

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

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I. Closing Cost Disclosures

A. HUD Booklet on Closing Costs

The Real Estate Settlement Procedures Act (“RESPA”), codified at 12 USC 2601, et seq., requires lenders to provide loan applicants with three types of federal, not state, mandated disclosures relating to settlement costs and charges with respect to applications for “federally-related mortgage loans.” The first is a booklet published by the U.S. Department of Housing and Urban Development (“HUD”) entitled “*Buying Your Home: Settlement Costs and Helpful Information*”. This was formerly known as “Settlement Costs: A HUD Guide” and may be referred to as the “Special Information Booklet”. The book serves two primary purposes. First, the booklet describes the loan settlement process and types of settlement charges, with suggestions regarding the types of questions to ask the mortgage provider. Secondly, the booklet details the settlement costs the customer may see on the HUD-1 Settlement Statement at the closing of the loan transaction. Each category is listed and described so that the customer has the tools to read the breakdown of costs, expenses and monies needed to close their transaction. This book must be provided to the customer within three business days of a loan application.

B. Good Faith Estimate of Settlement Costs

Secondly, a “Good Faith Estimate of Settlement Costs” (“Good Faith”) disclosure must be provided to each borrower within three business days of receipt by the lender of a loan application. The Good Faith may come from two sources. Generally, the lender will send out their own estimate of closing costs to the customer to ensure this requirement is met. However, this disclosure will also be provided by a mortgage broker who may be working with the customer and serving as the conduit for the actual provider of financing. There is a basic policy intended to be followed behind the good faith estimate, and that is, provide a clear and concise summary of the actual or range of charges the customer is likely to incur based upon the lender’s experience in that particular real estate market.

Good Faith Estimates require disclosure of each settlement charge the lender anticipates the borrower will eventually pay, regardless of whether the expense is paid to the lender, mortgage broker, or a third party settlement service provider. Settlement services are interpreted very broadly and include lender services, document preparation, attorney fees, title insurance, surveys, homeowners insurance, and many others. In addition, payment to an independent settlement service provider, even if not paid by the borrower, will be disclosed as “POC” or “paid outside of closing.” Ultimately, a policy of full disclosure is intended to permit customers to adequately evaluate a particular proposal and further shop the mortgage quote.

C. HUD-1 Statement of Settlement Costs

There are actually two types of HUD-1 Settlement Statements, a “HUD-1” which must be used for every settlement involving a federally-related mortgage loan involving a buyer and a seller. This may also be used for a refinance transaction involving only a borrower. A “HUD-1A” is designed and may be used in settlements involving only a borrower or “refinance” transaction. The settlement agent, which will be an attorney or “title company” in Kentucky, is almost always responsible for preparing the HUD-1.

The HUD-1 must set forth all charges to be paid by the borrower, and seller when applicable, in order to conclude the real estate refinance or purchase. These charges including lender, mortgage broker, real estate agent, insurance, escrow account, title, attorney, government recording, and many other forms of costs. By custom, the HUD-1 may also contain many other fees directly attributable to the refinance or purchase transaction, including pest inspections, home inspections, homeowners association dues, and many other costs not truly related to the settlement of the mortgage loan.

In addition, RESPA requires that the settlement agent provide, at the borrower’s request, a copy of the HUD-1 on the business day preceding the settlement. The settlement agent may omit items related to the seller’s transaction, but must place all items known to the settlement agent at the time of inspection on the HUD-1. Except in limited circumstances, the lender, borrower and seller, or their agents, will receive a completed and signed copy of the HUD-1 on the day of closing. A lender, or their assignee in cases where the loan or servicing rights are sold, must maintain a copy of the HUD-1 and related closing documents for five years. HUD retains the right to inspect copies of all such records during this time period, and there is a specific prohibition for a fee or charge for the preparation and distribution of HUD-1 settlement statements, escrow account disclosures or statements, or Truth In Lending Act disclosures.

II. Servicing Disclosures

Although a full description of mortgage servicing rules and requirements is beyond the scope of an introductory real estate seminar, it is important to understand that borrowers must be provided information regarding their mortgage servicing arrangements. These disclosures are required at the time of application and at any time when the lender transfers the servicing responsibilities of a loan to another company. However, this disclosure requirement does not apply when there will be no change in the payee or the address to which payment must be made, in circumstances such as transfers resulting from affiliations, mergers and acquisitions, or master servicing agreements with no change in the sub-servicer.

An initial servicing disclosure must be provided at the time of the mortgage application or within three business days, just like the initial Good Faith closing cost disclosure. Generally, this informs the borrower of the right of the mortgage broker or lender to assign, sell or transfer the rights to the mortgage loan. For lenders with the intention to service all or none of their loans, a simple statement to this effect will suffice. However, most servicing disclosures contain a range of percentages, rounded to the nearest 25 percentile, or 0-25%, 26-50%, 51-75%, and 76-100% categories, over the previous three full years.

Additional servicing disclosures are required by RESPA for the transferor and transferee servicers of a mortgage loan, and these entities must deliver a written "Notice of Transfer" document to the borrowers when the loan is assigned, sold or transferred. This requirement may be combined into one document by the transferor and transferee, in which case the disclosure must be delivered at least 15 days before the effective date of the transfer. If separate notices are to be sent, the transferor must deliver the notice at least 15 days before the effective date of the transfer, and the transferee must provide this notice no later than 15 days after the effective date of the transfer. There are a few limited extensions of time to provide this disclosure under RESPA.

III. Escrow Account Disclosures

Every servicer or lender of a federally-related mortgage loan has a responsibility under RESPA, at the time of a closing and annually thereafter, to provide a disclosure document containing itemized information regarding monies paid into or out of the escrow account. With respect to setting up an initial escrow account, which is typically at the time of closing, a servicer may not require more than an "amount sufficient to pay" the escrow items (property taxes, insurance, mortgage insurance premium) for the period of time attributable to the date such charges were last paid and until the initial payment date *plus* a cushion of no more than one-sixth of the estimated total annual payments from the escrow account. However, these maximum escrow amounts can be increased voluntarily by a borrower if waived in writing on a yearly basis.

There are many rules beyond the scope of this seminar with respect to the methods, rules and regulations governing escrow accounts. However, RESPA does make it clear that mortgage servicers must perform escrow account analysis under the nationwide accounting standard known as “aggregate accounting” at the time of originating the mortgage loan and every year thereafter. Specifically, the analysis should determine whether the servicer is within the limits of cushion described above, to prepare the annual escrow statement which is mailed to the customer, and to determine the amount of deficiencies that must be recouped or surpluses refunded to the customer.

IV. Unearned Fees, Kickbacks and Affiliated Businesses

A. Kickbacks

RESPA also contains two prohibitions regarding the referral relationships that exist in the real estate closing business. 12 USC 2607(a) & (b). First, the statute prohibits the payment or receipt of a “kickback” due to one party’s influence or control of the lending or closing process:

No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

“Thing of value” is defined very broadly to include money, ownership interests or increased equity, gifts, reduced or no cost services or leasable space, and the like. The policy behind these provisions of RESPA were stated to be the intent of Congress to stop the abusive practices found within the industry and ultimately bring down the “unnecessarily high settlement charges” resulting therefrom.

B. Unearned Fees

Second, the statute prohibits the payment or receipt of any part of a settlement charge that was not earned for services actually performed.

No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.

HUD has issued many policy statements in an effort to interpret and guide settlement service providers on the permissible arrangements that may satisfy RESPA.

C. Affiliate Business Arrangements

Formerly known as “Controlled Business Arrangements”, Affiliated Business Arrangements (“ABA”) are a growing trend among mortgage bankers, lenders, brokers, real estate professionals and the title agents who ultimately perform the closing duties. These affiliations take many forms, but the most prevalent are between lenders or banks who form their own title insurance companies to capture the revenue resulting from title insurance premiums. The most common ABA, however, results from a “partnership” among various players mentioned above who participate in the settlement process.

The primary exception to this law exists for banks or “lenders”. Lenders may require a buyer, borrower or seller to pay for the services of a specific attorney, credit reporting agency, or real estate appraiser to represent the lender’s interests, and such arrangements are exempted from this category of prohibited referrals.

In summary, a company or individual may form a new company or “joint venture” in an attempt to capture the revenue that exists in the real estate settlement arena, such as real estate appraisal, inspection, or agency fees, as well as closing and title insurance fees. This is generally permitted if (a) a proper disclosure is made at the time of the referral regarding the existence of the arrangement, (b) there is a written estimate of the charge or range of charges generally made by the service provider, (c) the customer or borrower is not required to use the particular provider, and (d) the only thing of value received from the arrangement, other than the payments described for the services, is a return on the ownership interest or franchise relationship.