

RESPA – More Is Not Better
Real Estate In-Depth October, 2008
By Edward I. Sumber, Board Counsel

Our office has handled thousands of residential real estate transactions over the 35 plus years in which this author has practiced law in the Hudson Valley. It is rare indeed that any client in those real estate transactions ever took the time to read through the mortgage documents, examine the good faith estimates, carefully reviewed a HUD-1 settlement statement or understood fully all of the nuances of his or her real estate transaction. I can remember and count a far greater number of attorneys, who sitting across the table, when asked by a client about the meaning of a particular document, could not adequately articulate its intent and meaning.

These statements introduce the arcane world of RESPA, enacted by Congress in 1974. “RESPA” stands for the Real Estate Settlement Procedures Act intended to protect consumers from abuse in residential real estate transactions. The Act requires lenders to disclose their practices, affiliated business relationships and the settlement costs to be incurred by consumers. In my experience, “RESPA” stands for glazed eyes and too much information.

What Does RESPA Cover?

Whenever a lender makes a federally related mortgage loan, whether it is a first mortgage or subordinate mortgage, i.e. a second mortgage, HELOC (home equity line of credit) or other subordinate lien involving residential 1-4 family properties, RESPA applies. The mortgage loans may relate to a home purchase, the refinancing of a mortgage, a lender approved assumption of a mortgage, home improvement loans, equity lines of credit and reverse mortgages.

Although there are transactions that are not covered such as farms on 25+ acre parcels, all cash transactions, sales in which a homeowner holds a mortgage or a rental or business transaction, the vast majority of residential transactions are touched by RESPA. Even timeshares, condominium units and cooperative apartment shares are covered under RESPA as long as they are not used for business purposes. Many individuals believe that RESPA only applies to federally sponsored loans such as the FHA and VA loans. That is not true. RESPA covers most conventional loans made through banks, mortgage brokers and mortgage bankers.

What Does RESPA Require?

In short, RESPA requires that a lender provide:

- a) A booklet published by the United States Department of Housing and Urban Development (“HUD”) entitled “Settlement Costs and You” to every person from whom they receive or for whom they prepare a loan application; and
- b) a good faith estimate of settlement costs (a “GFE”); and
- c) a HUD-1 uniform settlement statement prepared by the settlement agent (in New York it is usually the attorney for the lender) purportedly detailing all financial particulars of a transaction. Lenders are required to keep these statements for two (2) years after the date of closing unless the loan is sold in the aftermarket or its servicing is disposed of to another servicing bank or entity.

RESPA has significant provisions prohibiting the payment of kick-backs, unearned fees and improper compensation not fully disclosed to the consumer. These prohibitions do not include cooperation between real estate brokers or broker referral arrangements or the division of commissions between a principal broker and his or her sales personnel.

RESPA is administered by HUD. It applies to virtually everyone involved in the closing process, i.e. real estate brokers, mortgage brokers, lenders, title insurance agencies, appraisers, home inspection companies, attorneys, etc.

Prohibited Transactions

RESPA prohibits a lawyer, lender, real estate broker or other “settlement service provider” from “giving anything of value in exchange for referrals of business”. RESPA does not distinguish among different types of settlement providers. Any service in connection with a real estate closing including title certificates, title insurance, property surveys, credit reporting, pest and fungus inspections are all considered to be part and parcel of the loan transaction. Section 8 of RESPA also addresses affiliated business arrangements (AfBA’s). The goal of Congress in enacting RESPA in 1974 was to eliminate abusive practices that increase costs to homebuyers and also provide information to allow homebuyers to understand the settlement process and its costs.

An AfBA exists when an individual in a position to refer settlement services such as a real estate broker or a bank, has an affiliate relationship with or direct or beneficial ownership interest of 1% or more in an entity to which the business is referred. For example an individual who is a trustee of a bank (even though the individual does not own an interest in the bank) is considered to be an “associate” and must disclose to borrowers that her firm is compensated for and acts as the closing attorneys for the lender. Similarly, if an attorney refers title insurance business to a title agency in which the attorney has an ownership interest, the attorney must disclose the AfBA.

RESPA does not permit the direct payment to the referral source of compensation or “a thing of value” (a “thing of value” has been construed by HUD to include a donation to your favorite charity). Even when there is no ownership affiliation, a title company may not pay referral fees to attorneys; real estate brokers may not be paid or compensated for referrals of mortgage transactions; and title companies cannot be compensated by surveyors for referring business to the surveyor’s office.

Section 8(c)(4) of RESPA indicates that an AfBA is not a violation of Section 8 if a three part “safe harbor” test is applicable:

1. The AfBA owner referring business to the AfBA must provide a written disclosure on a separate sheet of paper to each consumer no later than the time of referral.
2. The customer must not be required to use the AfBA, in order to obtain the settlement services.
3. No payments other than a return on the ownership interest of the AfBA owner is permitted.

Industry Wide Confusion

The natural forces of the marketplace have created large and powerful lending institutions, title insurance companies and brokerage agencies. The industry trend is toward “one stop shopping”. RESPA has been the single greatest barrier to one-stop shopping. HUD, as regulator, has been inefficient in providing adequate guidance to the settlement services industries regarding what is permitted and what is not.

On July 9, 2007 the National Association of Realtors (“NAR”) sent a letter to General Counsel for HUD setting forth a series of specific questions, the answers to which would clarify what real estate agents can and cannot do. After 13 months, a response was submitted to NAR which not only does not respond to the specific questions posed, but rather, reflects long dissertations on the law and regulations. HUD’s response included the following statement:

“Some of the issues raised in your letter, however, would require responses developed through a more formal mechanism. HUD is committed to providing clear, more frequent, and more accessible guidance and information in the future, to both the various affected industries and consumer, about HUD’s requirements and expectations under RESPA. For those issues that you have raised that we cannot address through this letter and on our website as FAQ’s (frequently asked questions), HUD will consider responding in another format, such as through the issuance of statements of policy, rules or other formal guidance.”

A copy of the full response from the United States Department of Housing and Urban Development is available on the NAR website at http://www.realtor.org/fedistrk.nsf/pages/wk09082008?OpenDocument#report_1_09_08_2008. FAQ's about RESPA can be accessed at <http://www.hud.gov/offices/hsg/sfh/res/resindus.cfm>.

HUD Says the Consumer Needs More Information

Despite the reality that consumers glaze over at the massive amounts of paper involved in a real estate closing and have little understanding of the true meaning of the documents, HUD has pushed for the amendment of the RESPA Regulations despite objections by the industry. HUD submitted a proposal to overhaul the loan disclosure forms and change the rules governing settlement services. In response, a majority of the members of the House of Representatives, including 128 democrats, 113 republicans and 1 independent, signed an actual petition to the Department of Housing and Urban Development urging HUD to withdraw its proposed changes to RESPA and to work with the Federal Reserve on "simplified disclosure forms". The Congressmen signing the letter to HUD were concerned about information overload and pointed out that the RESPA Rules overlap the Truth in Lending Act and that it would be more desirable to create a simple form that would cover both laws.

HUD Responds

HUD Assistant Secretary Sheila Greenwood responded on August 18, 2008 indicating that HUD was not prepared to reconsider the implementation of its proposed rules because of the following:

"The current housing finance situation has dramatically highlighted the need to move forward responsibly and expeditiously with measures to help American home buyers. Many of the current difficulties, including the high rate of foreclosures, have been caused in part by consumers not fully understanding their loan terms and costs. The Department believes that a rule is needed to help consumers avoid such difficulties in the future."

The introductory paragraph at the beginning of this article reflects what our Washington bureaucrats will not choose to grasp. Buyers want to buy, sellers want to sell. Participants in real estate settlement transactions want to move through the process as quickly as they can because there is no cost benefit to spending hours explaining things to consumers and most importantly, the vast majority of consumers are even more anxious than the settlement agents to complete the transaction and to place their trust in others. Under the circumstances, it is unlikely that "more information" is the answer.

* * *

Legal Column authors Edward I. Sumber, Esq. and John Dolgetta, Esq. are part of the law firm of Edward I. Sumber, P.C. The firm has been counsel to the Westchester County Board of Realtors, Inc. since 1975 and the firm was responsible for incorporating the Westchester-Putnam Multiple Listing Service, Inc. in 1976. For information about Edward I. Sumber, P.C. go to <http://www.sumberlawpc.com/>.