the law, understating costs on the GFE can have disastrous results. Mistakes in basic information, such as the borrower's name or annual income, can be cause for withdrawal of the loan approval, resulting in resubmission of the loan to underwriting. Further, when costs are understated by mortgage brokers and title companies, someone will have to absorb the excess costs to keep the transaction alive. The key take away is that the GFE, now submitted to the borrower three business days after the date of the borrower's loan application, must be prepared accurately and reviewed by the borrower's attorney before it's signed. Mistakes on this document can be fatal to the transaction.

Taking the HUD Seriously

The story goes that years ago, after Senator Proxmire's daughter was overcharged on fees at a closing, federal legislation was enacted requiring the parties to execute a "Settlement Statement" in which the money flowing into and out of the transaction by both seller and buyer was documented at the closing. Although the "HUD", as we call it, is an important document in many states, in New York City residential real estate transactions, the HUD isn't used unless a lender is involved in the transaction. In most cases, the lender's counsel prepares the HUD at the closing table while the parties sign the other closing documents. At the end of the closing, the parties quickly sign the HUD, handshakes are exchanged and the closing is completed. Although a few banks require the HUD to be submitted to the underwriter for approval before the closing is over, that procedure is the exception and not the rule. Well things are now changing...big time.

Review of the HUD Before Closing

Attorneys and their clients would be well advised to review the proposed Settlement Statement in advance of the closing, as the charges on the GFE and the Settlement Statement actually have to match. How refreshing. If the numbers on each document can't be reconciled, the bank may not fund the loan and the transaction may have to be adjourned to rectify the inconsistencies. As Dan Shlufman pointed out, under the revised statute, the borrower has the right to request the HUD one business day prior to the closing. It should become standard operating procedure to make that request, so that the Settlement Statement can be reviewed in advance to insure that the closing does not blow up (with all of the painful complications that always ensue when a transaction does not happen).

Financial Reform Will Impose More Restrictions

There are more changes on the way. The financial reform legislation, if enacted, will impact the residential lending market in many ways. Most importantly, stated income loans, affectionately known as “liar loans” will go the way of the Edsel. Mortgage brokers will also experience tighter controls on how compensation is calculated and limitations on the loan programs that can be recommended to borrowers. New York State has also amended the Banking Law to impose greater requirements for licensing of mortgage brokers as well as implementing a host of other lending disclosures and restrictions.

One More Fun Fact

As if the above changes were not enough, as pointed out by [Warren Goldberg](#), a mortgage broker, Fannie Mae is now requiring an updated credit report to be pulled in close proximity to closing to insure that no material adverse change in the borrower's credit has occurred since the initial loan application was submitted. Yet another cog in the closing wheel to increase honesty, accuracy and anxiety.

Residential Reality: The Pendulum Swings the Other Way

Considering the damage that was done as a result of loan origination gone wild, many of the recently enacted changes were inevitable and will offer greater protection for the consumer against inappropriate fees and inappropriate loans. Without a doubt, there are going to be some disappointments along the way, as robotic paper shuffling morphs into careful review of documents and greater accuracy. At the end of the day, it's for the best. For the folks in the trenches, however, it means more work and more responsibility. Another situation where measure twice and cut once applies with a vengeance...

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